THE SECRETARY OF EDUCATION
WASHINGTON, DC 20202

May 21, 2008

Dear Colleague:

Over the past several months, the Departments of Education and Treasury have been closely monitoring events in the market for federal student loans. We analyzed market conditions and formed contingency plans in light of the recent turmoil in the capital markets and the decision by some lenders to suspend participation in the Federal Family Education Loan Program (FFELP).

As I have stated on a number of occasions, the Administration is committed to ensuring continued and timely access to federal student loans for all eligible student and parent borrowers. We also are committed to designing programs that respect and support the current FFEL Program as a successful public/private partnership, while protecting taxpayer interests.

The FFELP community is diverse. In fiscal year 2007, more than 2,000 lenders issued more than $50 billion in FFELP loans to 6.8 million borrowers. Some lenders fund loans from large balance sheets, while others depend heavily upon outside sources of capital that are prohibitively expensive under current market conditions. Some lenders service loans on a nationwide basis, while others focus on a single state or even a single community. Our response was shaped in this context.

There are four components to our plan:

- A specific package using authority granted to the Secretary under the recently enacted "Ensuring Continued Access to Student Loans Act of 2008" (P.L. 110-227) to offer to purchase loans from lenders for the 2008-2009 academic year and to offer lenders access to short-term liquidity.
- A continued commitment to working with the student lending community to ensure FFELP and other student lending programs serve the best interest of the students and taxpayers.
- An enhanced lender-of-last-resort program to ensure all students continue to have access to FFELP loans.
- The capability of doubling the capacity of our Direct Loan Program should it be needed.

I. LOAN PURCHASE COMMITMENT AND ACCESS TO SHORT-TERM LIQUIDITY

As widely reported, student loans originated in previous years are currently trading in the secondary market at prices below their original cost. This problem does not reflect on the value of student loans themselves, but on the increased cost of financing in the current market environment.

Many lenders today do not have access to funds at a cost that justifies originating new loans. Our plan is designed to provide viability in the marketplace for lenders who step up and make loans in this difficult environment.

The Department of Education (Department) will publish in the *Federal Register* the terms and conditions on which the Department will purchase FFELP loans originated for the 2008-2009 academic year. The terms of this offer remove uncertainty about the one-year return on these loans. The Department will enter agreements by July 1, 2009, to purchase loans. Lenders will have the option to complete the sale by September 30, 2009. That means a lender that completes the disbursement of a loan for the 2008-2009 academic year can hold and service the loan until September 30, 2009. Thus, this option provides an opportunity for lenders to finance and keep loans in the event that capital markets improve. This program is designed to protect lenders against losses on new loans for one year.

The Department will purchase an eligible FFELP loan at a price equal to the sum of (i) par value, (ii) accrued interest (net of Special Allowance Payments), (iii) the 1% origination fee paid to the Department, and (iv) a fixed amount of $75 per loan (used to defray the lender's estimated administrative costs). In the event loans are sold to the Department pursuant to this program, control of loan servicing will transfer to the Department. The Department will determine servicing arrangements for the loans based on costs and security concerns, taking into account the best interests of schools and students.

The option to sell will be useful to lenders who have access to their own funds, but we understand that many FFELP lenders historically have relied on outside capital to fund the loans they originate. In response to the needs of some lenders for short-term liquidity, we will also purchase participation interests in pools of loans made by lenders for the 2008-2009 academic year. We will hold these participation interests up to September 30, 2009.

Under this program, new loans originated by FFELP lenders will be put into short-term trusts. The Department then buys "participation interests" in these trusts. These participation interests will be priced to yield the Department the commercial paper rate plus 50 basis points. Upon expiration, a trust may refinance the loans in the private financial market and pay off the Department's participation interest or sell the loans to the Department as described above. All loans are originated and serviced as FFELP loans.

The Administration is continuing to refine the pricing and terms of these options to ensure they meet the legal requirement that they result in no net cost to the federal government. The *Federal Register* notice will include the final prices, terms, and conditions, as well as the Administration's methodology for determining cost neutrality. These offers of temporary federal support ensure lenders have the incentives, and, if necessary, the liquidity needed to continue serving students and families for the 2008-2009 academic year.

II. MAINTAINING A LONG-TERM COMMITMENT

The programs described above are a temporary remedy designed to ensure capital is available for loans this year. The Administration remains committed to maintaining a strong, competitive FFELP and will continue to work with the student lending community to ensure FFELP and other student aid programs serve the best interest of students and taxpayers.

III. LENDER-OF-LAST-RESORT PROGRAM

We are finalizing plans to ensure effective implementation of the lender-of-last-resort (LLR) authority under section 428(j) of the Higher Education Act of 1965. If FFELP loans are not otherwise available at every qualified school for every qualified student, the Department, in conjunction with guaranty agencies, is prepared to utilize the LLR program. The Department will provide, if necessary, federal advances to guaranty agencies so that they can make LLR loans to students who are otherwise unable to obtain FFELP loans. We expect to finalize these plans within the next several days and to begin accepting applications for advances, if necessary, on June 1, 2008. Although our goal is to keep the use of the LLR program at an absolute minimum, we have taken the prudent steps necessary to ensure that the program can handle a larger volume than ever before.

IV. DIRECT LOAN VOLUME

We have the capacity to double our Direct Loan origination volume ($15 billion to $30 billion), although we are confident that our liquidity and LLR programs will reduce the need for institutions to shift to the Direct Loan Program. As a further precautionary measure, we are addressing the hardware, software, and human resource constraints to further increase our ability to originate and service Direct Loans.

Thank you for your willingness to respond to student needs during this challenging time.

Sincerely,

/s/

Margaret Spellings