The Privatization of Sallie Mae and its Consequences

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Sallie Mae as a GSE

- Established 1972 to provide secondary market for guaranteed student loan program
  - Student loans small and hard to service
  - Sallie Mae could specialize in student loans and develop economies of scale
- Obtained substantial government benefits
  - More than other GSEs, e.g., authority to borrow with *explicit* federal guarantee and from FFB
- CBO in 1979: 98% of Sallie Mae resources supplied by federal government

Sallie Mae as a GSE

- Lower capital and higher leverage than competitors
- Ability to grow much faster than competitors
- Specialization in designated market without financial diversification
- Dependence on political process; development of political strength
- Perception that, if Sallie Mae failed, government would bail out debtholders

Sallie Mae as a GSE

- Fueled by its government benefits, Sallie Mae grew rapidly
- Sallie Mae obligations outstanding:

1975	$ 0.3 BN
1980	$ 2.7 BN
1985	$13.4 BN
1990	$ 39.0 BN
1995	$ 47.5 BN

Sallie Mae as a GSE

- Sallie Mae developed:
  - Economies of scale, especially in servicing
  - Close ties to lenders
    - e.g., through technology platforms and warehousing advances
  - Political strength

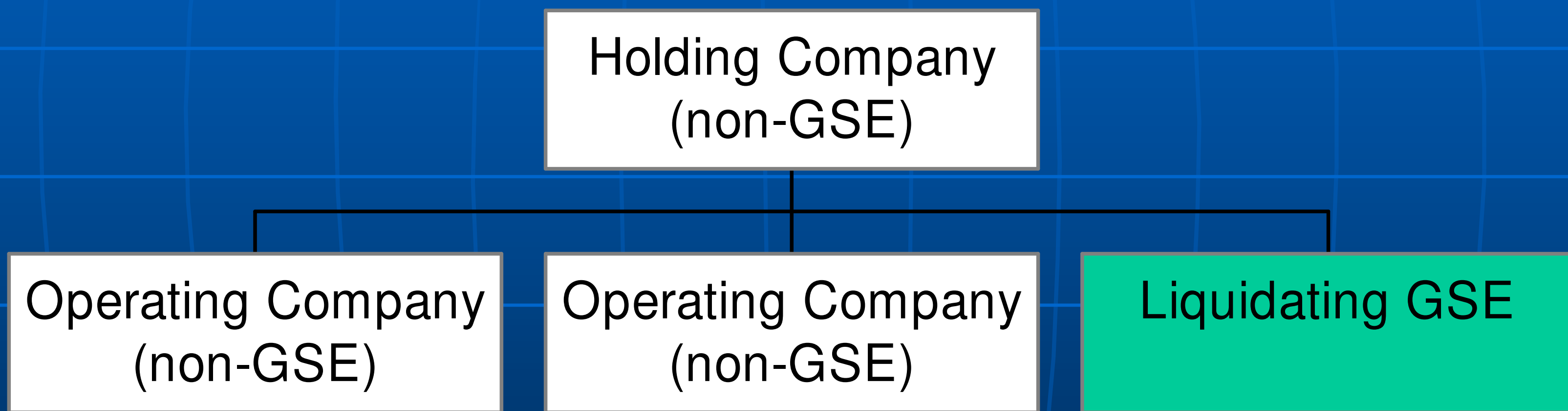
Sallie Mae as a GSE

- As a GSE, Sallie Mae remained subject to political risk
- In 1993 political risk materialized
  - 30 bp (0.3 percent) offset fee
  - New Federal Direct Loan Program
    - 1989: Sallie Mae held 27% of federal guaranteed loans outstanding; second largest company held 4 percent

Privatizing Sallie Mae

- 1996 Sallie Mae Privatization Act
  - Established privatization process
    - Holding company structure
      - Holding company could expand activities
    - Long transition period to operate GSE (to 2008)
    - Generally, no affiliation of GSE and a bank
    - ED could request lender-of-last-resort function
    - Modest exit fees ($ 36 million + $ 5 million)
    - Shareholder approval required

Privatizing Sallie Mae



Sallie Mae's Transition

- The company continued to grow (in a growing market)
- Total managed student loans ($ BN, held + ABS):

1998	$ 46.4
2000	$ 67.5
2002	$ 78.1
2004	$ 107.5
2006	$ 142.1

Sallie Mae's Transition

- The company expanded vertically and horizontally through acquisitions
  - Nellie Mae (lender: $ 2.6 BN portfolio)
  - Operations for USA Group (largest guaranty agency)
  - Noel-Levitz (enrollment management company)
  - GRC, AMS, and AFS (debt collectors)

Sallie Mae's Continuing Growth

The company continued its expansion:

- Acquired Upromise (saving for college)
- Established Sallie Mae Bank (ILC)
- 2006: Sallie Mae held 35% of federal guaranteed loans; second largest company held 8 percent
- 2007: agreed to be bought by private equity investors + Bank of America + JP Morgan Chase

Sallie Mae’s Continuing Growth

Costs of continued expansion:

ED IG: Sallie Mae’s common control of servicing operations and guaranty agencies creates conflict of interest:

“The potential for USA Education, Inc., to manipulate default aversion and collection activities is greater than it would be if a separate entity performed default aversion activities”

GAO: common control means that defaulted loans can be more profitable than performing loans

Sallie Mae's Continuing Growth

New York State Attorney General on Sallie Mae ties to schools:

- Sponsoring "advisory boards" comprised of school financial aid officers, to whom Sallie Mae provided remuneration, travel and lodging fees;
- Contracting with 20 schools to provide call-center services;
- Providing "entertainment" to officials at schools with which it does loan business; and
- Offering opportunity loans to "credit challenged" academically qualified students.

Sallie Mae Today

- Sallie Mae is not a GSE today. Yet some parallels are striking:
  - Lower capital and higher leverage than competitors
  - Ability to grow faster than most competitors
  - Specialization in designated market without financial diversification
  - Dependence on political process and exercise of political strength
  - Possibility that, if Sallie Mae failed, government might bail out the company
    - Unlikely that this is reflected in a borrowing advantage

Sallie Mae Today

- Sallie Mae possesses:
  - A commanding presence (“the dominant franchise”) in the student loan market
  - Economies of scale, especially in servicing
  - Close ties to schools and lenders
    - e.g., through technology platforms, and blandishments (e.g., opportunity pools)
  - Political strength

Public Policy Implications

- The paper recommends reforms for the federal student loan market
  - It is too late to look at the unusual market structure created by government and Sallie Mae's GSE status; privatization is complete
  - The government should look at market issues relating to federal guaranteed loan programs, e.g., need to diversify program risk
  - The government should look at consumer issues relating to federal guaranteed loan programs

Public Policy Implications

- There also are important lessons for the other GSEs from Sallie Mae's privatization
  - Consider beforehand the market implications of the privatization of a GSE
  - Consider, similar to acquisition of a nonprofit by a for-profit company, assessment of a fee to be used for public purposes