95-141530

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220
January 17, 1995

MEMORANDUM FOR SECRETARY RUBIN

THROUGH: DEPUTY SECRETARY NEWMAN FNN

FROM: Darcy Bradbury
Deputy Assistant Secretary
(Federal Finance)

INFORMATION

SUBJECT: Sallie Mae Privatization and the President's Budget

Treasury has been working with Education, OMB and NEC to analyze a possible privatization of Sallie Mae. Treasury is the safety and soundness oversight agency for Sallie Mae. The upcoming budget and concerns about Congressional scrutiny of the direct lending program have precipitated some rapid movement in this matter.

(1) OMB plans to include in the Budget a ramp up of direct student loans to 100% of the student loan market and a complete phase out of guaranteed student loans. This is expected to score at $5 billion over 5 years, and Treasury was not consulted in this decision.

(2) Education has commenced an administrative proceeding to stop Sallie Mae from vigorously competing with direct lending. Education's threat is to declare Sallie Mae an ineligible lender and void the federal guarantee on all outstanding loans held by Sallie Mae. This will intensify the hostility between Education and Sallie Mae. Education is also fighting with SLMA about whether Sallie has to pay the "offset fee" on loans it securitizes.

(3) We have convinced Education, OMB and NEC to link the legislation to eliminate guaranteed loans with the legislation for a complete privatization of Sallie Mae. Prior to this linkage, Education and OMB were not willing to agree to a certain transfer of Sallie Mae's assets and capital to a new private company.

(4) Direct lending was not very popular with the Republicans when it was passed -- hence the 60% cap on direct lending's market share in the statute. The Administration is now taking a very aggressive approach with Sallie Mae which will make passage of privatization legislation even more complex.

We expect to have draft legislation on the privatization ready in several weeks, and will brief you at that time to seek your approval. These other actions, however, will shape the Administration's position to a great degree.

EXECUTIVE SECRETARIAT

TREASURY CLEARANCE SHEET

NO. _____
Date 1/13/95

MEMORANDUM FOR: ☒ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER _____

FROM: Darcy Bradbury
THROUGH: DEPUTY SECRETARY NEWMAN
SUBJECT: Sallie Mae Privatization and the President's Budget

REVIEW OFFICES (Check when office clears)

- ☐ Under Secretary for Finance
  - ☐ Domestic Finance
  - ☐ Economic Policy
  - ☐ Fiscal
    - ☐ FMS
    - ☐ Public Debt
- ☐ Under Secretary for International Affairs
  - ☐ International Affairs
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  - ☐ Secret Service
- ☐ General Counsel
- ☐ Inspector General
- ☐ IRS
- ☐ Legislative Affairs
- ☐ Management
- ☐ OCC
- ☐ Policy Management
  - ☐ Scheduling
- ☐ Public Affairs/Liaison
- ☐ Tax Policy
- ☐ Treasurer
  - ☐ E & P
  - ☐ Mint
  - ☐ Savings Bonds
- ☐ Other _____

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
D. Bradbury	DB	1/13	Federal Finance	2-2037
REVIEWERS				
EQ Knight	GGK	1/13		
John Bowman	JB	1/13		

SPECIAL INSTRUCTIONS

☐ Review Officer _____ Date _____ ☐ Executive Secretary _____ Date _____

DO F 80-02.1 (04/89)

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

95-148-083

- Privatization of Sallie Mae
100% direct student loans
- Creates $5.2 bn in budget sav.
- Little support in Congress for 100% Student Loans

ACTION

MEMORANDUM FOR SECRETARY RUBIN

THROUGH: Under Secretary Hawke

FROM: Darcy Bradbury
Deputy Assistant Secretary (Federal Finance)

SUBJECT: Privatizing Sallie Mae

ACTION FORCING EVENT:

The Administration has prepared a bill to implement the President's goal to move to 100% direct student loans and to privatize Sallie Mae. Treasury has led the Administration working group to develop this legislation together with OMB, NEC, Education and DPC.

RECOMMENDATION:

That you sign, together with Secretary Riley, the transmittal letter to Congress.

✓ Agree _____Disagree _____Let's Discuss

BACKGROUND/ANALYSIS:

As the safety and soundness regulator for Sallie Mae, Treasury has been developing privatization legislation with this Administration working group for over a year. The President's FY 1996 budget includes moving to 100% direct student loan and phasing out the bank-based, guaranteed student loan program. That proposal creates $5.2 billion in budget savings in FY 1996-2000 and is consistent with the President's education priorities. The Administration has decided to submit one bill that includes both proposals. The concept of 100% direct lending has little support in Congress. The privatization piece will be acceptable to the Administration even if the current law on direct lending prevails, since 100% direct lending is permitted under current law at a later time.

The House is considering legislation to privatize Sallie Mae. A bill was reported out by the Education and Economic Opportunities Committee on June 8th. We testified in support of privatization in both the

EXECUTIVE SECRETARIAT

House and Senate, and have worked with House staff to improve their bill (which began with a Sallie Mae draft) as much as possible. If we transmit a bill to the Senate now, it will be easier to get a better bill.

ATTACHMENTS:

Tab A: Letters to Congress
Tab B: Outline of legislation
Tab C: Proposed legislation

Department
of the Treasury

Executive Secretary

to: _____

room: _____ date: _____

7/19

Bob:

While Sallie Mae's stock is privately held and is not owned by Treasury, Sallie Mae has a number of links to Treasury and to the U.S. government. These links include authority to borrow from Treasury, exemption from certain taxes, and Treasury regulation of its "safety and soundness." Sallie Mae bondholders and shareholders generally interpret the sum of these links to amount to a kind of implicit government guarantee on their investments.

"Privatization" of Sallie Mae amounts to a severing of these links. The attached table sets out additional links between Sallie Mae and other Government Sponsored Enterprises (GSEs) and the U.S. government.

With your approval I will send out the letters transmitting our proposal.

X Yes, send the letters.

____ No, please provide additional information.

J. Benjamin H. Nye
room 3408
phone 622-2735

Table 1

Government-sponsored Enterprise Links to the Federal Government

Feature	Federal National Mortgage Association	Federal Home Loan Mortgage Corporation	Federal Home Loan Banks	Farm Credit System	Federal Agricultural Mortgage Corporation	Student Loan Marketing Association	College Construction Loan Insurance Association
Chartered by Act of Congress	Yes	Yes	Yes	Yes	Yes	Yes	No
Ownership	Private	Private	Private	Private	Private	Private	Federal & Private (a)
President or presidential appointees appoint some board members	Yes (5/18)	Yes (5/18)	Yes (6/14) (b)	No	Yes (5/15)	Yes (7/21)	Yes (4/11)
Treasury lending authorized	$2.25B	$2.25B	$4.0B	No (c)	$1.5B (d)	$1.0B	No
Treasury approval of debt issuance	Yes	Yes	Yes	No	No	Yes	No
Eligible for Fed open market purchases	Yes	Yes	Yes	Yes	n/a (e)	Yes	No
Use of Fed as fiscal agent	Yes	Yes	Yes	Yes	Yes	Yes	No
Eligible to collateralize public deposits (all US Government; most State & local)	Yes	Yes	Yes	Yes	Yes	Yes	No
Exempt from SEC registration (1933 Act)	Yes	Yes	Yes	Yes	No	Yes	No
Government securities for purposes of the Securities Exchange Act of 1934	Yes	Yes	Yes	Yes	No	Yes	No
Eligible for unlimited investment by national banks and State bank FR members	Yes	Yes	Yes	Yes	Yes	Yes	No
Eligible for unlimited investment by thrifts regulated by FDIC or OTS	Yes	Yes	Yes	Yes	Yes	Yes	No
Exemption of corporate earnings from Federal income tax	No	No	Yes	Yes (f)	No	No	No
Exemption of corporate earnings from State and local income tax	Yes	Yes	Yes	Yes	No	Yes	No
Exemption of interest paid from State income tax	No	No	Yes	Yes	No	Yes	No
Subject to GAO audit	Yes (g)	Yes (g)	Yes	No	Yes	No	No
Federal regulator	HUD	HUD	FHFB	FCA (h)	FCA	~~None~~ TREAS	None

(a) Federally-owned stock may be sold after five years from date of incorporation.
(b) Each bank.
(c) Treasury is authorized to guarantee up to $4 billion of Financial Assistance Corporation bonds.
(d) Upon required certification from FAMC, borrowing from Treasury authorized to make payments under guarantee.
(e) Entity newly created.
(f) Federal Land Banks, Farm Credit Banks and Financial Assistance Corporation.
(g) Mortgage transactions may be subject to GAO audit under rules that may be prescribed by the Comptroller General.
(h) The Farm Credit System Assistance Board also has certain powers with respect to the Financial Assistance Corporation and the System institutions needing financial assistance.

Source: Statutes and regulations pertaining to the GSEs.

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE SECRETARY

July 18, 1995

Honorable Albert Gore, Jr.
President of the Senate
Washington, DC 20510

Dear Mr. President:

Enclosed for the consideration of the Congress is a legislative proposal entitled "The Accelerated Direct Loan Implementation and Student Loan Marketing Association Transition Act of 1995."

The proposed bill would amend the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.) to implement the William D. Ford Federal Direct Loan Program on an accelerated schedule and to authorize the Student Loan Marketing Association (Sallie Mae) to reorganize as a fully private business enterprise, without ties to the Federal Government. (The appendix to this letter summarizes the major provisions of the proposed bill.)

Direct lending offers the student borrower convenience, simplicity, and flexibility that encourages the pursuit of postsecondary education and the career of his or her choice. By accelerating the phase-in of direct lending, the proposed bill would ensure that these benefits would be available more quickly to more students, their parents, and participating institutions of higher education. In addition, accelerated implementation of direct lending and the phase-out of guaranteed lending would also provide budgetary savings in Fiscal Years 1996-2000 beyond the savings resulting from the current implementation schedule.

A Government-sponsored Enterprise (GSE) is no longer needed to provide liquidity in the secondary market for guaranteed student loans. Permitting privatization of Sallie Mae is a logical extension of the transition to direct lending. Furthermore, even in the context of the current FFEL Program, Sallie Mae currently purchases only about one-third of FFEL Loans.

Privatization would permit the company to enter into other economic activities as the guaranteed loan programs wind down and the need for secondary markets ultimately disappears. It would also be an example of a successful transition by an enterprise from government sponsorship to fully private status. The bill would ensure that the financial safety and soundness of the GSE is protected during the transition to private status in order to avoid any possibility that legislation might be needed to prevent default on the GSE's obligations. Should Sallie Mae's shareholders reject privatization, the bill provides for an orderly dissolution of the GSE over an eight-year period.

Finally, the bill would require the Secretary of Education to recall at least $1.1 billion in unneeded reserves held or controlled by guaranty agencies in fiscal years 1996 through 2000. In addition to realizing savings, this recovery of reserves is consistent with the systematic winding down of guaranty agency operations during the transition to direct lending as well as the requisite protection of Federal resources.

Pay-As-You-Go Requirement

The Omnibus Budget Reconciliation Act of 1990 requires that all revenue and direct spending legislation for years through fiscal year 1998 (when that Act is scheduled to expire) meet a pay-as-you-go requirement. That is, no such bill should result in an increase in the deficit, and if it does, it will trigger a sequester if not fully offset. Under current law, Sallie Mae pays certain fees to the Federal Government. Under this bill, Sallie Mae would be required to compensate the Government for loss of these revenues, thus ensuring PAYGO neutrality with respect to this revenue loss. The bill also requires the future issuance of stock purchase warrants or other consideration to the United States for the considerable benefits provided to Sallie Mae and its shareholders for more than two decades.

We estimate that this legislative proposal would reduce outlays by $2.9 billion over FY 1996-1998, as illustrated by the table below (estimate in millions), and by $5.2 billion over FY 1996-2000.

Accelerated Implementation of Direct Loans:

	1995	1996	1997	1998	1996-1998
Budget Authority	$0	$350	$1,067	$1,153	$2,570
Outlays	0	299	745	1,006	2,050

Recall of reserves:

	1995	1996	1997	1998	1996-1998
Budget Authority	$0	$350	$250	$250	$850
Outlays	0	350	250	250	850

Total savings:

	1995	1996	1997	1998	1996-1998
Budget Authority	$0	$700	$1,317	$1,403	$3,420
Outlays	0	649	995	1,256	2,900

We are aware that the Congressional Budget Resolution directs the Congressional Budget Office to deviate from current law in the scoring of Direct Loans, and that this direction would result in different estimates of the effect of this bill. Administration scoring follows statutory requirements.

We urge the Congress to give prompt and favorable consideration to this legislative proposal. If enacted, this proposal would continue the transition to an efficient, less costly student loan program, and eliminate Government ties to a major financial GSE in an orderly fashion that balances the interests of taxpayers, stockholders, and students. The Office of Management and Budget advises that there is no objection to the submission of this legislative proposal to the Congress, and that its enactment would be in accord with the program of the President. We are sending an identical letter to the Speaker of the House of Representatives.

Sincerely,

Richard W. Riley
Secretary of Education

Robert E. Rubin
Secretary of the Treasury

Enclosures

APPENDIX
The Accelerated Direct Loan Implementation
and Student Loan Marketing Association Transition Act of 1995

Accelerating the phase-in of Direct Loans

The proposed bill would amend the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.) to accelerate the transition from the FFEL Program to the Direct Loan Program so that Direct Loans would account for 80 percent of new student loan volume for academic year 1996-1997, and 100 percent of new volume for academic year 1997-1998 and succeeding academic years. Current law authorizes Direct Loans to account for 50 percent (plus demand) for academic years 1996-1997 and 1997-1998, and 60 percent (plus demand) for academic year 1998-1999.

Direct lending is a prime example of the best kind of private sector partnership. The Direct Loan Program uses competitively bid servicing contracts in a partnership with the private sector. In this way the Government gets the lowest price for the services needed and can oversee contractors to ensure quality. The Department of Education estimates that it will pay guaranty agencies nearly $174 million as an administrative expense allowance for the fiscal year 1995 cohort of FFEL loans, based solely on a uniform percentage of the agencies' portfolios that is unrelated to any particular agency's performance or operational efficiency. Under the Direct Loan Program, payments for administrative expenses are directly related to service and quality provided.

In addition, FFEL lenders receive statutorily-mandated payments to carry out their program responsibilities and to ensure that they receive a guaranteed rate of return. In fiscal year 1995 alone, for example, the Department of Education estimates that it will pay banks more than $600 million in special allowance payments that ensure that banks receive a guaranteed rate of return. These costs do not exist under the Direct Loan Program.

Apart from increasing efficiency through more effective use of the private sector, and the cost savings, there are substantial programmatic benefits that would be available to more students, their parents, and participating institutions of higher education. These benefits include a simpler and speedier process for obtaining loans, a single holder of the loan throughout its life, and flexible repayment options, including income contingent repayment. The structure of the Direct Loan Program does not suffer from the many delays, inefficiencies, and confusion inherent in the complicated interrelationships among the many lenders, guaranty agencies, secondary markets, and loan servicers in the FFEL Program. As a result, participating institutions can improve their service to students. Students can enjoy the convenience of obtaining all the components of their aid package

(Pell Grants, Federal campus-based assistance, and any nonfederal aid awarded by the institution, as well as Direct Loans) from the participating institution, which can serve as a one-stop student financial aid center--a service that lenders cannot perform. Furthermore, under the simpler Direct Loan Program, borrowers have a lower risk for errors and inadvertent defaults, as well as increased debt management options, which encourage Americans to pursue postsecondary education and the career of their choice, including lower-paying careers such as community service.

Accelerating the phase-in of direct lending would also build upon the successes enjoyed by the Department of Education in managing this program, and allow the Department to shift its administrative resources from FFEL and focus them on direct lending, thereby reducing the need for costly duplicative systems to oversee the two programs simultaneously. The Department of Education places a high priority on managing the Direct Loan Program efficiently, and we are pleased to report that its performance is viewed very favorably by Direct Loan borrowers and participating institutions alike.

Privatizing Sallie Mae

Over the past five years, a number of studies, including one by the Treasury Department issued in 1992, questioned whether there was a continuing need for the Student Loan Marketing Association (Sallie Mae) to have Government-sponsored Enterprise (GSE) status. The successful launch and expansion of direct lending has made it clear that it is time for Sallie Mae to cease to be a GSE, in accordance with an orderly transition plan. The proposed bill would authorize Sallie Mae, with stockholder approval, to change its status from a GSE to an ordinary business corporation pursuant to a reorganization plan that would be reviewed by the Secretaries of the Treasury and Education. The reorganization, if approved, must occur within 18 months of the date of enactment.

Under this reorganization, Sallie Mae, the GSE, would become a wholly-owned subsidiary of the ordinary business corporation (the "Holding Company") during a transition period, which would end with the dissolution of Sallie Mae no later than December 31, 2004. At the option of Sallie Mae's shareholders, the reorganization plan could include the opportunity for the Holding Company, through other subsidiaries, to continue in Sallie Mae's current line of business, but not as a GSE.

The choice whether to reorganize under the conditions stated in the bill belongs to Sallie Mae's stockholders. However, the choice whether Sallie Mae should continue to be a GSE is the Federal Government's. Under the proposed bill, if the stockholders did not approve Sallie Mae's reorganization as an ordinary business corporation, a program of orderly liquidation

over an eight-year period leading to dissolution of the company would be triggered. Sallie Mae could request an acceleration or extension of the date of dissolution, with the approval of the Secretaries of the Treasury and Education.

If no reorganization occurs, then Sallie Mae must develop a termination plan for the orderly winding down of its operations. This plan, which would be subject to approval by the Secretary of the Treasury, must ensure that Sallie Mae will maintain adequate capital during wind-down and have sufficient assets to transfer to the trust at the date of dissolution. Sallie Mae would be precluded from making distributions unless it was in compliance with the termination plan.

As of the dissolution date, any outstanding Sallie Mae debt would be transferred to a trust, together with enough noncallable full faith and credit United States obligations to pay all principal and interest on that debt. If the reorganization has occurred, the Holding Company would be responsible for making up any shortfall of obligations transferred.

During the transition period, Sallie Mae could issue new GSE debt obligations, provided that these obligations mature no later than the dissolution date, but its business activities would be restricted to existing contractual commitments and to certain authorities designed to ensure continued student loan access.

The bill would ensure that Sallie Mae's separate corporate identity is preserved during the transition period, and would insulate it from any financial risk that the Holding Company may experience during that time. The GSE would be permitted to make distributions to the Holding Company, as long as it is in compliance with its capital ratio and any required payments to the United States have been made.

Other measures in this proposal that are intended to ensure the financial safety and soundness of Sallie Mae during the transition period include provisions that would strengthen the Secretary of the Treasury's oversight authority, add additional reporting requirements, and increase the GSE's minimum capital ratio (along with a requirement that the Holding Company contribute if Sallie Mae falls below that minimum).

Two additional concerns addressed in the proposed legislation are ensuring the budget neutrality of the change in Sallie Mae's status and compensating the Federal Government in recognition of the significant benefits the Federal Government has provided to Sallie Mae and its stockholders through GSE status for more than two decades. To address the first concern, Sallie Mae would be required to compensate the Federal Government for the loss of revenues that it would have paid to the Federal Government under current law, if it had continued its GSE status. As to the

second concern, the proposal would require the issuance of stock purchase warrants, or other consideration, to the United States.

Recall of advances

This legislative proposal would require the Secretary to recover from the reserve funds held by guaranty agencies at least $1.1 billion in unneeded funds by fiscal year 2000. In addition to furthering the transition from the FFEL Program to the Direct Loan Program, recovering reserve funds is fully consistent with the current role of the guaranty agency in the FFEL Program--because the Secretary of Education is the ultimate insurer of all FFEL guarantees, a guaranty agency functions more like a loan servicer than a guarantor. As a result, guaranty agencies' need for reserve funds to protect against losses is diminished.

The proposal would authorize the Secretary of Education to establish a required level of reserve funds for each guaranty agency. These reserve amounts would be set at levels designed to meet the needs of the FFEL Program, assist in the transition to Direct Loans, and protect the Federal fiscal interest. In addition, the Secretary would be authorized to establish an alternative to reserves as a means of providing financial support to guaranty agencies; one such alternative could be a system providing working capital to guaranty agencies on a case-by-case basis. This authority would give the Secretary of Education the flexibility to address the changing needs of the guaranty agencies and the FFEL and Direct Loan systems during the transition. Consistent with the proposed recovery of reserve funds, the bill would also make a conforming amendment that would greatly reduce the amount of funds guaranty agencies need to have on hand to discharge their insurance obligations.

Other provisions to ensure access to loan capital before direct lending is available

As we have noted previously, a central consideration during the current as well as the accelerated phase-in schedule for direct lending is continued access to student loans. Under current law, until July 1, 1997, the Secretary is limited as to how much direct lending can be done. Even under the accelerated phase-in, there may be instances in which direct lending is not immediately available to meet a temporary loan access problem. Therefore, the bill would provide several new authorities. The Secretary of Education would be able to provide funds to Sallie Mae for new lender-of-last-resort (LLR) activities, under a proposed expansion of its current LLR authority. In addition, eligible entities functioning as secondary markets would be authorized to make LLR loans, as well as to purchase loans, using funds provided by the Secretary of Education. These provisions are options designed to ensure continued student loan access; the Department of Education does not anticipate having to use these

authorities. Finally, this proposal would also authorize the Secretary of Education to resume providing Federal loan insurance (instead of merely reinsuring loans that have been insured by guaranty agencies) as necessary to ensure students continued access to loan capital. These provisions would ensure that the Secretary of Education has the flexibility to address loan access issues in an orderly manner and to assist in the transition from guaranteed to direct lending.

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE SECRETARY

July 18, 1995

Honorable Newt Gingrich
Speaker of the House of Representatives
Washington, DC 20515

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Sincerely,

Richard W. Riley
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Privatizing Sallie Mae

Over the past five years, a number of studies, including one by the Treasury Department issued in 1992, questioned whether there was a continuing need for the Student Loan Marketing Association (Sallie Mae) to have Government-sponsored Enterprise (GSE) status. The successful launch and expansion of direct lending has made it clear that it is time for Sallie Mae to cease to be a GSE, in accordance with an orderly transition plan. The proposed bill would authorize Sallie Mae, with stockholder approval, to change its status from a GSE to an ordinary business corporation pursuant to a reorganization plan that would be reviewed by the Secretaries of the Treasury and Education. The reorganization, if approved, must occur within 18 months of the date of enactment.

Under this reorganization, Sallie Mae, the GSE, would become a wholly-owned subsidiary of the ordinary business corporation (the "Holding Company") during a transition period, which would end with the dissolution of Sallie Mae no later than December 31, 2004. At the option of Sallie Mae's shareholders, the reorganization plan could include the opportunity for the Holding Company, through other subsidiaries, to continue in Sallie Mae's current line of business, but not as a GSE.

The choice whether to reorganize under the conditions stated in the bill belongs to Sallie Mae's stockholders. However, the choice whether Sallie Mae should continue to be a GSE is the Federal Government's. Under the proposed bill, if the stockholders did not approve Sallie Mae's reorganization as an ordinary business corporation, a program of orderly liquidation

over an eight-year period leading to dissolution of the company would be triggered. Sallie Mae could request an acceleration or extension of the date of dissolution, with the approval of the Secretaries of the Treasury and Education.

If no reorganization occurs, then Sallie Mae must develop a termination plan for the orderly winding down of its operations. This plan, which would be subject to approval by the Secretary of the Treasury, must ensure that Sallie Mae will maintain adequate capital during wind-down and have sufficient assets to transfer to the trust at the date of dissolution. Sallie Mae would be precluded from making distributions unless it was in compliance with the termination plan.

As of the dissolution date, any outstanding Sallie Mae debt would be transferred to a trust, together with enough noncallable full faith and credit United States obligations to pay all principal and interest on that debt. If the reorganization has occurred, the Holding Company would be responsible for making up any shortfall of obligations transferred.

During the transition period, Sallie Mae could issue new GSE debt obligations, provided that these obligations mature no later than the dissolution date, but its business activities would be restricted to existing contractual commitments and to certain authorities designed to ensure continued student loan access.

The bill would ensure that Sallie Mae's separate corporate identity is preserved during the transition period, and would insulate it from any financial risk that the Holding Company may experience during that time. The GSE would be permitted to make distributions to the Holding Company, as long as it is in compliance with its capital ratio and any required payments to the United States have been made.

Other measures in this proposal that are intended to ensure the financial safety and soundness of Sallie Mae during the transition period include provisions that would strengthen the Secretary of the Treasury's oversight authority, add additional reporting requirements, and increase the GSE's minimum capital ratio (along with a requirement that the Holding Company contribute if Sallie Mae falls below that minimum).

Two additional concerns addressed in the proposed legislation are ensuring the budget neutrality of the change in Sallie Mae's status and compensating the Federal Government in recognition of the significant benefits the Federal Government has provided to Sallie Mae and its stockholders through GSE status for more than two decades. To address the first concern, Sallie Mae would be required to compensate the Federal Government for the loss of revenues that it would have paid to the Federal Government under current law, if it had continued its GSE status. As to the

second concern, the proposal would require the issuance of stock purchase warrants, or other consideration, to the United States.

Recall of advances

This legislative proposal would require the Secretary to recover from the reserve funds held by guaranty agencies at least $1.1 billion in unneeded funds by fiscal year 2000. In addition to furthering the transition from the FFEL Program to the Direct Loan Program, recovering reserve funds is fully consistent with the current role of the guaranty agency in the FFEL Program--because the Secretary of Education is the ultimate insurer of all FFEL guarantees, a guaranty agency functions more like a loan servicer than a guarantor. As a result, guaranty agencies' need for reserve funds to protect against losses is diminished.

The proposal would authorize the Secretary of Education to establish a required level of reserve funds for each guaranty agency. These reserve amounts would be set at levels designed to meet the needs of the FFEL Program, assist in the transition to Direct Loans, and protect the Federal fiscal interest. In addition, the Secretary would be authorized to establish an alternative to reserves as a means of providing financial support to guaranty agencies; one such alternative could be a system providing working capital to guaranty agencies on a case-by-case basis. This authority would give the Secretary of Education the flexibility to address the changing needs of the guaranty agencies and the FFEL and Direct Loan systems during the transition. Consistent with the proposed recovery of reserve funds, the bill would also make a conforming amendment that would greatly reduce the amount of funds guaranty agencies need to have on hand to discharge their insurance obligations.

Other provisions to ensure access to loan capital before direct lending is available

As we have noted previously, a central consideration during the current as well as the accelerated phase-in schedule for direct lending is continued access to student loans. Under current law, until July 1, 1997, the Secretary is limited as to how much direct lending can be done. Even under the accelerated phase-in, there may be instances in which direct lending is not immediately available to meet a temporary loan access problem. Therefore, the bill would provide several new authorities. The Secretary of Education would be able to provide funds to Sallie Mae for new lender-of-last-resort (LLR) activities, under a proposed expansion of its current LLR authority. In addition, eligible entities functioning as secondary markets would be authorized to make LLR loans, as well as to purchase loans, using funds provided by the Secretary of Education. These provisions are options designed to ensure continued student loan access; the Department of Education does not anticipate having to use these

authorities. Finally, this proposal would also authorize the Secretary of Education to resume providing Federal loan insurance (instead of merely reinsuring loans that have been insured by guaranty agencies) as necessary to ensure students continued access to loan capital. These provisions would ensure that the Secretary of Education has the flexibility to address loan access issues in an orderly manner and to assist in the transition from guaranteed to direct lending.

SUMMARY OF PROPOSED LEGISLATION
TO PROVIDE FOR TRANSITION OF
THE STUDENT LOAN MARKETING ASSOCIATION

Elimination of GSE Status

- The legislation would provide two alternatives for terminating the status of the Student Loan Marketing Association ("Sallie Mae") as a government-sponsored enterprise.
  - The shareholders of Sallie Mae would be given the option to reorganize Sallie Mae as an ordinary state-chartered business corporation.
  - If the shareholders do not choose to reorganize, then Sallie Mae would be required to wind down its business.

- Under either alternative,
  - Sallie Mae would dissolve as of December 31, 2004.
  - Sallie Mae would be required to issue stock warrants or other consideration to the United States and to compensate the government for lost revenue from offset fees for a specified number of years.
  - Sallie Mae would enter a transition period during which new business activities would be restricted and new debt issued would have to mature by December 31, 2004.
  - Sallie Mae's minimum capital ratio would be increased from 2 to 3 percent beginning in the year 2000.
  - Treasury's safety and soundness oversight authority would be enhanced, and Treasury would be authorized to assess Sallie Mae for reasonable costs of such oversight.
  - Sallie Mae would be required to establish a trust which would hold Treasury securities or other full faith and credit obligations of the United States sufficient to pay any debt obligations of Sallie Mae that are outstanding as of the date of dissolution in accordance with their terms.

A BILL

To amend the Higher Education Act of 1965 to provide for the full implementation of the William D. Ford Federal Direct Loan Program by Fiscal Year 1997, to provide for orderly termination of the status of the Student Loan Marketing Association as a government-sponsored enterprise, to require the return of certain Federal funds held in reserve by guaranty agencies under the Federal Family Education Loan Program, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SEC. 1. SHORT TITLE.

This Act may be cited as "The Accelerated Direct Loan Program Implementation and Student Loan Marketing Association Transition Act of 1995."

SEC. 2. FINDINGS AND PURPOSE.

(a) Findings.--The Congress hereby finds that--

(1) the William D. Ford Federal Direct Loan Program provides substantially greater benefits to borrowers, participating institutions of higher education, and

1 taxpayers than the Federal Family Education Loan Program,
2 including--
3 (A) a simpler and speedier process through which
4 to obtain loans, which, by reducing processing time and
5 using electronic data and funds transfers, improves the
6 level of service to students, and frees institutional
7 administrative personnel for more important duties,
8 such as counseling students regarding financial aid;
9 (B) flexible repayment options, including income
10 contingent repayment, which, by varying loan repayments
11 in relation to income, encourages Americans to pursue
12 postsecondary education and mitigates the impact of
13 student loan repayments on students' decisions about
14 whether to pursue lower-paying careers, such as public
15 service;
16 (C) a single holder throughout the life of the
17 loan, which enables the borrower to send one payment,
18 or a single request for deferment or forbearance, for
19 all Direct Loans to one place, regardless of the number
20 of loans or where they were originated; and
21 (D) the elimination of the delays,
22 inefficiencies, and confusion inherent in the
23 complicated interrelationships of the many lenders,
24 guaranty agencies, secondary markets, and loan
25 servicers in the Federal Family Education Loan Program;
26

(2) the Department of Education's performance in managing the Direct Loan phase-in is viewed very favorably by borrowers and participating institutions alike, and the Department has demonstrated its commitment to the Direct Loan Program by devoting the necessary resources--through hiring or reassigning personnel, increased training and technical assistance, and upgraded technology--to ensure the program's success and the Department's capacity to manage a full-scale student loan program;

(3) accelerating the phase-in of the Direct Loan Program would achieve significant additional savings compared to the phase-in schedule in current law; would make the benefits of the Direct Loan Program available to large numbers of students, their parents, and participating institutions far more quickly than under the current schedule; and would enable the Department to focus more resources on the Direct Loan Program more quickly, rather than dividing those resources between the duplicative systems needed to oversee two large student loan programs simultaneously, one guaranteed and one direct;

(4) full implementation of the Direct Loan Program creates an environment that does not require a government-sponsored enterprise to serve as a secondary market and warehousing facility for Federal Family Education Loans, following a transition period during which the Student Loan

Marketing Association will continue to carry out its statutory responsibilities;

(5) when considered apart from the needs of the Direct Loan Program, the current Federal Family Education Loan Program itself does not have a long-term need for the services of a government-sponsored enterprise to perform secondary market and warehousing facility functions;

(6) authorizing the Student Loan Marketing Association (hereinafter referred to as the "Association") to reorganize as an ordinary business corporation, without ties to the Federal Government, will demonstrate the effectiveness of a public-private partnership to create a viable public-purpose secondary market entity, the Federal support for which can be discontinued once the secondary market has been established;

(7) authorizing reorganization of the Association will set a precedent for permitting other government-sponsored enterprises to convert to completely private status;

(8) over $1.5 billion in Federal funds are currently held or controlled by guaranty agencies (or their transferees) as reserves under the Federal Family Education Loan Program;

(9) while reserves under that program were intended to assist in the establishment of the guaranty agency system, and to ensure that the guaranty agencies would be financially able to carry out their responsibilities in

connection with the guarantees issued by such agencies, section 432(o) of the Higher Education Act of 1965 clarifies that the Secretary of Education is the ultimate insurer of all guarantees under that program, eliminating the underlying need for most reserve funds; and

(10) the orderly transition from the Federal Family Education Loan Program to the William D. Ford Federal Direct Loan Program would be benefitted by systematically phasing out many guaranty agency operations and recalling most reserve funds in the manner that the Secretary of Education determines would best meet the needs of the Federal Family Education Loan Program, assist in the transition to the William D. Ford Federal Direct Loan Program, and protect the Federal fiscal interest.

(b) Purposes.--It is the purpose of this Act--

(1) to accelerate the transition from the Federal Family Education Loan Program to the William D. Ford Federal Direct Loan Program, so that by academic year 1997-1998, Direct Loans will provide 100 percent of the new student loan volume, and no new loan guarantees will be made by the Secretary under the Federal Family Education Loan Program after June 30, 1997;

(2) to require, as part of the systematic phase-out of guaranty agency operations during the transition from the Federal Family Education Loan Program to the William D. Ford Federal Direct Loan Program, the Secretary of Education to

recall at least $1.1 billion in reserves held or controlled by guaranty agencies (or their transferees) over the period fiscal years 1996 through 2000;

(3) to authorize the Association to reorganize as an ordinary business corporation, without Government sponsorship, after a transition period, during which the Association's business, operations, and assets would be transferred to a new State- or District of Columbia-chartered corporation; and

(4) to provide for orderly termination of the Association as a Government-sponsored enterprise on or before December 31, 2004.

TITLE I--DIRECT LOAN PROGRAM AMENDMENTS

SEC. 101. ACCELERATION OF DIRECT LOAN IMPLEMENTATION SCHEDULE.

Section 453(a) of the Higher Education Act of 1965 (20 U.S.C. 1001 et seq., hereinafter in this Act referred to as "the Act") is amended--

(a) in paragraph (2) by amending subparagraphs (C) and (D) to read as follows:

"(C) for academic year 1996-1997, loans made under this part shall represent 80 percent of the new student loan volume for such year; and

"(D) for academic year 1997-1998 and succeeding academic years, loans made under this part shall represent

100 percent of the new student loan volume for such years."; and

(b) in paragraph (3), by striking out "subparagraphs (C) or (D)" and inserting in lieu thereof "subparagraph (C)".

SEC. 102. TAX TREATMENT OF INCOME CONTINGENT DIRECT LOANS.

(a) Section 455(e)(4) of the Act is amended--

(1) by inserting immediately following the paragraph heading the subparagraph designation "(A)"; and

(2) by adding at the end thereof the following new subparagraph:

"(B) If, after 25 years of repayment, there is a balance (which may consist of unpaid principal, accrued interest, and any fees, late charges, and collection costs assessed on such loan) remaining on a loan made under this part that is being repaid pursuant to income contingent repayment, such remaining balance shall be cancelled, and such amount cancelled shall not be considered income for purposes of the Internal Revenue Code of 1986."

(b) Section 108(f) of the Internal Revenue Code of 1986 is amended--

(1) by inserting the subparagraph designation "(A)" immediately after "pursuant to";

(2) by striking out the period at the end thereof and inserting in lieu thereof a semicolon and "or (B) section 455(e)(4) of the Higher Education Act, under which any

balance remaining after 25 years of repayment on a loan made under part D of title IV of such Act that is being repaid pursuant to income contingent repayment shall be cancelled.".

TITLE II -- TRANSITION OF THE STUDENT LOAN MARKETING ASSOCIATION

SEC. 201. TRANSITION OF THE STUDENT LOAN MARKETING ASSOCIATION.

Part B of Title IV of the Act is amended by adding at the end thereof the following new section:

"SEC. 440. TRANSITION OF THE STUDENT LOAN MARKETING ASSOCIATION.

"(a) Reorganization of the Association.--

"(1) Authority to Reorganize.--The Student Loan Marketing Association (hereinafter in this section referred to as the 'Association') is authorized to carry out a restructuring of the common stock ownership of the Association, as set forth in a plan of reorganization adopted by the Board of Directors (the 'Plan'), the terms of which shall be consistent with this section, so that all of the outstanding common shares of the Association shall be directly owned by an ordinary business corporation chartered under the law of any of the 50 States or the District of Columbia (the "Holding Company"). The reorganization shall

occur as of the effective time set forth in the Plan (the "Effective Time"), which shall be no later than the date that is 18 months after the date of enactment of the Accelerated Direct Loan Program Implementation and Student Loan Marketing Association Transition Act of 1995. The Plan may provide for a merger of a wholly-owned subsidiary of the Holding Company with and into the Association, which would have the effect provided in the Plan and the law of the jurisdiction in which such subsidiary is incorporated, and the conversion of the common shares of the Association, at the Effective Time, to common shares of the Holding Company on a one-for-one basis, consistent with applicable State or District of Columbia law.

"(2) Plan Review and Amendment.--Upon adoption of the Plan by the Board of Directors of the Association, the Plan shall be submitted to the Secretary of the Treasury and the Secretary of Education. The Secretary of the Treasury and the Secretary of Education, in their sole discretion, may require the Board to adopt such amendments as are necessary or appropriate to ensure the continued safety and soundness of the Association, consistency with the provisions of this section, and the ability of the Association to continue to fulfill the purposes for which it was formed until its dissolution.

"(3) Stockholder Approval.--After adoption of the Plan by the Board of Directors with any amendments required in accordance with paragraph (2), the Plan shall be submitted to the common stockholders of the Association for their approval. The reorganization shall occur at the Effective Time, provided that the Plan has been approved by the affirmative votes, cast in person or by proxy, of the holders of a majority of the shares of the common stock of the Association.

"(4) Board Authority.--The Board of Directors of the Association may take or cause to be taken any action, consistent with this section, that it deems necessary or appropriate to effect the reorganization in accordance with this section, applicable State law, and the Plan.

"(b) Transition Provisions.--

"(1) The provisions in paragraph (2) shall apply-

"(A) in the event the shareholders of the Association approve the reorganization pursuant to subsection (a)(3), beginning at the Effective Time; or

"(B) in the event no reorganization occurs, beginning on the date which is 18 months after the date of enactment of the Accelerated Direct Loan Program Implementation and Student Loan Marketing Association Transition Act of 1995.

"(2) Consideration to the United States.--

"(A) Warrants or Other Consideration.-- The plan of reorganization or the termination plan, whichever is applicable, shall provide for the issuance of stock purchase warrants or other consideration to the United States, in such amount and on such terms and conditions as are acceptable to the Secretary of the Treasury.

"(B) Compensation for Lost Federal Revenues.--The Association shall pay to the Secretary (who may use such payment for any purpose for which funds under section 458 of the Act are available)--

"(i) $98,000,000 for fiscal year 1996;

"(ii) $91,000,000 for fiscal year 1997;

"(iii) $102,000,000 for fiscal year 1998;

"(iv) $106,000,000 for fiscal year 1999; and

"(v) $99,000,000 for fiscal year 2000;

"minus any amount paid by the Association pursuant to section 439(h)(7) for such fiscal year with respect to loans held by the Association that were made, insured, or guaranteed on or after October 1, 1995, except that in no case shall such subtraction result in a negative number.

1 "(C) Issuance of Obligations by the
2 Association During the Transition Period.--The
3 Association shall not issue debt obligations which
4 mature later than December 31, 2004, nor issue
5 debt obligations for any purpose other than to
6 finance activities permitted under subparagraphs
7 (D) and (E). The Secretary of Education and the
8 Secretary of the Treasury may extend this date if
9 they have extended the date of dissolution as
10 provided in subsection (e). Nothing in this
11 subsection shall modify the attributes accorded
12 the debt obligations of the Association by
13 section 439, regardless of when such debt
14 obligations are incurred or whether such
15 obligations are transferred to a trust in
16 accordance with subsection (e).
17 "(D) Restrictions on New Business Activity or
18 Acquisition of Assets by Association.--The
19 Association shall not engage in any new business
20 activities or acquire any new assets other than in
21 connection with--
22 "(i) contractual commitments for future
23 student loan purchases or warehousing
24 advances, or pursuant to letters of credit or
25 standby bond purchase agreements in either

case which are outstanding as of the date this paragraph becomes effective;

"(ii) serving as a lender of last resort pursuant to subsection 439(q); and

"(iii) purchasing loans pursuant to section 440A.

"(E) Limitation on Liquidity Portfolio.-- The Association's portfolio of liquid assets and cash equivalents may not exceed five percent of total assets, except with the prior written approval of the Secretary of the Treasury and the Secretary of Education.

"(c) Additional Transition Provisions in the Event of Reorganization.--In the event the shareholders of the Association approve the reorganization pursuant to subsection (a)(3) above, the following provisions shall apply beginning at the Effective Time:

"(1) Continuation of Rights and Duties.--Except as specifically provided in this section, the Association shall continue to have the rights, privileges, duties and obligations set forth in, and shall be subject to the limitations and restrictions of, section 439, and the Association shall continue to carry out the purposes for which it was formed.

"(2) Management and Operational Support.--The Holding Company (or its subsidiaries other than the

1 Association) shall provide all necessary and
2 appropriate management and operational (including loan
3 servicing) support to the Association, as requested by
4 the Association. The Association may also obtain such
5 management and operational support from other persons
6 or entities. Loan servicing agreements between the
7 Association and the Holding Company or any of its
8 subsidiaries shall be on terms no less favorable to the
9 Association than the Association could obtain from an
10 unrelated third-party and shall be subject to the
11 approval of the Secretary of Education.
12 "(3) Restrictions on Transactions with
13 Affiliates.--The Association shall not extend credit to
14 the Holding Company or any of its affiliates, nor
15 guarantee or provide any credit enhancement to any
16 obligations of the Holding Company or any of its
17 affiliates.
18 "(4) Dividends.--
19 "(A) After the Effective Time, the
20 Association may make cash or non-cash
21 distributions provided that--
22 "(i) amounts required to be paid under
23 subsection (b)(2) have been paid;
24 "(ii) immediately after payment of such
25 distributions, the Association's capital is
26 in compliance with section 439(r)(4); and

"(iii) the Secretary of Education and the Secretary of the Treasury have approved the Association's certification under subparagraph (B).

"(B) Prior to any distribution, the Association shall certify to the Secretary of the Treasury that the payment of the distribution will be in compliance with this paragraph and shall provide copies of all calculations needed to make such certification.

"(5) Holding Company Activities.--Until the dissolution date under subsection (e), Holding Company activities shall be limited to ownership of the Association and any other subsidiaries. All business activities shall be conducted through such subsidiaries.

"(6) Use of Sallie Mae Name.--

"(A) The names of the Holding Company and any other direct or indirect subsidiary of the Holding Company other than the Association may not contain the words "Student Loan Marketing Association", or "Sallie Mae", or any variations thereof.

"(B) Subject to subparagraph (A), the Association may assign to the Holding Company, or any direct or indirect subsidiary of the Holding Company other than the Association, the "Sallie

1 Mae" name as a trademark and service mark, except
2 that neither the Holding Company nor any direct or
3 indirect subsidiary of the Holding Company may use
4 the "Sallie Mae" name on, or to identify the
5 issuer of, any debt obligation or other security
6 offered or sold by the Holding Company or any
7 direct or indirect subsidiary.
8 "(C) Until three years after the dissolution
9 date, the Holding Company, and any direct or
10 indirect subsidiary of the Holding Company other
11 than the Association, shall prominently display in
12 any document offering its securities, and in any
13 advertisement or promotional materials which use
14 the "Sallie Mae" name or mark, a statement that--
15 "(i) neither the Holding Company nor
16 any such subsidiary is a Government-sponsored
17 enterprise or instrumentality of the United
18 States; and
19 "(ii) the obligations of the Holding
20 Company and any such subsidiary are not
21 guaranteed by the full faith and credit of
22 the United States.
23 "(7) Separate Operation of Corporations.--
24 "(A) The funds and assets of the Association
25 shall at all times be maintained separately from
26 the funds and assets of the Holding Company or any

of its other subsidiaries and shall be used by the Association solely to carry out its purposes and to fulfill its obligations.

"(B) The Association shall maintain books and records that clearly reflect the assets and liabilities of the Association, separate from the assets and liabilities of the Holding Company or any of its other subsidiaries.

"(C) The Association shall maintain a corporate office that is physically separate from any office of the Holding Company or any of its subsidiaries.

"(D) The Holding Company may not transfer or pledge the stock of the Association without the prior approval of the Secretary of the Treasury.

"(E) The Holding Company and its subsidiaries may not cause or agree to the liquidation of the Association nor cause the Association to file a petition for bankruptcy under Title 11 of the United States Code without the prior approval of the Secretary of Education and the Secretary of the Treasury.

"(F) No director of the Association that is appointed by the President pursuant to section 439(c)(1)(A) may serve as a director of the Holding Company.

"(G) At least one executive officer of the Association shall remain an officer solely of the Association.

"(H) Any amounts collected on behalf of the Association by the Holding Company or any of its other subsidiaries with respect to the assets of the Association, pursuant to a servicing contract or other arrangement between the Association and the Holding Company or any of its other direct or indirect subsidiaries, shall be collected solely for the benefit of the Association and shall be immediately deposited by the Holding Company or such other subsidiary to an account under the sole control of the Association.

"(I) The Secretary of the Treasury may order the Association or the Holding Company to take any action the Secretary determines to be necessary or appropriate to preserve the separate corporate identity of the Association and to maintain arm's length relationships between the Association and the Holding Company, and between the Association and other subsidiaries of the Holding Company.

"(8) Tax Matters.--

"(A) Obligations purchased or acquired pursuant to sections 439(d)(1)(B) and (C) that are--

"(i) purchased prior to the Effective Time and the income of which is exempt from taxation under the Internal Revenue Code of 1986, or

"(ii) acquired after the Effective Time in connection with contractual commitments for future purchases that are outstanding as of the Effective Time,

shall not be considered tax exempt obligations for purposes of section 265(a)(2) of the Internal Revenue Code of 1986 to the extent that the average outstanding amount of such obligations is less than or equal to the average stockholders' equity of the Association for the most recent taxable year ending on or before the day of the Effective Time.

"(B) The assets and indebtedness of the Association shall not be considered in any determination under section 265(a)(2) as to whether the Holding Company and its subsidiaries have incurred or continued indebtedness to purchase or carry tax-exempt obligations.

"(d) Additional Transition Provisions in the Event of No Reorganization.--In the event no reorganization occurs within 18 months after the date of enactment of the Accelerated Direct Loan Implementation and Student Loan

1 Marketing Association Transition Act of 1995, the following
2 provisions shall apply:
3 "(1) Termination Plan.--No later than the date
4 which is 24 months after the date of enactment of the
5 Accelerated Direct Loan Implementation and Student Loan
6 Marketing Association Transition Act of 1995, the
7 Association shall submit for the approval of the
8 Secretary of the Treasury (hereinafter in this
9 subsection the "Secretary") a plan for the orderly
10 winding up of its business which shall ensure that the
11 capital of the Association will be in compliance with
12 section 439(r)(4) and that the Association have
13 adequate assets to transfer to a trust, as provided in
14 subsection (e), to ensure payment of debt obligations
15 of the Association that are outstanding as of December
16 31, 2004, ("Remaining Obligations") in accordance with
17 their terms.
18 "(2) Plan Review and Amendment.--The Secretary
19 may require any amendments to the plan as the Secretary
20 deems necessary or appropriate to ensure full payment
21 of the Remaining Obligations. Once the plan or amended
22 plan has been approved by the Secretary, the Secretary
23 shall continue to review the plan and the financial
24 condition of the Association no less than annually.
25 After each review, the Secretary may require any

1 additional amendments to the plan as are necessary to
2 ensure full payment of the Remaining Obligations.
3 "(3) Implementation by the Association.--The
4 Association shall promptly implement the plan or
5 amended plan approved by the Secretary and shall
6 promptly implement any subsequent amendments required
7 based on the annual review.
8 "(4) Payment of Distributions.--
9 "(A) The Association may make cash or non-
10 cash distributions provided that--
11 "(i) amounts required to be paid under
12 subsection (b)(2) have been paid;
13 "(ii) immediately after payment of such
14 distributions, the Association's capital is
15 in compliance with section 439(r)(4);
16 "(iii) the Secretary has approved the
17 termination plan and the Association is in
18 full compliance with the plan as approved,
19 including any subsequent amendments required
20 by the Secretary; and
21 "(iv) the Secretary of Education and
22 the Secretary of the Treasury have approved
23 the Association's certification under
24 subparagraph (B).
25 "(B) Prior to any distribution, the
26 Association shall certify to the Secretary of the

1 Treasury that the payment of the distribution will
2 be in compliance with this paragraph and shall
3 provide copies of all calculations needed to make
4 such certification.
5 "(e) Termination of Association.--The Association shall
6 dissolve, and its separate existence shall terminate on
7 December 31, 2004, after discharge of all outstanding debt
8 obligations and liquidation pursuant to this subsection.
9 Upon the request of the Association, the Secretary of
10 Education and the Secretary of the Treasury may extend the
11 date of dissolution if they determine that the continued
12 participation of the Association in the transition to direct
13 lending is necessary or appropriate. The Association may
14 dissolve pursuant to this subsection prior to such date with
15 the approval of the Secretary of Education and the Secretary
16 of the Treasury. On the date of dissolution, the
17 Association shall take the following actions:
18 "(1) The Association shall, under the terms of an
19 irrevocable trust agreement in form and substance
20 satisfactory to the Secretary of the Treasury, the
21 Association and the appointed trustee, irrevocably
22 transfer all outstanding debt obligations of the
23 Association (the 'Transferred Obligations') to the
24 trust. Further, the Association shall, under the terms
25 of an irrevocable trust agreement in form and substance
26 satisfactory to the Secretary of the Treasury, the

1 Association and the appointed trustee, irrevocably
2 deposit or cause to be deposited into such trust, to be
3 held as trust funds solely for the benefit of holders
4 of the Transferred Obligations, money or direct non-
5 callable obligations of the United States of America or
6 any agency thereof if the United States has pledged its
7 full faith and credit to payment of the non-callable
8 obligations. Such obligations shall mature as to
9 principal and interest in such amounts and at such
10 times as are determined by the Secretary of the
11 Treasury to be sufficient, without consideration of any
12 significant reinvestment of such interest. The money
13 or direct non-callable obligations deposited in the
14 trust shall be used to pay the principal of, and
15 interest on, the Transferred Obligations in accordance
16 with their terms.
17 "(2) All money, obligations or financial assets
18 deposited into the trust pursuant to this subsection
19 shall be applied by the trustee to the payment of the
20 Transferred Obligations assumed by the trust. Upon the
21 fulfillment of the trustee's duties under the trust,
22 and with the approval of the Secretary of Education and
23 the Secretary of the Treasury, any remaining assets of
24 the trust shall be transferred to the shareholders of
25 the Association.

"(3) The Association shall make proper provision for all other obligations of the Association, including the repurchase or redemption, or the making of proper provision for the repurchase or redemption, of any preferred stock of the Association then outstanding.

"(4) In the event that a reorganization has occurred as permitted in subsection (a)--

"(A) to the extent that the Association cannot provide money or qualifying obligations as required for the trust under paragraph (1), the Holding Company shall be required to transfer money or qualifying obligations to the trust in the amount necessary to prevent any deficiency; and

"(B) any obligations of the Association which cannot be fully satisfied as required under paragraph (3) shall become liabilities of the Holding Company as of the date of dissolution.

"(5) After compliance with paragraphs (1) through (3), and paragraph (4) if applicable, and with approval of the Secretary of Education and the Secretary of the Treasury, the Association may distribute to its shareholders any remaining assets of the Association.

"(f) The Secretary of Education or the Secretary of the Treasury, as appropriate, may request the Attorney General of the United States to bring an action in the United States

1 District Court for the District of Columbia for the
2 enforcement of any provision of this section. Such court
3 shall have jurisdiction and power to order and require
4 compliance herewith.".
5 **SEC. 202.** AMENDMENTS TO SECTION 439.
6 (a) Sec. 439 of the Act is amended--
7 (1) by amending the heading of subsection (r) to read
8 as follows:
9 "(r) SAFETY AND SOUNDNESS OF ASSOCIATION AND ORDERLY
10 TRANSITION PURSUANT TO SECTION 440.--";
11 (2) in subsection (r) --
12 (A) by amending paragraph (1) by adding the
13 following new subparagraph:
14 "(C) Within 45 days of the end of each
15 calendar quarter, the Association shall provide to
16 the Secretary of the Treasury (i) financial
17 statements of the Association and (ii) a report
18 showing the calculation of the capital ratio in a
19 form and containing such information as is
20 approved by the Secretary."
21 (B) in paragraph (2)--
22 (i) by amending subsection (A)(i) to read as
23 follows:
24 "(i) appoint auditors or examiners to conduct
25 audits of the Association from time to time to
26 determine the condition of the Association for the

1 purpose of assessing its financial safety and
2 soundness and to determine whether the
3 requirements of section 440 are being met."; and
4 (ii) by adding at the end thereof the following
5 new subparagraph:
6 "(D) The Secretary of the Treasury may
7 establish and collect from the Association an
8 annual assessment in an amount sufficient to
9 provide for reasonable costs and expenses of the
10 Secretary to carry out the duties of the Secretary
11 under this subsection and section 440.";
12 (C) in paragraph (3), in the second sentence, by
13 striking out "and identify" and all that follows
14 through the end thereof and inserting in lieu thereof a
15 period;
16 (D) by amending paragraph (7) to read as follows:
17 "(7) The Association shall maintain a
18 capital ratio of at least 2.0 percent through
19 the calendar year 1999. Beginning with the
20 calendar year 2000, the Association shall
21 maintain a capital ratio of at least 3.0
22 percent. If the capital ratio is less than
23 the required percentage at the end of the
24 Association's most recent calendar quarter,
25 the Secretary of the Treasury may, until the
26 capital ratio equals or exceeds the required

1 percentage, take any one or more of the
2 following actions:
3 "(A) Limit increase in
4 liabilities.--Limit any increase in, or
5 order the reduction of, any liabilities
6 of the Association, except as necessary
7 to fund student loan purchases and
8 warehousing advances.
9 "(B) Restrict growth.--Restrict or
10 eliminate growth of the Association's
11 assets, other than student loan
12 purchases and warehousing advances.
13 "(C) Restrict distributions.--
14 Restrict the Association from making any
15 capital distribution.
16 "(D) Require issuance of new
17 capital.--Require the Association to
18 issue new capital in any form and in any
19 amount sufficient to restore the capital
20 ratio to the required percentage.
21 "(E) Limit executive
22 compensation.--Prohibit the Association
23 from increasing for any executive
24 officer any compensation including
25 bonuses at a rate exceeding that
26 officer's average rate of compensation

1 during the previous 12 calendar months
2 and prohibiting the Board from adopting
3 any new employment severance contracts."
4 (E) by striking out paragraphs (4), (5), and (6)
5 and (8) through (11);
6 (F) by redesignating paragraphs (7), (12) and
7 (13) as paragraphs (4), (5) and (6) respectively.
8 (G) in paragraph (6) as redesignated by
9 subparagraph (F) --
10 (i) by striking out subparagraph (A); and
11 (ii) by redesignating subparagraphs (B) and
12 (C) as subparagraphs (A) and (B) respectively; and
13 (H) by adding at the end the following new
14 paragraph--
15 "(7) The Secretary of the Treasury may
16 request the Attorney General of the United States
17 to bring an action in the United States District
18 Court for the District of Columbia for the
19 enforcement of any provision of this subsection.
20 Such court shall have jurisdiction and power to
21 order and require compliance herewith.".
22 (b) Section 439(q) of the Act is further amended--
23 (1) in paragraph (1)(B), by striking out "to this
24 subsection" and "paragraph (2)(A) of this subsection" and
25 inserting in lieu thereof "to this paragraph" and
26 "subparagraph (B)(i) of this paragraph", respectively;

(2) by redesignating paragraph (1), and subparagraphs (A) and (B) thereof, as subparagraph (A), and clauses (i) and (ii) thereof, respectively;

(3) by redesignating paragraph (2), and subparagraphs (A) and (B) thereof, as subparagraph (B), and clauses (i) and (ii) thereof, respectively;

(4) by redesignating paragraph (3) as subparagraph (C);

(5) by inserting immediately after the subsection heading the following: "(1) LENDER-OF-LAST-RESORT LOANS MADE BY THE ASSOCIATION FROM ITS OWN FUNDS.--;" and

(6) by adding at the end thereof the following new paragraph:

"(2) LENDER-OF-LAST-RESORT LOANS MADE AND SERVICED BY THE ASSOCIATION ON BEHALF OF THE SECRETARY OF EDUCATION.--

"(A)(i) In order to ensure the availability of loan capital during the transition from the Federal Family Education Loan Program under this part to the William D. Ford Federal Direct Loan Program under part D of this title, the Secretary is authorized to provide the Association with funds, with such restrictions on their use and such requirements for their repayment as are determined appropriate by the Secretary,

1 to enable the Association, on behalf of the
2 Secretary, to make and service loans as the
3 lender-of-last-resort whenever the Secretary
4 determines that eligible borrowers are
5 seeking and are unable to obtain loans under
6 this part.
7 "(ii) Notwithstanding any other
8 provision of law, the Secretary may provide
9 such funds to the Association without regard
10 to the availability of a lender-of-last-
11 resort program of a guaranty agency operating
12 in a State.
13 "(iii) The Association shall make such
14 loans on behalf of the Secretary in
15 accordance with this subsection and the
16 requirements of the Secretary. The Secretary
17 may require that the Association make loans
18 to borrowers within a geographic area or for
19 the benefit of students attending
20 institutions of higher education that
21 certify, in accordance with standards
22 established by the Secretary, that their
23 students are seeking and unable to obtain
24 loans.
25 "(iv) Notwithstanding any other
26 provision in this part, the Association shall

be required to pay over to the Secretary, at such intervals as the Secretary may specify, the interest paid by the borrowers of loans made pursuant to this paragraph. Any negative subsidy receipts, as defined by the Federal Credit Reform Act of 1990, shall be available for the same purposes as funds available under section 458.

"(B) Loans made pursuant to this paragraph shall be insurable by the Secretary under section 429 with a certificate of comprehensive insurance coverage provided for under section 429(b)(1).

"(C) Notwithstanding any other provision in this part, the Secretary shall pay the Association a fee, in an amount established by the Secretary in consultation with the Association, for making and servicing such lender-of-last-resort loans on behalf of the Secretary in lieu of interest and special allowance subsidies, and the Association shall hold such loans, and repayments of principal thereon, on behalf of the Secretary until requested to provide such loans or such repayments to the Secretary (which the Association shall do promptly and without delay upon the Secretary's request).

"(D) The Secretary may provide the funds and pay the fees described in this paragraph from funds available under this part or under section 458 of the Act.".

SEC. 203. ADDITIONAL AMENDMENTS TO SECTION 439.

In the event that a reorganization occurs as provided in section 440(a)(1) of the Act, as added by section 201 of this Act, section 439 is further amended-

(a) by amending subsection (c)(1)(A) to read as follows:

"(c) Board of Directors.--

"(1) Composition of Board; Chairman.--(A) The Association shall have a Board of Directors which shall consist of 11 persons, three of whom shall be appointed by the President and shall be representative of the general public. The remaining 8 directors shall be elected by the common stockholders of the Association entitled to vote pursuant to subsection (f) of this section. Four of the elected directors shall be affiliated with an eligible institution; and four of the elected directors shall be affiliated with an eligible lender.";

(b) by amending subsection (r)(4), as redesignated by section 202, by adding the following new subparagraph:

1 "(F) Require contribution of new capital.--Require the
2 Holding Company to contribute additional capital to the
3 Association."; and
4 (c) by amending subsection (r) by inserting at the end the
5 following new paragraph:
6 "(8) ADDITIONAL REPORTING.--
7 "(A) The Holding Company, as defined in section
8 440(a)(1), shall promptly furnish to the Secretary of
9 Education and the Secretary of the Treasury copies of
10 all periodic financial reports publicly distributed by
11 the Holding Company.
12 "(B)(i) The Association shall obtain such
13 information and make and keep such records as the
14 Secretary of the Treasury may from time to time
15 prescribe concerning (I) the financial risk to the
16 Association resulting from the activities of any of its
17 associated persons, to the extent such activities are
18 reasonably likely to have a material impact on the
19 financial condition of the Association, including its
20 capital ratio, its liquidity, or its ability to conduct
21 and finance its operations, and (II) the Association's
22 policies, procedures, or systems for monitoring and
23 controlling such financial risk. Such records shall
24 describe, in the aggregate, the activities conducted
25 by, and customary sources of capital and funding of,
26 those of its associated persons whose business

activities are reasonably likely to have a material impact on the financial or operational condition of the Association. The Secretary may require summary reports of such information to be filed with the Secretary.

"(ii) If, as a result of adverse market conditions or based on reports provided pursuant to subparagraph (A) of this paragraph or other available information, the Secretary has concerns regarding the financial or operational condition of the Association, the Secretary may require the Association to make reports concerning the activities of any of the Association's associated persons, other than a natural person, whose business activities are reasonably likely to have a material impact on the financial or operational condition of the Association.

"(iii) The term "associated person" shall mean any person other than a natural person, directly or indirectly controlling, controlled by, or under common control with the Association.".

SEC. 204. SECONDARY MARKETS.

Part B of Title IV of the Act is further amended by adding at the end thereof the following new section:

"SEC. 440A. SECONDARY MARKETS.

"(a) FUNDS AUTHORIZED; PURPOSES.--In order to ensure the availability of loan capital during the transition from the Federal Family Education Loan Program under this part to

1 the William D. Ford Federal Direct Loan Program under part D
2 of this title, and to ensure the success of such transition,
3 the Secretary is authorized to provide funds to one or more
4 secondary markets described in subsection (b), from funds
5 specified in subsection (e), to enable such secondary market
6 to--
7 "(1) make and service loans on behalf of the
8 Secretary as the lender-of-last-resort, on terms
9 described in subsection (c), whenever the Secretary
10 determines that eligible borrowers are seeking and are
11 unable to obtain loans under this part; or
12 "(2) purchase loans on behalf of the Secretary
13 made under this part that are insured by a guaranty
14 agency on terms described in subsection (d).
15 "(b) ELIGIBLE SECONDARY MARKET.--In order to be
16 eligible to receive funds under this section, an entity
17 functioning as a secondary market must meet the definition
18 of an eligible lender in section 435(d) and such other
19 eligibility criteria as the Secretary may specify.
20 "(c) REQUIREMENTS FOR LENDER-OF-LAST RESORT LOANS MADE
21 ON BEHALF OF THE SECRETARY.--
22 "(1)
23 "(A) The Secretary may place such
24 restrictions on the use of, and such requirements
25 for the repayment of, funds provided by the
26 Secretary under this subsection to a secondary

1 market as are determined appropriate by the
2 Secretary.
3 "(B) Notwithstanding any other provision of
4 law, the Secretary may provide such funds to a
5 secondary market without regard to the
6 availability of a lender-of-last-resort program of
7 a guaranty agency operating in a State.
8 "(C) A secondary market shall make and
9 service such loans on behalf of the Secretary in
10 accordance with this subsection and the
11 requirements of the Secretary. The Secretary may
12 require that the secondary market make loans to
13 borrowers within a geographic area, or for the
14 benefit of students attending institutions of
15 higher education that certify, in accordance with
16 standards established by the Secretary, that their
17 students are seeking and unable to obtain loans.
18 "(D) Notwithstanding any other provision in
19 this part, the secondary market shall be required
20 to pay over to the Secretary, at such intervals as
21 the Secretary may specify, the interest paid by
22 the borrowers of loans made pursuant to this
23 paragraph. Any negative subsidy receipts, as
24 defined by the Federal Credit Reform Act of 1990,
25 shall be available for the same purposes as funds
26 available under section 458.

1 "(2) Loans made pursuant to this paragraph shall
2 be insurable by the Secretary under section 429 with a
3 certificate of comprehensive insurance coverage
4 provided for under section 429(b)(1).
5 "(3) Notwithstanding any other provision in this
6 part, the Secretary shall pay a secondary market a fee,
7 in an amount established by the Secretary in
8 consultation with the secondary market, for making and
9 servicing such lender-of-last resort loans on behalf of
10 the Secretary in lieu of interest and special allowance
11 subsidies, and the secondary market shall hold such
12 loans, and repayments of principal thereon, on behalf
13 of the Secretary until requested to provide such loans
14 or such repayments to the Secretary (which the
15 secondary market shall do promptly and without delay
16 upon the Secretary's request).
17 "(d) REQUIREMENTS FOR FUNDS PROVIDED FOR LOAN
18 PURCHASES.--
19 "(1) The Secretary may place such restrictions on
20 the use of, and such requirements for the repayment of,
21 funds provided by the Secretary under this subsection
22 as are determined appropriate by the Secretary.
23 "(2) Loans purchased pursuant to this section
24 shall be insurable by the Secretary under section 429,
25 with a certificate of comprehensive insurance coverage
26 provided for under section 429(b)(1), in lieu of the

1 insurance provided by a guaranty agency prior to such
2 purchase.
3 "(3) Notwithstanding any other provision in this
4 part, the secondary market shall be required to pay to
5 the Secretary, at such intervals as the Secretary may
6 specify, the interest paid by the borrowers of loans
7 made pursuant to this subsection. Any negative subsidy
8 receipts, as defined by the Federal Credit Reform Act
9 of 1990, shall be available for the same purposes as
10 funds available under section 458.
11 "(4) Notwithstanding any other provision in this
12 part, the Secretary shall pay a secondary market a fee,
13 in an amount established by the Secretary in
14 consultation with the secondary market, in lieu of
15 interest and special allowance subsidies on the loans
16 purchased on behalf of the Secretary under this
17 subsection, and the secondary market shall hold such
18 loans on behalf of the Secretary until requested to
19 provide them to the Secretary (which the secondary
20 market shall do promptly and without delay upon the
21 Secretary's request).
22 "(e) SOURCES OF FUNDS.--The Secretary may provide the
23 funds and pay the fees described in this section from funds
24 available under this part or under section 458 of the Act.".

1 **SEC. 205.** REPEAL OF SECTION 439.

2 Section 439 of the Act shall be repealed as of the date the
3 Association is dissolved pursuant to section 440(c) of the Act,
4 as added by section 201 of this Act.

5

6 TITLE III--FEDERAL FAMILY EDUCATION LOAN
7 PROGRAM AMENDMENTS

8

9 **SEC. 301.** RECOVERY OF RESERVES.

10 (a) Section 422 of the Act is amended--

11 (1) in subsection (g)(1)--

12 (A) in the second sentence therein, by inserting
13 "except as provided in subsection (h)," immediately
14 after "However,";

15 (B) in the third sentence therein, by striking
16 out "The reserves" and inserting in lieu thereof
17 "Reserves not recovered pursuant to subsection (h)";

18 (C) by striking out subparagraph (A);

19 (D) in subparagraph (D), by striking out
20 "subparagraph (A) or (B)" and inserting in lieu thereof
21 "subparagraph (A)"; and

22 (E) by redesignating subparagraphs (B), (C), and
23 (D) as subparagraphs (A), (B), and (C), respectively;
24 and

25 (2) by adding at the end thereof the following new
26 subsection:

1 "(h) RECOVERY OF RESERVES IN FISCAL YEARS 1996
2 THROUGH 2000.--(1) Notwithstanding any other provision
3 of law, the Secretary shall recover from the reserve
4 funds held by guaranty agencies an aggregate amount
5 that is not less than $350,000,000 for fiscal year
6 1996, $250,000,000 for each of fiscal years 1997 and
7 1998, $150,000,000 for fiscal year 1999, and
8 $100,000,000 for fiscal year 2000, except that such
9 annual minimum recovery amounts shall not apply once
10 the Secretary has recovered $1.1 billion under this
11 subsection. The Secretary shall establish criteria for
12 selecting the guaranty agencies that shall be required
13 to return reserve funds, as well as criteria for
14 determining the amount of reserve funds (which shall
15 include the value of any reserve fund assets, and may
16 include reserve funds or assets held by, or under the
17 control of, any other entity) that each guaranty agency
18 selected by the Secretary shall be required to return.
19 Except as provided in paragraph (3), funds returned to
20 the Secretary under this subsection shall be deposited
21 in the Treasury.
22 "(2) The criteria described in paragraph (1)
23 shall be established by the Secretary after consulting
24 with representatives of the higher education community,
25 and shall be designed to meet the needs of the Federal
26 Family Education Loan Program under this part, assist

1 in the orderly transition from such program to the
2 William D. Ford Federal Direct Loan Program under part
3 D of this title, and protect the Federal fiscal
4 interest.
5 "(3) If funds in excess of $1.1 billion in the
6 aggregate are returned under this subsection, such
7 excess funds shall be available to the Secretary for
8 use in the orderly transition from the Federal Family
9 Education Loan Program under this part to the William
10 D. Ford Federal Direct Loan Program under part D of
11 this title.".
12 (b) Section 428 of the Act is amended--
13 (1) in subsection (b)(1)(X), by striking out
14 "maintains reserve funds determined by the Secretary to be
15 sufficient in relation to such agency's guarantee
16 obligations." and inserting in lieu thereof "maintains a
17 level of financial strength that meets the requirements
18 established by the Secretary pursuant to
19 section 439(c)(9)(A)."; and
20 (2) in subsection (c)(9)--
21 (A) by amending the paragraph heading to read as
22 follows: "FINANCIAL STRENGTH OF GUARANTY AGENCIES;
23 TERMINATION OF GUARANTY AGENCY AGREEMENTS.--";
24 (B) by amending subparagraph (A) to read as
25 follows:

1 "(A)(i) Notwithstanding any other provision
2 of law, the Secretary is authorized to establish a
3 required level of reserve funds for each guaranty
4 agency that has entered into an agreement with the
5 Secretary pursuant to this subsection. Such
6 reserve requirements shall be designed to meet the
7 needs of the Federal Family Education Loan Program
8 under this part, assist in the orderly transition
9 from such program to the William D. Ford Federal
10 Direct Loan Program under part D of this title,
11 and protect the Federal fiscal interest.
12 "(ii) If, in carrying out section 422(h),
13 the Secretary determines that the needs of the
14 Federal Family Education Loan Program under this
15 part, the orderly transition from such program to
16 the William D. Ford Federal Direct Loan Program
17 under part D of this title, and the Federal fiscal
18 interest would be better served by a method of
19 providing financial support for guaranty agency
20 operations other than the use of reserve funds,
21 then, notwithstanding any other provision of law,
22 the Secretary is authorized, after consulting with
23 representatives of the higher education community
24 and informing the Congress, to establish such
25 alternate method in lieu of reserves. Such
26 alternate method may include, but shall not be

limited to, the provision of working capital to guaranty agencies on a case-by-case basis."; and

(C) in subparagraph (C)(i), by striking out "falls below the required minimum reserve level" and inserting in lieu thereof "fails to meet the financial strength requirements established by the Secretary pursuant to subparagraph (A)".

SEC. 302. FISL AMENDMENTS.

(a) section 421(a)(1) of the Act is amended--

(1) in subparagraph (A), by striking out the comma at the end thereof and inserting in lieu thereof a semicolon;

(2) in subparagraph (B), by adding at the end thereof the following: "or to a loan made under part D of this title;"; and

(3) in subparagraph (C), by striking out the comma and inserting in lieu thereof a semicolon.

(b) Section 423 of the Act is amended--

(1) in subsection (a), by striking out the period at the end thereof and inserting in lieu thereof a comma and "or to direct loans under part D of this title."; and

(2) in subsection (b)--

(A) in paragraph (2), by striking out "or" at the end thereof;

(B) in paragraph (3), by striking out the period at the end thereof and inserting in lieu thereof a semicolon and "or"; and

(C) by adding at the end thereof the following new paragraph:

"(4) for the insurance of loans made to student borrowers (or to parents, on behalf of students) in a State where there is no State or private non-profit student loan insurance program for student borrowers in that State with which the Secretary has an agreement under section 428(b), without regard to whether there is another State or private nonprofit student loan insurance program willing to operate in such State.".

(c) Section 424 of the Act is repealed.

(d) Section 425(b) of the Act is amended--

(1) by amending the subsection heading to read as follows: "DETERMINATION OF INSURANCE OBLIGATIONS OF THE SECRETARY.--"; and

(2) by amending paragraph (1) to read as follows:

"(1) LEVEL OF INSURANCE COVERAGE.--The insurance liability on any loan insured by the Secretary under this part shall be 98 percent of the unpaid principal and accrued interest on such loan."

SEC. 303. CONFORMING AMENDMENTS.

(a) Section 421(d) of the Act is amended by striking out "issued after June 30, 1994," and all that follows through the end thereof and inserting in lieu thereof "issued after June 30,

1997 on loans insured under a program of a State, or of a nonprofit private institution or organization, that meets the requirements of section 428(a)(1)(B).".

(b) Section 428(c)(1)(A) of the Act is amended--

(1) in the fourth sentence therein, by inserting a comma and "or that will be expended by it, as the case may be," immediately following "expended by it"; and

(2) in the fifth sentence therein, by striking out "45 days" and all that follows through the end thereof and inserting in lieu thereof "45 days after the guaranty agency approves a claim that would discharge its insurance obligation on the loan, and the guaranty agency shall not discharge such obligation until the guaranty agency has received from the Secretary reimbursement according to the provisions of this subsection.".

TITLE IV--EFFECTIVE DATES

SEC. 401. EFFECTIVE DATES.

The amendments made by this Act shall be effective upon enactment, except that--

(1) the amendments made by section 102 shall be effective for loans made under part D of the Act on or after July 1, 1994; and

(2) the amendments made by sections 202(a) shall be effective as of the earlier of the Effective Time specified in

1 section 440(a)(1) of the Act (as added by section 201 of this
2 Act), or 18 months after the date of enactment of this Act; and
3 (3) the amendments made by section 203 shall be effective
4 as of the Effective Time specified in section 440(a)(1) of the
5 Act (as added by section 201 of this Act). If no reorganization
6 occurs pursuant to section 440(a)(1), then the amendments made by
7 section 203 shall be of no effect.
8

SECTION-BY-SECTION ANALYSIS OF THE ACCELERATED DIRECT LOAN PROGRAM IMPLEMENTATION AND STUDENT LOAN MARKETING ASSOCIATION TRANSITION ACT OF 1995

Section 1. Section 1 provides that this Act may be cited as the "Accelerated Direct Loan Program Implementation and Student Loan Marketing Association Transition Act of 1995".

Section 2. Section 2 sets forth the findings and purpose of this Act.

TITLE I--DIRECT LOAN PROGRAM AMENDMENTS

Section 101. Section 101 of the bill would amend section 453(a) of the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.; the "Act") to accelerate the phase-in of the William D. Ford Federal Direct Loan Program. Under this proposal, Direct Loans would account for 80 percent of new student loan volume for academic year 1996-1997, and 100 percent of new volume for academic year 1997-1998 and succeeding academic years, rather than 50 percent for academic years 1996-1997 and 1997-1998 and 60 percent for academic year 1998-1999. Current law permits the Secretary to exceed the percentages specified for academic year 1996-1997 and beyond if warranted by institutional demand; the bill would explicitly require the faster phase-in of direct loans.

Accelerating the phase-in of the Direct Loan Program, together with the recall of guaranty agency reserves as proposed in section 301 of the bill, would save an additional $5.2 billion through fiscal year 2000, compared to the phase-in schedule in current law. In addition to these savings, under this proposal many students, their parents, and participating institutions would be able to enjoy the benefits of the Direct Loan Program far more quickly than under the current schedule. These benefits are described in the findings in section 2 of the bill, above.

Section 102. Section 102 would amend section 455(e)(4) of the Act to specify more clearly that remaining balances on income contingent Direct Loans are cancelled after 25 years of repayment, and that there is no tax liability resulting from that cancellation. Currently, the statutory maximum repayment period is 25 years, and there is an implicit forgiveness of amounts not repaid within that time period. However, without a statutory change, the borrower would then become liable for income taxes on the amount forgiven, because it would be considered income to the borrower at the time of forgiveness. It is illogical and inequitable to impose a potentially large tax liability on someone whose income has been insufficient to repay his or her income contingent Direct Loan in full over a 25 year period, and

contrary to the intent underlying income contingent repayment. A corresponding amendment is made to section 108(f) of the Internal Revenue Code of 1986.

TITLE II--REORGANIZATION OF THE STUDENT LOAN MARKETING ASSOCIATION

Section 201. Section 201 would amend the Act to add a new section 440 to provide the Student Loan Marketing Association with the authority to change its status, after a transition period, to that of an ordinary business corporation without ties to the Federal Government. If the shareholders of Sallie Mae choose not to reorganize, the Act would provide that Sallie Mae dissolve by a specified date.

Section 440 (a) would permit the Board of Directors of the Student Loan Marketing Association (the "Association") to recommend to the stockholders of the Association the restructuring of its common stock ownership pursuant to a plan of reorganization (the "Plan") so that the Association would become a wholly-owned subsidiary of an ordinary business corporation chartered under the laws of any one of the 50 States or the District of Columbia (the "Holding Company"). The reorganization must be effective no later than 18 months after the date of enactment of the bill. The Plan may provide for a merger of the Association into a wholly-owned subsidiary of the Holding Company and the conversion of the common shares of the Association to shares of the Holding Company on a one-for-one basis.

Section 440(a) provides for review of the Plan by the Secretary of Education and the Secretary of the Treasury, who may require amendments to the Plan that are necessary or appropriate to ensure the continued safety and soundness of the Association, consistency with the provisions of section 440, and the ability of the Association to continue to fulfill its purposes until its dissolution, which is provided for in section 440(e).

After any required amendments to the Plan are adopted by the Board of Directors of the Association (the "Board"), the Plan is to be submitted to the common stockholders of the Association for their approval. The reorganization will occur at the time specified in the Plan (the "Effective Time") provided that the Plan is approved by the holders of a majority of the outstanding common stock of the Association. Shares may be voted in person or by proxy.

Section 440(b) contains transition provisions applicable to the Association prior to its dissolution. If the stockholders approve the reorganization, as described above, the transition provisions will apply beginning at the Effective Time. If no

reorganization occurs, then the transition provisions shall apply beginning 18 months after the date of enactment.

The transition provisions require that the Association or the Holding Company, as appropriate, issue stock purchase warrants or other consideration to the United States in such amount and on such terms and conditions as are acceptable to the Secretary of the Treasury. The Association is also required to pay to the Secretary of Education specified amounts for fiscal years 1996 through 2000 to compensate the government for lost Federal revenues.

In addition, the transition provisions include three limitations on the Association's operations. First, although the Association may continue to issue debt obligations under section 439 to finance permitted activities, new debt must mature no later than December 31, 2004. This date may be extended by the Secretary of Education and the Secretary of the Treasury if they decide to extend the date of dissolution, as described below. This provision also clarifies that debt issued by the Association, whether before or after the Effective Time, shall continue to have the attributes accorded to debt obligations of the Association by section 439. For example, such debt obligations will continue to be exempt from the securities laws and will continue to have the same tax treatment as provided by section 439.

Section 440(b) also places restrictions on new business activity of the Association. The Association is precluded from engaging in any new business activity or acquiring any new assets other than in connection with (1) contractual commitments which are outstanding as of the Effective Time; and (2) serving as lender of last resort pursuant to subsection 439(q); and (3) purchases of loans pursuant to section 440A as added by this bill.

Finally, section 440(b) limits the Association's liquidity portfolio to five percent of total assets, except with the prior written approval of the Secretary of the Treasury and the Secretary of Education.

Section 440(c) contains additional transition provisions which are applicable only if the stockholders approve the reorganization. Generally, the Association will continue to have the rights, privileges, duties and obligations set forth in section 439 of the Act and will continue to be subject to the limitations and restrictions of section 439. The Association is specifically required to continue to carry out the purposes for which it was formed.

Since personnel of the Association may be transferred to the Holding Company or other subsidiaries of the Holding Company as

part of the reorganization, section 440(c) requires the Holding Company to provide all necessary and appropriate management and operational support to the Association. Loan servicing agreements between the Association and the Holding Company or other subsidiaries of the Holding Company are required to be on an arm's-length basis and are subject to the approval of the Secretary of Education. The Association is not precluded from obtaining management and operational support from other sources.

Section 440(c) precludes the Association from extending credit to, or providing credit enhancement for, the Holding Company or any of its other affiliates. This prohibition, as well as other provisions described below, is intended to insulate the Association from any financial distress or failure that the Holding Company may experience.

Section 440(c)(4) permits the Association to make distributions to the Holding Company, subject to certain restrictions. Distributions may be paid only after amounts required to be paid to the United States, as described above under section (b), have been paid. The Association also must be in compliance with its capital standard after payment of the distribution.

To ensure that these restrictions are met, the Association is required to certify that the payment of any distribution will be in compliance with section 440(c)(4) and must provide copies of all relevant calculations. The Secretary of Education and the Secretary of the Treasury must approve the certification before the distribution is paid.

To further insulate the Association, section 440(c)(5) requires the Holding Company to conduct its new business only through other subsidiaries.

Section 440(c)(6) provides that the names of the Holding Company and its subsidiaries may not contain the terms "Student Loan Marketing Association", "Sallie Mae", or any variations thereof. The Association may assign the "Sallie Mae" name to the Holding Company as a trade mark or service mark. The Holding Company and its other subsidiaries are nevertheless expressly precluded from using the Sallie Mae name to identify the issuer of any security offered by the Holding Company or any subsidiary. In addition, the Holding Company and its subsidiaries are required to clearly state, in securities offerings or promotional materials, that the entities are not government sponsored enterprises or instrumentalities of the United States.

Section 440(c)(7) contains several requirements that are intended to insulate the Association from any financial distress or failure of the Holding Company or its new subsidiaries by ensuring that the separate corporate identity of the Association

is preserved during the Transition Period and that persons dealing with the Holding Company or its new subsidiaries are dealing with completely private entities and not with the Association.

Section 440(c)(8) contains provisions which "grandfather" current tax treatment of the Association's portfolio for purposes of calculating the Association's interest expense deduction under section 265 of the Internal Revenue Code.

Section 440(d) provides for additional transition provisions that will apply in the event no reorganization occurs. The Association is required to develop a plan for the orderly winding up of its business. The termination plan must ensure that the Association will have on hand at the dissolution date adequate assets to fulfill its obligation to establish a trust, as required under section 440(e), for the benefit of holders of debt of the Association which is still outstanding as of the date of dissolution. The termination plan must be approved by the Secretary of the Treasury and reviewed by the Secretary annually. The Secretary may require such amendments to the plan as are necessary to ensure full payment of any outstanding debt. The Association must certify to the Secretary of the Treasury that it is in compliance with the plan and any required amendments, prior to payment of any distribution. The Association is precluded from paying any cash or non-cash distributions unless the plan is approved, the Association is in full compliance, and the Secretary has approved the certification of compliance.

Section 440(e) provides for dissolution of the Association no later than December 31, 2004. The dissolution occurs on this date regardless of whether shareholders of the Association have elected to reorganize as an ordinary private business corporation, as provided above. However, upon request of the Association, the Secretary of Education and the Secretary of the Treasury may extend the date of dissolution if they determine that the continued participation of the Association in the transition to direct lending is necessary or appropriate.

Under section 440(e)(1), any outstanding debt of the Association will be transferred to a trust along with full faith and credit obligations of the United States in an amount sufficient to pay all principal and interest on the debt obligations in accordance with their terms. The Association is also required to make proper provision for all other obligations of the Association including the repurchase or redemption of any outstanding preferred stock of the Association.

Section 440(e) also provides that if a reorganization occurs, to the extent that the Association does not have sufficient obligations to transfer to the trust, the Holding Company shall be required to make up any shortfall. In addition,

any obligations not fully satisfied by the Association shall become liabilities of the Holding Company as of the date of dissolution.

Section 440(f) provides that the Secretary of Education or the Secretary of the Treasury, as appropriate, may request that the Attorney General bring an action in the United States District Court for the District of Columbia to enforce any provision of section 440.

Section 202. Section 202(a) would amend certain provisions of section 439 of the Act. Under section 401 of the bill, these amendments would become effective as of the earlier of the Effective Time of the reorganization or 18 months after enactment.

Section 202(a) would amend the oversight authority of the Secretary of the Treasury in several respects. In addition to the current requirement to provide the Secretary of the Treasury with copies of publicly distributed periodic financial reports, the Association would also be required to provide the Secretary of the Treasury with quarterly financial statements and a quarterly report showing the calculation of the capital ratio set forth in section 439(r). This report must be in a form and must contain such information as is approved by the Secretary of the Treasury.

Section 202(a) would also amend section 439(r)(2) o authorize the Secretary of the Treasury to appoint auditors or examiners to conduct audits of the Association to determine its condition, to assess its financial safety and soundness, and to determine whether the requirements of section 440, as described above, are being met. Section 439(r)(2) is also amended to require the Association to pay an assessment to Treasury to cover reasonable costs and expenses to carry out sections 439 and 440.

Section 202(a) would also amend section 439(r)(7) and redesignate it as section 439(r)(4). The amendment would increase the minimum capital ratio requirement for the Association to 3.0 percent beginning in the calendar year 2000.

Existing paragraphs (4),(5), and (6) and (8) through (11) would be deleted. Finally, section 202(a) would add a new section 439(r)(7) providing that the Secretary of the Treasury may request the Attorney General to bring an action to enforce any provision of subsection (r).

Next, section 202(b) of the bill would amend section 439(q) of the Act to add a new paragraph (2) that would authorize the Secretary of Education to provide the Association with funds to enable the Association to make loans on the Secretary's behalf as the lender-of-last-resort whenever the Secretary determines that

eligible borrowers are seeking and are unable to obtain loans under this part. These funds, as well as the provisions in section 203 of the bill, as described below, are intended to assist in ensuring the availability of loan capital during the transition from the Federal Family Education Loan Program (the "FFEL Program") to direct lending. The funds (as well as the fees described below) would be provided from funds available under the FFEL Program or section 458 of the Act, and would be subject to such restrictions on their use as the Secretary of Education determines are appropriate. The funds could be provided regardless of whether there is a lender-of-last-resort program of a guaranty agency operating in that State.

Loans made by the Association on the Secretary's behalf using these funds would be subject to this proposed new subsection and any additional requirements imposed by the Secretary of Education. The Association would be required to pay to the Secretary of Education the interest paid by the borrowers of the lender-of-last-resort loans made from the funds provided. The Secretary would be authorized to use that interest paid by the Association for any purpose for which funds under section 458 of the Act are available. Rather than paying interest and special allowance subsidies on loans made by the Association on the Secretary's behalf from the funds provided, the Secretary of Education would pay the Association a fee for making the loans on the Secretary's behalf, and the Association would hold the loans on behalf of the Secretary of Education until requested to provide them to the Secretary.

Section 203. Section 203 would further amend section 439 in the event a reorganization occurs. First, section 203(a) would reduce the size of the Board of Directors of the Association, but would generally retain the proportion of elected directors to Presidentially-elected directors and the representation of eligible institutions and eligible lenders. The size of the Board would be reduced from 21 to 11 directors. The number of Presidential appointees would be reduced from seven to three. The remaining 8 directors would be elected by the common stockholders of the Association. Four of the elected directors would be affiliated with an eligible institution and four would be affiliated with an eligible lender.

Section 203(b) would add to the enforcement authorities of the Secretary of the Treasury the ability to require a contribution of additional capital by the Holding Company in the event the Association's capital falls below the minimum ratio.

Section 203(c) would impose additional reporting requirements. The Association would also be required to keep records concerning the financial risk to the Association resulting from the activities of any associated persons.

Section 204. Section 204 would add a new section 440A to Part B of Title IV of the Act that, consistent with the authorities described in section 202 of the bill in relation to the Association, would authorize the Secretary of Education to provide funds to eligible entities functioning as secondary markets to enable them to make loans as the lender-of-last-resort on the Secretary's behalf. Additionally, eligible secondary markets would also be able to purchase loans on behalf of the Secretary of Education using funds provided by the Secretary. In order to be eligible to receive funds under this section, a secondary market must meet the definition of an eligible lender in section 435(d) and such other eligibility criteria as the Secretary of Education may specify.

Section 205. Section 205 would repeal section 439 as of the date the Association is dissolved.

TITLE III--FEDERAL FAMILY EDUCATION LOAN PROGRAM AMENDMENTS

Section 301. Section 301 of the bill would amend various provisions of part B of title IV of the Act to require the Secretary to recover from the reserve funds held by guaranty agencies not less than $1.1 billion in the aggregate in the fiscal years 1996 through 2000. This amount would be recalled over that five-year period as follows: not less than $350,000,000 would be recalled in fiscal year 1996, $250,000,000 in each of fiscal years 1997 and 1998, $150,000,000 in fiscal year 1999, and $100,000,000 in fiscal year 2000.

The recall of these reserve funds would be a component of the ongoing transition from the FFEL Program to the Direct Loan Program. While $1.1 billion in recalled reserves would be returned to the Treasury to reduce the deficit, the Secretary could use amounts recalled in excess of that sum for transition activities.

In addition to furthering the transition from guaranteed to direct student loans, the proposed recall of reserves is consistent with the current role of the guaranty agency in the FEEL Program. Section 432(o) of the Act, which was added by the Higher Education Amendments of 1992 (P.L. 102-325), clarifies that the Secretary is the ultimate insurer of all FFEL guarantees. Thus, guaranty agencies actually function more like loan services than guarantors, and therefore have limited need for reserve funds to protect against losses.

The specific statutory changes that would be made by section 301 of the bill are as follows:

Section 301(a)(1) of the bill would amend section 422(g)(1) of the Act to make conforming changes and to eliminate subparagraph (A), a provision that currently authorizes the Secretary to direct a guaranty agency to return reserves that the Secretary determines are unnecessary to pay program expenses and contingent liabilities of the guaranty agency. This authority would be replaced by a new subsection (h), discussed below. This new recall authority would be part of the broader plan to wind down guaranty agency operations in the transition to the direct loan program, instead of authorizing the recall of reserves solely because they are "unnecessary" in an ongoing guaranty agency system.

Section 301(a)(2) of the bill would further amend section 422 to add a new subsection (h) that would require the Secretary to recall at least $1.1 billion in reserve funds, as described above. The Secretary will establish criteria for selecting the agencies required to reserve funds and a formula to calculate the amount to be returned. These criteria and this formula would be established by the Secretary after consulting with the higher education community, and would be designed to meet the needs of the FFEL Program, assist in the transition to the Direct Loan Program, and protect the Federal fiscal interest.

Sections 301(b)(1) and (2)(A) of the bill would amend section 428(b)(1)(X) and the heading for section 428(c)(9) of the Act, respectively, to conform with the changes made by section 301(c)(2)(B) of the bill. Section 301(b)(2)(B) of the bill would completely revise section 428(c)(9)(A) of the Act, which currently describes the minimum reserve levels that guaranty agencies are required to maintain. Reserves at these levels are not consistent with the current role of the guaranty agency in the FFEL Program, and its potential for loss, as discussed above. Instead, this provision would be amended to authorize the Secretary, notwithstanding any other provision of law, to establish a required level of reserve funds for each guaranty agency. These reserve amounts would be set at levels designed to meet the needs of the FFEL Program, assist in the transition to direct loans, and protect the Federal fiscal interest.

This amendment would also authorize the Secretary, as part of the proposed recall of reserves, to establish an alternate method of providing financial support to guaranty agencies rather than through the use of reserve funds. Prior to establishing such an alternative (one example of which would be a system of providing working capital to guaranty agencies on a case-by-case basis) the Secretary would first be required to determine that the needs of the FFEL Program, the transition to direct lending, and the Federal fiscal interest would be better served by a method other than reserves, to consult with the higher education community and to inform the Congress. This provision would give the Secretary the flexibility to address the changing needs of

the guaranty agencies and the guaranteed and direct loan systems during the transition.

Finally, section 301(b)(2)(C) of the bill would amend section 428(c)(9)(C)(i) of the Act to conform with the changes made in subparagraphs (A) and (B) of section 301(b)(2) of the bill.

Section 302. Section 302 of the bill would make several changes to Part B of Title IV of the Act that would enable the Secretary to resume providing Federal loan insurance (instead of merely reinsuring loans that have been insured by guaranty agencies) as necessary to ensure students continued access to loan capital and to assist in the transition from guaranteed to direct lending.

Section 302(a) of the bill would amend section 421(a)(1) of the Act to expand the purposes of Part B of Title IV of the Act to reflect that the Federal loan insurance program is intended to enable the Secretary of Education to provide loan insurance for students who do not have reasonable access to direct loans, not just access to a State or private nonprofit program of student loan insurance.

Section 302(b) would amend section 423 of the Act to permit the Secretary to issue certificates of insurance for the insurance of loans made to student borrowers (or their parents), in a State in which there is no State student loan insurance program for student borrowers in that State and with which the Secretary has an agreement under section 428(b), regardless of whether another State or private nonprofit student loan insurance program is willing to operate in the State. This amendment would provide the Secretary with the flexibility needed to address loan access issues in an orderly manner as part of the broader plan to wind down guaranty agency operations in the transition to direct lending.

Section 302(c) of the bill would repeal section 424 of the Act. Section 424 currently sets limits on the amounts of loans that may be covered by Federal loan insurance, and specifies dates after which no further Federal loan insurance may be granted. These limits are inconsistent with the amendments proposed in this section of the bill to reactivate the Federal loan insurance program as an additional means of ensuring loan access.

Section 302(d) of the bill would amend Section 425(b) of the Act to specify that the level of insurance coverage provided by the Secretary on any loan covered by Federal loan insurance will be 98 percent of the unpaid principal and accrued interest on such loan. This amendment would make the level of insurance coverage for loans insured through Federal loan insurance

consistent with the level of coverage for loans that are insured by guaranty agencies.

Section 303. Section 303(a) of the bill would make a conforming change to section 421(d) of the Act that would terminate the Secretary's authority to make new FFEL guarantees as of June 30, 1997. This termination would not affect the Secretary's authority to insure loans directly under section 427 of the Act.

Section 303(b) of the bill would make a conforming change to section 428(c)(1) of the Act to require a guaranty agency to file its claim for reimbursement with the Secretary of Education within 45 days after the guaranty agency approves a claim that would discharge its insurance obligation on the loan. In addition, the guaranty agency would be prohibited from discharging its obligation until the guaranty agency has received reimbursement from the Secretary. Under current law, a guaranty agency is required to file its claim for reimbursement within 45 days after the guaranty agency actually pays a claim that discharges its insurance obligation on the loan. This amendment conforms to the changes made concerning guaranty agency reserves in section 301, and would greatly reduce the amount of funds guaranty agencies need to have on hand to discharge their insurance obligations.

TITLE IV--EFFECTIVE DATES

Section 401 provides that the amendments made by the Accelerated Direct Loan Program Implementation and Student Loan Marketing Association Transition Act of 1995 are effective on the date of enactment, with three exceptions. The amendments made by section 102, relating to cancellation of remaining balances on certain loans, would be effective for loans made on or after July 1, 1994. The amendments made by section 202(a), which amend existing provisions of section 439(r), would be effective on the earlier of the Effective Time of the reorganization, as set forth in section 440 (as added by section 201 of this Act), or 18 months after the date of enactment. Finally, the amendments made by section 203 would be effective as of the Effective Time of the reorganization. If no reorganization occurs, then the amendments made by section 203 would be of no effect.

TREASURY CLEARANCE SHEET

NO. _____
Date 6/22/95

MEMORANDUM FOR: ☒ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER _____

FROM: Darcy Bradbury
THROUGH: Under Secretary Hawke
SUBJECT: Privatizing Sallie Mae

☐ Under Secretary for Finance
- ☐ Domestic Finance
- ☐ Economic Policy
- ☐ Fiscal
  - ☐ FMS
  - ☐ Public Debt

☐ Under Secretary for Int'l Affairs
- ☐ International Affairs

☐ Enforcement
- ☐ ATF
- ☐ Customs
- ☐ FLETC
- ☐ Secret Service

☐ General Counsel
- ☐ Inspector General

☐ IRS

☐ Legislative Affairs
- ☐ Management
- ☐ OCC

☐ Policy Management
- ☐ Scheduling
- ☐ Public Affairs/Liaison
- ☐ Tax Policy

☐ Treasurer
- ☐ E & P
  - ☐ Mint
- ☐ Savings Bonds

☐ Other _____

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
D. Bradbury	DB		Federal Finance	2-2037
REVIEWERS				
John Bowman	JB	7/14	Assistant General Counsel	
1 Ed Knight	EK		General Counsel	2-0287
2 L. Robertson	MLH LR	7/5/95	Legislative Affairs	2-1900
3 G. Kohl	GK	7/10/95	Tax Policy	2-0140
4				

SPECIAL INSTRUCTIONS

Call Gene Reynolds at 2-~~1871~~ 2630 for pick up

☐ Review Officer Date: ☐ Executive Secretary Date

1996-SE-005844

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

July 11, 1996

The Honorable James A. Leach
Chairman
Committee on Banking and Financial Services
U.S. House of Representatives
Washington, D.C. 20515-6050

Dear Mr. Chairman:

I am pleased to transmit the Department of the Treasury's report on the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

As required by section 1355 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, this report examines the desirability and feasibility of ending the federal government's sponsorship of Fannie Mae and Freddie Mac. Pursuant to this statutory mandate, we have conducted a broad review of the government's relationship with the two enterprises. We examined the benefits and constraints of government sponsorship, the enterprises' public purpose, and the effects of maintaining or amending the existing relationship between the enterprises and the federal government. The Department of Housing and Urban Development, the Congressional Budget Office, and the General Accounting Office have also conducted studies pursuant to the Act.

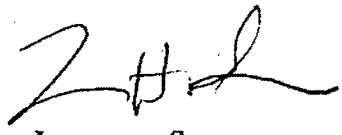
As a result of over three generations of U.S. government policy supporting homeownership, the United States now has the strongest housing finance market in the world. Today, homeownership rates in the U.S. are at their highest levels in sixteen years. Fannie Mae and Freddie Mac have played critical roles in building a liquid secondary market for home mortgages, thereby helping make homeownership possible for millions of Americans. Through their affordable housing activities, they have also contributed to expanding homebuying opportunities for low- and moderate-income families.

We believe that firm conclusions regarding the desirability of ending or modifying the government's sponsorship of Fannie Mae and Freddie Mac are premature. Considerable uncertainty exists on an array of important issues. For example, it is still too early to assess the efficacy of various provisions of the 1992 Act, notably including the affordable housing goals applicable to the two enterprises, and the new system of safety and soundness regulation. Moreover, attempting to quantify the benefits and costs of government sponsorship is inherently difficult and imprecise. Our report estimates that the two GSEs

retain a substantial portion of the benefits of their government subsidy. These and other issues would benefit substantially from further study aimed at helping policymakers better understand the benefits and costs of continued federal government sponsorship both to the public and to the enterprises.

Fannie Mae and Freddie Mac are important institutions participating in markets that affect millions of Americans. Ultimately, any change in their status will require a rigorous public discussion and a broad consensus. We hope this report is a helpful contribution to that process.

Sincerely,



Lawrence Summers
Deputy Secretary

Enclosure

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

July 11, 1996

The Honorable Henry B. Gonzalez
Ranking Member
Committee on Banking and Financial Services
U.S. House of Representatives
Washington, D.C. 20515-6050

Dear Congressman Gonzalez:

I am pleased to transmit the Department of the Treasury's report on the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

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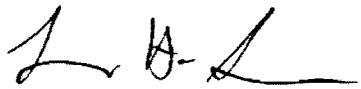

Lawrence Summers
Deputy Secretary

Enclosure

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

July 11, 1996

The Honorable Alfonse M. D'Amato
Chairman
Committee on Banking, Housing,
and Urban Affairs
U.S. Senate
Washington, D.C. 20510-6075

Dear Mr. Chairman:

I am pleased to transmit the Department of the Treasury's report on the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

As required by section 1355 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, this report examines the desirability and feasibility of ending the federal government's sponsorship of Fannie Mae and Freddie Mac. Pursuant to this statutory mandate, we have conducted a broad review of the government's relationship with the two enterprises. We examined the benefits and constraints of government sponsorship, the enterprises' public purpose, and the effects of maintaining or amending the existing relationship between the enterprises and the federal government. The Department of Housing and Urban Development, the Congressional Budget Office, and the General Accounting Office have also conducted studies pursuant to the Act.

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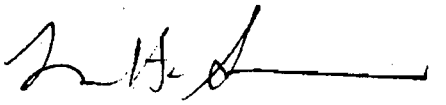

Lawrence Summers
Deputy Secretary

Enclosure

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

July 11, 1996

The Honorable Paul S. Sarbanes
Ranking Member
Committee on Banking, Housing,
and Urban Affairs
U.S. Senate
Washington, D.C. 20510-6075

Dear Senator Sarbanes:

I am pleased to transmit the Department of the Treasury's report on the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

As required by section 1355 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, this report examines the desirability and feasibility of ending the federal government's sponsorship of Fannie Mae and Freddie Mac. Pursuant to this statutory mandate, we have conducted a broad review of the government's relationship with the two enterprises. We examined the benefits and constraints of government sponsorship, the enterprises' public purpose, and the effects of maintaining or amending the existing relationship between the enterprises and the federal government. The Department of Housing and Urban Development, the Congressional Budget Office, and the General Accounting Office have also conducted studies pursuant to the Act.

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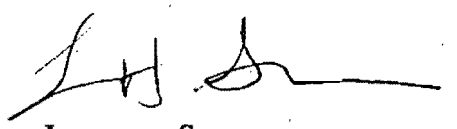

Lawrence Summers
Deputy Secretary

Enclosure

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

July 11, 1996

The Honorable Paul E. Kanjorski
Ranking Member
Subcommittee on Capital Markets, Securities,
and Government Sponsored Enterprises
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Kanjorski:

I am pleased to transmit the Department of the Treasury's report on the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

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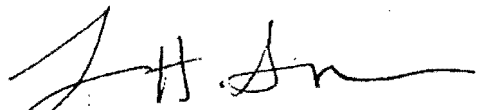

Lawrence Summers
Deputy Secretary

Enclosure

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

July 11, 1996

The Honorable Richard H. Baker
Chairman
Subcommittee on Capital Markets, Securities,
and Government Sponsored Enterprises
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am pleased to transmit the Department of the Treasury's report on the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

As required by section 1355 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, this report examines the desirability and feasibility of ending the federal government's sponsorship of Fannie Mae and Freddie Mac. Pursuant to this statutory mandate, we have conducted a broad review of the government's relationship with the two enterprises. We examined the benefits and constraints of government sponsorship, the enterprises' public purpose, and the effects of maintaining or amending the existing relationship between the enterprises and the federal government. The Department of Housing and Urban Development, the Congressional Budget Office, and the General Accounting Office have also conducted studies pursuant to the Act.

As a result of over three generations of U.S. government policy supporting homeownership, the United States now has the strongest housing finance market in the world. Today, homeownership rates in the U.S. are at their highest levels in sixteen years. Fannie Mae and Freddie Mac have played critical roles in building a liquid secondary market for home mortgages, thereby helping make homeownership possible for millions of Americans. Through their affordable housing activities, they have also contributed to expanding homebuying opportunities for low- and moderate-income families.

We believe that firm conclusions regarding the desirability of ending or modifying the government's sponsorship of Fannie Mae and Freddie Mac are premature. Considerable uncertainty exists on an array of important issues. For example, it is still too early to assess the efficacy of various provisions of the 1992 Act, notably including the affordable housing goals applicable to the two enterprises, and the new system of safety and soundness regulation. Moreover, attempting to quantify the benefits and costs of government

retain a substantial portion of the benefits of their government subsidy. These and other issues would benefit substantially from further study aimed at helping policymakers better understand the benefits and costs of continued federal government sponsorship both to the public and to the enterprises.

Fannie Mae and Freddie Mac are important institutions participating in markets that affect millions of Americans. Ultimately, any change in their status will require a rigorous public discussion and a broad consensus. We hope this report is a helpful contribution to that process.

Sincerely,

Lawrence Summers
Deputy Secretary

Enclosure

GOVERNMENT SPONSORSHIP OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION

THE UNITED STATES DEPARTMENT OF THE TREASURY

JULY 11, 1996