

The Privatization of Sallie Mae

As prepared for delivery

by
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Throughout much of Sallie Mae's 26-year existence, our GSE status was viewed by many as favorable. As a GSE we had access to the agency markets which provided us with attractive funding costs. We were also exempt from SEC registration and filing requirements---although for all intents and purposes we behaved as if we weren't. And we were exempt from most state and local taxes.

In the 90's however, things began to change dramatically. In 1993, with a stroke of the pen, the Congress effectively eliminated our funding advantage. Equally important, Sallie Mae's primary role of making a secondary market for student loans, its purpose for being, faded in the face of increased competition and the evolution of the capital markets. It was increasingly clear that THIS GSE's lifecycle had run full course. Our attention, as well as the Congress's, shifted to privatization as the logical end.

The success of the privatization effort demanded a solution that would accomplish several goals:

- guard the interests of Sallie Mae's shareholders and bond holders---the providers of capital that allow a GSE to fulfill its mandate;
- protect the public policy concern of providing adequate liquidity in the higher education marketplace; and,
- recognize the significant role the corporation played in the overall competitive balance of the industry.

As the nation's leading provider of origination and servicing for student loans, Sallie Mae was in a unique position with regards to privatizing. Some factors are distinctly tied to the particular nature of the student loan business. Other factors were more personal---related specifically to the future direction of the corporation.

As the privatization discussion came to the forefront, the student loan marketplace was experiencing significant changes which fueled both the public and private interest in moving ahead. Sallie Mae's traditional customer base had been banks and other lenders acting as loan originators. These customers had increasingly come to rely on Sallie Mae not simply as a provider of capital but as the developer of new products and service offerings, which altered the relationships. Whereas lenders originally determined secondary market transactions at the time of the sale, the market evolved into longer-term marketing and servicing alliances with pre-defined secondary market transactions.

Sallie Mae's ability to provide marketing and product development expertise across lender relationships had also begun to expand our focus solely from lenders to include schools and students, the originally intended beneficiaries of the student loan programs.

Sallie Mae was determined to provide a national brand of products to meet the increasingly demanding expectations of schools for standardized loan delivery and top-flight service levels. To gain and maintain campus loyalty required a broader definition of student loan services: student loan market share often depended upon providing tangential or related services for other administrative needs.

Because corporate charter limitations prevented Sallie Mae from being a direct originator or pursuing some new business lines, major investments and technological innovations the corporation brought to the program did not necessarily lead to better economics or improved business opportunities. As a privatized entity, Sallie Mae could also better explore a wider variety of campus-based services, opening the door to heightened brand awareness and new sources of revenue.

Beginning in the early 1990's, the student loan industry faced perhaps its stiffest competition from the very agency tasked with regulation and oversight of the FFELP. The Department of Education became a lender and service provider in direct competition with Sallie Mae and its loan origination partners with the introduction of the Federal Direct Student Loan Program (FDSLPL). Government entry into our competitive marketplace demanded nimble and targeted responses from all other players in the industry. Sallie Mae was concerned that the restrictions of our charter would keep us from responding to the new challenge independently and cost-effectively.

The infrastructure of the guaranteed student loan program is nearly wholly determined by government and political entities, from loan terms to insurance requirements to basic servicing level expectations. Most notably, the *LAW* mandates interest rates instead of allowing the rates to be subject to traditional market forces. With an active Congress interested in protecting the financial concerns of students and a non-market based determination of interest rates, the funding benefits of a GSE could – and were – effectively eliminated.

As a GSE with a unique role in the student loan program, Sallie Mae's charter became a tool for legislators to make statements and shape policy. In the years leading up to the privatization effort, there were legislative actions that adversely impacted the corporation's perceived benefit as a GSE:

- Imposition of a 30 basis point per annum offset fee that equated to a special form of taxation and effectively eliminated our agency funding advantage.
- Mandated role as a lender of last resort within the program for students who could not otherwise get guaranteed loans because of high default rate problems at their institutions.
- Specific statutory minimum capital requirements.
- Restrictions on avenues of business allowed by the charter

The deliberation over privatization did not exist solely in the halls of Congress, the floor of the exchanges or the quads of our nations' higher education institutions. Internally, we were in the middle of a debate over the future of the company; and the impact of a potential privatization effort had become a strategic point. There was no consensus on

the exact formula for future success, but nearly all parties involved had reached the conclusion that our corporate viability was dependent upon having the freedom to respond in a timely manner to a changing marketplace without concern over charter restrictions or political action.

The 1996 privatization legislation created a corporate entity consisting of a state-chartered holding company, which owned the federally chartered GSE as well as other non-GSE subsidiaries. Dissolution of the GSE was designed to take place over a ten-year period. The GSE remains open for its traditional secondary market business and can continue to issue debt obligations as long as they mature prior to the dissolution date.

The holding company structure allowed Sallie Mae to continue to utilize the GSE for student loan purchasing activities while beginning to explore and pursue new business opportunities. No restraints were placed on the privatized Sallie Mae subsidiaries with regards to new business lines. However, the publicly traded holding company and its non-GSE subsidiaries could not engage in student loan purchase activities if the GSE was to continue to be used for that purpose.

A key feature of the privatization legislation passed by Congress was the element of choice for Sallie Mae shareholders. The Congress recognized that allowing shareholders a choice was prudent at the end of this public/private partnership---after all it was the shareholders of Sallie Mae who brought their capital to the table over the last 26 years. If shareholders had rejected the proposed privatization plan, an alternative wind-down plan for the GSE operations would be proposed.

The economics of the privatization allowed Sallie Mae to trade GSE benefits, which had been decaying under increased political pressure and public policy concerns, for an opportunity to pursue expanded business opportunities in a marketplace that had strategically changed. The legislation as approved provided a workable framework for the transition that minimized the impact to Sallie Mae's core business while adding significant growth opportunity.

In some respects, it is still too early to fully evaluate the success and impact of Sallie Mae's privatization. Most notably, the GSE wind-down is still a work in progress. However, there are some meaningful signs that the arguments put forth by the company and its supporters held true. Sallie Mae is becoming an originator on many of our nation's campuses. Our investments in new technologies are helping to revolutionize the entire student loan industry. The FFELP program, once faced with a serious threat from Direct Lending, has made strong inroads in its efforts to reclaim market share. And we continue to report strong quarterly earnings.

Not every line of business that we expressed an interest in pursuing has borne fruit. Some have already come and gone from the organization, while others never fully materialized. Some see this as evidence that privatization led to solid business practice. Decisions to enter new markets or provide new services were based on the collective expertise of the corporation, instead of the strength of public sentiment and political winds. Sallie Mae will continue to identify, evaluate and implement new ideas based on the dictates of our strategic business plan.

I am not here today to say that privatization is or isn't the natural conclusion of the public/private partnership embodied in all GSEs. But in the case of student loans and Sallie Mae, it appears that all parties – consumers, campuses, American taxpayers, shareholders and employees alike – have benefited from this course of action.