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Government & Industry Relations

September 10, 2008

The Honorable Bob Duff, Chair  
Banks Committee  
Legislative Office Building, Room 2400  
Hartford, CT 06106-1591

The Honorable Ryan Barry, Chair  
Banks Committee  
Legislative Office Building, Room 2405  
Hartford, CT 06106-1591

The Honorable Joan Hartley, Chair  
Higher Education and Employment  
Advancement Committee  
Legislative Office Building, Room 1800  
Hartford, CT 06106-1591

The Honorable Roberta Willis, Chair,  
Higher Education and Employment  
Advancement Committee  
Legislative Office Building, Room 1802  
Hartford, CT 06106-1591

Dear Chairs Duff, Hartley, Barry and Willis:

Thank you for the opportunity to provide the Committees on Banks and Higher Education and Employment Advancement with information regarding the ongoing challenges in the student loan marketplace. Your efforts to bring additional public attention to the issue of the availability of student loans are both appropriate and timely. By convening this public forum, the General Assembly is working to protect the interests of thousands of Connecticut students and their families as they pursue a higher education, and we are pleased to join in your efforts.

As you are aware, leaders in the State of Connecticut have played an important role in helping to avert a potential college access crisis during the 2008-2009 academic year. As the sub-prime mortgage crisis prompted widespread turmoil in the domestic and international credit markets, the inability of many lenders to raise capital and the significant increase in borrowing costs incurred by lenders that were able to raise capital placed both the federal and non-federal student loan markets under severe stress. Earlier this year, our nation's higher education system faced a potential crisis where the demand for student loans could significantly outstrip the available supply of student loans for the 2008-2009 academic year.

One of the key turning points was a hearing convened on April 15, 2008 by Senator Christopher Dodd of Connecticut. As the Chairman of the Senate Banking Committee, Senator Dodd acted swiftly to bring greater attention to the problem and sponsored bipartisan legislation to provide additional liquidity to the student loan markets. With students, parents and colleges facing unprecedented uncertainty in the student loan marketplace, Congress acted with great speed to approve H.R. 5715, the *Ensuring Continued Access to Student Loans Act of 2008*.

H.R. 5715 grants authority to the U.S. Department of Education to purchase loans from lenders for the 2008-2009 academic year and offers lenders access to short-term liquidity or funds to make loans. In response, the U.S. Department of Education and the U.S. Department of the Treasury were able to design a proactive solution, at no net cost to taxpayers, to address the unprecedented disruption in the global credit markets that threatened the availability of federal student loans. Under the new federal solution, lenders who make new federal loans during the current academic year (2008-2009) can, until September 30, 2009, sell loans first disbursed between May 1, 2008 and June 30, 2009 to the U.S. Department of Education for full principal value of the loan, including accrued interest, a loan origination fee rebate and a \$75 administrative processing fee per loan. This federal solution also allows the U.S. Department of Education to invest in trusts containing federal student loans. In exchange for its investment, the federal government receives payouts from the trust equal to commercial paper interest rates, currently about 2.7 percent, plus a 50 basis-point margin.

H.R. 5715 also expanded federal resources to help students and families pay for college by increasing the amounts available under the federal student loan program and providing parents who may be experiencing certain adverse credit issues with the relief they need to secure a federal PLUS loan on behalf of their child in college.

As the nation's leading saving- and paying-for-college company, Sallie Mae responded to the student loan credit crunch by affirming our longstanding commitment to fund all eligible federal student loan applications from all students at all colleges across the country. In fact, Sallie Mae expects to originate more than \$20 billion in eligible federal student loans during the current academic year (2008-2009).

Sallie Mae is also using all of its resources to implement H.R. 5715 and thereby ensure the continued universal availability of federal student loans to all eligible students and parents. Following passage of H.R. 5715, Sallie Mae immediately implemented the increased federal loan limits for the current academic year. Sallie Mae also expanded availability of federal PLUS loans to families facing extenuating credit circumstances due to the current mortgage crisis. In addition, Sallie Mae is allowing parent PLUS loan borrowers the ability to choose whether they want to delay repayment on loans disbursed after July 1, 2008 while their child is in school.

We commend Congress, the U.S. Department of Education and the U.S. Department of the Treasury for acting decisively and proactively to prevent a college access crisis this fall. As our higher education system works to embrace the largest high school class in history, bipartisan efforts across our government have helped renew the promise of economic opportunity and other lifelong benefits that education provides for all Americans.

It is important to note, however, that the federal liquidity program in place today is only a temporary, one-year solution. Given the ongoing turbulence in the domestic and international credit markets, Sallie Mae believes it is critical to act now to extend the loan purchase authority

under H.R. 5715 through the next academic year and beyond. This would give students, parents and colleges continued confidence that federal loans will be available regardless of credit market conditions next year and beyond.

The financing of federal student loans is reliant on a well-functioning and well-priced credit market. Unfortunately, as you know, that this is not the environment in which we operate today. Surprisingly, the spreads demanded by investors (the amount of interest they need in order to invest in federal student loan assets) have increased rapidly and significantly despite the federal government's liquidity solution. For example, in July 2007, Sallie Mae financed securities backed by federal student loan assets at LIBOR +10 basis points. Recent transactions in the asset-backed security (ABS) market have been financed at LIBOR +160, with spreads increasing, not decreasing, as we both hoped and expected.

For non-federal loans, the ability of student loan providers to finance loans is even more challenging than the federal student loan market. Indeed, like the federal student loan market, a number of lenders have significantly reduced or eliminated offerings of private education loans. It is also important to note that there have not been any securitizations of private loans of a significant size in over one year.

In April, when Sallie Mae and other experts testified before Chairman Dodd's Banking Committee, the consensus position was that federal government action would send a strong and clear message to the market that the government stands behind guaranteed student loan assets. We expected this to help hasten a return of investors to this asset class. We also testified that we expected that creating liquidity for federal loans would have spillover benefits to the non-federal market as well. Unfortunately, the ABS market is still behaving irrationally due to continuing turbulence unrelated to student loans.

Sallie Mae is strongly positioned with access to funds to continue to make both federal and private student loans this year. It is, however, absolutely critical that the federal government continue its role in helping to improve market conditions. Extending the federal liquidity solution before Congress adjourns must be one of those steps.

Sallie Mae looks forward to working closely with the State of Connecticut, schools, families and lawmakers to ensure that ongoing turbulence in financial markets do not limit the ability of students to attend the college or university of their choice.

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Please feel free to contact me at (202) 969-8004 if you have questions or need additional information.

Sincerely,

A handwritten signature in black ink, appearing to read "Stephen M. Heyman", with a long horizontal flourish extending to the right.

Stephen M. Heyman  
Vice President, State Affairs

**Testimony of John F. (Jack) Remondi**

**Before the U.S. Senate Committee on Banking, Housing and Urban Affairs**

**Tuesday, April 15, 2008**

**Hearing on the Impact of Turmoil in the  
Credit Markets on the Availability of Student Loans**

Good morning Chairman Dodd, Ranking Member Shelby and Members of the Committee. My name is Jack Remondi, and I am Vice Chairman and Chief Financial Officer of Sallie Mae. On behalf of Sallie Mae's more than 10,000 employees and 10 million student borrowers, thank you for the opportunity to testify on the impact of turmoil in the credit markets on the availability of student loans.

Let me begin by also thanking you and the members of the Senate Banking Committee for holding this hearing. As the nation's leading provider of saving, planning and financing solutions for college, we share your goal of ensuring that borrowers who will need federally-guaranteed and non-federal student loans have the ability to pursue their education plans this fall.

Over the last decade, the cost of a college education has dramatically exceeded the growth of federal grants and loan limits in the Stafford Loan program. Increasingly, credit-based non-federal, or "private" student loans have helped families close the gap between state and federal financial aid, scholarships, limited family resources, and the actual cost of attending college.

Sallie Mae is proud to be a leader not only in the delivery of federally-guaranteed student loans, but in making this "gap financing" available. Often, it means the difference between attending

or not attending the college of a student's choice. At the same time, we understand that the growth in non-federal student loans raises important consumer and policy issues. At Sallie Mae, our policy is to promote a 1-2-3 approach: First, tap personal financial resources and "free money;" second, utilize low-cost federal loans; and, lastly, only as needed to close the gap between available funds and the cost of attendance, take advantage of private loans.

This year, we will see the largest high school graduation class in history enroll in college. Higher education enrollments typically increase in periods of economic downturns. Home equity borrowing, sometimes used to pay for education, is in decline. Due to these factors, demand for federal and non-federal loans is on the rise. The U.S. Department of Education estimates that approximately 7 million borrowers will need more than \$68 billion in federal loans this academic year. Private education loans are estimated to add another \$20 billion.

Yet, both federal and non-federal student loan markets are under severe stress. For the current academic year lending season, we are facing a scenario where demand for student loans will significantly outstrip the supply.

I would like to use my time here today to describe the current state of the student loan finance markets and Sallie Mae's recent experience in them. And, finally, I will briefly describe key steps we recommend the federal government can take to restore liquidity for this primary source of paying for college.

Over 75% of federal student loans are financed by non-bank, specialty finance companies such as Sallie Mae, including not-for-profit lenders and state agencies that make some loans and buy other loans from banks. Non-bank lenders fund their loans primarily through the term asset-backed securities (ABS) market, while others access a financing mechanism known as auction rate securities (ARS) market. Sallie Mae does the vast majority of its financing through the term ABS market, thus, I will concentrate my remarks there.

In a typical asset-backed security financing, lenders transfer student loans to a bankruptcy remote securitization trust that issues securities to investors. The securitization trust is structured such that the investor looks solely to the underlying loan collateral for repayment of the investment. This insulates the investor from any credit events that may occur over time at the company that sponsored the ABS trust. Typically, these student loan asset-backed securities are given ratings from AAA to AA by credit rating agencies based on their risk and maturities. Asset-backed securities backed by loans made in the Federal Family Education Loan Program, or "FFELP," are consistently rated AAA because each individual loan carries a 97% federal government guarantee. Investors in these securitizations generally receive different floating rates of interest, known as spreads, based on the credit rating and maturity of the purchased security. To meet the demand for loans we expect, Sallie Mae should securitize approximately \$2.5 billion in loans a month for the balance of 2008. To date, Sallie Mae's pace of issuance in the term ABS market is 40 percent below this plan. In addition, the limited funding available requires investor spreads that are so expensive that newly originated loans are uneconomical.

The financing of federal student loans is reliant on a well-functioning and well-priced credit market. I am confident you are aware that this is not the environment in which we operate today. The spreads demanded by investors have increased rapidly and significantly since mid-summer of last year. Where we financed last July at LIBOR +10 basis points, recent transactions in the ABS market have been done at LIBOR +140, with spreads doubling in the past six weeks alone.

For non-federal loans, the situation is even worse. Because of the market disruption, there have been no term asset-backed securitizations for private credit-based student loans this year. Sallie Mae last did a private credit term ABS transaction in the spring of 2007.

As a result of today's funding levels, every federal loan funded in the term ABS market generates a negative spread before any operating expenses are taken into account. This unprecedented cost of borrowing, added to the 70 basis point yield cuts contained in last year's College Cost Reduction and Access Act, mean that every loan originated in the FFELP program will be made at a loss.

Because of these economics, upwards of 50 lenders have already ceased or suspended making federal or private student loans. Absent any relief, we expect a major shortfall in access to student loans this year.

It is important to note that given the seasonal nature of student lending, the impact of tightening loan availability is only now beginning to reach students and schools. Demand is always low in



the first quarter of the calendar year, but will increase significantly over the next several months.

In fact, three-fourths of all student loans are made from April to September.

It is our view that the gap between available loans and the demand for them could manifest itself as early as May. Between now and then, lenders who have not already left the business of student lending will be faced with the difficult decision of exiting the student loan business or continuing to make loans at a significant loss.

However, the federal government could take budget-neutral steps that would avert a student loan access crisis. Our view is that steps should be taken that are non-disruptive to students, are temporary, and are geared toward guaranteeing borrower access to loans this academic year.

The least disruptive, most cost-effective, most manageable, and quickest proposal to implement would be for the Department of Treasury's Federal Financing Bank, or FFB, to provide liquidity for federally guaranteed loans. The FFB is already authorized by statute to purchase and sell any obligation which is issued, sold or guaranteed by a Federal agency. Therefore, legislative action is unnecessary to make this happen. Upon deciding to exercise this authority and make funding available for new loans, the Bush Administration can do this in time to help.

Under this proposal, the FFB would purchase, for the "life of the loan," participation interests in pools of newly originated guaranteed loans from eligible FFELP lenders. Borrowing costs would be set at a rate low enough for lenders to have an incentive to access this credit in today's

inhospitable environment, but high enough that lenders will be eager to return to the markets when conditions improve.

To ensure the least amount of disruption to the borrower and to relieve the FFB of any responsibility to service the loans, lenders would continue to manage and service the loans under the same strict requirements that govern all FFELP loans. Servicing and guaranty agency agreements would remain with the lender. Consequently, day-to-day administration of the loans would be the responsibility of the eligible lender, not the Federal Financing Bank.

We believe this plan would provide desperately needed liquidity to the FFEL program, and ensure that student access to guaranteed loans is undisrupted. But such an action, if undertaken, would do more than that. It would be a signal to the market that the government stands behind this guaranteed asset. We believe this would hasten a return of investors to this asset class. With front page articles beginning to appear in the nation's newspapers detailing students' inability to get new loans, this plan would help restore consumer confidence as parents and students would know that the federal program specifically designed to provide them access to low cost loans will be there when they need it.

Most important for the subject of this hearing today, I believe that creating liquidity for federal loans would have spillover benefits to the non-federal market as well.

Another proposal put forward that does not require congressional action would have an indirect but positive impact on liquidity in the student loan financing market. Specifically, it would

allow primary dealers and issuers to use student loan ABS as collateral to borrow from the newly created Term Securities Lending Facility (TSLF) of the Federal Reserve Bank.

Although we advocate this change, and believe it will directly benefit the FFELP ABS market, it is unlikely to provide sufficient liquidity to ensure students have access to student loans this year.

Congress, too, is taking action.

Last week, Sen. John Kerry (D-MA) introduced the Senate companion to H.R. 5723, the Emergency Student Loan Market Liquidity Act, sponsored by U.S. Representative Paul Kanjorski (D-PA). S. 2847 would support the student loan financing markets by authorizing the Federal Home Loan Bank (FHLB) system to take federal student loans as collateral for advances, which in turn would be used by lenders to make new loans. The legislation would also authorize Federal Home Loan Banks to invest their surplus funds in student loan asset backed securities. We believe this legislation would be a step in the right direction and we support its passage.

We are also encouraged that HELP Committee Chairman Kennedy and Education & Labor Chairman Miller have both introduced legislation designed to support student access to loans. We look forward to working with both Houses of Congress as this legislation is debated and refined.

In conclusion, the financing environment for student loans is under unprecedented pressure due to the combination of legislative cuts and severe dislocation of ABS and ARS markets. Action is

needed now to prevent a crisis of student access to FFELP and private education loans. We do not have weeks or months to decide the best course of action. The Administration can move immediately to make available advances from the Federal Financing Bank, and that would have the least disruptive, most immediate and beneficial impact on the situation. We hope Congress can urge them to do so without delay. But Congress can do more by passing the Emergency Student Loan Market Liquidity Act and pursuing other liquidity enhancing solutions.

Thank you for allowing me to appear. I firmly believe that Sallie Mae and other FFEL lenders provide a necessary and important service to students, their families and the schools they attend.

I look forward to answering any questions you may have.

*Hearing of the US Senate Committee on Banking, Housing, and Urban Affairs*  
Turmoil in U.S. Credit Markets: Impact on the Cost and Availability of Student Loans

**Testimony by Mark Kantrowitz, Publisher, FinAid.org**

Thank you Chairman Dodd, Ranking Member Shelby and the distinguished members of the Senate Committee on Banking, Housing and Urban Affairs for convening this hearing and for the opportunity to appear before you.

I am Mark Kantrowitz, Publisher of FinAid.org and Director of Advanced Projects for FastWeb.com. FinAid is the most popular free web site for student financial aid information, advice and tools. FastWeb is the largest free scholarship matching service.

Contagion from the subprime mortgage credit crisis has infected the education loan marketplace. There have been no successful bond issues for state loan agencies and no securitizations of private student loans since last fall. While there have been some securitizations of federally-guaranteed student loans, the volume is down by 57% year-over-year and the cost of funds has increased by 137 basis points. None of these securitizations have involved federally-guaranteed student loans originated since October 1, 2007. The auction-rate securitization market is dead. These problems are occurring despite the AAA-rating of the student loan securities.

The lack of liquidity has lead to an unprecedented exodus of education lenders from federal and private student loans. As of today, 57 education lenders have suspended their

participation in federally-guaranteed student loans and 19 lenders have suspended their private student loan programs.

In FY2006 these lenders originated more than \$6.5 billion in Stafford and PLUS loans to more than 800,000 borrowers and more than \$48.5 billion in consolidation loans to more than 1.6 million borrowers. That represents 13% of Stafford and PLUS loan volume and 67% of consolidation loan volume.

These lenders include 21 of the top 100 originators of federal Stafford and PLUS loans and 27 of the top 100 originators of federal Consolidation loans. The top 100 lenders originate 91.5% of Stafford and PLUS loans and 99.8% of Consolidation loans.

Last week Sallie Mae, the largest education lender, announced that it will no longer be making consolidation loans. The Education Resources Institute (TERI), the largest nonprofit guarantor of private student loans, filed for Chapter 11 bankruptcy. Nelnet sold \$1.2 billion of student loans for an after-tax loss of \$28 million. There have been more than 2,500 layoffs industry-wide.

The credit crisis has also had a direct impact on borrower eligibility for federal and private student loans. Borrowers with a foreclosure in the last five years are ineligible for the federal PLUS loan. There will be about a 10% increase in PLUS loan denials at the start of the 2008-2009 student loan season. Lenders are also tightening credit underwriting criteria for private student loans. Credit score requirements are increasing

from 620 to at least 650 and approval rates have dropped by 10% to 25%. Overall, more than 100,000 additional families will become ineligible for both the federal PLUS and private student loans.

The cost of federal and private student loans has also increased. Most lenders have cut their Stafford and PLUS loan discounts in half and have eliminated discounts on consolidation loans. More than a dozen private student loans have increased the interest rates by an average of 7/8 of a percent.

These are signs of a very serious threat to our nation's education financing system and cause for concern. Without loans, some students may be forced to drop out of college.

Existing solutions are inadequate. Neither the Direct Loan program nor the lender-of-last-resort program has been tested under the extreme conditions we face today. For example, Federal Direct Consolidation Loan volume will be more than four times last year's volume and more than twice the peak volume. Neither program addresses the liquidity problems that are forcing education lenders to exit the marketplace. Both are reactive solutions that offer the potential for significant disruption during any transition period.

It is better to implement proactive solutions that prevent a crisis. The most effective solutions will involve injecting liquidity into the student loan system. Three possible approaches include allowing the Federal Home Loan Bank and the Federal Financing Bank to invest in highly-rated student loan securities, allowing lenders to pledge highly-

rated student loan securities as collateral for the Term Securities Lending Facility and conducting a reverse student loan auction in which lenders would compete for US Treasury investment in highly-rated student loan securities. The third approach would set margins competitively and is of limited duration, minimizing the need to wean lenders off of a source of cheap capital.

Other proposed solutions are aimed at restoring investor confidence. These include standby loan purchase agreements, government insurance of bonds and securitizations against lender default and eliminating the index rate mismatch. (Currently federal education lenders receive income that is indexed to the three-month Commercial Paper Rate while their cost of funds is indexed to the LIBOR index. Eliminating this index rate mismatch would yield more predictable spreads and would simplify the structure of student loan ABS by avoiding the need for interest rate swaps.) These solutions would reassure investors by reducing some of the risks associated with investing in these instruments.

Chairman Dodd and Ranking Member Shelby, I once again thank you and the committee for taking an interest in ensuring the continued availability of education loans, and for inviting me to share my thoughts on the matter. I would be happy to answer any questions you may have.