

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.