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January 18, 2006

VIA E-MAIL (regs.comments@federalreserve.gov)
Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551
Docket No. R-1238

VIA E-MAIL (comments@FDIC.gov)
Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
Attn: Comments/ Legal ESS

VIA E-MAIL (regs.comments@occ.treas.gov)
Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 1-5
Washington, DC 20219
Docket No. 05-16

VIA E-MAIL (regs.comments@ots.treas.gov)
Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552
Attn: No. 2005-40

Re: Comments on Joint Advance Notice of Proposed Rulemaking: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications

Ladies and Gentlemen:

I am writing on behalf of SLM Corporation (SLM), commonly known as Sallie Mae,[1] to comment on the joint advance notice of proposed rulemaking (the "ANPR") published by your agencies (the "Agencies") on October 20, 2005.[2] SLM supports the Agencies' efforts to enhance

[1] SLM is the nation's No. 1 paying-for-college company, managing nearly $121 billion in student loans for 8 million borrowers. Sallie Mae was originally created in 1972 as a government sponsored enterprise (GSE) and terminated all ties to the federal government in 2004. The company remains the country's largest originator of federally insured student loans. More information is available at www.SallieMae.com. SLM Corporation and its subsidiaries are not sponsored by or agencies of the United States of America.
[2] Federal Register, Vol. 70, p. 61068.

the risk sensitivity of the existing risk-based capital framework by expanding the number of risk-weight categories. We further support the notion on which the Agencies seek comment that "the risk-based capital framework should include more risk-weight categories than those proposed, such as a lower risk weight for the *highest quality assets with very low historical default rates*."[3] Both the existing and proposed (under Basel II) risk-based capital frameworks do not take into account the unique nature of student loan asset-backed securities backed solely by U.S. government guaranteed student loans ("student loan ABS"). By investing in asset-backed securities backed by U.S. government guaranteed student loans, holders of these securities are largely exposed to the credit risk of a AAA-rated sovereign. By not recognizing the unique credit characteristics of student loan ABS, the existing and proposed risk-based capital guidelines do not provide any incentive for banking organizations to hold these extremely low-risk assets.

We propose additional modifications to the existing U.S. domestic risk-based capital framework relating to securitizations. Specifically, we propose for AAA-rated tranches of asset-backed securities backed solely by U.S. government guaranteed student loans either: (1) reducing the risk-weight to 0% risk weight or, (2) adding a new risk weight category (e.g., 5% or 10%) that better reflects the largely sovereign nature of the credit risk.

The "one size fits all" approach of the existing risk-based capital framework that applies a 20% risk weighting to AAA to AA- rated ABS tranches is not risk-sensitive enough to reflect the extremely low level of credit risk inherent in student loan ABS. The credit quality of student loan ABS is reflected in their market performance: in almost all cases student loan ABS trade at spreads tighter than other AAA to AA- rated ABS and in some cases, up to 100 basis points tighter. Under the current and proposed risk-weight frameworks, however, banks may have no incentive to hold high quality student loan ABS in favor of other AAA rated ABS that are backed by assets that are a considerably weaker credit.

The high quality of student loan ABS derives primarily from the largely sovereign risk nature of the underlying assets. To better illustrate the sovereign risk, the following discussion describes the U.S. Government's guarantee of federally insured student loans. Under Title IV of the Higher Education Act, Federal Family education Loan Program (the FFELP) provides for student loans made under the FFELP ("Guaranteed Student Loans")[4] to be made to students or parents of dependent students enrolled in eligible institutions[5] to finance a portion of the costs of attending school. If a borrower defaults on a Guaranteed Student Loan, becomes permanently disabled, dies, files for bankruptcy or attends a school that closes prior to the student earning a degree, or if the applicable educational institution falsely certifies the borrower's eligibility for a Guaranteed Student Loan (collectively, "Insurance Triggers"), the holder of the loan, which must

[3] Id. at pp. 61071 - 72 (emphasis supplied).
[4] Guaranteed Student Loans currently include: (a) loans to students who pass certain financial needs tests ("Subsidized Stafford Loans"); (b) loans to students who do not pass the Stafford needs tests or who need additional loans to supplement their Subsidized Stafford Loans ("Unsubsidized Stafford Loans"); (c) loans to parents of students who are dependents and whose need exceeds the financing available from Unsubsidized Stafford Loans and/or Subsidized Stafford Loans; and (d) loans to consolidate the borrower's obligations under various federally authorized student loan programs into a single loan.
[5] Eligible institutions are post-secondary schools that meet the requirements set forth in the Higher Education Act and include institutions of higher education, proprietary institutions of higher education and post-secondary vocational schools. 20 U.S.C. § 1071 et seq.

be an eligible lender,[6] may file a claim with the applicable state or non-profit guarantee agency (the "Guarantor"). Provided that the Guaranteed Student Loan has been properly originated and serviced, the Guarantor pays the holder all or a portion of the unpaid principal balance on the loan as well as accrued interest.[7] Under the FFELP, payment of principal of and interest on the Guaranteed Student Loans is guaranteed upon occurrence of an insurance trigger by the applicable Guarantor[8] and reinsured by the DOE.[9]

A Guaranteed Student Loan is considered to be in default for purposes of the Higher Education Act when the borrower fails to make an installment payment when due, or to comply with other terms of the loan, and if the failure persists for 270 days in the case of a loan repayable in monthly installments or for 330 days in the case of a loan repayable in less frequent installments.[10] If the Guaranteed Student Loan is guaranteed by a Guarantor, the eligible lender is reimbursed by the Guarantor for 98% of the unpaid principal balance of the loan plus accrued unpaid interest on such loan in the event of an Insurance Trigger so long as the eligible lender has properly originated and serviced the loan.[11] As described below, under most circumstances, a loan deemed ineligible for reimbursement may be "cured", i.e., restored to eligibility.[12]

Guaranteed Student Loans must be originated and serviced in accordance with "due diligence" requirements imposed both by the Higher Education Act, the related federal regulations and the Guarantors. The federal requirements prescribe specific procedures and time frames for pursuing and collecting delinquent loans as well as Guarantor claim filing procedures that generally provide for certain actions, such as sending collection letters or making telephone contact, to occur in certain time periods within the delinquency cycle.[13] The penalty for noncompliance with the due diligence requirements can include the loss of the guaranty. In most cases, however, due diligence requirements may be "cured" and the rejected guaranty reinstated if the applicable Guarantor's cure procedures are successfully followed.[14] In fact, the historical data for Sallie Mae student loan ABS reveals that, in practice, virtually all guaranty claims rejected based on noncompliance with the due diligence requirements are eventually cured.[15]

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[6] Lenders eligible to make and/or hold Guaranteed Student Loans generally include banks, savings and loan associations, credit unions, pension funds, insurance companies and, under certain conditions, schools and Guarantors. 20 U.S.C. § 1085 (d).

[7] 20 U.S.C. § 1078 (c).

[8] Id. Guarantors enter into reinsurance agreements with the United States Secretary of Education pursuant to which the Secretary agrees to reimburse the Guarantor for all or a portion of the amount expended by the Guarantor (depending upon when the loan was made and the default experience of the Guarantor) in discharge of its guarantee obligation with respect to default claims provided the Guaranteed Students Loans have been properly originated and serviced. For claims resulting from death, disability or bankruptcy, the Secretary pays the full amount of the claim.

[9] 20 U.S.C. § 1082(o).

[10] 20 U.S.C. § 1085(l).

[11] 34 C.F.R. Pt. 682. 406 (a).

[12] Office of Postsecondary Education, 34 C.F.R Pt. 682, App. D (1997).

[13] For, example, if a borrower is between one and 15 days delinquent on the payment of a Guaranteed Student Loan, the lender must send at least one written notice or collection letter to the borrower informing the borrower of the delinquency and urging the borrower to make payments sufficient to eliminate the delinquency. 34 C.F.R. § 682.411(c). The notice or collection must include certain information such as a lender or servicer contact and telephone number. Id.

[14] 34 C.F.R. Pt. 682 App. D (1997)

[15] Historical data show that over 99% of submitted default claims are paid in full.

The Higher Education Act requires that, subject to compliance with the Higher Education Act, the U.S. Secretary of Education (the "Secretary") must pay all amounts that may be required to be paid under the Higher Education Act as a result of the Insurance Triggers.[16] It further provides that the Guarantors have a contractual right against the United States to receive reinsurance in accordance with its provisions,[17] until such time as the obligations are transferred to a new Guarantor capable of meeting such obligations or until a successor Guarantor assumes the obligations.[18] Importantly, if the Secretary determines that a Guarantor is unable to meet its insurance obligations, "the holder of the loans insured by the [Guarantor] may submit insurance claims directly to the Secretary and *the Secretary shall pay* to the holder the full insurance obligation of the [Guarantor], in accordance with insurance requirements no more stringent than those of the [Guarantor]."[19]

Some of the exceptional characteristics of AAA rated senior tranches of student loan ABS are as follows:

- As discussed above, the U.S. government's guarantee of Guaranteed Student Loans is direct,[20] explicit,[21] irrevocable[22] and effectively unconditional.[23] The FFELP is the largest program that the federal government has to provide aid to students and families pursuing a higher education.

- As also discussed above, Guaranteed Student Loans are generally subject to a 2% risk share (98% U.S. government guarantee) which is expected to increase to a 3% risk share (97% guarantee) on new loans originated after July 1, 2006 (death and disability is guaranteed at 100%).

- The typical structuring of a student loan ABS transaction includes credit enhancement of 3% AA+ rated subordinated ABS, approximately 80 basis points to 120 basis points of excess spread and 25 basis points of cash reserve. Because of the credit enhancement the AAA rated senior notes are, in effect, supported entirely by sovereign risk. To illustrate this assertion, examine an extreme stress case where 100 percent of the underlying loans default; the AAA rated senior note holder would not lose one penny of principal as the default risk-sharing losses would be covered by the subordination. The remaining bonds (97%) are AAA rated and would be covered by the governments guarantee on the defaulted loan principal and accrued interest.

- For every 1% in principal defaults in a pool of Guaranteed Student Loans backing ABS, annual net charge-offs, given 2% risk-sharing, are a mere 2 basis points.

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[16] 20 U.S.C. § 1078(c)(1).
[17] Id.
[18] 20 U.S.C. § 1082(o).
[19] Id. (emphasis supplied)
[20] See footnote 19 and related text.
[21] See footnote 16 and related text.
[22] Id.
[23] See footnote 15 and related text.

- National default rates on Guaranteed Student Loans are low. According to the Department of Education ("DE"), the 2003 cohort (2-year) default rate[24] for student loans was 4.5%[25] in 2003 (the most recent data available). Over the five-year period 1999-2003, cohort default rates averaged 5.3%.[26] This means the average annual default rate was 2.65% (5.3% divided by 2). However, this annualized DE "2-year, cohort-based" rate significantly overstates the "over the life" portfolio default rate because student loan defaults are heavily front-loaded in the loan repayment life. Nonetheless, using a conservative 2.65% average annual default rate would translate to 0.053% (2% times 2.65%) annual losses. In which case 0.40%, or a 5% (8% times 5%) risk weighted capital amount, would cover 7.5 times annual losses on an unrated, unenhanced student loan portfolio. As stated above, typical AAA student loan ABS subordination is 3%, so the structure already would cover 57 times (3% divided by 0.053%) these stated annual losses before considering excess spread or reserve funds. Accordingly, we believe that even a 5% risk weight is very conservative in terms of credit loss coverage.

- The AAA rated senior notes of student loan ABS are comparable to GNMA securities and *Phandbriefe* in terms of sovereign exposure and credit risk and therefore justify a risk weight from 0% to 10%.

In conclusion, we support the Agencies effort to expand the risk weight categories to enhance the risk sensitivity of the existing risk-based framework. We further support the idea that the risk-based capital framework should include more risk weight categories than those proposed, such as a lower risk weight for the highest quality assets with very low historical default rates. The current and proposed framework do not accord lower risk weighting for AAA and AA+ rated student loan ABS vis-à-vis other similarly rated ABS even though student loan ABS collateral is 98% backed by sovereign risk and have very low historical default rates. By applying a "one size fits all" approach to AAA- rated ABS, the Agencies have not created any incentive for banks to hold the much lower risk student loan ABS. When consumer and/or corporate credit is deteriorating, AAA- rated student loan ABS is precisely what bank regulators should be encouraging banks to hold. Therefore, we would strongly urge the Agencies to expand the risk-based framework to include a separate risk weight category for AAA- rated senior tranches of student loan ABS backed solely by U.S. government guaranteed student loans. Due to the sovereign nature of the exposure and the *de minimus* credit risk, a student loan ABS risk-weight category between 0% and 10% is justified. If the Agencies believe that a separate category for student loan ABS would cause unnecessary burden on banking organizations, we believe that the AAA- rated senior tranches of student loan ABS should be treated like GNMA securities and placed in the 0% risk-weight category.

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[24] A cohort default rate is a percentage of a school's borrowers who enter repayment on certain FFELP or William D. Ford Federal Direct Loan Program Loans during a particular federal fiscal year, October 1 to September 30, and default or meet other specified conditions prior to the end of the next fiscal year. Available at http://www.ed.gov/offices/OSFAP/defaultmanagement/cdr.html.

[25] Id.

[26] Available at http://www.ed.gov/offices/OSFAP/defaultmanagement/defaultrates.html

If you have any questions, please feel free to call me at the above number or Guido van der Ven at 315.685.9825.

Sincerely,

C E And

C.E. Andrews
Executive Vice President
Finance, Accounting and Risk Management