

SALLIE MAE® HELPS STUDENTS AVOID NEGATIVE IMPACT OF DEFAULT

*Comparison of Cohort Default Rates Shows Sallie Mae Borrowers
Average 30 Percent Fewer Defaults Than Direct Loan Borrowers*

**Sallie Mae Research Paper
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SALLIE MAE HELPS STUDENTS AVOID NEGATIVE IMPACT OF DEFAULT Cohort Default Rate for Sallie Mae Borrowers Averages 30% Less Than Direct Loans

Summary: As policymakers consider how to structure the future of the federal student loan program, they will best serve students and taxpayers by maintaining default aversion incentives that currently help students avoid the negative impact of student loan default. Lower defaults have tangible benefits for student loan borrowers, who preserve their good credit, and taxpayers, who save billions of dollars.

An analysis of Sallie Mae’s federal student loan portfolio performance reveals that the structure of the Federal Family Education Loan Program, in which a lender owns the asset, assumes default risk and works in partnership with guaranty agencies, results in a 30-percent difference in default prevention success compared to the model used in the Direct Loan program. In fact, the last two years of federal student loan repayment data show that, at similar schools in every school sector, Sallie Mae borrowers defaulted at lower rates than Direct Loan borrowers. For borrowers at private not-for-profit schools, Sallie Mae borrowers defaulted at half the rate of Direct Loan borrowers. At community colleges, the rate was 30 percent less. Furthermore, when institutions are separated by competitiveness of admissions, Sallie Mae cohort default rates were less than Direct Loan rates across all segments of competitiveness.

Lower default rates mean real savings for both borrowers and taxpayers. If Sallie Mae had managed the entire Direct Loan portfolio for borrowers entering repayment in 2005 and 2006, more than 15,000 borrowers would not have defaulted on \$200 million of student loans, saving them millions in federally prescribed fees and penalties and preserving their credit from the many adverse impacts of default. Conversely, if the Direct Loan program had served Sallie Mae’s borrowers, an additional 30,000 borrowers would have defaulted on nearly \$400 million of loans.

These results, and resulting consequences for student loan borrowers, deserve significant consideration as policymakers deliberate changes to the funding structure of federal student loans.

Table 1
Default Rate Comparison
2005 & 2006 Cohort Defaults by School Sector

	Sallie Mae			Direct Loan Schools			% Difference in Default Rate
	Defaulted borrowers	Total Borrowers	% Default	Defaulted borrowers	Total Borrowers	% Default	
School Sector							
Public 2-year	9,857	177,767	5.5%	12,168	151,407	8.0%	-31%
Public 4-year	11,760	533,049	2.2%	25,497	845,194	3.0%	-27%
Private, not-for-profit	9,655	624,179	1.5%	5,121	158,650	3.2%	-52%
For-profit	50,318	722,363	7.0%	11,982	139,796	8.6%	-19%

Overview of Analysis

The cohort default rate is a snapshot of the relative performance of federal student loan providers' efforts to ensure repayment of federal student loans and prevent defaults that adversely impact the lives of student loan borrowers and cost taxpayers billions of dollars each year. Examination of recent two-year cohort default rates, a measure regularly tracked by the U.S. Department of Education, provides insight into the effectiveness of Sallie Mae's default prevention success in FFELP by comparison with default rates in the current Direct Loan program.

This analysis reviewed all two-year default data provided by the U.S. Department of Education for the 2005 and 2006 student loan cohorts, the most recent data available. The analysis compared cohort borrower data on all loans serviced by Sallie Mae with cohort borrower data at Direct Loan Schools.¹

It is important to review the default rates by school sector because there are significant differences between the sectors of schools primarily served by the Direct Loan program and those served by Sallie Mae. Nearly two-thirds of Direct Loan borrowers attend four-year public institutions, which tend to have a lower default rate than other schools. Sallie Mae borrowers are more evenly divided across school sectors, similar to other FFELP providers. **Because of the predominance of four-year public institutions in its portfolio, Direct Loans have a total cohort default rate appearing similar to that of Sallie Mae. However, disaggregating the default rate by school sectors shows that Direct Loan default performance lags behind Sallie Mae consistently and by a wide margin.**

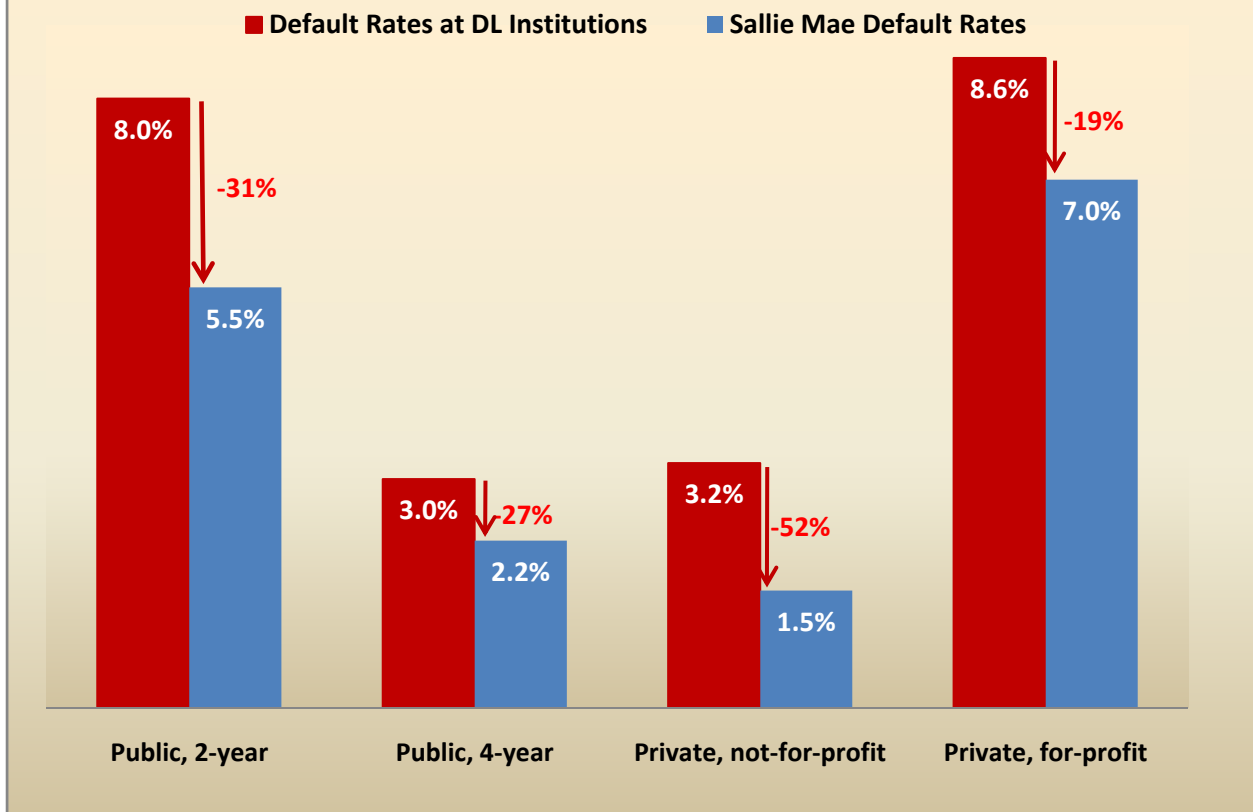
The analysis also compared Sallie Mae's loan servicing performance to Direct Loans based on the varying admissions competitiveness of academic institutions, due to major differences in borrower composition by this criterion. A far larger proportion of Direct Loan students attend schools with higher barriers to admission and less likelihood of future loan default. Because of this, Direct Loans again appear similar to Sallie Mae in the overall cohort default rate. But disaggregation by competitiveness segment shows that Sallie Mae has lower default rates in all such segments.

FINDINGS BY SCHOOL SECTOR

Separating institutions by private for-profit, private not-for-profit, and 2-year and 4-year public status in Table 1 and Chart A, **Sallie Mae's institutional default rates are significantly lower than those for Direct Loan institutions in all school sectors.**

¹ Department of Education cohort default data by school where Direct Loan volume represented a minimum of 75 percent of loan volume (see appendix for detailed methodology).

**Chart A: Two-Year Default Rates by School Sector
2005 and 2006 Borrower Cohorts**



- At public four-year institutions, where nearly two-thirds of Direct Loan recipients go to college, Sallie Mae’s cohort default rate is 27% percent lower than that of Direct Loan borrowers.
- At private not-for-profit institutions, where Sallie Mae services quadruple the number of borrowers as Direct Loans, Sallie Mae’s cohort default rate is less than half that of Direct Loans.
- In a separate analysis of Historically Black Colleges and Universities, Sallie Mae-serviced borrowers are 43 percent less likely to enter default compared with Direct Loans.

Based on the findings, the analysis estimated how many borrowers at Direct Loan institutions could have avoided default in the first two years assuming Sallie Mae’s cohort default rates at similar schools. In the 2005 and 2006 cohorts, **more than 15,000 borrowers would have avoided defaulting on nearly \$200 million in loans and paying at least \$40 million in federally prescribed default collection fees by using Sallie Mae instead of the current Direct Loan program – in just two years.** Conversely, the servicing of Sallie Mae loans at Direct Loan school-sector cohort default rates would result in 30,000 new defaults at a cost of approximately \$400 million in loans and \$80 million in default collection fees – in just two years.

The cohort default rate is a snapshot of default performance after borrowers have been in repayment for two years. Although many of the defaults occur in the first two years, the life-of-loan default rate tends to be two to three times the cohort default rate, depending on the school sector. There is no public data on the life-time default rates for the student loan programs. However, one would expect that the ownership and risk incentives that drive the lower default rates on the Sallie Mae loans would continue past the second year, resulting in both significant benefits for borrowers avoiding the consequences of default and savings for the federal taxpayer.

FINDINGS BY INSTITUTIONAL COMPETITIVENESS

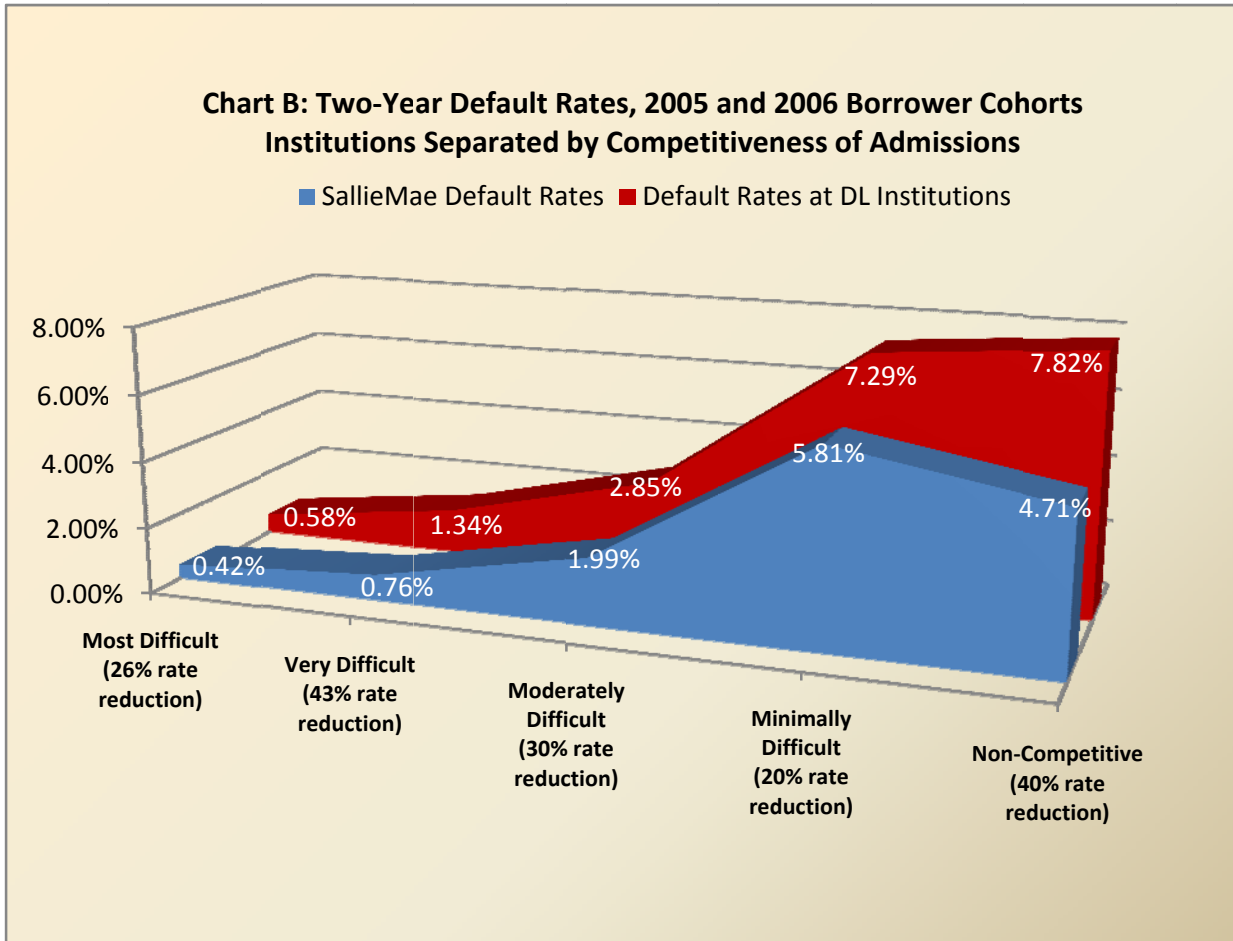
Default performance also varies greatly among institutions based upon their competitiveness in admissions. Use of the Peterson’s classification system of institutional competitiveness shows that default rates rise as admissions competitiveness decreases. Not surprisingly, the schools classified as the “most difficult” in their admissions have extremely low default rates. Defaults are highest at the institutions for which Peterson’s classifies admissions as “minimally difficult” or “non-competitive.”

The analysis of cohort data shows that, as with the comparison by school sector, Sallie Mae’s default rate is significantly lower than that of Direct Loans in every classification of institutional competitiveness. In the minimally difficult and non-competitive classifications, where default rates are a significant issue, Sallie Mae makes a considerable difference.

- For the non-competitive schools, Sallie Mae’s default rate is 4.7 percent, 40 percent below the Direct Loan rate of 7.8 percent.
- At schools with minimally difficult admissions, Sallie Mae’s default rate is 5.8 percent compared to 7.3 percent at Direct Loan schools.
- Even at schools with the most difficult admissions standards, Sallie Mae shows better default performance, with a default rate of 0.4 percent which is 26 percent below that at Direct Loan schools in the same classification.

Table 2
Default Rate Comparison
2005 & 2006 Cohort Defaults by School Competitiveness

	Sallie Mae			Direct Loan Schools			% Difference in Default Rate
	Defaulted borrowers	Total Borrowers	% Default	Defaulted borrowers	Total Borrowers	% Default	
Competitiveness in Admissions							
Most Difficult	208	49,073	0.4%	103	17,895	0.6%	-26%
Very Difficult	912	119,479	0.8%	1,370	102,118	1.3%	-43%
Moderately Difficult	14,460	727,541	2.0%	22,010	771,972	2.9%	-30%
Minimally Difficult	18,890	325,348	5.8%	6,389	87,665	7.3%	-20%
Non-Competitive	20,428	433,584	4.7%	14,322	183,175	7.8%	-40%
Other	27,035	410,646	6.6%	10,685	134,118	8.0%	-17%



Consequences of Default

A lower default rate has tangible benefits for borrowers and for taxpayers. For the \$90 billion of new loans that will be originated in fiscal 2010, a 30 percent lower default rate over the life of those loans translates to \$3 to \$4 billion less in defaults.

While this is a far better result for the taxpayer, the results are even more dramatic for borrowers. The consequences of default on an individual borrower are immediate, severe, and can be far-reaching. The box below is a summary of the consequences to borrowers taken from Department of Education debt management publications. With early indicators showing that default rates may be on the rise due to rising unemployment, a growing number of borrowers who default will not only face additional accruing interest but also the addition of federally prescribed collection costs (up to 22 percent), severe damage to the borrower’s credit, the prospect of wage garnishment, the seizure of income tax returns and federal benefit payments, the loss of eligibility for additional federal student aid, the denial or loss of professional licenses, and the possibility of civil litigation. As policymakers consider new funding options for

Consequences to Borrowers of Student Loan Default

- Entire loan balance (principal and interest) will be due in full immediately.
- College records may be placed on hold.
- Loss of student loan deferment options.
- Loss of eligibility for additional federal student aid.
- Significant penalties including late fees and collection costs, all of which become part of the debt.
- Credit rating damaged for several years because defaulted loans are reported to national credit bureaus.
- Difficulty qualifying for credit cards, a car loan, a mortgage, or renting an apartment (credit checks are required to rent an apartment).
- Federal and state income tax refunds can be withheld and applied to student loan debt. This is called a tax offset.
- Wages garnished (withheld).
- Unable to obtain a professional license or get hired by an employer that performs credit checks.

student loans, it is critical to keep the incentives aligned between borrowers and lenders/servicers to keep defaults low.

Conclusion

The data clearly show how the FFELP model's powerful incentives - ownership of the student loan and risk sharing - successfully lower student loan defaults. As market leader, Sallie Mae has, in conjunction with its guarantor partners, employed loan servicing and default aversion practices that go beyond the statutory due diligence requirements to communicate to borrowers the importance of successful student loan repayment and direct them to the programs available to avoid default. The value of these activities is unmistakable: across the board, by school sector or by school competitiveness, Sallie Mae has had more success preventing student loan defaults than the Direct Loan program by an average of 30 percent.

As policymakers consider changes to the funding structure for federal student loans, it is important to bear in mind the effects of such changes on default rates and student credit histories. Since student loan defaults present significant and lasting challenges for the students impacted, any legislation changing the structure of the student loan program must take care to retain the benefits of risk sharing and ownership that now create such powerful incentives to reduce defaults.

APPENDIX: METHODOLOGY FOR THIS ANALYSIS AND ADDITIONAL DATA TABLES

For purposes of this analysis, a Direct Loan institution has at least 75 percent of its student loan volume listed as Direct Loan volume based on academic year 2007-2008 originations data extracted from the U.S. Department of Education's National Student Loan Data System.

Cohort default data for all institutions were extracted from the Department's Postsecondary Education Participants System, and school sector identification data for all institutions were extracted from the Department's Integrated Postsecondary Education Data System. School competitiveness data were extracted from campus-reported data assembled by Peterson's; schools that did not report or provide a difficulty level were labeled as "Other".

Schools were aggregated into various different groupings in order to compare default rate performance as measured by Department cohort rates. The published Department cohort rates were compared to Sallie Mae rates, which were calculated in the same manner as Department rates but using a Sallie Mae database that mirrors the Department's calculation methodology (an explanation of the Department's methodology is available at <http://ifap.ed.gov/DefaultManagement/guide/attachments/CDRGuideMasterSept06.pdf>.) Sallie Mae data was subtracted from the Department cohort rate data to extrapolate all other servicers and enable comparison of Sallie Mae to other servicers. Schools with at least 75 percent in Direct Loan volume were grouped in the same categories in order to differentiate between Sallie Mae and Direct Loan default performance for all tables and charts herein.

Estimates of total dollars in borrower defaults are based on data provided by Pioneer Credit Recovery, Inc.[®], a division of Sallie Mae, using 2008 averages for principal and interest values of newly defaulted Direct Loans placed with Pioneer and the average number of loans per defaulting borrower. Default collection costs are valued at up to 20% of principal and interest.

Other supporting data tables follow.

Table 3
Default Rate Comparison
2005 & 2006 Cohort Defaults at Historically Black Colleges and Universities

	Sallie Mae			Direct Loan Schools			% Difference in Default Rate
	Defaulted borrowers	Total Borrowers	% Default	Defaulted borrowers	Total Borrowers	% Default	
Private not-for-profit	683	14,340	4.8%	2,058	18,277	11.3%	-58%
Public	2,351	40,262	5.8%	2,769	31,158	8.9%	-34%
Totals	3,034	54,602	5.6%	4,827	49,435	9.8%	-43%

Table 4
Impact on Borrowers
2005 & 2006 Cohort Defaults Avoided Due to Sallie Mae Servicing

	Sallie Mae	Direct Loan Schools	Change in # of DL Defaulted Borrowers if Sallie Mae/FFELP managed loans	# of Sallie Mae Borrowers who would have defaulted at higher DL rates
	% Default	% Default		
School Sector				
Public 2-year	5.5%	8.0%	-3,773	4,429
Public 4-year	2.2%	3.0%	-6,851	4,321
Private, not-for-profit	1.5%	3.2%	-2,667	10,493
For-profit	7.0%	8.6%	-2,244	11,596
Total Change in Defaults			-15,534	30,839

Table 5
Sallie Mae and Direct Loan Cohort Default Rates
By Cohort Year, By Region, By School Sector

Region	School sector	Sallie Mae			Direct Loan Schools			Difference in % Default
		Defaulted Borrowers	Total Borrowers	% Default	Defaulted Borrowers	Total Borrowers	% Default	
2006 Cohort Year								
Northeast	Private for-profit	4,465	58,916	7.6%	2,301	22,568	10.2%	-25.7%
Northeast	Private not-for-profit	1,491	104,977	1.4%	727	35,498	2.0%	-30.6%
Northeast	Public 2-Year	983	15,809	6.2%	1,184	16,229	7.3%	-14.8%
Northeast	Public 4-Year or More	811	39,325	2.1%	2,163	71,740	3.0%	-31.6%
Midwest	Private for-profit	5,768	76,794	7.5%	845	11,417	7.4%	1.5%
Midwest	Private not-for-profit	1,551	78,683	2.0%	598	24,140	2.5%	-20.4%
Midwest	Public 2-Year	1,743	25,481	6.8%	2,742	32,881	8.3%	-18.0%
Midwest	Public 4-Year or More	1,445	68,530	2.1%	4,277	151,014	2.8%	-25.5%
Other	Private for-profit	4	137	2.9%	---	---	---	---
Other	Private not-for-profit	361	4,504	8.0%	---	---	---	---
Other	Public 2-Year	---	---	---	---	---	---	---
Other	Public 4-Year or More	2	106	1.9%	---	---	---	---
Southeast	Private for-profit	7,329	85,597	8.6%	1,274	15,699	8.1%	5.5%
Southeast	Private not-for-profit	1,434	69,289	2.1%	1,152	14,991	7.7%	-73.1%
Southeast	Public 2-Year	1,426	22,825	6.2%	972	13,825	7.0%	-11.1%
Southeast	Public 4-Year or More	3,112	92,579	3.4%	4,086	90,320	4.5%	-25.7%
West	Private for-profit	12,805	164,032	7.8%	2,677	24,421	11.0%	-28.8%
West	Private not-for-profit	760	53,280	1.4%	208	5,687	3.7%	-61.0%
West	Public 2-Year	1,714	26,945	6.4%	1,532	15,782	9.7%	-34.5%
West	Public 4-Year or More	1,702	67,441	2.5%	3,006	110,626	2.7%	-7.1%
2005 Cohort Year								
Northeast	Private for-profit	4,075	55,198	7.4%	1,765	20,654	8.5%	-13.6%
Northeast	Private not-for-profit	1,469	112,870	1.3%	606	33,766	1.8%	-27.5%
Northeast	Public 2-Year	887	17,071	5.2%	1,151	15,184	7.6%	-31.5%
Northeast	Public 4-Year or More	800	42,801	1.9%	1,922	68,431	2.8%	-33.5%
Midwest	Private for-profit	4,595	65,138	7.1%	686	10,476	6.5%	7.7%
Midwest	Private not-for-profit	1,018	72,921	1.4%	536	23,734	2.3%	-38.2%
Midwest	Public 2-Year	1,266	23,625	5.4%	2,512	30,159	8.3%	-35.7%
Midwest	Public 4-Year or More	1,199	70,201	1.7%	3,896	149,932	2.6%	-34.3%
Other	Private for-profit	1	78	1.3%	---	---	---	---
Other	Private not-for-profit	180	4,337	4.2%	---	---	---	---
Other	Public 2-Year	---	---	---	---	---	---	---
Other	Public 4-Year or More	0	97	0.0%	---	---	---	---
Southeast	Private for-profit	4,708	74,314	6.3%	743	14,084	5.3%	20.1%
Southeast	Private not-for-profit	984	68,108	1.4%	1,113	15,572	7.1%	-79.8%
Southeast	Public 2-Year	860	20,470	4.2%	800	13,349	6.0%	-29.9%
Southeast	Public 4-Year or More	1,710	83,761	2.0%	3,409	89,197	3.8%	-46.6%
West	Private for-profit	6,568	142,159	4.6%	1,691	20,477	8.3%	-44.1%
West	Private not-for-profit	407	55,210	0.7%	181	5,262	3.4%	-78.6%
West	Public 2-Year	978	25,543	3.8%	1,330	15,106	8.8%	-56.5%
West	Public 4-Year or More	979	68,244	1.4%	2,729	113,497	2.4%	-40.3%

Table 6
Sallie Mae and Direct Loan Cohort Default Rates
By Cohort Year, By Peterson's Admissions Competitiveness Segment

Admissions Competitiveness Segment	Cohort Year	Sallie Mae			Direct Loan			Difference in % Default
		Defaulted Borrowers	Total Borrowers	% Default	Defaulted Borrowers	Total Borrowers	% Default	
Most Difficult	2005	102	26,058	0.4%	51	8,935	0.6%	-32.5%
Very Difficult	2005	420	62,703	0.7%	641	51,316	1.2%	-46.6%
Moderately Difficult	2005	5,949	363,349	1.6%	10,246	383,714	2.7%	-38.9%
Minimally Difficult	2005	8,225	153,620	5.4%	3,013	43,641	6.9%	-22.4%
Non-Competitive	2005	7,692	202,954	3.8%	6,627	88,430	7.5%	-49.2%
Other	2005	10,406	197,679	5.2%	4,524	63,454	7.1%	-26.5%
Most Difficult	2006	106	23,015	0.5%	52	8,960	0.6%	-21.2%
Very Difficult	2006	492	56,776	0.9%	729	50,802	1.4%	-39.6%
Moderately Difficult	2006	8,511	364,192	2.3%	11,764	388,258	3.0%	-23.0%
Minimally Difficult	2006	10,665	171,728	6.2%	3,376	44,024	7.7%	-19.0%
Non-Competitive	2006	12,736	230,630	5.5%	7,695	94,745	8.1%	-31.8%
Other	2006	16,629	212,967	7.8%	6,161	70,664	8.7%	-10.5%

Direct Loan borrowers exclude Sallie Mae borrowers at those schools

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