

July 30, 2003

MP&T Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, Connecticut 06856

Letter of Comment No: 20  
File Reference: 1200-001  
Date Received: 07/30/03

Re: File Reference No. 1200-01  
Exposure Draft on Qualifying Special-Purpose Entities and Isolation  
Of Transferred Assets, an amendment to FASB Statement No. 140

Ladies and Gentlemen:

SLM Corporation (the "Company" or "Sallie Mae") thank the Financial Accounting Standards Board ("FASB") for this opportunity to comment on the Exposure Draft referenced above. In reviewing the Exposure Draft we have comments and concerns regarding four specific issues:

- (1) We are opposed to the provisions of the amendment which would prevent a SPE from being a QSPE if the SPE and transferor were counterparties to certain "plain vanilla" types of derivatives.
- (2) We are unclear as to what is considered a "reissuance" of beneficial interests by a SPE. As discussed below, the current definition of "reissuance" includes what we consider to be, in reality, rollovers or market repricing mechanisms. We feel that these should not be included in the definition of "reissuance".
- (3) We request clarification regarding what might be considered reissuances out of a traditional master trust structure and believe such periodic issuances of securities should not be considered reissuances.
- (4) We are unclear as to certain of the transition requirements if certain of our beneficial interests were considered reissuances. We feel that the transition requirements need to be clarified relative to the issue of reissuing beneficial interests.

#### **Issue 1: Derivatives between a SPE and transferor and the proposed prevention of QSPE status**

##### *Amendment Provision:*

The Exposure Draft reads as follows:

"A QSPE would not be permitted to enter into the following arrangements with a transferor, its affiliates, or its agents:

- a) A liquidity commitment, financial guarantee, or other commitment ("Support Commitments") to deliver additional cash or other assets to the SPE or its

beneficial interest holders to fulfill the SPE's obligations to the beneficial interest holders.

- b) A total return swap, other derivative instruments, or other arrangement requiring delivery of assets to a QSPE."

### *SLM Corporation Background*

A part of our business is the securitization of student loans. Student loans are variable rate and indexed to either a treasury index, commercial paper index or Prime rate index. Usually the beneficial interests sold to third party investors are variable rate instruments indexed to LIBOR. This creates basis risk within the SPE (or "Trust"). The SPE mitigates this basis risk on behalf of the holders of its beneficial interests by entering into plain vanilla interest rate swaps or interest rate cap agreements with either external parties or, in some cases, the Company. The decision as to who to engage as the counterparty to the derivative is purely an economical and administrative one. In a typical interest rate swap arrangement, the SPE will pay to the Company an index that the SPE assets reset to and receive the related LIBOR payment to be paid on the beneficial interests. In a typical interest rate cap agreement the SPE will purchase a LIBOR indexed interest rate cap from the Company.

We do not provide any Support Commitments (as defined in the above amendment provisions) related to our securitizations except, at the time of securitization, the Company provides customary "representations and warranties". These are a normal part of asset sales, providing remedies to purchasers and investors if the Company accidentally or intentionally sold assets that are not what they were represented to be. Upon securitization, a typical reserve account (or other accounts providing credit or liquidity enhancements) is funded from proceeds of the securitization, however these accounts are subsequently funded by SPE assets and the Company would never be required to contribute additional cash to these accounts.

### *SFAS 140 Amendment's impact to SLM Corporation*

1. Derivatives between the Company and the SPE: Every securitization in which the Company and the SPE are counterparties to the same derivative would prevent the SPE from being a QSPE and the securitization would be treated as a financing as opposed to a sale.
2. Support Commitments between the SPE and the Company. The Company interprets the amendment to include the "representation and warranty" commitments that were discussed above. If the amendment included these customary "representation and warranties" to fall under the scope of Support Commitments, then every securitization that the Company completes would fail to be a QSPE and the securitization would be treated as a financing as opposed to a sale.

### *SLM Corporation's issues and comments on the Exposure Draft*

#### 1. Derivatives:

Not all types of derivatives between a SPE and transferor should prohibit a SPE from being a QSPE. There is a significant difference between a plain vanilla derivative such as an interest rate cap or interest rate swap and an exotic derivative such as a total return swap or credit loss swap. The overall intent of SFAS 140 related to being a QSPE relates to the idea of isolation and effective control. Generally, if the transferred assets have been isolated from the transferor and the transferor does not retain effective control over the transferred assets, a

transfer of assets is considered to be a sale. A plain vanilla derivative does not result in the principles of isolation and effective control being compromised. The Company, as the counterparty to the derivative, has no additional decision making abilities related to the SPE (a plain vanilla derivative is passive in nature as currently defined by SFAS 140) nor does the derivative change the degree of isolation between the Company and the transferred assets to the SPE.

If a SPE enters into a interest rate swap or interest rate cap agreement with the Company, either directly or through a back to back swap, there is no enhancement to the Company's (transferors) return when viewing the retained residual interest together with the derivative. The effects of the relationship are actually \$0 and the Company overall is entitled to the residual cash flows that existed prior to the impacts of the swap relationship. The Company's return, as the transferor and residual interest holder, is only effected if the SPE enters into a derivative with a third party with no back to back relationship.

A derivative is a financial instrument as defined by SFAS 107. A derivative retained in a securitization is no different than any other financial instrument retained such as a bond, note, mortgage backed security or Interest-Only strip. These types of instruments do not generally give the owner any effective decision making abilities related to the SPE and are passive in nature. A derivative retained related to a securitization that qualifies for sale accounting should be recorded as any other retained interest as part of the gain/loss on sale. SFAS 133 would govern the accounting of the retained derivative on a prospective basis.

## 2. Support Commitments:

Support Commitments related to normal "representation and warranties" should be specifically carved out of the proposed amendment. If included, then virtually every securitization transacted by every company would fail QSPE status and we do not believe that was the intention of the amendment. The amendment should distinguish between credit enhancing recourse (that would be a Support Commitment) and factual warranties unrelated to ongoing performance or credit quality (that would not be a Support Commitment). Representations and warranties are generally not relied upon as an expected source of payments on beneficial interests. Rather, they are a normal part of asset sales, providing remedies to purchasers and investors if the transferor accidentally or intentionally sells assets that are not what was represented.

### *SLM Corporation's proposed changes to the Exposure Draft*

1. Derivatives - Plain vanilla derivatives (as appropriately defined but to include standard interest rate swap agreements and interest rate cap agreements) between the SPE and transferor or its affiliates/agents (agents including the counterparty in between a back to back swap) should not prevent a SPE from being a QSPE. These types of derivatives should be specifically carved out of the proposed amendment as (1) the principles of isolation and effective control are not compromised related to the SPE and (2) these derivatives do not enhance the transferor's return related to the residual interest.

2. Support Commitments related to normal representations and warranties between the SPE and transferor or its affiliates/agents should not prevent a SPE from being a QSPE. This type of Support Commitment should be specifically carved out of the proposed amendment based on the fact that, if included, virtually every securitization transacted by every company would fail QSPE status and we do not believe that was the intention of the amendment. The amendment should distinguish between credit enhancing recourse (that would be a Support Commitment) and factual warranties unrelated to ongoing performance or credit quality (that would not be a Support Commitment). Representations and warranties are generally not relied upon as an expected source of payments on beneficial interests. Rather, they are a normal part of asset sales, providing remedies to purchasers and investors if the transferor accidentally or intentionally sells assets that are not what was represented.

## **Issue 2: Reissuance of Beneficial Interests by a SPE**

### *Amendment Provision:*

The Exposure Draft reads as follows:

“A QSPE that can reissue beneficial interests is prohibited from holding liquidity commitments, financial guarantees, or other commitments (“Support Commitments”) that entitle it to receive assets in addition to the original transfer if necessary to fulfill obligations to beneficial interest holders unless:

- a) No party (including affiliates or agents) provides a commitment with a fair value that is more than half the aggregate fair value of all such commitments.
- b) No party (including affiliates or agents) that makes decisions about reissuing beneficial interests provides such a commitment
- c) No party (including affiliates or agents) that holds beneficial interests that are not the most senior in priority provides such a commitment.”

### *SLM Corporation Background*

As discussed under Issue 1 above, the Company securitizes its student loans. The beneficial interests sold to investors include many different types, one of which the Company refers to as an Auction Rate Security (“ARS”). In addition, the SPEs will issue Reset Rate Notes (“RRN”) that have minor differences from the ARS. In the terms of substance however, RRNs are the same as the ARS. Our discussion will highlight the ARS, but any issues, comments and conclusions regarding the ARS pertain to the RRN as well. The following details important features of the ARSs:

- Through a “Dutch auction” process the ARSs are sold to new investors every 28 days (or some other pre-defined interval) based on bids received.
- Pre-determined steps are outlined in the Auction Agent Agreement or some other legal agreement that determines what interest rate will be set (actual auction rate, default interest rate, 18% or average student loan yield of the assets within the SPE).
- The determination of the interest rate is formulaic and requires no decision making on the part of the SPE or the Company as the transferor.
- The remarketing of the ARS every 28 days (or other pre-determined interval) occurs outside of the trust. Proceeds from the remarketing of the ARS do not flow through the SPE.

- Broker/Dealers coordinate the buying/selling of the ARS outside of the SPE. There is no “new security” created or issued at each auction. The ARS, throughout every auction over the life of the SPE, are the same legal instrument and retain their original legal character with only the interest rate changing. This is analogous to investors buying and selling the same fixed rate security over time and paying a premium/discount at each buy/sell in order to get to a market rate.
- The SPE does not hold any Support Commitments that entitle it to receive assets in addition to the original transfer if necessary to fulfill obligations to beneficial interest holders except for the “representation and warranties” commitment discussed in Issue 1 above.

#### *SFAS 140 Amendment’s impact to SLM Corporation*

If the FASB determined that the ARSs are “reissued beneficial interests” and the SPE held any liquidity commitments, financial guarantees or other commitments (Support Commitments) that entitle it to receive assets in addition to the original transfer if necessary to fulfill obligations to beneficial interest holders, then the related SPE would not be considered a QSPE and the SPE would be consolidated on the Company’s balance sheet.

#### *SLM’s Corporation’s issues and comments on the Exposure Draft*

Based on the attributes of the ARS discussed above, the Company does not consider the ARSs to be reissuances of beneficial interests. All auction activity occurs outside of trust; the ARS retain their original legal form with only a change in interest rates while the term of the ARS continues to match the term of the underlying assets. The overall intent of SFAS 140 related to being a QSPE relates to the idea of isolation and effective control. The auction rate mechanism does not compromise the principles of isolation and effective control. We view the ARSs as “Rollovers” as opposed to “reissuances” and believe this distinction needs to be defined in the amendment with Rollovers not considered reissuances under the context of the amendment. Rollovers are nothing more than a market mechanism to re-price (reset the variable interest rate) the bonds.

We believe the original intent of the amendment was to eliminate QSPE status for commercial paper conduits. Differences between the Company’s ARSs and commercial paper conduits are:

- (1) The commercial paper issued actually matures and a new note is issued (new legal instrument). Our ARSs do not mature and a new security is not issued/created.
- (2) The sponsor of a commercial paper conduit provides a liquidity commitment to the SPE in that, if new investors are not sufficient to cover maturing commercial paper, then the sponsor will purchase or have a line of credit available to purchase the maturing commercial paper to provide liquidity to the SPE. In the case of the ARSs the current investor retains the ARS if new investors are not found and receives a higher interest rate in consideration. Neither the Company nor any other entity steps in to purchase the ARS.
- (3) Commercial Paper bonds have shorter lives than the assets of the SPE – the ARS have matched lives, as the original securities do not mature until paid down by the SPE’s asset cashflow.

Even if the FASB determined the ARS were reissuances, the Trust does not hold any liquidity commitments, financial guarantees or other commitments (Support Commitments) that entitle it to receive assets in addition to the original transfer if necessary to fulfill obligations to beneficial

interest holders. Because of this, even if the ARS are considered reissuances, because the SPE does not hold Support Commitments, the SPE should be considered a QSPE.

*SLM Corporation's proposed changes to the Exposure Draft*

ARSs are Rollovers (as we have defined) as opposed to reissuances and Rollovers should not prevent a SPE from being a QSPE. As a result Rollovers should be carved out of the amendment for the reasons discussed above. As previously discussed, the auction rate mechanism does not compromise the principles of isolation and effective control and the mechanics of the auction rate feature are very different than the typical commercial paper conduit. If the FASB does not carve out the Rollovers, we ask that the FASB conclude that our fact pattern of containing no Support Commitments (except for the representations and warranties addressed in Issue 1) related to our ARS SPEs would result in the SPE being considered a QSPE if all other criteria was met.

**Issue 3: Reissuances and Master Trust Structures**

*SLM Corporation's issues and comments on the Exposure Draft*

We believe that some companies might believe that the concept of "reissuance" as used in the Exposure Draft includes periodic issuances of securities in traditional master trust structures. Several factors indicate that the FASB should not be, and we hope was not, concerned by this type of issuance:

- (1) The FASB carved the forward commitments in these transactions out of the restriction in new paragraph 35(e). The problem is that there is no clear parallel carve out in 35(f), relating to entities that can reissue beneficial interests.
- (2) The descriptions of "reissuance" in the Exposure Draft are much more consistent with a commercial paper type of funding program – where proceeds of new issuances of BIs are used to repay maturing beneficial interests – than a traditional master trust program, where each series is paid from collections, and proceeds of new issuances are paid to the transferor as a reduction of the retained transferor interest. Since traditional master trust issuances result in a reduction of the retained transferor interest, there has been no prior sale/derecognition. The portion of the receivables represented by that interest was initially transferred solely in exchange for beneficial interests.

*SLM Corporation's proposed changes to the Exposure Draft*

For the reasons discussed above, we ask that the FASB more clearly to define reissuance to exclude traditional master trust structures.

**Issue 4: Transition Requirements**

*Amendment Provision:*

"A formerly qualifying SPE that fails to meet one or more of the conditions for being a QSPE as amended shall continue to be considered a QSPE if it maintains its qualifying status under previous accounting standards, does not issue new beneficial interests after the effective date and does not receive assets other than those it was committed to receive (through commitments to

beneficial interest holders unrelated to the transferor) under arrangements made before the effective date of this Statement.”

*SLM Corporation's issues/comments on the Exposure Draft*

As currently worded, the Company is unclear as to the intent of the transition guidance. For a formerly qualifying QSPE that would not be a QSPE under the new rules – it appears as though a SPE who reissues beneficial interests but does not have Support Commitments would be required to be consolidated at transition even though, on a go forward basis, a new SPE with the same fact pattern would be considered a QSPE.

*SLM Corporation's proposed changes to the Exposure Draft*

We ask the FASB to clarify the transition guidance to indicate that if a qualifying QSPE fails to meet one or more of the conditions for being a QSPE, as amended, then the QSPE will no longer meet QSPE status only if the SPE issues beneficial interests after the effective date AND has Support Commitments as defined above.

**Conclusion**

We have tried to identify the key issues that impact the Company and appreciate your consideration of such matters. We look forward to participating in the roundtable discussion on the Exposure Draft and would be pleased to provide further assistance if needed. If you have any questions or desire any clarification on the matters addressed above please do not hesitate to contact myself at (703) 810-7800.

Sincerely,

/s/ C.E. Andrews

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