# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

**(Mark One)**

R **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2006 or**

£ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to .**

**Commission File Number: 001-13251**

# SLM CORPORATION

*(Exact name of registrant as specified in its charter)*

| | |
|---|---|
| **Delaware** | **52-2013874** |
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |
| **12061 Bluemont Way, Reston, Virginia** | **20190** |
| *(Address of principal executive offices)* | *(Zip Code)* |

**(703) 810-3000**

*(Registrant's telephone number, including area code)*

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☑ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ☑

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

| Class | Outstanding at October 31, 2006 |
|---|---|
| Voting common stock, $.20 par value | 408,760,194 shares |

## GLOSSARY

Listed below are definitions of key terms that are used throughout this document.

**Borrower Benefits—**Borrower Benefits are financial incentives offered to borrowers who qualify based on pre-determined qualifying factors, which are generally tied directly to making on-time monthly payments. The impact of Borrower Benefits is dependent on the estimate of the number of borrowers who will eventually qualify for these benefits and the amount of the financial benefit offered to the borrower. We occasionally change Borrower Benefits programs in both amount and qualification factors. These programmatic changes must be reflected in the estimate of the Borrower Benefits discount.

**Consolidation Loans—**Under both the Federal Family Education Loan Program ("FFELP") and the William D. Ford Federal Direct Student Loan Program ("FDLP"), borrowers with eligible student loans may consolidate them into one note with one lender and convert the variable interest rates on the loans being consolidated into a fixed rate for the life of the loan. The new note is considered a Consolidation Loan. Typically a borrower can consolidate his student loans only once unless the borrower has another eligible loan to consolidate with the existing Consolidation Loan. The borrower rate on a Consolidation Loan is fixed for the term of the loan and is set by the weighted average interest rate of the loans being consolidated, rounded up to the nearest 1/8th of a percent, not to exceed 8.25 percent. In low interest rate environments, Consolidation Loans provide an attractive refinancing opportunity to certain borrowers because they allow borrowers to consolidate variable rate loans into a long-term fixed rate loan. Holders of Consolidation Loans are eligible to earn interest under the Special Allowance Payment ("SAP") formula (see definition below).

**Consolidation Loan Rebate Fee—**All holders of Consolidation Loans are required to pay to the U.S. Department of Education ("ED") an annual 105 basis point Consolidation Loan Rebate Fee on all outstanding principal and accrued interest balances of Consolidation Loans purchased or originated after October 1, 1993, except for loans for which consolidation applications were received between October 1, 1998 and January 31, 1999, where the Consolidation Loan Rebate Fee is 62 basis points.

**Constant Prepayment Rate ("CPR")—**A variable in life of loan estimates that measures the rate at which loans in the portfolio pay before their stated maturity. The CPR is directly correlated to the average life of the portfolio. CPR equals the percentage of loans that prepay annually as a percentage of the beginning of period balance.

**"Core Earnings"—**In accordance with the Rules and Regulations of the Securities and Exchange Commission ("SEC"), we prepare financial statements in accordance with generally accepted accounting principles in the United States of America ("GAAP"). In addition to evaluating the Company's GAAP-based financial information, management evaluates the Company's business segments on a basis that, as allowed under Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information," differs from GAAP. We refer to management's basis of evaluating our segment results as "Core Earnings" presentations for each business segment and we refer to these performance measures in our presentations with credit rating agencies and lenders. While "Core Earnings" results are not a substitute for reported results under GAAP, we rely on "Core Earnings" performance measures in operating each business segment because we believe these measures provide additional information regarding the operational and performance indicators that are most closely assessed by management.

Our "Core Earnings" performance measures are the primary financial performance measures used by management to evaluate performance and to allocate resources. Accordingly, financial information is reported to management on a "Core Earnings" basis by reportable segment, as these are the measures used regularly by our chief operating decision maker. Our "Core Earnings" performance measures are used in developing our financial plans and tracking results, and also in establishing corporate performance targets and determining incentive compensation. Management believes this information provides



additional insight into the financial performance of the Company's core business activities. Our "Core Earnings" performance measures are not defined terms within GAAP and may not be comparable to similarly titled measures reported by other companies. "Core Earnings" net income reflects only current period adjustments to GAAP net income. Accordingly, the Company's "Core Earnings" presentation does not represent another comprehensive basis of accounting.

See "NOTE 11 TO THE CONSOLIDATED FINANCIAL STATEMENTS—Segment Reporting" and "MANAGEMENT'S DISCUSSION AND ANALYSIS—BUSINESS SEGMENTS—Limitations of 'Core Earnings' " for further discussion of the differences between "Core Earnings" and GAAP, as well as reconciliations between "Core Earnings" and GAAP.

In prior filings with the SEC of SLM Corporation's annual report on Form 10-K and quarterly report on Form 10-Q, "Core Earnings" has been labeled as " 'Core' net income" or "Managed net income" in certain instances.

**Direct Loans—**Student loans originated directly by ED under the FDLP.

**ED—**The U.S. Department of Education.

**Embedded Fixed Rate/Variable Rate Floor Income—**Embedded Floor Income is Floor Income (see definition below) that is earned on off-balance sheet student loans that are in securitization trusts sponsored by us. At the time of the securitization, the value of Embedded Fixed Rate Floor Income is included in the initial valuation of the Residual Interest (see definition below) and the gain or loss on sale of the student loans. Embedded Floor Income is also included in the quarterly fair value adjustments of the Residual Interest.

**Exceptional Performer ("EP") Designation—**The EP designation is determined by ED in recognition of a servicer meeting certain performance standards set by ED in servicing FFELP loans. Upon receiving the EP designation, the EP servicer receives 99 percent reimbursement on default claims (100 percent reimbursement on default claims filed before July 1, 2006) on federally guaranteed student loans for all loans serviced for a period of at least 270 days before the date of default and will no longer be subject to the three percent Risk Sharing (see definition below) on these loans. The EP servicer is entitled to receive this benefit as long as it remains in compliance with the required servicing standards, which are assessed on an annual and quarterly basis through compliance audits and other criteria. The annual assessment is in part based upon subjective factors which alone may form the basis for an ED determination to withdraw the designation. If the designation is withdrawn, the three percent Risk Sharing may be applied retroactively to the date of the occurrence that resulted in noncompliance.

**FDLP—**The William D. Ford Federal Direct Student Loan Program.

**FFELP—**The Federal Family Education Loan Program, formerly the Guaranteed Student Loan Program.

**FFELP Stafford and Other Student Loans—**Education loans to students or parents of students that are guaranteed or reinsured under the FFELP. The loans are primarily Stafford loans but also include PLUS and HEAL loans.

**Fixed Rate Floor Income—**We refer to Floor Income (see definition below) associated with student loans whose borrower rate is fixed to term (primarily Consolidation Loans and Stafford Loans originated on or after July 1, 2006) as Fixed Rate Floor Income.

**Floor Income—**FFELP student loans generally earn interest at the higher of a floating rate based on the Special Allowance Payment or SAP formula (see definition below) set by ED and the borrower rate, which is fixed over a period of time. We generally finance our student loan portfolio with floating rate debt over all interest rate levels. In low and/or declining interest rate environments, when the fixed borrower rate is higher than the rate produced by the SAP formula, our student loans earn at a fixed rate while the



interest on our floating rate debt continues to decline. In these interest rate environments, we earn additional spread income that we refer to as Floor Income. Depending on the type of the student loan and when it was originated, the borrower rate is either fixed to term or is reset to a market rate each July 1. As a result, for loans where the borrower rate is fixed to term, we may earn Floor Income for an extended period of time, and for those loans where the borrower interest rate is reset annually on July 1, we may earn Floor Income to the next reset date. In accordance with new legislation enacted in 2006, lenders are required to rebate Floor Income to ED for all new FFELP loans disbursed on or after April 1, 2006.

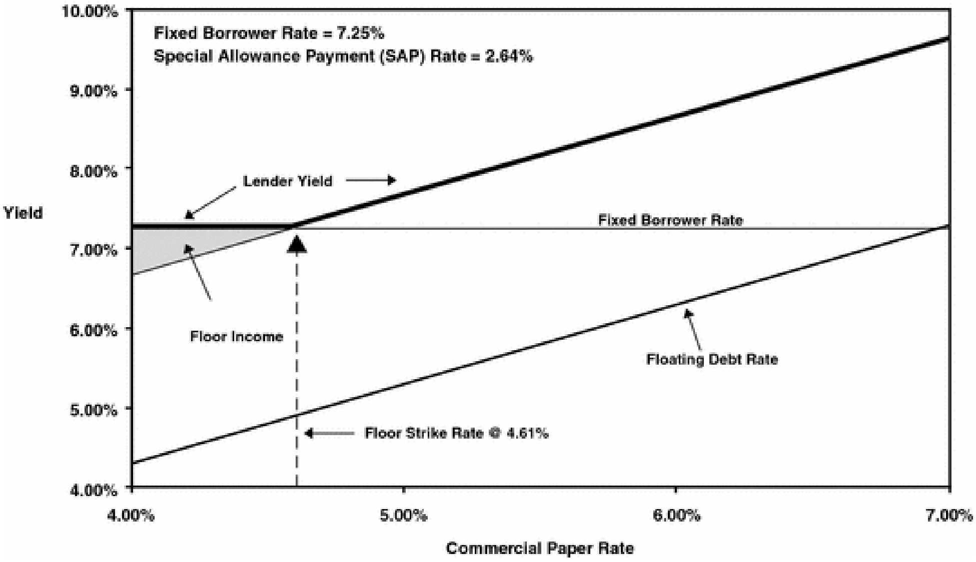
The following example shows the mechanics of Floor Income for a typical fixed rate Consolidation Loan originated between July 1, 2006 and June 30, 2007 (with a commercial paper-based SAP spread of 2.64 percent):

| | |
|---|---|
| Fixed Borrower Rate | 7.25% |
| SAP Spread over Commercial Paper Rate | (2.64)% |
| Floor Strike Rate[(1)] | 4.61% |

(1) The interest rate at which the underlying index (Treasury bill or commercial paper) plus the fixed SAP spread equals the fixed borrower rate. Floor Income is earned anytime the interest rate of the underlying index declines below this rate.

Based on this example, if the quarterly average commercial paper rate is over 4.61 percent, the holder of the student loan will earn at a floating rate based on the SAP formula, which in this example is a fixed spread to commercial paper of 2.64 percent. On the other hand, if the quarterly average commercial paper rate is below 4.61 percent, the SAP formula will produce a rate below the fixed borrower rate of 7.25 percent and the loan holder earns at the borrower rate of 7.25 percent. The difference between the fixed borrower rate and the lender's expected yield based on the SAP formula is referred to as Floor Income. Our student loan assets are generally funded with floating rate debt, so when student loans are earning at the fixed borrower rate, decreases in interest rates may increase Floor Income.

***Graphic Depiction of Floor Income:***



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**Floor Income Contracts—**We enter into contracts with counterparties under which, in exchange for an upfront fee representing the present value of the Floor Income that we expect to earn on a notional amount of underlying student loans being economically hedged, we will pay the counterparties the Floor Income earned on that notional amount over the life of the Floor Income Contract. Specifically, we agree to pay the counterparty the difference, if positive, between the fixed borrower rate less the SAP (see definition below) spread and the average of the applicable interest rate index on that notional amount, regardless of the actual balance of underlying student loans, over the life of the contract. The contracts generally do not extend over the life of the underlying student loans. This contract effectively locks in the amount of Floor Income we will earn over the period of the contract. Floor Income Contracts are not considered effective hedges under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and each quarter we must record the change in fair value of these contracts through income.

**GSE—**The Student Loan Marketing Association was a federally chartered government-sponsored enterprise and wholly owned subsidiary of SLM Corporation that was dissolved under the terms of the Privatization Act (see definition below) on December 29, 2004.

**HEA—**The Higher Education Act of 1965, as amended.

**Managed Basis—**We generally analyze the performance of our student loan portfolio on a Managed Basis, under which we view both on-balance sheet student loans and off-balance sheet student loans owned by the securitization trusts as a single portfolio, and the related on-balance sheet financings are combined with off-balance sheet debt. When the term Managed is capitalized in this document, it is referring to Managed Basis.

**Preferred Channel Originations—**Preferred Channel Originations are comprised of: 1) student loans that are originated by lenders with forward purchase commitment agreements with Sallie Mae and are committed for sale to Sallie Mae, such that we either own them from inception or acquire them soon after origination, and 2) loans that are originated by internally marketed Sallie Mae brands.

**Preferred Lender List—**To streamline the student loan process, most higher education institutions select a small number of lenders to recommend to their students and parents. This recommended list is referred to as the Preferred Lender List.

**Private Education Loans—**Education loans to students or parents of students that are not guaranteed or reinsured under the FFELP or any other federal or private student loan program. Private Education Loans include loans for traditional higher education, undergraduate and graduate degrees, and for alternative education, such as career training, private kindergarten through secondary education schools and tutorial schools. Traditional higher education loans have repayment terms similar to FFELP loans, whereby repayments begin after the borrower leaves school. Repayment for alternative education or career training loans generally begins immediately.

**Privatization Act—**The Student Loan Marketing Association Reorganization Act of 1996.

**Reconciliation Legislation—**The Higher Education Reconciliation Act of 2005, which reauthorized the student loan programs of the HEA and generally became effective as of July 1, 2006.

**Residual Interest—**When we securitize student loans, we retain the right to receive cash flows from the student loans sold to trusts we sponsor in excess of amounts needed to pay servicing, derivative costs (if any), other fees, and the principal and interest on the bonds backed by the student loans. The Residual Interest, which may also include reserve and other cash accounts, is the present value of these future expected cash flows, which includes the present value of Embedded Fixed Rate Floor Income described above. We value the Residual Interest at the time of sale of the student loans to the trust and at the end of each subsequent quarter.

**Retained Interest—**The Retained Interest includes the Residual Interest (defined above) and servicing rights (as the Company retains the servicing responsibilities).

**Risk Sharing—**When a FFELP loan defaults, the federal government guarantees 97 percent of the principal balance (98 percent on loans disbursed before July 1, 2006) plus accrued interest and the holder of the loan generally must absorb the three percent (two percent before July 1, 2006) not guaranteed as a Risk Sharing loss on the loan. FFELP student loans acquired after October 1, 1993 are subject to Risk Sharing on loan default claim payments unless the default results from the borrower's death, disability or bankruptcy. FFELP loans serviced by a servicer that has EP designation (see definition above) from ED and are subject to one-percent Risk Sharing for claims filed after July 1, 2006.

**Special Allowance Payment ("SAP")—**FFELP student loans originated prior to July 1, 2006 generally earn interest at the greater of the borrower rate or a floating rate determined by reference to the average of the applicable floating rates (91-day Treasury bill rate or commercial paper) in a calendar quarter, plus a fixed spread that is dependent upon when the loan was originated and the loan's repayment status. If the resulting floating rate exceeds the borrower rate, ED pays the difference directly to us. This payment is referred to as the Special Allowance Payment or SAP and the formula used to determine the floating rate is the SAP formula. We refer to the fixed spread to the underlying index as the SAP spread. SAP is available on variable rate PLUS Loans and SLS Loans only if the variable rate, which is reset annually, exceeds the applicable maximum borrower rate. Effective for SAP made after April 1, 2006, this limitation on SAP for PLUS loans disbursed on and after January 1, 2000 is repealed.

**Title IV Programs and Title IV Loans—**Student loan programs created under Title IV of the HEA, including the FFELP and the FDLP, and student loans originated under those programs, respectively.

**Variable Rate Floor Income—**For FFELP Stafford student loans whose borrower interest rate resets annually on July 1, we may earn Floor Income or Embedded Floor Income (see definitions above) based on a calculation of the difference between the borrower rate and the then current interest rate. We refer to this as Variable Rate Floor Income because Floor Income is earned only through the next reset date.

**Wind-Down—**The dissolution of the GSE under the terms of the Privatization Act (see definitions above).



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**SLM CORPORATION**
**FORM 10-Q**
**INDEX**
**September 30, 2006**





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## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements**

**SLM CORPORATION**
**CONSOLIDATED BALANCE SHEETS**
**(Dollars and shares in thousands, except per share amounts)**

| | September 30, 2006 (Unaudited) | December 31, 2005 |
|---|---|---|
| **Assets** | | |
| FFELP Stafford and Other Student Loans (net of allowance for losses of $7,649 and $6,311, respectively) | $ 22,613,604 | $ 19,988,116 |
| Consolidation Loans (net of allowance for losses of $10,720 and $8,639, respectively) | 57,201,754 | 54,858,676 |
| Private Education Loans (net of allowance for losses of $274,974 and $204,112, respectively) | 8,222,400 | 7,756,770 |
| Other loans (net of allowance for losses of $18,327 and $16,180, respectively) | 1,257,252 | 1,137,987 |
| Investments | | |
| Available-for-sale | 1,719,526 | 2,095,191 |
| Other | 139,361 | 273,808 |
| Total investments | 1,858,887 | 2,368,999 |
| Cash and cash equivalents | 2,389,752 | 2,498,655 |
| Restricted cash and investments | 3,957,535 | 3,300,102 |
| Retained Interest in off-balance sheet securitized loans | 3,613,376 | 2,406,222 |

| | | |
|---|---|---|
| Goodwill and acquired intangible assets, net | 1,333,123 | 1,105,104 |
| Other assets | 4,605,014 | 3,918,053 |
| Total assets | $ 107,052,697 | $ 99,338,684 |
| **Liabilities** | | |
| Short-term borrowings | $ 3,669,842 | $ 3,809,655 |
| Long-term borrowings | 94,816,563 | 88,119,090 |
| Other liabilities | 4,053,931 | 3,609,332 |
| Total liabilities | 102,540,336 | 95,538,077 |
| **Commitments and contingencies** | | |
| **Minority interest in subsidiaries** | 9,338 | 9,182 |
| **Stockholders' equity** | | |
| Preferred stock, par value $.20 per share, 20,000 shares authorized; Series A: 3,300 and 3,300 shares issued, respectively, at stated value of $50 per share; Series B: 4,000 and 4,000 shares issued, respectively, at stated value of $100 per share | 565,000 | 565,000 |
| Common stock, par value $.20 per share, 1,125,000 shares authorized; 431,590 and 426,484 shares issued, respectively | 86,318 | 85,297 |
| Additional paid-in capital | 2,490,851 | 2,233,647 |
| Accumulated other comprehensive income (net of tax of $244,438 and $197,834, respectively) | 460,527 | 367,910 |
| Retained earnings | 1,928,204 | 1,111,743 |
| Stockholders' equity before treasury stock | 5,530,900 | 4,363,597 |
| Common stock held in treasury at cost: 22,229 and 13,347 shares, respectively | 1,027,877 | 572,172 |
| Total stockholders' equity | 4,503,023 | 3,791,425 |
| Total liabilities and stockholders' equity | $ 107,052,697 | $ 99,338,684 |

See accompanying notes to consolidated financial statements.



## SLM CORPORATION
## CONSOLIDATED STATEMENTS OF INCOME
## (Dollars and shares in thousands, except per share amounts)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 (Unaudited) | 2005 (Unaudited) | 2006 (Unaudited) | 2005 (Unaudited) |
| **Interest income:** | | | | |
| FFELP Stafford and Other Student Loans | $ 364,621 | $ 270,444 | $ 1,000,211 | $ 699,687 |
| Consolidation Loans | 916,091 | 676,820 | 2,579,017 | 1,739,670 |
| Private Education Loans | 254,747 | 173,467 | 729,796 | 429,892 |
| Other loans | 24,550 | 21,614 | 71,398 | 61,813 |
| Cash and investments | 141,083 | 70,541 | 361,847 | 186,835 |
| Total interest income | 1,701,092 | 1,212,886 | 4,742,269 | 3,117,897 |
| **Interest expense:** | | | | |
| Short-term debt | 57,414 | 47,409 | 162,172 | 125,627 |
| Long-term debt | 1,305,857 | 780,713 | 3,497,950 | 1,930,958 |
| Total interest expense | 1,363,271 | 828,122 | 3,660,122 | 2,056,585 |
| Net interest income | 337,821 | 384,764 | 1,082,147 | 1,061,312 |
| Less: provisions for losses | 67,242 | 12,217 | 194,957 | 137,688 |
| Net interest income after provisions for losses | 270,579 | 372,547 | 887,190 | 923,624 |
| **Other income:** | | | | |
| Gains on student loan securitizations | 201,132 | — | 902,417 | 311,895 |
| Servicing and securitization revenue | 187,082 | (16,194) | 368,855 | 276,698 |
| Losses on securities, net | (13,427) | (43,030) | (24,899) | (56,976) |
| Gains (losses) on derivative and hedging activities, net | (130,855) | 316,469 | (94,875) | 176,278 |
| Guarantor servicing fees | 38,848 | 35,696 | 99,011 | 93,922 |
| Debt management fees | 122,556 | 92,727 | 304,329 | 261,068 |
| Collections revenue | 57,913 | 41,772 | 181,951 | 118,536 |
| Other | 87,923 | 74,174 | 234,380 | 206,187 |
| Total other income | 551,172 | 501,614 | 1,971,169 | 1,387,608 |
| **Operating expenses:** | | | | |
| Salaries and benefits | 179,910 | 162,897 | 523,977 | 461,165 |
| Other | 173,584 | 129,064 | 469,428 | 380,500 |
| Total operating expenses | 353,494 | 291,961 | 993,405 | 841,665 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 468,257 | 582,200 | 1,864,954 | 1,469,567 |
| Income taxes | 203,686 | 149,821 | 722,559 | 512,860 |
| Income before minority interest in net earnings of subsidiaries | 264,571 | 432,379 | 1,142,395 | 956,707 |
| Minority interest in net earnings of subsidiaries | 1,099 | 1,029 | 3,544 | 5,458 |
| **Net income** | 263,472 | 431,350 | 1,138,851 | 951,249 |
| Preferred stock dividends | 9,221 | 7,288 | 26,309 | 14,071 |
| Net income attributable to common stock | $ 254,251 | $ 424,062 | $ 1,112,542 | $ 937,178 |
| Basic earnings per common share | $ .62 | $ 1.02 | $ 2.71 | $ 2.24 |
| Average common shares outstanding | 410,034 | 417,235 | 411,212 | 419,205 |

| | | | | |
|---|---|---|---|---|
| Diluted earnings per common share | $ .60 | $ .95 | $ 2.56 | $ 2.10 |
| Average common and common equivalent shares outstanding | 449,841 | 458,798 | 452,012 | 461,222 |
| Dividends per common share | $ .25 | $ .22 | $ .72 | $ .63 |

See accompanying notes to consolidated financial statements.



## SLM CORPORATION
## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
### (Dollars in thousands, except share and per share amounts)
### (Unaudited)

| | Preferred Stock Shares | Common Stock Shares Issued | Common Stock Shares Treasury | Common Stock Shares Outstanding | Preferred Stock | Common Stock | Additional Paid-In Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Treasury Stock | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance at June 30, 2005** | 7,300,000 | 486,706,143 | (66,531,905) | 420,174,238 | $565,000 | $97,341 | $ 2,035,676 | $ 473,121 | $ 2,862,730 | $ (2,382,130) | $ 3,651,738 |
| Comprehensive income: | | | | | | | | | | | |
| Net income | | | | | | | | | 431,350 | | 431,350 |
| Other comprehensive income, net of tax: | | | | | | | | | | | |
| Change in unrealized gains (losses) on investments, net of tax | | | | | | | | (68,680) | | | (68,680) |
| Change in unrealized gains (losses) on derivatives, net of tax | | | | | | | | 3,327 | | | 3,327 |
| Comprehensive income | | | | | | | | | | | 365,997 |
| Cash dividends: | | | | | | | | | | | |
| Common stock ($.22 per share) | | | | | | | | | (91,758) | | (91,758) |
| Preferred stock, series A ($.87 per share) | | | | | | | | | (2,886) | | (2,886) |
| Preferred stock, series B ($1.12 per share) | | | | | | | | | (4,244) | | (4,244) |
| Issuance of common shares | | 1,818,734 | 8,409 | 1,827,143 | | 364 | 58,205 | | | 487 | 59,056 |
| Preferred stock issuance costs and related amortization | | | | | | | 68 | | (158) | | (90) |
| Tax benefit related to employee stock option and purchase plans | | | | | | | 14,012 | | | | 14,012 |
| Repurchase of common shares: | | | | | | | | | | | |
| Equity forwards: | | | | | | | | | | | |
| Exercise cost, cash | | | (2,936,023) | (2,936,023) | | | | | | (148,181) | (148,181) |
| (Gain) loss on settlement | | | — | — | | | | | | 2,554 | 2,554 |
| Benefit plans | | | (467,626) | (467,626) | | | | | | (22,400) | (22,400) |
| **Balance at September 30, 2005** | 7,300,000 | 488,524,877 | (69,927,145) | 418,597,732 | $565,000 | $97,705 | $ 2,107,961 | $ 407,768 | $ 3,195,034 | $ (2,549,670) | $ 3,823,798 |
| **Balance at June 30, 2006** | 7,300,000 | 430,753,515 | (19,078,488) | 411,675,027 | $565,000 | $86,151 | $ 2,440,565 | $ 370,204 | $ 1,775,948 | $ (878,100) | $ 4,359,768 |
| Comprehensive income: | | | | | | | | | | | |
| Net income | | | | | | | | | 263,472 | | 263,472 |
| Other comprehensive income, net of tax: | | | | | | | | | | | |
| Change in unrealized gains (losses) on investments, net of tax | | | | | | | | 98,168 | | | 98,168 |
| Change in unrealized gains (losses) on derivatives, net of tax | | | | | | | | (7,845) | | | (7,845) |
| Comprehensive income | | | | | | | | | | | 353,795 |
| Cash dividends: | | | | | | | | | | | |
| Common stock ($.25 per share) | | | | | | | | | (101,995) | | (101,995) |
| Preferred stock, series A ($.87 per share) | | | | | | | | | (2,875) | | (2,875) |
| Preferred stock, series B ($1.54 per share) | | | | | | | | | (6,183) | | (6,183) |
| Issuance of common shares | | 836,344 | 4,996 | 841,340 | | 167 | 43,428 | | | 259 | 43,854 |
| Preferred stock issuance costs and related amortization | | | | | | | 163 | | (163) | | — |
| Tax benefit related to employee stock option and purchase plans | | | | | | | 6,695 | | | | 6,695 |
| Repurchase of common shares: | | | | | | | | | | | |
| Open market repurchases | | | (2,159,827) | (2,159,827) | | | | | | (100,000) | (100,000) |
| Equity forwards: | | | | | | | | | | | |
| Exercise cost, cash | | | (861,576) | (861,576) | | | | | | (47,163) | (47,163) |
| (Gain) loss on settlement | | | — | — | | | | | | 3,826 | 3,826 |
| Benefit plans | | | (134,033) | (134,033) | | | | | | (6,699) | (6,699) |
| **Balance at September 30, 2006** | 7,300,000 | 431,589,859 | (22,228,928) | 409,360,931 | $565,000 | $86,318 | $ 2,490,851 | $ 460,527 | $ 1,928,204 | $ (1,027,877) | $ 4,503,023 |

See accompanying notes to consolidated financial statements.



## SLM CORPORATION
## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
### (Dollars in thousands, except share and per share amounts)
### (Unaudited)

| | Preferred Stock Shares | Common Stock Shares Issued | Common Stock Shares Treasury | Common Stock Shares Outstanding | Preferred Stock | Common Stock | Additional Paid-In Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Treasury Stock | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Balance at December 31, 2004** | 3,300,000 | 483,266,408 | (59,634,019) | 423,632,389 | $ 165,000 | $96,654 | $ 1,905,460 | $ 440,672 | $ 2,521,740 | $ (2,027,222) | $ 3,102,304 |
| Comprehensive income: | | | | | | | | | | | |
| Net income | | | | | | | | | 951,249 | | 951,249 |
| Other comprehensive income, net of tax: | | | | | | | | | | | |
| Change in unrealized gains (losses) on investments, net of tax | | | | | | | | (37,936) | | | (37,936) |
| Change in unrealized gains (losses) on derivatives, net of tax | | | | | | | | 5,032 | | | 5,032 |
| Comprehensive income | | | | | | | | | | | 918,345 |
| Cash dividends: | | | | | | | | | | | |
| Common stock ($.63 per share) | | | | | | | | | (263,884) | | (263,884) |
| Preferred stock, series A ($2.61 per share) | | | | | | | | | (8,636) | | (8,636) |
| Preferred stock, series B ($1.12 per share) | | | | | | | | | (5,239) | | (5,239) |
| Issuance of common shares | | 5,258,469 | 73,406 | 5,331,875 | | 1,051 | 169,065 | | | 3,762 | 173,878 |
| Issuance of preferred shares | 4,000,000 | | | | 400,000 | | | | | | 400,000 |
| Preferred stock issuance costs and related amortization | | | | | | | (2,894) | | (196) | | (3,090) |
| Tax benefit related to employee stock option and purchase plans | | | | | | | 36,330 | | | | 36,330 |
| Repurchase of common shares: | | | | | | | | | | | |
| Equity forwards: | | | | | | | | | | | |
| Exercise cost, cash | | | (9,405,676) | (9,405,676) | | | | | | (468,267) | (468,267) |
| (Gain) loss on settlement | | | — | — | | | | | | (11,276) | (11,276) |
| Benefit plans | | | (960,856) | (960,856) | | | | | | (46,667) | (46,667) |
| **Balance at September 30, 2005** | 7,300,000 | 488,524,877 | (69,927,145) | 418,597,732 | $ 565,000 | $97,705 | $ 2,107,961 | $ 407,768 | $ 3,195,034 | $ (2,549,670) | $ 3,823,798 |
| **Balance at December 31, 2005** | 7,300,000 | 426,483,527 | (13,346,717) | 413,136,810 | $ 565,000 | $85,297 | $ 2,233,647 | $ 367,910 | $ 1,111,743 | $ (572,172) | $ 3,791,425 |
| Comprehensive income: | | | | | | | | | | | |
| Net income | | | | | | | | | 1,138,851 | | 1,138,851 |
| Other comprehensive income, net of tax: | | | | | | | | | | | |
| Change in unrealized gains (losses) on investments, net of tax | | | | | | | | 91,356 | | | 91,356 |
| Change in unrealized gains (losses) on derivatives, net of tax | | | | | | | | 1,256 | | | 1,256 |
| Minimum pension liability adjustment | | | | | | | | 5 | | | 5 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Comprehensive income | | | | | | | | | | | 1,231,468 |
| Cash dividends: | | | | | | | | | | | |
| Common stock ($.72 per share) | | | | | | | | | (296,081) | | (296,081) |
| Preferred stock, series A ($2.61 per share) | | | | | | | | | (8,625) | | (8,625) |
| Preferred stock, series B ($4.28 per share) | | | | | | | | | (17,200) | | (17,200) |
| Issuance of common shares | | 5,106,332 | 58,745 | 5,165,077 | | 1,021 | 212,066 | | | 3,234 | 216,321 |
| Preferred stock issuance costs and related amortization | | | | | | | 484 | | (484) | | — |
| Tax benefit related to employee stock option and purchase plans | | | | | | | 44,654 | | | | 44,654 |
| Repurchase of common shares: | | | | | | | | | | | |
| Open market repurchases | | | (2,159,827) | (2,159,827) | | | | | | (100,000) | (100,000) |
| Equity forwards: | | | | | | | | | | | |
| Exercise cost, cash | | | (5,395,979) | (5,395,979) | | | | | | (295,376) | (295,376) |
| (Gain) loss on settlement | | | — | — | | | | | | 10,907 | 10,907 |
| Benefit plans | | | (1,385,150) | (1,385,150) | | | | | | (74,470) | (74,470) |
| **Balance at September 30, 2006** | 7,300,000 | 431,589,859 | (22,228,928) | 409,360,931 | $ 565,000 | $ 86,318 | $ 2,490,851 | $ 460,527 | $ 1,928,204 | $ (1,027,877) | $ 4,503,023 |

See accompanying notes to consolidated financial statements.



# SLM CORPORATION
## CONSOLIDATED STATEMENTS OF CASH FLOWS
### (Dollars in thousands)

| | Nine Months Ended September 30, 2006 (Unaudited) | Nine Months Ended September 30, 2005 (Unaudited) |
|---|---|---|
| **Operating activities** | | |
| Net income | $ 1,138,851 | $ 951,249 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Gains on student loan securitizations | (902,417) | (311,895) |
| Losses on securities, net | 24,899 | 56,976 |
| Unrealized (gains)/losses on derivative and hedging activities, excluding equity forwards | (193,972) | (420,878) |
| Unrealized (gains)/losses on derivative and hedging activities—equity forwards | 181,616 | (64,519) |
| Provisions for losses | 194,957 | 137,688 |
| Minority interest, net | (5,639) | (6,714) |
| Mortgage loans originated | (1,030,296) | (1,335,468) |
| Proceeds from sales of mortgage loans | 1,052,750 | 1,239,425 |
| (Increase) in restricted cash | (587,724) | (279,814) |
| (Increase) in accrued interest receivable | (722,659) | (469,714) |
| Increase in accrued interest payable | 167,418 | 82,764 |
| Adjustment for non-cash (income)/loss related to Retained Interest | 147,839 | 194,231 |
| Decrease in other assets, goodwill and acquired intangible assets, net | 144,974 | 153,860 |
| Increase in other liabilities | 332,889 | 594,256 |
| Total adjustments | (1,195,365) | (429,802) |
| Net cash (used in) provided by operating activities | (56,514) | 521,447 |
| **Investing activities** | | |
| Student loans acquired | (27,072,346) | (23,108,450) |
| Loans purchased from securitized trusts (primarily loan consolidations) | (5,903,077) | (7,459,199) |
| Reduction of student loans: | | |
| Installment payments | 7,019,033 | 4,909,516 |
| Claims and resales | 827,142 | 768,328 |
| Proceeds from securitization of student loans treated as sales | 19,521,365 | 9,045,932 |
| Proceeds from sales of student loans | 94,578 | 166,471 |
| Other loans originated | (1,302,201) | (346,473) |
| Other loans repaid | 1,159,201 | 393,838 |
| Purchases of available-for-sale securities | (58,867,668) | (50,629,556) |
| Proceeds from sales of available-for-sale securities | 3,428 | 983,469 |
| Proceeds from maturities of available-for-sale securities | 59,374,975 | 50,764,290 |
| Purchases of held-to-maturity and other securities | (559,098) | (713,852) |
| Proceeds from maturities of held-to-maturity securities and other securities | 650,480 | 685,132 |
| Return of investment from Retained Interest | 66,781 | 161,183 |
| Purchase of subsidiaries, net of cash acquired | (289,162) | (178,844) |
| Net cash used in investing activities | (5,276,569) | (14,558,215) |
| **Financing activities** | | |
| Short-term borrowings issued | 15,858,049 | 56,745,936 |
| Short-term borrowings repaid | (15,860,749) | (56,834,645) |
| Long-term borrowings issued | 7,698,469 | 8,286,865 |
| Long-term borrowings repaid | (4,494,881) | (4,957,066) |
| Borrowings collateralized by loans in trust issued | 6,203,019 | 9,808,399 |
| Borrowings collateralized by loans in trust—activity | (3,631,741) | (627,003) |
| Excess tax benefit from the exercise of stock-based awards | 27,445 | — |
| Common stock issued | 216,321 | 173,878 |
| Common stock repurchased | (469,846) | (514,934) |
| Common dividends paid | (296,081) | (263,884) |
| Preferred stock issued | — | 396,910 |
| Preferred dividends paid | (25,825) | (13,875) |
| Net cash provided by financing activities | 5,224,180 | 12,200,581 |
| Net decrease in cash and cash equivalents | (108,903) | (1,836,187) |
| Cash and cash equivalents at beginning of period | 2,498,655 | 3,395,487 |
| **Cash and cash equivalents at end of period** | $ 2,389,752 | $ 1,559,300 |
| Cash disbursements made for: | | |
| Interest | $ 3,117,085 | $ 1,701,632 |
| Income taxes | $ 574,220 | $ 234,962 |

See accompanying notes to consolidated financial statements.

**1. Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited, consolidated financial statements of SLM Corporation (the "Company") have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments considered necessary for a fair statement of the results for the interim periods have been included. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Operating results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results for the year ending December 31, 2006. The consolidated balance sheet at December 31, 2005, as presented, was derived from the audited financial statements included in the Company's Annual Report on Form 10-K for the period ended December 31, 2005. These unaudited financial statements should be read in conjunction with the audited financial statements and related notes included in the Company's 2005 Annual Report on Form 10-K.

***Reclassifications***

Certain reclassifications have been made to the balances as of and for the three and nine months ended September 30, 2005 to be consistent with classifications adopted for 2006.

***Recently Issued Accounting Pronouncements***

**Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans**

In September 2006, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements Nos. 87, 88, 106 and 132(R)." SFAS No. 158 requires an employer that sponsors one or more single-employer defined benefit plans to (a) recognize the overfunded or underfunded status of a benefit plan in its statement of financial position, (b) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to SFAS No. 87, "Employers' Accounting for Pensions," or SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," (c) measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end, and (d) disclose in the notes to financial statements additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition asset or obligation. SFAS No. 158 is effective for the Company's fiscal year ending December 31, 2006. The Company does not expect the adoption of SFAS No. 158 to have a material impact on its financial statements.



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**1. Significant Accounting Policies (Continued)**

**Fair Value Measurements**

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. This statement defines fair value, establishes a framework for measuring fair value within GAAP, and expands disclosures about fair value measurements. This statement applies to other accounting pronouncements that require or permit fair value measurements. Accordingly, this statement does not change which types of instruments are carried at fair value, but rather establishes the framework for measuring fair value. The Company is currently evaluating the potential impact of SFAS No. 157 on its financial statements.

**Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements**

In September 2006, the Securities and Exchange Commission (the "SEC") issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB No. 108 eliminates the diversity of practice surrounding how public companies quantify financial statement misstatements. It establishes an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of a company's financial statements and the related financial statement disclosures. SAB No. 108 is effective for fiscal years ending on or after November 15, 2006, with earlier adoption encouraged. The Company does not expect the adoption of SAB No. 108 to have a material impact on its financial statements.

**Accounting for Uncertainty in Income Taxes**

In July 2006, the FASB issued Financial Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes," which amends SFAS No. 109, "Accounting for Income Taxes." This statement will be effective for the Company beginning January 1, 2007.

This interpretation:

- Changes historical methods of recording the impact to the financial statements of uncertain tax positions from a model based upon probable liabilities to be owed, to a model based upon the tax benefit most likely to be sustained.
- Prescribes a threshold for the financial statement recognition of tax positions taken or expected to be taken in a tax return, based upon whether it is more likely than not that a tax position will be sustained upon examination.

- Provides rules on the measurement in the financial statements of tax positions that meet this recognition threshold, requiring that the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement to be recorded.
- Provides guidance on the financial statement treatment of changes in the assessment of an uncertain tax position, as well as accounting for such changes in interim periods.
- Requires new disclosures regarding uncertain tax positions.



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**1. Significant Accounting Policies (Continued)**

The Company is currently evaluating this interpretation to assess its impact on the Company's financial statements.

**Accounting for Servicing of Financial Assets**

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets," which amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." This statement will be effective for the Company beginning January 1, 2007.

This statement:

- Requires an entity to recognize a servicing asset or liability each time it undertakes an obligation to service a financial asset as the result of i) a transfer of the servicer's financial assets that meet the requirement for sale accounting; ii) a transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale or trading securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities"; or iii) an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates.
- Requires all separately recognized servicing assets or liabilities to be initially measured at fair value, if practicable.
- Permits an entity to either i) amortize servicing assets or liabilities in proportion to and over the period of estimated net servicing income or loss and assess servicing assets or liabilities for impairment or increased obligation based on fair value at each reporting date (amortization method); or ii) measure servicing assets or liabilities at fair value at each reporting date and report changes in fair value in earnings in the period in which the changes occur (fair value measurement method). The method must be chosen for each separately recognized class of servicing asset or liability.
- At its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under SFAS No. 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or liabilities that a servicer elects to subsequently measure at fair value.
- Requires separate presentation of servicing assets and liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and liabilities.

The Company expects that the adoption of SFAS No. 156 will not have a material impact on the Company's financial statements.



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**1. Significant Accounting Policies (Continued)**

**Accounting for Certain Hybrid Financial Instruments**

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments" which amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and SFAS No. 140. This statement will be effective for the Company beginning January 1, 2007.

This statement:

- Allows a hybrid financial instrument containing an embedded derivative that would have required bifurcation under SFAS No. 133 to be measured at fair value as one instrument on a case by case basis;
- Clarifies which interest-only strips and principal-only strips are exempt from the requirements of SFAS No. 133;
- Requires that all interests in securitized financial assets be evaluated to determine if the interests are free standing instruments or if the interests contain an embedded derivative;
- Clarifies that the concentrations of credit risk in the form of subordination are not an embedded derivative; and

· Amends SFAS Statement No. 140 to eliminate the prohibition of a qualifying special purpose entity from holding a derivative financial instrument that pertains to beneficial interests other than another derivative financial instrument.

The Company continues to assess the impact of adopting SFAS No. 155 on the Company's financial statements. There have been varying interpretations as to how SFAS No. 155 may impact the accounting related to Residual Interests. Specifically, the standard may require the Company to separately record embedded derivatives that may be within the Company's Residual Interest. The standard as currently written would only require prospective application in 2007 for new securitizations, and would not apply to the Company's current Residual Interest portfolio. The FASB plans to release clarifying guidance in early 2007.

*Accounting for Loans Held for Investment and Loans Held for Sale*

If the Company has the ability and intent to hold loans for the foreseeable future, such loans are held for investment and therefore carried at amortized cost. Any loans held for sale are carried at the lower of cost or fair value. The Company actively securitizes loans but securitization is viewed as one of many different sources of financing. At the time of a funding need, the most advantageous funding source is identified and, if that source is the securitization program, loans are selected based on the required characteristics to structure the desired transaction (i.e., type of loan, mix of interim vs. repayment status, credit rating, maturity dates, etc.). The Company structures securitizations to obtain the most favorable financing terms and as a result, due to some of the structuring terms, certain transactions qualify for sale treatment under SFAS No. 140 while others do not qualify for sale treatment and are recorded as





**1. Significant Accounting Policies (Continued)**

financings. Because the Company does not securitize all loans and not all securitizations qualify as sales, only when the Company has selected the loans to securitize and such transaction qualifies as a sale under SFAS No. 140 has the Company made a decision to sell loans. At such time, selected loans are transferred into the held-for-sale classification and carried at the lower of cost or fair value. If the Company will recognize a gain related to the impending securitization, no allowance is needed to adjust the loans below their respective cost basis.

*Accounting for Stock-Based Compensation*

On January 1, 2006, the Company adopted SFAS No. 123(R), "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation," using the modified prospective transition method. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Prior to January 1, 2006, the Company accounted for its stock option plans using the intrinsic value method of accounting provided under Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, and therefore no related compensation expense was recorded for awards granted with no intrinsic value. Accordingly, for periods prior to January 1, 2006, share-based compensation was included as a pro forma disclosure in the financial statement footnotes.

Using the modified prospective transition method of SFAS No. 123(R), the Company's compensation cost in the nine months ended September 30, 2006 includes: 1) compensation cost related to the remaining unvested portion of all share-based payments granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123; and 2) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

As a result of adopting SFAS No. 123(R), the Company's earnings before income taxes for the three and nine months ended September 30, 2006 were $15 million and $48 million lower, respectively, than if it had continued to account for stock-based compensation under APB No. 25, and net earnings were $10 million and $30 million lower, respectively.

SFAS No. 123(R) requires that the excess (i.e., windfall) tax benefits from tax deductions on the exercise of share-based payments exceeding the deferred tax assets from the cumulative compensation cost previously recognized be classified as cash inflows from financing activities in the consolidated statement of cash flows. Prior to the adoption of SFAS No. 123(R), the Company presented all excess tax benefits resulting from the exercise of share-based payments as operating cash flows. The excess tax benefit for the three and nine months ended September 30, 2006 was $4 million and $27 million, respectively.





**1. Significant Accounting Policies (Continued)**

The following table provides pro forma net income and earnings per share had the Company applied the fair value method of SFAS No. 123(R) for the three and nine months ended September 30, 2005.

| | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2005 |
|---|---|---|
| Net income: | | |
| Reported net income attributable to common stock | $424,062 | $ 937,178 |
| Less: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects | (9,081) | (29,670) |
| Pro forma net income attributable to common stock | $414,981 | $ 907,508 |
| Earnings per common share: | | |
| Reported basic earnings per common share | $ 1.02 | $ 2.24 |
| Pro forma basic earnings per common share | $ .99 | $ 2.16 |
| Reported diluted earnings per common share | $ .95 | $ 2.10 |
| Pro forma diluted earnings per common share | $ .93 | $ 2.04 |

**2. Allowance for Student Loan Losses**

The Company's provisions for student loan losses represent the periodic expense of maintaining an allowance sufficient to absorb losses, net of recoveries, inherent in the student loan portfolios. The evaluation of the provisions for student loan losses is inherently subjective as it requires material estimates that may be susceptible to significant changes. The Company believes that the allowance for student loan losses is appropriate to cover probable losses in the student loan portfolios.

The following table summarizes changes in the allowance for student loan losses for both the Private Education Loan and federally insured student loan portfolios for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| **Allowance at beginning of period** | $268,562 | $ 233,518 | $ 219,062 | $ 179,664 |
| Provisions for student loan losses | 61,864 | 8,908 | 184,480 | 127,425 |
| Charge-offs | (37,954) | (48,624) | (108,107) | (116,914) |
| Recoveries | 5,652 | 5,157 | 18,081 | 14,670 |
| Net charge-offs | (32,302) | (43,467) | (90,026) | (102,244) |
| Balance before reductions for student loan sales and securitizations | 298,124 | 198,959 | 313,516 | 204,845 |
| Reductions for student loan sales and securitizations | (4,781) | — | (20,173) | (5,886) |
| **Allowance at end of period** | $293,343 | $ 198,959 | $ 293,343 | $ 198,959 |

In addition to the provisions for student loan losses, provisions for losses on other Company loans totaled $5 million and $3 million for the three months ended September 30, 2006 and 2005, respectively and $10 million for both the nine months ended September 30, 2006 and 2005, respectively.





**2. Allowance for Student Loan Losses (Continued)**

The following table summarizes changes in the allowance for student loan losses for Private Education Loans for the three and nine months ended September 30, 2006 and 2005.

| **(Dollars in millions)** | Three Months Ended September 30, 2006 | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2005 |
|---|---|---|---|---|
| Allowance at beginning of period | $ 252 | $ 228 | $ 204 | $ 172 |
| Provision for Private Education Loan losses | 58 | 56 | 175 | 135 |
| Change in estimate | — | — | — | 40 |
| Change in recovery estimate | — | (49) | — | (49) |
| Total provision | 58 | 7 | 175 | 126 |
| Charge-offs | (37) | (47) | (105) | (113) |
| Recoveries | 6 | 5 | 18 | 14 |
| Net charge-offs | (31) | (42) | (87) | (99) |
| Balance before securitization of Private Education Loans | 279 | 193 | 292 | 199 |
| Reduction for securitization of Private Education Loans | (4) | — | (17) | (6) |
| Allowance at end of period | $ 275 | $ 193 | $ 275 | $ 193 |
| Net charge-offs as a percentage of average loans in repayment (annualized) | 3.19% | 5.35% | 3.06% | 4.37% |
| Allowance as a percentage of the ending total loan balance | 3.24% | 2.34% | 3.24% | 2.34% |
| Allowance as a percentage of ending loans in repayment | 6.91% | 6.00% | 6.91% | 6.00% |
| Allowance coverage of net charge-offs (annualized) | 2.22 | 1.15 | 2.35 | 1.46 |
| Average total loans | $8,079 | $7,193 | $8,348 | $ 6,615 |
| Ending total loans | $8,497 | $8,272 | $8,497 | $ 8,272 |

| | | | | |
|---|---|---|---|---|
| Average loans in repayment | $3,879 | $3,150 | $3,821 | $ 3,031 |
| Ending loans in repayment | $3,980 | $3,220 | $3,980 | $ 3,220 |





## 2. Allowance for Student Loan Losses (Continued)

### Delinquencies

The table below presents the Company's Private Education Loan delinquency trends as of September 30, 2006, December 31, 2005 and September 30, 2005. Delinquencies have the potential to adversely impact earnings if the account charges off and results in increased servicing and collection costs.

| | September 30, 2006 | | December 31, 2005 | | September 30, 2005 | |
|---|---|---|---|---|---|---|
| **(Dollars in millions)** | **Balance** | **%** | **Balance** | **%** | **Balance** | **%** |
| Loans in-school/grace/deferment[1] | $4,497 | | $ 4,301 | | $ 5,042 | |
| Loans in forbearance[2] | 341 | | 303 | | 311 | |
| Loans in repayment and percentage of each status: | | | | | | |
| Loans current | 3,462 | 87.0% | 3,311 | 90.4% | 2,873 | 89.2% |
| Loans delinquent 31-60 days[3] | 209 | 5.3 | 166 | 4.5 | 145 | 4.5 |
| Loans delinquent 61-90 days[3] | 121 | 3.0 | 77 | 2.1 | 75 | 2.3 |
| Loans delinquent greater than 90 days[3] | 188 | 4.7 | 108 | 3.0 | 127 | 4.0 |
| Total Private Education Loans in repayment | 3,980 | 100% | 3,662 | 100% | 3,220 | 100% |
| Total Private Education Loans, gross | 8,818 | | 8,266 | | 8,573 | |
| Private Education Loan unamortized discount | (321) | | (305) | | (301) | |
| Total Private Education Loans | 8,497 | | 7,961 | | 8,272 | |
| Private Education Loan allowance for losses | (275) | | (204) | | (193) | |
| Private Education Loans, net | $8,222 | | $ 7,757 | | $ 8,079 | |
| Percentage of Private Education Loans in repayment | 45.1% | | 44.3% | | 37.6% | |
| Delinquencies as a percentage of Private Education Loans in repayment | 13.0% | | 9.6% | | 10.8% | |

(1) Loans for borrowers who still may be attending school or engaging in other permitted educational activities and are not yet required to make payments on their loans, e.g., residency periods for medical students or a grace period for bar exam preparation.

(2) Loans for borrowers who have requested extension of grace period or who have temporarily ceased making full payments due to hardship or other factors. When loans exit forbearance status and enter repayment, they are initially included in current status.

(3) The period of delinquency is based on the number of days scheduled payments are contractually past due.





## 3. Goodwill and Acquired Intangible Assets

Intangible assets include the following:

| | | As of September 30, 2006 | | |
|---|---|---|---|---|
| **(Dollars in millions)** | **Average Amortization Period** | **Gross** | **Accumulated Amortization** | **Net** |
| *Intangible assets subject to amortization:* | | | | |
| Customer, services, and lending relationships | 11 years | $384 | $ (99) | $ 285 |
| Tax exempt bond funding[1] | 10 years | 67 | (57) | 10 |
| Software and technology | 7 years | 80 | (59) | 21 |
| Non-compete agreements | 2 years | 10 | (9) | 1 |
| Total | | 541 | (224) | 317 |
| *Intangible assets not subject to amortization:* | | | | |
| Trade name and trademark | Indefinite | 78 | — | 78 |
| Total acquired intangible assets | | $619 | $ (224) | $ 395 |

| (Dollars in millions) | Average Amortization Period | As of December 31, 2005 Gross | Accumulated Amortization | Net |
|---|---|---|---|---|
| *Intangible assets subject to amortization:* | | | | |
| Customer, services, and lending relationships | 12 years | $256 | $ (76) | $ 180 |
| Tax exempt bond funding[1] | 10 years | 67 | (25) | 42 |
| Software and technology | 7 years | 80 | (51) | 29 |
| Non-compete agreements | 2 years | 11 | (8) | 3 |
| Total | | 414 | (160) | 254 |
| *Intangible assets not subject to amortization:* | | | | |
| Trade name and trademark | Indefinite | 78 | — | 78 |
| Total acquired intangible assets | | $492 | $ (160) | $ 332 |

(1) In connection with the Company's acquisition of Southwest Student Services Corporation and Washington Transferee Corporation, the Company acquired certain tax exempt bonds that enable the Company to earn a 9.5 percent Special Allowance Payment ("SAP") rate on student loans funded by those bonds in indentured trusts. During the third quarter of 2006, the Company recognized an intangible impairment of $21 million due to changes in projected interest rates used to initially value the intangible asset and to a regulatory change that restricts the loans on which the Company is entitled to earn a 9.5 percent yield. The impaired intangible asset is reported in the lending segment and the impairment charge was recorded to amortization expense, which is included in other operating expenses in the Consolidated Statement of Income.





### 3. Goodwill and Acquired Intangible Assets (Continued)

The Company recorded intangible impairment and amortization of acquired intangibles totaling $37 million and $16 million for the three months ended September 30, 2006 and 2005, respectively, and $68 million and $45 million for the nine months ended September 30, 2006 and 2005, respectively. In the third quarter of 2006, the Company recognized an intangible impairment of $21 million due to an increase in borrower interest rates since the July 1, 2006 reset and to a regulatory change to its 9.5 percent SAP loans.

A summary of changes in the Company's goodwill by reportable segment (see Note 11, "Segment Reporting") is as follows:

| (Dollars in millions) | December 31, 2005 | Adjustments | September 30, 2006 |
|---|---|---|---|
| Lending | $410 | $ (4) | $ 406 |
| Debt Management Operations | 299 | 6 | 305 |
| Corporate and Other | 64 | 164 | 228 |
| Total | $773 | $ 166 | $ 939 |

Acquisitions are accounted for under the purchase method of accounting as defined in SFAS No. 141, "Business Combinations." The Company allocates the purchase price to the fair value of the acquired tangible assets, liabilities and identifiable intangible assets as of the acquisition date as determined by an independent appraiser. Goodwill associated with the Company's acquisitions is reviewed for impairment in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," addressed further in Note 2, "Significant Accounting Policies," within the Company's 2005 Annual Report on Form 10-K.

On August 23, 2006, the Company acquired Upromise, Inc. for approximately $309 million including cash consideration and certain acquisition costs. Upromise markets and administers saving-for-college plans and also provides administration services for college savings plans. The excess purchase price over the fair value of net assets acquired, or goodwill, is estimated to be $164 million.

On August 31, 2005, the Company acquired 100 percent controlling interest in GRP/AG Holdings, LLC and its subsidiaries (collectively, "GRP") for a purchase price of approximately $137 million including cash consideration and certain acquisition costs. GRP engages in the acquisition and resolution of distressed residential mortgage loans and foreclosed residential properties. In the third quarter of 2006, the Company finalized its purchase price allocation for GRP, which resulted in an excess purchase price over the fair value of net assets acquired, or goodwill, of $53 million.





### 3. Goodwill and Acquired Intangible Assets (Continued)

On December 22, 2005, the Company acquired an additional 12 percent interest in Arrow Financial Services ("AFS") for a purchase price of approximately $59 million, increasing the Company's total purchase price for its 76 percent controlling interest in AFS to approximately $226 million including cash consideration and certain acquisition costs. AFS is a full-service, accounts receivable management company that purchases charged-off debt, conducts contingency collection work and performs third-party receivables servicing across a number of consumer asset classes. Under the terms of the August 31, 2004 initial purchase agreement, the Company has the option to purchase the remaining minority interest in AFS over the next two-year period.

The Company finalized its purchase price allocation for its initial acquisition of 64 percent interest in AFS as well as its December 2005 acquisition of an additional 12 percent interest in AFS, which resulted in an aggregate excess purchase price over the fair value of net assets acquired, or goodwill, of $162 million for the total AFS acquisition.

**4. Student Loan Securitization**

***Securitization Activity***

The Company securitizes its student loan assets and for transactions qualifying as sales, retains a Residual Interest and servicing rights (as the Company retains the servicing responsibilities), all of which are referred to as the Company's Retained Interest in off-balance sheet securitized loans. The Residual Interest is the right to receive cash flows from the student loans and reserve accounts in excess of the amounts needed to pay servicing, derivative costs (if any), other fees, and the principal and interest on the bonds backed by the student loans. The investors of the securitization trusts have no recourse to the Company's other assets should there be a failure of the securitized student loans to pay when due.





**4. Student Loan Securitization (Continued)**

The following table summarizes the Company's securitization activity for the three and nine months ended September 30, 2006 and 2005. Those securitizations listed as sales are off-balance sheet transactions and those listed as financings remain on balance sheet.

| | Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | | | 2005 | | | |
| (Dollars in millions) | No. of Transactions | Loan Amount Securitized | Pre-Tax Gain | Gain % | No. of Transactions | Loan Amount Securitized | Pre-Tax Gain | Gain % |
| FFELP Stafford/PLUS loans | — | $ — | $ — | —% | — | $ — | $ — | —% |
| Consolidation Loans | 2 | 4,001 | 19 | .5 | — | — | — | — |
| Private Education Loans | 1 | 1,088 | 182 | 16.7 | — | — | — | — |
| Total securitizations—sales | 3 | 5,089 | $ 201 | 4.0% | — | — | $ — | —% |
| Consolidation Loans(1) | 1 | 3,001 | | | 3 | 7,276 | | |
| Total securitizations—financings | 1 | 3,001 | | | 3 | 7,276 | | |
| Total securitizations | 4 | $ 8,090 | | | 3 | $ 7,276 | | |

| | Nine Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | | | 2005 | | | |
| (Dollars in millions) | No. of Transactions | Loan Amount Securitized | Pre-Tax Gain | Gain % | No. of Transactions | Loan Amount Securitized | Pre-Tax Gain | Gain % |
| FFELP Stafford/PLUS loans | 2 | $ 5,004 | $ 17 | .3% | 2 | $ 3,530 | $ 50 | 1.4% |
| Consolidation Loans | 4 | 9,503 | 55 | .6 | 2 | 4,011 | 31 | .8 |
| Private Education Loans | 3 | 5,088 | 830 | 16.3 | 1 | 1,505 | 231 | 15.3 |
| Total securitizations—sales | 9 | 19,595 | $ 902 | 4.6% | 5 | 9,046 | $ 312 | 3.4% |
| Consolidation Loans(1) | 2 | 6,002 | | | 4 | 9,502 | | |
| Total securitizations—financings | 2 | 6,002 | | | 4 | 9,502 | | |
| Total securitizations | 11 | $ 25,597 | | | 9 | $ 18,548 | | |

(1) In certain Consolidation Loan securitizations there are certain terms within the deal structure that result in such securitizations not qualifying for sale treatment and accordingly, they are accounted for on-balance sheet as variable interest entities ("VIEs"). The terms that are present within these structures that prevent sale treatment are: (1) the Company may hold certain rights that can affect the remarketing of certain bonds, (2) the trust may enter into interest rate cap agreements after the initial settlement of the securitization which do not relate to the reissuance of third party beneficial interests and (3) the Company may hold an unconditional call option related to a certain percentage of the securitized assets.





**4. Student Loan Securitization (Continued)**

Key economic assumptions used in estimating the fair value of Residual Interests at the date of securitization resulting from the student loan securitization sale transactions completed during the three and nine months ended September 30, 2006 and 2005 were as follows:

| | Three Months Ended September 30, 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| | FFELP Stafford[1] | Consolidation Loans | Private Education Loans | FFELP Stafford[1] | Consolidation Loans[1] | Private Education Loans[1] |
| Prepayment speed (annual rate)[2] | — | 6% | 4% | — | — | — |
| Weighted average life | — | 7.9 yrs. | 9.2 yrs. | — | — | — |
| Expected credit losses (% of principal securitized) | — | .09% | 4.75% | — | — | — |
| Residual cash flows discounted at (weighted average) | — | 11.0% | 12.7% | — | — | — |

| | Nine Months Ended September 30, 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| | FFELP Stafford | Consolidation Loans | Private Education Loans | FFELP Stafford | Consolidation Loans | Private Education Loans |
| Prepayment speed (annual rate)[2] | * | 6% | 4% | ** | 6% | 4% |
| Weighted average life | 3.7 yrs. | 8.2 yrs. | 9.4 yrs. | 4.0 yrs. | 7.9 yrs. | 9.0 yrs. |
| Expected credit losses (% of principal securitized) | .15% | .19% | 4.79% | —% | —% | 4.38% |
| Residual cash flows discounted at (weighted average) | 12.4% | 10.8% | 12.9% | 12% | 10.1% | 12.4% |

(1) No securitizations qualified for sale treatment in the period.

(2) The prepayment assumptions include the impact of projected defaults.

* 20 percent for 2006, 15 percent for 2007 and 10 percent thereafter.

** 20 percent for 2005, 15 percent for 2006 and 6 percent thereafter.





## 4. Student Loan Securitization (Continued)

***Retained Interest in Securitized Receivables***

The following tables summarize the fair value of the Company's Residual Interests, included in the Company's Retained Interest (and the assumptions used to value such Residual Interests), along with the underlying off-balance sheet student loans that relate to those securitizations in transactions that were treated as sales as of September 30, 2006 and December 31, 2005.

| (Dollars in millions) | As of September 30, 2006 FFELP Stafford and PLUS | Consolidation Loan Trusts[1] | Private Education Loan Trusts | Total |
|---|---|---|---|---|
| Fair value of Residual Interests[2] | $ 777 | $ 735 | $ 2,101 | $ 3,613 |
| Underlying securitized loan balance[3] | 16,916 | 18,254 | 13,365 | 48,535 |
| Weighted average life | 2.6 yrs. | 8.0 yrs. | 8.1 yrs | |
| Prepayment speed (annual rate)[4] | 10%-30%[5] | 6% | 4% | |
| Expected credit losses (% of student loan principal) | .06% | .07% | 4.67% | |
| Residual cash flows discount rate | 12.6% | 10.5% | 12.6% | |

| (Dollars in millions) | As of December 31, 2005 FFELP Stafford and PLUS | Consolidation Loan Trusts[1] | Private Education Loan Trusts | Total |
|---|---|---|---|---|
| Fair value of Residual Interests[2] | $ 773 | $ 483 | $ 1,150 | $ 2,406 |
| Underlying securitized loan balance[3] | 20,372 | 10,272 | 8,946 | 39,590 |
| Weighted average life | 2.7 yrs. | 8.0 yrs. | 7.8 yrs | |
| Prepayment speed (annual rate)[4] | 10%-20%[5] | 6% | 4% | |
| Expected credit losses (% of student loan principal) | .14% | .23% | 4.74% | |
| Residual cash flows discount rate | 12.3% | 10.3% | 12.4% | |

(1) Includes $176 million and $235 million related to the fair value of the Embedded Floor Income as of September 30, 2006 and December 31, 2005, respectively. Changes in the fair value of the Embedded Floor Income are primarily due to changes in the interest rates and the paydown of the underlying loans.

(2) At September 30, 2006 and December 31, 2005, the Company had unrealized gains (pre-tax) in accumulated other comprehensive income of $574 million and $370 million, respectively, that related to the Retained Interests, primarily those associated with off-balance sheet Private Education Loan trusts.

(3) In addition to student loans in off-balance sheet trusts, the Company had $43.0 billion and $40.9 billion of securitized student loans outstanding (face amount) as of September 30, 2006 and December 31, 2005, respectively, in on-balance sheet securitization trusts.

(4) The prepayment speed assumptions include the impact of projected defaults.

(5) 30% for the fourth quarter of 2006, 15% for 2007 and 10% thereafter for September 30, 2006 valuations and 20% for 2006, 15% for 2007 and 10% thereafter for December 31, 2005 valuations.





### 4. Student Loan Securitization (Continued)

The Company recorded $4 million and $171 million of impairment related to the Retained Interests for the three months ended September 30, 2006 and 2005, respectively and $148 million and $195 million of impairment related to the Retained Interests for the nine months ended September 30, 2006 and 2005, respectively. The impairment charges were primarily the result of FFELP Stafford loans prepaying faster than projected through loan consolidation ($97 million and $191 million for the nine months ended September 30, 2006 and 2005, respectively) and the effect of market interest rates on the Embedded Floor Income which is a part of the Retained Interest ($51 million and $4 million for the nine months ended September 30, 2006 and 2005, respectively). The level and timing of Consolidation Loan activity is highly volatile, and in response the Company continues to revise its estimates of the effects of Consolidation Loan activity on the Company's Retained Interests and it may result in additional impairment recorded in future periods if Consolidation Loan activity remains higher than projected.

The table below shows the Company's off-balance sheet Private Education Loan delinquency trends as of September 30, 2006, December 31, 2005 and September 30, 2005.

| | September 30, 2006 | | December 31, 2005 | | September 30, 2005 | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | Balance | % | Balance | % | Balance | % |
| Loans in-school/grace/deferment(1) | $ 6,861 | | $ 3,679 | | $ 3,272 | |
| Loans in forbearance(2) | 901 | | 614 | | 552 | |
| Loans in repayment and percentage of each status: | | | | | | |
| Loans current | 5,281 | 94.3% | 4,446 | 95.6% | 3,514 | 94.9% |
| Loans delinquent 31-60 days(3) | 164 | 2.9 | 136 | 2.9 | 94 | 2.5 |
| Loans delinquent 61-90 days(3) | 68 | 1.2 | 35 | .7 | 38 | 1.0 |
| Loans delinquent greater than 90 days(3) | 90 | 1.6 | 36 | .8 | 59 | 1.6 |
| Total off-balance sheet Private Education Loans in repayment | 5,603 | 100% | 4,653 | 100% | 3,705 | 100% |
| Total off-balance sheet Private Education Loans, gross | $ 13,365 | | $ 8,946 | | $ 7,529 | |

(1) Loans for borrowers who still may be attending school or engaging in other permitted educational activities and are not yet required to make payments on their loans, e.g., residency periods for medical students or a grace period for bar exam preparation.

(2) Loans for borrowers who have requested extension of grace period or who have temporarily ceased making full payments due to hardship or other factors. When loans exit forbearance status and enter repayment, they are initially included in current status.

(3) The period of delinquency is based on the number of days scheduled payments are contractually past due.





### 5. Derivative Financial Instruments

**Summary of Derivative Financial Statement Impact**

The following tables summarize the fair values and notional amounts or number of contracts of all derivative instruments at September 30, 2006 and December 31, 2005 and their impact on other comprehensive income and earnings for the three and nine months ended September 30, 2006 and 2005. At September 30, 2006 and December 31, 2005, $578 million (of which $92 million is in restricted cash and investments on the balance sheet) and $666 million (fair value), respectively, of available-for-sale investment securities and $74 million and $249 million, respectively, of cash were pledged as collateral against these derivative instruments.

| | Cash Flow | | Fair Value | | Trading | | Total | |
|---|---|---|---|---|---|---|---|---|
| (Dollars in millions) | September 30, 2006 | December 31, 2005 | September 30, 2006 | December 31, 2005 | September 30, 2006 | December 31, 2005 | September 30, 2006 | December 31, 2005 |
| **Fair Values** | | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Interest rate swaps | $ (12) | $ 5 | $ (380) | $ (347) | $ (21) | $ (48) | $ (413) | $ (390) |
| Floor/Cap contracts | — | — | — | — | (232) | (371) | (232) | (371) |
| Futures | — | — | — | — | (1) | (1) | (1) | (1) |
| Equity forwards | — | — | — | — | (56) | 67 | (56) | 67 |
| Cross currency interest rate swaps | — | — | 718 | (148) | — | — | 718 | (148) |
| Total | $ (12) | $ 5 | $ 338 | $ (495) | $ (310) | $ (353) | $ 16 | $ (843) |
| **(Dollars in billions)** | | | | | | | | |
| **Notional Values** | | | | | | | | |
| Interest rate swaps | $ 2.2 | $ 1.2 | $ 15.2 | $ 14.6 | $ 148.8 | $ 125.4 | $ 166.2 | $ 141.2 |
| Floor/Cap contracts | — | — | — | — | 38.6 | 41.8 | 38.6 | 41.8 |
| Futures | .1 | .1 | — | — | .6 | .6 | .7 | .7 |
| Cross currency interest rate swaps | — | — | 20.9 | 18.6 | — | — | 20.9 | 18.6 |
| Other[1] | — | — | — | — | 2.0 | 2.0 | 2.0 | 2.0 |
| Total | $ 2.3 | $ 1.3 | $ 36.1 | $ 33.2 | $ 190.0 | $ 169.8 | $ 228.4 | $ 204.3 |
| **(Shares in millions)** | | | | | | | | |
| **Contracts** | | | | | | | | |
| Equity forwards | — | — | — | — | 48.1 | 42.7 | 48.1 | 42.7 |

(1) "Other" consists of an embedded derivative bifurcated from the convertible debenture issuance that relates primarily to certain contingent interest and conversion features of the debt. The embedded derivative has had a *de minimis* fair value since inception.





## 5. Derivative Financial Instruments (Continued)

| | Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Cash Flow | | Fair Value | | Trading | | Total | |
| **(Dollars in millions)** | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| ***Changes to accumulated other comprehensive income, net of tax*** | | | | | | | | |
| Change in fair value to cash flow hedges | $ (11) | $ (2) | $ — | $ — | $ — | $ — | $ (11) | $ (2) |
| Amortization of effective hedges and transition adjustment[1] | 4 | 5 | — | — | — | — | 4 | 5 |
| Change in accumulated other comprehensive income, net | $ (7) | $ 3 | $ — | $ — | $ — | $ — | $ (7) | $ 3 |
| ***Earnings Summary*** | | | | | | | | |
| Amortization of closed futures contracts' gains/losses in interest expense[2] | $ (6) | $ (9) | $ — | $ — | $ — | $ — | $ (6) | $ (9) |
| Gains (losses) on derivative and hedging activities—Realized[3] | — | — | — | — | (18) | (93) | (18) | (93) |
| Gains (losses) on derivative and hedging activities—Unrealized[4] | — | — | (20) | 8 | (93) | 401 | (113) | 409 |
| Total earnings impact | $ (6) | $ (9) | $ (20) | $ 8 | $ (111) | $ 308 | $ (137) | $ 307 |

(1) The Company expects to amortize $3 million of after-tax net losses from accumulated other comprehensive income to earnings during the next 12 months related to closed futures contracts that were hedging the forecasted issuance of debt instruments that are outstanding as of September 30, 2006.

(2) For futures contracts that qualify as SFAS No. 133 hedges where the hedged transaction occurs.

(3) Includes net settlement income/expense related to trading derivatives and realized gains and losses related to derivative dispositions.

(4) The change in the fair value of cash flow and fair value hedges represents amounts related to ineffectiveness.





## 5. Derivative Financial Instruments (Continued)

| | Nine Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Cash Flow | | Fair Value | | Trading | | Total | |
| **(Dollars in millions)** | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| ***Changes to accumulated other comprehensive income, net of tax*** | | | | | | | | |
| Change in fair value to cash flow hedges | $ (9) | $ (15) | $ — | $ — | $ — | $ — | $ (9) | $ (15) |
| Amortization of effective hedges and transition adjustment(1) | 11 | 20 | — | — | — | — | 11 | 20 |
| Change in accumulated other comprehensive income, net | $ 2 | $ 5 | $ — | $ — | $ — | $ — | $ 2 | $ 5 |
| ***Earnings Summary*** | | | | | | | | |
| Amortization of closed futures contracts' gains/losses in interest expense(2) | $ (17) | $ (32) | $ — | $ — | $ — | $ — | $ (17) | $ (32) |
| Gains (losses) on derivative and hedging activities—Realized(3) | — | — | — | — | (107) | (309) | (107) | (309) |
| Gains (losses) on derivative and hedging activities—Unrealized(4) | — | — | 23 | (4) | (11) | 489 | 12 | 485 |
| Total earnings impact | $ (17) | $ (32) | $ 23 | $ (4) | $ (118) | $ 180 | $ (112) | $ 144 |

(1) The Company expects to amortize $3  million of after-tax net losses from accumulated other comprehensive income to earnings during the next 12 months related to closed futures contracts that were hedging the forecasted issuance of debt instruments that are outstanding as of September 30, 2006.

(2) For futures contracts that qualify as SFAS No. 133 hedges where the hedged transaction occurs.

(3) Includes net settlement income/expense related to trading derivatives and realized gains and losses related to derivative dispositions.

(4) The change in the fair value of cash flow and fair value hedges represents amounts related to ineffectiveness.





## 6. Stockholders' Equity

The following table summarizes the Company's common share repurchases, issuances and equity forward activity for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| **(Shares in millions)** | **2006** | **2005** | **2006** | **2005** |
| Common shares repurchased: | | | | |
| Open market | 2.2 | — | 2.2 | — |
| Equity forwards | .9 | 2.9 | 5.4 | 9.4 |
| Benefit plans(1) | .1 | .5 | 1.4 | 1.0 |
| Total shares repurchased | 3.2 | 3.4 | 9.0 | 10.4 |
| Average purchase price per share | $48.76 | $50.12 | $52.55 | $49.67 |
| Common shares issued | .8 | 1.8 | 5.2 | 5.3 |
| Equity forward contracts: | | | | |
| Outstanding at beginning of period | 45.9 | 51.7 | 42.7 | 42.8 |
| New contracts | 3.1 | 1.4 | 10.8 | 16.8 |
| Exercises | (.9) | (2.9) | (5.4) | (9.4) |
| Outstanding at end of period | 48.1 | 50.2 | 48.1 | 50.2 |
| Authority remaining at end of period to repurchase or enter into equity forwards | 5.7 | 19.0 | 5.7 | 19.0 |

(1) Includes shares withheld from stock option exercises and vesting of performance stock to satisfy minimum statutory tax withholding obligations and shares tendered by employees to satisfy option exercise costs.

As of September 30, 2006, the expiration dates and purchase prices for outstanding equity forward contracts were as follows:

| Year of Maturity (Contracts in millions of shares) | Outstanding Contracts | Range of Purchase Prices | Average Purchase Price |
|---|---|---|---|
| 2008 | 7.3 | $54.74 | $ 54.74 |
| 2009 | 14.7 | 54.74 | 54.74 |
| 2010 | 15.0 | 54.74 | 54.74 |
| 2011 | 9.0 | 50.30 – 53.76 | 52.72 |
| 2012 | 2.1 | 46.30 – 46.70 | 46.40 |
| | 48.1 | | $ 54.00 |

The closing price of the Company's common stock on September 30, 2006 was $51.98.

SLM CORPORATION

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**(Information at September 30, 2006 and for the three and nine months ended September 30, 2006 and 2005 is unaudited)**
**(Dollars in thousands, except per share amounts, unless otherwise noted)**

**6. Stockholders' Equity (Continued)**

***Accumulated Other Comprehensive Income***

Accumulated other comprehensive income includes the after-tax change in unrealized gains and losses on available-for-sale investments, unrealized gains and losses on derivatives qualifying as cash flow hedges, and the minimum pension liability adjustment. The following table presents the cumulative balances of the components of other comprehensive income as of September 30, 2006, December 31, 2005 and September 30, 2005.

| | September 30, 2006 | December 31, 2005 | September 30, 2005 |
|---|---|---|---|
| Net unrealized gains (losses) on investments(1) | $ 473,671 | $ 382,316 | $ 429,438 |
| Net unrealized gains (losses) on derivatives(2) | (11,304) | (12,560) | (20,626) |
| Minimum pension liability adjustment(3) | (1,840) | (1,846) | (1,044) |
| Total accumulated other comprehensive income | $ 460,527 | $ 367,910 | $ 407,768 |

(1) Net of tax expense of $251,941, $203,495 and $229,426 as of September 30, 2006, December 31, 2005 and September 30, 2005, respectively.

(2) Net of tax benefit of $6,512, $4,667 and $9,392 as of September 30, 2006, December 31, 2005 and September 30, 2005, respectively.

(3) Net of tax benefit of $991, $994 and $562 as of September 30, 2006, December 31, 2005 and September 30, 2005, respectively.



SLM CORPORATION

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**(Information at September 30, 2006 and for the three and nine months ended September 30, 2006 and 2005 is unaudited)**
**(Dollars in thousands, except per share amounts, unless otherwise noted)**

**7. Earnings per Common Share**

Basic earnings per common share ("EPS") is calculated using the weighted average number of shares of common stock outstanding during each period. A reconciliation of the numerators and denominators of the basic and diluted EPS calculations is as follows for the three and nine months ended September 30, 2006 and 2005:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| **Numerator:** | | | | |
| Net income attributable to common stock | $ 254,251 | $ 424,062 | $ 1,112,542 | $ 937,178 |
| Adjusted for debt expense of convertible debentures ("Co-Cos"), net of taxes(1) | 17,962 | 11,971 | 49,239 | 30,887 |
| Adjusted for non-taxable unrealized gains on equity forwards(2) | (707) | — | (3,528) | — |
| Net income attributable to common stock, adjusted | $ 271,506 | $ 436,033 | $ 1,158,253 | $ 968,065 |
| **Denominator *(shares in thousands):*** | | | | |
| Weighted average shares used to compute basic EPS | 410,034 | 417,235 | 411,212 | 419,205 |
| Effect of dilutive securities: | | | | |
| Dilutive effect of Co-Cos | 30,312 | 30,312 | 30,312 | 30,312 |
| Dilutive effect of stock options, nonvested deferred compensation, nonvested restricted stock, restricted stock units, Employee Stock Purchase Plan ("ESPP") and equity forwards(3)(4) | 9,495 | 11,251 | 10,488 | 11,705 |
| Dilutive potential common shares(5) | 39,807 | 41,563 | 40,800 | 42,017 |
| Weighted average shares used to compute diluted EPS | 449,841 | 458,798 | 452,012 | 461,222 |
| **Net earnings per share:** | | | | |
| Basic EPS | $ .62 | $ 1.02 | $ 2.71 | $ 2.24 |
| Dilutive effect of Co-Cos(1) | — | (.04) | (.07) | (.08) |
| Dilutive effect of equity forwards(2)(4) | (.01) | — | (.01) | — |
| Dilutive effect of stock options, nonvested deferred compensation, nonvested restricted stock, restricted stock units, and ESPP(3) | (.01) | (.03) | (.07) | (.06) |
| Diluted EPS | $ .60 | $ .95 | $ 2.56 | $ 2.10 |

(1) Emerging Issues Task Force ("EITF") Issue No. 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share," requires the shares underlying Co-Cos to be included in diluted EPS computations regardless of whether the market price trigger or the conversion price has been met, using the "if-converted" method.

(2) SFAS No. 128, "Earnings per Share," and the additional guidance provided by EITF Topic No. D-72, "Effect of Contracts That May Be Settled in Stock or Cash on the Computation of Diluted Earnings per Share," require both the denominator and the numerator to be adjusted in calculating the potential impact of the Company's equity forward contracts on diluted EPS. Under this

(Dollars in thousands, except per share amounts, unless otherwise noted)

guidance, when certain conditions are satisfied, the impact can be dilutive when: (1) the average share price during the period is lower than the respective strike prices on the Company's equity forward contracts, and (2) the Company recorded an unrealized gain or loss on derivative and hedging activities related to its equity forward contracts.

(3) Reflects the potential dilutive effect of additional common shares that are issuable upon exercise of outstanding stock options, nonvested deferred compensation, nonvested restricted stock, restricted stock units, and the outstanding commitment to issue shares under the ESPP, determined by the treasury stock method.

(4) Reflects the potential dilutive effect of equity forward contracts, determined by the reverse treasury stock method.

(5) For the three months ended September 30, 2006 and 2005, stock options and equity forwards of approximately 60 million shares and 50 million shares, respectively, and for the nine months ended September 30, 2006 and 2005, stock options and equity forwards of approximately 54 million shares and 19 million shares, respectively, were outstanding but not included in the computation of diluted earnings per share because they were antidilutive.





## 8. Stock-Based Compensation Plans

The Company has various stock-based compensation programs, which include stock options, restricted stock units, restricted stock, performance stock, and the ESPP.

The SLM Corporation Incentive Plan (the "Incentive Plan") was approved by shareholders in 2004 and amended in 2005. A total of 17.2 million shares are authorized to be issued from this plan. Upon approval of the Incentive Plan, the Company discontinued the Employee Stock Option Plan (the "ESOP") and Management Incentive Plan (the "MIP"). Shares available for future issuance under the ESOP and MIP were canceled; however, terms of outstanding grants remain unchanged. Awards under the Incentive Plan may be in the form of stock, stock options, performance stock, restricted stock and restricted stock units. Stock-based compensation is also granted to non-employee directors of the Company under the shareholder-approved Directors Stock Plan. A total of 9.3 million shares are authorized to be issued from this plan and awards may be in the form of stock options and stock. The Company's non-employee directors are considered employees under the provisions of SFAS No. 123(R). The shares issued under the Incentive Plan, the Directors Stock Plan and the ESPP may be either shares reacquired by the Company or shares that are authorized but unissued.

An amount equal to the dividends payable on the Company's common stock ("dividend equivalents") is credited on "full value" stock-based compensation awards, which are nonvested performance stock, nonvested restricted stock and restricted stock units, and on share amounts credited under deferred compensation arrangements. Dividend equivalents are not credited on stock option awards.

The total stock-based compensation cost recognized in the consolidated statements of income for the three and nine months ended September 30, 2006 was $19 million and $58 million, respectively. The related income tax benefit for the three and nine months ended September 30, 2006 was $8 million and $22 million, respectively. As of September 30, 2006, there was $74 million of total unrecognized compensation cost related to stock-based compensation programs. That cost is expected to be recognized over a weighted average period of 2.1 years.

### *Stock Options*

Under the Incentive Plan, ESOP and MIP, the maximum term for stock options is 10 years and the exercise price must be equal to or greater than the market price of SLM common stock on the date of grant. Stock options granted to officers and management employees under the plans generally vest upon the Company's common stock price reaching a closing price equal to or greater than 20 percent above the fair market value of the common stock on the date of grant for five days, but no earlier than 12 months from the grant date. Stock options granted to members of executive management have included more difficult price vesting targets and are more fully disclosed in Exhibits 10.13, 10.14 and 10.23 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005. In any event, all options vest upon the eighth anniversary of their grant date. Options granted to rank-and-file employees are time-vested with the grants vesting one-half in 18 months from their grant date and the second one-half vesting 36 months from their grant date.

Under the Directors Stock Plan, the maximum term for stock options is 10 years and the exercise price must be equal to or greater than the market price of the Company's common stock on the date of grant.





## 8. Stock-Based Compensation Plans (Continued)

Stock options granted to directors are generally subject to the following vesting schedule: all options vest upon the Company's common stock price reaching a closing price equal to or greater than 20 percent above the fair market value of the common stock on the date of grant for five days or the director's election to the Board, whichever occurs later. In any event, all options vest upon the fifth anniversary of their grant date.

The fair values of the options granted in the three and nine months ended September 30, 2006 and 2005 were estimated as of the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |

| | | | | |
|---|---|---|---|---|
| Risk free interest rate | 5.15% | 3.98% | 4.75% | 3.63% |
| Expected volatility | 19.62% | 22.13% | 20.23% | 21.66% |
| Expected dividend rate | 1.91% | 1.72% | 1.71% | 1.52% |
| Expected life of the option | 3 years | 3 years | 3 years | 3 years |

The expected life of the options is based on observed historical exercise patterns. Groups of employees that have received similar option grant terms were considered separately for valuation purposes. The expected volatility is based on implied volatility from publicly-traded options on the Company's stock at the date of grant and historical volatility of the Company's stock. The risk-free interest rate is based on the U.S. Treasury spot rate consistent with the expected term of the option. The dividend yield is based on the projected annual dividend payment per share, divided by the stock price at the date of grant.

As of September 30, 2006, there was $54 million of unrecognized compensation cost related to stock options, which is expected to be recognized over a weighted average period of 2.1 years.

The following table summarizes stock option activity for the nine months ended September 30, 2006.

| | Number of Options | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2005 | 41,484,567 | $ 34.52 | | |
| Granted—direct options | 6,732,825 | 54.45 | | |
| Granted—replacement options | 100,478 | 54.78 | | |
| Exercised | (4,483,534) | 30.78 | | |
| Canceled | (1,121,375) | 49.87 | | |
| Outstanding at September 30, 2006 | 42,712,961 | $ 37.71 | 6.77 yrs | $ 610 million |
| Exercisable at September 30, 2006 | 27,051,267 | $ 30.03 | 5.57 yrs | $ 594 million |





**8. Stock-Based Compensation Plans (Continued)**

The weighted average fair value of options granted was $8.09 and $9.31 for the three months ended September 30, 2006 and 2005, respectively, and $9.37 and $8.98 for the nine months ended September 30, 2006 and 2005, respectively. The total intrinsic value of options exercised was $16 million and $37 million for the three months ended September 30, 2006 and 2005, respectively, and $104 million and $92 million for the nine months ended September 30, 2006 and 2005, respectively.

Cash received from option exercises was $23 million and $44 million for the three months ended September 30, 2006 and 2005, respectively, and $111 million and $137 million for the nine months ended September 30, 2006 and 2005, respectively. The actual tax benefit realized for the tax deductions from option exercises totaled $7 million and $15 million, respectively, for the three months ended September 30, 2006 and 2005, and $37 million and $37 million, respectively, for the nine months ended September 30, 2006 and 2005.

***Restricted Stock***

Restricted stock granted under the Incentive Plan may vest no sooner than three years from grant date or may vest ratably over three years. Performance stock granted must vest over a minimum of a 12-month performance period. Performance criteria may include the achievement of any of several financial and business goals, such as "Core Earnings" per share, loan volume, market share, overhead or other expense reduction, or "Core Earnings" net income.

In accordance with SFAS No. 123(R), the fair value of restricted stock awards is estimated on the date of grant based on the market price of the stock and is amortized to compensation expense on a straight-line basis over the related vesting periods. As of September 30, 2006, there was $11 million of unrecognized compensation cost related to restricted stock, which is expected to be recognized over a weighted average period of 2.5 years.

The following table summarizes restricted stock activity for the nine months ended September 30, 2006.

| | Number of Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Nonvested at December 31, 2005 | 357,444 | $ 44.34 |
| Granted | 163,398 | 55.82 |
| Vested | (76,949) | 41.58 |
| Canceled | (35,167) | 42.44 |
| Nonvested at September 30, 2006 | 408,726 | $ 49.61 |

The total fair value of shares that vested during the three months ended September 30, 2006 and 2005 was $1 million and $2 million, respectively. The total fair value of shares that vested during the nine months ended September 30, 2006 and 2005 was $3 million and $5 million, respectively.

(Dollars in thousands, except per share amounts, unless otherwise noted)

**8. Stock-Based Compensation Plans (Continued)**

***Restricted Stock Units***

The Company has granted restricted stock units ("RSUs") to certain executive management employees. RSUs are subject to continued employment and generally vest over two to five years. Conversion of vested RSUs to common stock is deferred until the employees' retirement or termination of employment. The fair value of each grant is estimated on the date of grant based on the market price of the stock and is amortized to compensation expense on a straight-line basis over the related vesting periods. As of September 30, 2006, there was $8 million of unrecognized compensation cost related to RSUs, which is expected to be recognized over a weighted average period of 2.1 years.

The following table summarizes RSU activity for the nine months ended September 30, 2006.

| | Number of RSUs | Weighted Average Grant Date Fair Value |
|---|---|---|
| Outstanding at December 31, 2005 | 840,000 | $ 34.81 |
| Granted | 100,000 | 55.82 |
| Vested | — | — |
| Canceled | — | — |
| Converted to common stock | (300,000) | 31.93 |
| Outstanding at September 30, 2006 | 640,000 | $ 39.45 |

There were 31,536 dividend equivalents on outstanding RSUs at September 30, 2006.

The total fair value of RSUs that vested during the nine months ended September 30, 2005 was $10 million. There were no RSUs that vested in the current period. The total intrinsic value of RSUs converted to common stock during the nine months ended September 30, 2006 was $10 million. There were no RSUs converted to common stock in the year-ago period.

***Employee Stock Purchase Plan***

Employees may purchase shares of the Company's common stock under the ESPP at the end of a 24-month period at a price equal to the share price at the beginning of the 24-month period, less 15 percent, up to a maximum purchase price of $10,000 plus accrued interest. There are four ESPP offerings a year, one per quarter, and the purchase price for each offering is determined at the beginning of the offering period. The total number of shares which may be sold pursuant to the plan may not exceed 7.6 million shares, of which 1.2 million shares remained available at September 30, 2006.





**8. Stock-Based Compensation Plans (Continued)**

The fair values of the stock purchase rights of the ESPP offerings in the three and nine months ended September 30, 2006 were calculated using a Black-Scholes option pricing model with the following weighted average assumptions.

| | Three Months Ended September 30, 2006 | Nine Months Ended September 30, 2006 |
|---|---|---|
| Risk free interest rate | 4.98% | 4.81% |
| Expected volatility | 19.85% | 19.68% |
| Expected dividend rate | 2.00% | 1.80% |
| Expected life | 2 years | 2 years |

The expected volatility is based on implied volatility from publicly-traded options on the Company's stock at the date of grant and historical volatility of the Company's stock. The risk-free interest rate is based on the U.S. Treasury spot rate consistent with the expected term. The dividend yield is based on the projected annual dividend payment per share, divided by the stock price at the date of grant.

The weighted average fair values of the stock purchase rights of the ESPP offerings in the three and nine months ended September 30, 2006 were $11.02 and $11.77, respectively. The fair value is amortized to compensation cost on a straight-line basis over a two-year vesting period. As of September 30, 2006, there was $1 million of unrecognized compensation cost related to ESPP, which is expected to be recognized over a weighted average period of 1.1 years.

During the three and nine months ended September 30, 2006, 40,862 shares and 109,558 shares, respectively, of the Company's common stock were purchased by plan participants.

**9. Pension Plans**

(Dollars in thousands, except per share amounts, unless otherwise noted)

### Components of Net Periodic Pension Cost

Net periodic pension cost included the following components:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Service cost—benefits earned during the period | $ 2,072 | $ 2,474 | $ 6,218 | $ 7,420 |
| Interest cost on project benefit obligations | 2,862 | 2,805 | 8,586 | 8,417 |
| Expected return on plan assets | (4,070) | (4,109) | (12,208) | (12,326) |
| Net amortization and deferral | 123 | (30) | 367 | (89) |
| Total net periodic pension cost | $ 987 | $ 1,140 | $ 2,963 | $ 3,422 |

### Employer Contributions

The Company previously disclosed in its financial statements for the year ended December 31, 2005 that it did not expect to contribute to its qualified pension plan (the "Qualified Plan") in 2006. As of September 30, 2006, the Company had made no contributions to its Qualified Plan.





### 10. Contingencies

The Company was named as a defendant in a putative class action lawsuit brought by three Wisconsin residents on December 20, 2001 in the Superior Court for the District of Columbia. The lawsuit sought to bring a nationwide class action on behalf of all borrowers who allegedly paid "undisclosed improper and excessive" late fees over the past three years. The plaintiffs sought damages of $1,500 per violation plus punitive damages and claimed that the class consisted of two million borrowers. In addition, the plaintiffs alleged that the Company charged excessive interest by capitalizing interest quarterly in violation of the promissory note. On February 27, 2003, the Superior Court granted the Company's motion to dismiss the complaint in its entirety. On March 4, 2004, the District of Columbia Court of Appeals affirmed the Superior Court's decision granting the Company's motion to dismiss the complaint, but granted plaintiffs leave to re-plead the first count, which alleged violations of the D.C. Consumer Protection Procedures Act. On September 15, 2004, the plaintiffs filed an amended class action complaint. On October 15, 2004, the Company filed a motion to dismiss the amended complaint with the Superior Court for failure to state a claim and non-compliance with the Court of Appeals' ruling. On December 27, 2004, the Superior Court granted the Company's motion to dismiss the plaintiffs' amended complaint. Plaintiffs appealed the Superior Court's dismissal order to the Court of Appeals. On June 8, 2006, the Court of Appeals issued an opinion reversing the order of the trial court dismissing the amended complaint. The Court of Appeals did not address the merits of the complaint but concluded that the trial court improperly relied upon facts extrinsic to the complaint. The Court of Appeals noted in its decision that the plaintiffs failed to file a motion for class certification within the time required by the District of Columbia rules. The trial court conducted a status conference on August 18, 2006, and set a briefing schedule for the issue of whether plaintiffs have waived their right to move for class certification. Sallie Mae filed its answer and on September 1, 2006, Sallie Mae filed its opening brief, plaintiffs have opposed and Sallie Mae filed a reply. This motion is pending. Plaintiff also filed a motion to strike Sallie Mae's answer on September 1, 2006. Sallie Mae opposed this motion and it is pending. While these motions have been pending, the trial judge recused herself and the case will be reassigned to another Superior Court Judge. The Company does not believe that it is reasonably likely that a nationwide class will be certified.

The Company is also subject to various claims, lawsuits and other actions that arise in the normal course of business. Most of these matters are claims by borrowers disputing the manner in which their loans have been processed or the accuracy of the Company's reports to credit bureaus. In addition, the collections subsidiaries in the Company's debt management operation group are occasionally named in individual plaintiff or class action lawsuits in which the plaintiffs allege that the Company has violated a federal or state law in the process of collecting their account. Management believes that these claims, lawsuits and other actions will not have a material adverse effect on its business, financial condition or results of operations.

### Inspector General Audit of Nelnet on Special Allowance Payments

On September 29, 2006, the U.S. Department of Education's Office of Inspector General ("OIG") issued a Final Audit Report on "Special Allowance Payments to Nelnet for Loans Funded by Tax-Exempt Obligations." In the report, the OIG concluded that Nelnet may have been improperly paid more than $278 million in SAP from January 1, 2003 to June 30, 2005. Under the Higher Education Act ("HEA"), FFELP student loans funded by tax-exempt obligations originally issued before October 1, 1993 are only eligible to receive one-half of the SAP rate that would otherwise be payable, but the quarterly SAP rate must not be less than 9.5 percent, less the interest the lender receives from the borrower or the





### 10. Contingencies (Continued)

government ("9.5 percent SAP"). In the report, the OIG claims that the loans were not acquired with funds from an eligible source in compliance with the HEA or the regulations or guidance issued by the Department of Education ("ED"). The Company believes that the OIG's legal analysis is incorrect and is inconsistent with well established ED guidance. The Secretary of ED may reject the OIG's findings. In May 2005, the OIG issued a Final Audit Report on 9.5 percent SAP payments to New Mexico Educational Assistance Foundation that contained findings on different issues but that were also inconsistent with well established guidance; the Secretary subsequently rejected those findings. Nevertheless, there can be no assurance that the Secretary will reject the OIG's findings and recommendations that Nelnet return past and forgo prospective 9.5 percent SAP payments. In the event the Secretary accepts the OIG's finding regarding Nelnet, it is possible that other holders of 9.5 percent SAP loans, including Sallie Mae, could be directed to calculate SAP in accordance with the OIG's interpretation and return funds to ED. As of September 30, 2006 and 2005, Sallie Mae held approximately $550 million and $1.4 billion, respectively, in 9.5 percent SAP loans, which were inherited by acquiring four non-profit lending agencies. At this time, the Company cannot predict the likelihood of such an outcome or the time period it might cover.

**11. Segment Reporting**

The Company has two primary operating segments as defined in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information"—the Lending and Debt Management Operations ("DMO") segments. The Lending and DMO operating segments meet the quantitative thresholds for reportable segments identified in SFAS No. 131. Accordingly, the results of operations of the Company's Lending and DMO segments are presented below. The Company has smaller operating segments including the Guarantor Servicing and Student Loan Servicing operating segments as well as certain other products and services provided to colleges and universities which do not meet the quantitative thresholds identified in SFAS No. 131. Therefore, the results of operations for these operating segments and the revenues and expenses associated with these other products and services are combined with corporate overhead and other corporate activities within the Corporate and Other reporting segment.

The management reporting process measures the performance of the Company's operating segments based on the management structure of the Company as well as the methodology used by management to evaluate performance and allocate resources. Management, including the Company's chief operating decision maker, evaluates the performance of the Company's operating segments based on their profitability. As discussed further below, management measures the profitability of the Company's operating segments based on "Core Earnings" net income. Accordingly, information regarding the Company's reportable segments is provided based on a "Core Earnings" basis. The Company's "Core Earnings" performance measures are not defined terms within GAAP and may not be comparable to similarly titled measures reported by other companies. "Core Earnings" net income reflects only current period adjustments to GAAP net income as described below. Unlike financial accounting, there is no comprehensive, authoritative guidance for management reporting. The management reporting process measures the performance of the operating segments based on the management structure of the Company and is not necessarily comparable with similar information for any other financial institution. The Company's operating segments are defined by the products and services they offer or the types of customers they serve, and they reflect the manner in which financial information is currently evaluated by management. Intersegment revenues and expenses are netted within the appropriate financial statement





**11. Segment Reporting (Continued)**

line items consistent with the income statement presentation provided to management. Changes in management structure or allocation methodologies and procedures may result in changes in reported segment financial information.

The Company's principal operations are located in the United States, and its results of operations and long-lived assets in geographic regions outside of the United States are not significant. In the Lending segment, no individual customer accounted for more than 10 percent of its total revenue during the nine months ended September 30, 2006 and 2005. United Student Aid Funds, Inc. ("USA Funds") is the Company's largest customer in both the DMO and Corporate and Other segments. During the nine months ending September 30, 2006 and 2005, it accounted for 32 percent and 38 percent, respectively, of the aggregate revenues generated by the Company's DMO and Corporate and Other segments. No other customers accounted for more than 10 percent of total revenues in those segments for the years mentioned.

***Lending***

In the Company's Lending business segment, the Company originates and acquires both federally guaranteed student loans, which are administered by the U.S. Department of Education ("ED"), and Private Education Loans, which are not federally guaranteed. Private Education Loans are primarily used by borrowers to supplement FFELP loans to meet the rising cost of education. The Company manages student loans for nearly 10 million student and parent customers; its Managed student loan portfolio totaled $136.9 billion at September 30, 2006, of which $115.7 billion or 85 percent are federally insured. In addition to education lending, the Company also originates mortgage and consumer loans with the intent of selling the majority of such loans. During the nine months ended September 30, 2006, the Company originated $1.3 billion in mortgage and consumer loans of which $1.0 billion pertained to mortgages in the held for sale portfolio. The Company's mortgage and consumer loan portfolio totaled $667 million at September 30, 2006.

In addition to its federally insured FFELP products, the Company originates and acquires Private Education Loans which consist of two general types: (1) those that are designed to bridge the gap between the cost of higher education and the amount financed through either capped federally insured loans or the borrowers' resources, and (2) those that are used to meet the needs of students in alternative learning programs such as career training, distance learning and lifelong learning programs. Most higher education Private Education Loans are made in conjunction with a FFELP Stafford loan and as such are marketed through the same channel as FFELP loans by the same sales force. Unlike FFELP loans, Private Education Loans are subject to the full credit risk of the borrower. The Company manages this additional risk through industry-tested loan underwriting standards and a combination of higher interest rates and loan origination fees that compensate the Company for the higher risk.

***DMO***

The Company provides a wide range of accounts receivable and collections services through six operating units that comprise its DMO operating segment. These services include defaulted student loan portfolio management services, contingency collections services for student loans and other asset classes, student loan default aversion services, and accounts receivable management and collection for purchased

**11. Segment Reporting (Continued)**

portfolios of receivables that have been charged off by their original creditors, as well as sub-performing and nonperforming mortgage loans. The Company's DMO operating segment primarily serves the student loan marketplace through a broad array of default management services on a contingency fee or other pay-for-performance basis to 14 FFELP guarantors and for campus-based programs.

In addition to collecting on its own purchased receivables and mortgage loans, the DMO operating segment provides receivable management and collection services for large federal agencies, credit card clients and other holders of consumer debt.

***Corporate and Other***

The Company's Corporate and Other business segment includes the aggregate activity of its smaller operating segments, including its Guarantor Servicing and Loan Servicing business segments, other products and services as well as corporate overhead.

In the Guarantor Servicing operating segment, the Company provides a full complement of administrative services to FFELP guarantors including guarantee issuance, account maintenance, and guarantee fulfillment. In the Loan Servicing operating segment, the Company provides a full complement of activities required to service student loans on behalf of lenders who are unrelated to the Company. Such servicing activities generally commence once a loan has been fully disbursed and include sending out payment coupons to borrowers, processing borrower payments, originating and disbursing Consolidation Loans on behalf of the lender, and other administrative activities required by ED. The Company's other products and services include comprehensive financing and loan delivery solutions that it provides to college financial aid offices and students to streamline the financial aid process. Corporate overhead includes all of the typical headquarter functions such as executive management, accounting and finance, human resources and marketing.

***Measure of Profitability***

The tables below include the condensed operating results for each of the Company's reportable segments. Management, including the chief operating decision maker, evaluates the Company on certain performance measures that the Company refers to as "Core Earnings" performance measures for each operating segment. While "Core Earnings" results are not a substitute for reported results under GAAP, the Company relies on "Core Earnings" performance measures to manage each operating segment because it believes these measures provide additional information regarding the operational and performance indicators that are most closely assessed by management.

"Core Earnings" performance measures are the primary financial performance measures used by management to develop the Company's financial plans, track results, and establish corporate performance targets and incentive compensation. Management believes this information provides additional insight into the financial performance of the core business activities of its operating segments. Accordingly, the tables presented below reflect "Core Earnings" operating measures reviewed and utilized by management to manage the business. Reconciliations of the "Core Earnings" segment totals to the Company's consolidated operating results in accordance with GAAP are also included in the tables below.





**11. Segment Reporting (Continued)**

***Segment Results and Reconciliations to GAAP***

| | Three Months Ended September 30, 2006 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | Lending | DMO | Corporate and Other | Total "Core Earnings" | Adjustments[3] | Total GAAP |
| Interest income: | | | | | | |
| FFELP Stafford and Other Student Loans | $ 702 | $ — | $ — | $ 702 | $ (337) | $ 365 |
| Consolidation Loans | 1,242 | — | — | 1,242 | (326) | 916 |
| Private Education Loans | 558 | — | — | 558 | (303) | 255 |
| Other loans | 24 | — | — | 24 | — | 24 |
| Cash and investments | 207 | — | 3 | 210 | (69) | 141 |
| Total interest income | 2,733 | — | 3 | 2,736 | (1,035) | 1,701 |
| Total interest expense | 2,124 | 6 | 4 | 2,134 | (771) | 1,363 |
| Net interest income | 609 | (6) | (1) | 602 | (264) | 338 |
| Less: provisions for losses | 80 | — | — | 80 | (13) | 67 |
| Net interest income after provisions for losses | 529 | (6) | (1) | 522 | (251) | 271 |
| Fee income | — | 122 | 39 | 161 | — | 161 |
| Collections revenue | — | 58 | — | 58 | — | 58 |
| Other income | 46 | — | 41 | 87 | 245 | 332 |
| Operating expenses[1] | 156 | 91 | 70 | 317 | 37 | 354 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 419 | 83 | 9 | 511 | (43) | 468 |
| Income tax expense[2] | 155 | 31 | 3 | 189 | 15 | 204 |
| Minority interest in net earnings of subsidiaries | — | 1 | — | 1 | — | 1 |
| Net income | $ 264 | $ 51 | $ 6 | $ 321 | $ (58) | $ 263 |

(1) Operating expenses for the Lending, DMO, and Corporate and Other Business segments include $8 million, $4 million, and $4 million, respectively, of stock-based compensation expense due to the implementation of SFAS No. 123(R) in the first quarter of 2006.

(2) Income taxes are based on a percentage of net income (loss) before tax for the individual reportable segment.

(3) "Core Earnings" adjustments to GAAP:

| (Dollars in millions) | Three Months Ended September 30, 2006 Net Impact of Securitization Accounting | Net Impact of Derivative Accounting | Net Impact of Floor Income | Net Impact of Acquired Intangibles[(A)] | Total |
|---|---|---|---|---|---|
| Net interest income | $ (229) | $ 18 | $ (53) | $ — | $ (264) |
| Less: provisions for losses | (13) | — | — | — | (13) |
| Net interest income after provisions for losses | (216) | 18 | (53) | — | (251) |
| Fee income | — | — | — | — | — |
| Collections revenue | — | — | — | — | — |
| Other income | 376 | (131) | — | — | 245 |
| Operating expenses | — | — | — | 37 | 37 |
| Total pre-tax "Core Earnings" adjustments to GAAP | $ 160 | $ (113) | $ (53) | $ (37) | (43) |
| Income tax expense | | | | | 15 |
| Minority interest in net earnings of subsidiaries | | | | | — |
| Total "Core Earnings" adjustments to GAAP | | | | | $ (58) |

(A) Represents goodwill and intangible impairment and the amortization of acquired intangibles.





## 11. Segment Reporting (Continued)

| | Three Months Ended September 30, 2005 Lending | DMO | Corporate and Other | Total "Core Earnings" | Adjustments[(3)] | Total GAAP |
|---|---|---|---|---|---|---|
| Interest income: | | | | | | |
| FFELP Stafford and Other Student Loans | $ 586 | $ — | $ — | $ 586 | $ (316) | $ 270 |
| Consolidation Loans | 833 | — | — | 833 | (156) | 677 |
| Private Education Loans | 312 | — | — | 312 | (138) | 174 |
| Other loans | 22 | — | — | 22 | — | 22 |
| Cash and investments | 112 | — | 1 | 113 | (43) | 70 |
| Total interest income | 1,865 | — | 1 | 1,866 | (653) | 1,213 |
| Total interest expense | 1,299 | 6 | 1 | 1,306 | (477) | 829 |
| Net interest income | 566 | (6) | — | 560 | (176) | 384 |
| Less: provisions for losses | — | — | — | — | 12 | 12 |
| Net interest income after provisions for losses | 566 | (6) | — | 560 | (188) | 372 |
| Fee income | — | 93 | 36 | 129 | — | 129 |
| Collections revenue | — | 42 | — | 42 | — | 42 |
| Other income | — | — | 36 | 36 | 295 | 331 |
| Operating expenses[(1)] | 134 | 72 | 65 | 271 | 21 | 292 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 432 | 57 | 7 | 496 | 86 | 582 |
| Income tax expense (benefit)[(2)] | 160 | 21 | 2 | 183 | (33) | 150 |
| Minority interest in net earnings of subsidiaries | — | 1 | — | 1 | — | 1 |
| Net income | $ 272 | $ 35 | $ 5 | $ 312 | $ 119 | $ 431 |

(1) In the first quarter of 2006, the Company changed its method for allocating certain overhead and other expenses between its business segments. Balances for the three months ending September 30, 2005 have been updated to reflect the new allocation methodology.

(2) Income taxes are based on a percentage of net income (loss) before tax for the individual reportable segment.

(3) "Core Earnings" adjustments to GAAP:

| (Dollars in millions) | Three Months Ended September 30, 2005 Net Impact of Securitization Accounting | Net Impact of Derivative Accounting | Net Impact of Floor Income | Net Impact of Acquired Intangibles[(A)] | Total |
|---|---|---|---|---|---|
| Net interest income | $ (215) | $ 93 | $ (54) | $ — | $ (176) |
| Less: provisions for losses | 12 | — | — | — | 12 |
| Net interest income after provisions for losses | (227) | 93 | (54) | — | (188) |
| Fee income | — | — | — | — | — |
| Collections revenue | — | — | — | — | — |
| Other income | (21) | 316 | — | — | 295 |
| Operating expenses | 5 | — | — | 16 | 21 |
| Total pre-tax "Core Earnings" adjustments to GAAP | $ (253) | $ 409 | $ (54) | $ (16) | 86 |
| Income tax expense | | | | | (33) |
| Minority interest in net earnings of subsidiaries | | | | | — |
| Total "Core Earnings" adjustments to GAAP | | | | | $ 119 |

(A) Represents goodwill and intangible impairment and the amortization of acquired intangibles.

## 11. Segment Reporting (Continued)

| | Nine Months Ended September 30, 2006 | | | | | |
|---|---|---|---|---|---|---|
| | Lending | DMO | Corporate and Other | Total "Core Earnings" | Adjustments[3] | Total GAAP |
| Interest income: | | | | | | |
| FFELP Stafford and Other Student Loans | $ 2,070 | $ — | $ — | $ 2,070 | $ (1,070) | $ 1,000 |
| Consolidation Loans | 3,385 | — | — | 3,385 | (806) | 2,579 |
| Private Education Loans | 1,472 | — | — | 1,472 | (742) | 730 |
| Other loans | 71 | — | — | 71 | — | 71 |
| Cash and investments | 507 | — | 5 | 512 | (150) | 362 |
| Total interest income | 7,505 | — | 5 | 7,510 | (2,768) | 4,742 |
| Total interest expense | 5,687 | 17 | 6 | 5,710 | (2,050) | 3,660 |
| Net interest income | 1,818 | (17) | (1) | 1,800 | (718) | 1,082 |
| Less: provisions for losses | 215 | — | — | 215 | (20) | 195 |
| Net interest income after provisions for losses | 1,603 | (17) | (1) | 1,585 | (698) | 887 |
| Fee income | — | 304 | 99 | 403 | — | 403 |
| Collections revenue | — | 182 | — | 182 | — | 182 |
| Other income | 138 | — | 95 | 233 | 1,153 | 1,386 |
| Operating expenses[1] | 481 | 266 | 178 | 925 | 68 | 993 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 1,260 | 203 | 15 | 1,478 | 387 | 1,865 |
| Income tax expense[2] | 466 | 75 | 6 | 547 | 175 | 722 |
| Minority interest in net earnings of subsidiaries | — | 4 | — | 4 | — | 4 |
| Net income | $ 794 | $ 124 | $ 9 | $ 927 | $ 212 | $ 1,139 |

(1) Operating expenses for the Lending, DMO, and Corporate and Other Business segments include $26 million, $9 million, and $13 million, respectively, of stock-based compensation expense due to the implementation of SFAS No. 123(R) in the first quarter of 2006.

(2) Income taxes are based on a percentage of net income (loss) before tax for the individual reportable segment.

(3) "Core Earnings" adjustments to GAAP:

| | Nine Months Ended September 30, 2006 | | | | |
|---|---|---|---|---|---|
| (Dollars in millions) | Net Impact of Securitization Accounting | Net Impact of Derivative Accounting | Net Impact of Floor Income | Net Impact of Acquired Intangibles[A] | Total |
| Net interest income | $ (668) | $ 108 | $ (158) | $ — | $ (718) |
| Less: provisions for losses | (20) | — | — | — | (20) |
| Net interest income after provisions for losses | (648) | 108 | (158) | — | (698) |
| Fee income | — | — | — | — | — |
| Collections revenue | — | — | — | — | — |
| Other income | 1,248 | (95) | — | — | 1,153 |
| Operating expenses | — | — | — | 68 | 68 |
| Total pre-tax "Core Earnings" adjustments to GAAP | $ 600 | $ 13 | $ (158) | $ (68) | 387 |
| Income tax expense | | | | | 175 |
| Minority interest in net earnings of subsidiaries | | | | | — |
| Total "Core Earnings" adjustments to GAAP | | | | | $ 212 |

(A) Represents goodwill and intangible impairment and the amortization of acquired intangibles.





## 11. Segment Reporting (Continued)

| | Nine Months Ended September 30, 2005 | | | | | |
|---|---|---|---|---|---|---|
| | Lending | DMO | Corporate and Other | Total "Core Earnings" | Adjustments[3] | Total GAAP |
| Interest income: | | | | | | |
| FFELP Stafford and Other Student Loans | $ 1,678 | $ — | $ — | $ 1,678 | $ (978) | $ 700 |
| Consolidation Loans | 2,080 | — | — | 2,080 | (341) | 1,739 |
| Private Education Loans | 787 | — | — | 787 | (357) | 430 |
| Other loans | 62 | — | — | 62 | — | 62 |
| Cash and investments | 268 | — | 3 | 271 | (84) | 187 |
| Total interest income | 4,875 | — | 3 | 4,878 | (1,760) | 3,118 |
| Total interest expense | 3,291 | 14 | 4 | 3,309 | (1,252) | 2,057 |
| Net interest income | 1,584 | (14) | (1) | 1,569 | (508) | 1,061 |
| Less: provisions for losses | 69 | — | — | 69 | 69 | 138 |
| Net interest income after provisions for losses | 1,515 | (14) | (1) | 1,500 | (577) | 923 |
| Fee income | — | 261 | 94 | 355 | — | 355 |
| Collections revenue | — | 119 | — | 119 | — | 119 |
| Other income | 72 | — | 97 | 169 | 745 | 914 |
| Operating expenses[1] | 408 | 204 | 179 | 791 | 51 | 842 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 1,179 | 162 | 11 | 1,352 | 117 | 1,469 |
| Income tax expense[2] | 437 | 60 | 3 | 500 | 13 | 513 |
| Minority interest in net earnings of subsidiaries | 2 | 3 | — | 5 | — | 5 |
| Net income | $ 740 | $ 99 | $ 8 | $ 847 | $ 104 | $ 951 |

(1) In the first quarter of 2006, the Company changed its method for allocating certain overhead and other expenses between its business segments. Balances for the nine months ending September 30, 2005 have been updated to reflect the new allocation methodology.

(2) Income taxes are based on a percentage of net income (loss) before tax for the individual reportable segment.

(3) "Core Earnings" adjustments to GAAP:

| | Nine Months Ended September 30, 2005 | | | | |
|---|---|---|---|---|---|
| (Dollars in millions) | Net Impact of Securitization Accounting | Net Impact of Derivative Accounting | Net Impact of Floor Income | Net Impact of Acquired Intangibles[A] | Total |
| Net interest income | $ (664) | $ 304 | $ (148) | $ — | $ (508) |
| Less: provisions for losses | 69 | — | — | — | 69 |

| | | | | | |
|---|---|---|---|---|---|
| Net interest income after provisions for losses | (733) | 304 | (148) | — | (577) |
| Fee income | — | — | — | — | — |
| Collections revenue | — | — | — | — | — |
| Other income | 561 | 184 | — | — | 745 |
| Operating expenses | 6 | — | — | 45 | 51 |
| Total pre-tax “Core Earnings” adjustments to GAAP | $ (178) | $ 488 | $ (148) | $ (45) | 117 |
| Income tax expense | | | | | 13 |
| Minority interest in net earnings of subsidiaries | | | | | — |
| Total “Core Earnings” adjustments to GAAP | | | | | $ 104 |

(A) Represents goodwill and intangible impairment and the amortization of acquired intangibles.





## 11. Segment Reporting (Continued)

***Summary of “Core Earnings” Adjustments to GAAP***

The adjustments required to reconcile from the Company’s “Core Earnings” results to its GAAP results of operations relate to differing treatments for securitization transactions, derivatives, Floor Income related to the Company’s student loans, and certain other items that management does not consider in evaluating the Company’s operating results. The following table reflects aggregate adjustments associated with these areas for the three and nine months ended September 30, 2006 and 2005.

| (Dollars in millions) | Three Months Ended September 30, 2006 | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2005 |
|---|---|---|---|---|
| **“Core Earnings” adjustments to GAAP:** | | | | |
| Net impact of securitization accounting(1) | $ 160 | $ (253) | $ 600 | $ (178) |
| Net impact of derivative accounting(2) | (113) | 409 | 13 | 488 |
| Net impact of Floor Income(3) | (53) | (54) | (158) | (148) |
| Net impact of acquired intangibles(4) | (37) | (16) | (68) | (45) |
| Net tax effect(5) | (15) | 33 | (175) | (13) |
| Total “Core Earnings” adjustments to GAAP | $ (58) | $ 119 | $ 212 | $ 104 |

(1) **Securitization:** Under GAAP, certain securitization transactions in the Company’s Lending operating segment are accounted for as sales of assets. Under the Company’s “Core Earnings” presentation for the Lending operating segment, the Company presents all securitization transactions on a “Core Earnings” basis as long-term non-recourse financings. The upfront “gains” on sale from securitization transactions as well as ongoing “servicing and securitization revenue” presented in accordance with GAAP are excluded from “Core Earnings” net income and replaced by the interest income, provisions for loan losses, and interest expense as they are earned or incurred on the securitization loans. The Company also excludes transactions with its off-balance sheet trusts from “Core Earnings” net income as they are considered intercompany transactions on a “Core Earnings” basis.

(2) **Derivative accounting:** “Core Earnings” net income excludes periodic unrealized gains and losses arising primarily in the Company’s Lending operating segment, and to a lesser degree in the Company’s Corporate and Other reportable segment, that are caused primarily by the one-sided mark-to-market derivative valuations prescribed by SFAS No. 133 on derivatives that do not qualify for “hedge treatment” under GAAP. Under the Company’s “Core Earnings” presentation, the Company recognizes the economic effect of these hedges, which generally results in any cash paid or received being recognized ratably as an expense or revenue over the hedged item’s life. “Core Earnings” net income also excludes the gain or loss on equity forward contracts that under SFAS No. 133, are required to be accounted for as derivatives and are marked-to-market through GAAP net income.

(3) **Floor Income:** The timing and amount (if any) of Floor Income earned in the Company’s Lending operating segment is uncertain and in excess of expected spreads. Therefore, the Company excludes such income from “Core Earnings” net income when it is not economically hedged. The Company employs derivatives, primarily Floor Income Contracts and futures, to economically hedge Floor Income. As discussed above in “Derivative Accounting,” these derivatives do not qualify as effective accounting hedges and therefore, under GAAP, are marked-to-market through the “gains (losses) on derivative and hedging activities, net” line on the income statement with no offsetting gain or loss recorded for the economically hedged items. For “Core Earnings” net income, the Company reverses the fair value adjustments on the Floor Income Contracts and futures economically hedging Floor Income and includes the amortization of net premiums received (net of Eurodollar futures contracts’ realized gains or losses) in income.

(4) **Acquired Intangibles:** The Company excludes goodwill and intangible impairment and amortization of acquired intangibles.

(5) **Net Tax Effect:** Such tax effect is based upon the Company’s “Core Earnings” effective tax rate for the year. The net tax effect results primarily from the exclusion of the permanent income tax impact of the equity forward contracts.



## Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

**MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**
**Three and nine months ended September 30, 2006 and 2005**
**(Dollars in millions, except per share amounts, unless otherwise noted)**

### FORWARD-LOOKING AND CAUTIONARY STATEMENTS

This quarterly report contains forward-looking statements and information that are based on management’s current expectations as of the date of this document. When used in this report, the words “anticipate,” “believe,” “estimate,” “intend” and “expect” and similar expressions are intended to identify forward-looking statements. These forward-looking statements are subject to risks, uncertainties, assumptions and other factors that may cause the actual results to be materially different from those reflected in such forward-looking statements. These factors include, among others, changes in the terms of student loans and the educational credit marketplace arising from the implementation of applicable laws and regulations and from changes in these laws and regulations, which may reduce the volume, average term and yields on student loans under the Federal Family Education Loan Program ("FFELP") or result in loans being originated or refinanced under non-FFELP programs or may affect the terms upon which banks and others agree to sell FFELP loans to SLM Corporation, more commonly known as Sallie Mae, and its subsidiaries (collectively, "the Company"). In addition, a larger than expected increase in third party consolidations of our FFELP loans could materially adversely affect our results of operations. The Company could also be affected by changes in the demand for educational financing or in financing preferences of lenders, educational institutions, students and their families; incorrect estimates or assumptions by management in connection with the preparation of our consolidated financial statements; changes in the composition of our Managed FFELP and Private Education Loan portfolios; a significant decrease in our common stock price, which may result in counterparties terminating equity forward positions with us, which, in turn, could have a materially dilutive effect on our common stock; changes in the general interest rate environment and in the securitization markets for education loans, which may increase the costs or limit the availability of financings necessary to initiate, purchase or carry education loans; losses from loan defaults; changes in prepayment rates and credit spreads; and changes in the demand for debt management services and new laws or changes in existing laws that govern debt management services.

## OVERVIEW

We are the largest source of funding, delivery and servicing support for education loans in the United States. Our primary business is to originate, acquire and hold both federally guaranteed student loans and Private Education Loans, which are not federally guaranteed. The primary source of our earnings is from net interest income earned on those student loans as well as gains on the sales of such loans in securitization transactions. We also earn fees for pre-default and post-default receivables management services on student loans, such that we are engaged in every phase of the student loan life cycle—from originating and servicing student loans to default prevention and ultimately the collection on defaulted student loans. In addition, we provide a wide range of other financial services, processing capabilities and information technology to meet the needs of educational institutions, lenders, students and their families, and guarantee agencies. SLM Corporation, more commonly known as Sallie Mae, is a holding company that operates through a number of subsidiaries and references in this report to the "Company" refer to SLM Corporation and its subsidiaries.

We have used both internal growth and strategic acquisitions to attain our leadership position in the education finance marketplace. Our sales force, which delivers our products on campuses across the country, is the largest in the student loan industry. The core of our marketing strategy is to promote our



on-campus brands, which generate student loan originations through our Preferred Channel. Loans generated through our Preferred Channel are more profitable than loans acquired through other acquisition channels because we own them earlier in the student loan's life and generally incur lower costs to acquire such loans. We have built brand leadership among the Sallie Mae name, the brands of our subsidiaries and those of our lender partners. These sales and marketing efforts are supported by the largest and most diversified servicing capabilities in the industry, providing an unmatched array of servicing capability to financial aid offices.

In recent years we have diversified our business through the acquisition of several companies that provide default management and loan collections services, all of which are combined in our Debt Management Operations ("DMO") business segment. Our capabilities now include a full range of accounts receivable management services to a number of different industries. The DMO business segment has been expanding rapidly such that revenue grew 25 percent in the nine months ended September 30, 2006, compared to the same period in 2005, and we now employ approximately 4,000 people in this segment.

We manage our business through two primary operating segments: the Lending operating segment and the DMO operating segment. Accordingly, the results of operations of the Company's Lending and DMO segments are presented separately below under "BUSINESS SEGMENTS." These operating segments are considered reportable segments under the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information," based on quantitative thresholds applied to the Company's financial statements.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

A discussion of the Company's critical accounting policies, which include premiums, discounts and Borrower Benefits, securitization accounting and Retained Interests, provisions for loan losses, derivative accounting and the effects of Consolidation Loan activity on estimates, can be found in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. There have been no material changes to these policies during the third quarter of 2006.



## SELECTED FINANCIAL DATA

### Condensed Statements of Income

| | Three Months Ended September 30, | | Increase (Decrease) | | Nine Months Ended September 30, | | Increase (Decrease) | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | 2005 | $ | % | 2006 | 2005 | $ | % |
| Net interest income | $ 338 | $ 384 | $ (46) | (12)% | $ 1,082 | $ 1,061 | $ 21 | 2% |
| Less: provisions for losses | 67 | 12 | 55 | 458 | 195 | 138 | 57 | 41 |
| Net interest income after provisions for losses | 271 | 372 | (101) | (27) | 887 | 923 | (36) | (4) |
| Gains on student loan securitizations | 201 | — | 201 | — | 902 | 312 | 590 | 189 |
| Servicing and securitization revenue | 187 | (16) | 203 | 1269 | 369 | 277 | 92 | 33 |
| Losses on securities, net | (13) | (43) | 30 | 70 | (25) | (57) | 32 | 56 |
| Gains (losses) on derivative and hedging activities, net | (131) | 316 | (447) | (141) | (95) | 176 | (271) | (154) |
| Guarantor servicing fees | 39 | 36 | 3 | 8 | 99 | 94 | 5 | 5 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Debt management fees | 122 | 93 | 29 | 31 | 304 | 261 | 43 | 16 |
| Collections revenue | 58 | 42 | 16 | 38 | 182 | 119 | 63 | 53 |
| Other income | 88 | 74 | 14 | 19 | 235 | 206 | 29 | 14 |
| Operating expenses | 354 | 292 | 62 | 21 | 993 | 842 | 151 | 18 |
| Income taxes | 204 | 150 | 54 | 36 | 722 | 513 | 209 | 41 |
| Minority interest in net earnings of subsidiaries | 1 | 1 | — | — | 4 | 5 | (1) | (20) |
| **Net income** | 263 | 431 | (168) | (39) | 1,139 | 951 | 188 | 20 |
| Preferred stock dividends | 9 | 7 | 2 | 29 | 26 | 14 | 12 | 86 |
| Net income attributable to common stock | $ 254 | $ 424 | $ (170) | (40)% | $ 1,113 | $ 937 | $ 176 | 19% |
| **Basic earnings per common share** | $ .62 | $ 1.02 | $ (.40) | (39)% | $ 2.71 | $ 2.24 | $ .47 | 21% |
| **Diluted earnings per common share** | $ .60 | $ .95 | $ (.35) | (37)% | $ 2.56 | $ 2.10 | $ .46 | 22% |
| Dividends per common share | $ .25 | $ .22 | $ .03 | 14% | $ .72 | $ .63 | $ .09 | 14% |



**Condensed Balance Sheets**

| | September 30, 2006 | December 31, 2005 | Increase (Decrease) $ | % |
|---|---|---|---|---|
| **Assets** | | | | |
| FFELP Stafford and Other Student Loans, net | $ 22,614 | $ 19,988 | $ 2,626 | 13% |
| Consolidation Loans, net | 57,202 | 54,859 | 2,343 | 4 |
| Private Education Loans, net | 8,222 | 7,757 | 465 | 6 |
| Other loans, net | 1,257 | 1,138 | 119 | 10 |
| Cash and investments | 4,249 | 4,868 | (619) | (13) |
| Restricted cash and investments | 3,958 | 3,300 | 658 | 20 |
| Retained Interest in off-balance sheet securitized loans | 3,613 | 2,406 | 1,207 | 50 |
| Goodwill and acquired intangible assets, net | 1,333 | 1,105 | 228 | 21 |
| Other assets | 4,605 | 3,918 | 687 | 18 |
| Total assets | $ 107,053 | $ 99,339 | $ 7,714 | 8% |
| **Liabilities and Stockholders' Equity** | | | | |
| Short-term borrowings | $ 3,670 | $ 3,810 | $ (140) | (4)% |
| Long-term borrowings | 94,817 | 88,119 | 6,698 | 8 |
| Other liabilities | 4,054 | 3,609 | 445 | 12 |
| Total liabilities | 102,541 | 95,538 | 7,003 | 7 |
| Minority interest in subsidiaries | 9 | 9 | — | — |
| Stockholders' equity before treasury stock | 5,531 | 4,364 | 1,167 | 27 |
| Common stock held in treasury at cost | 1,028 | 572 | 456 | 80 |
| Total stockholders' equity | 4,503 | 3,792 | 711 | 19 |
| Total liabilities and stockholders' equity | $ 107,053 | $ 99,339 | $ 7,714 | 8% |

## RESULTS OF OPERATIONS

## CONSOLIDATED EARNINGS SUMMARY

### Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005

For the three months ended September 30, 2006, net income of $263 million ($.60 diluted earnings per share) was a 39 percent decrease from net income of $431 million ($.95 diluted earnings per share) for the three months ended September 30, 2005. Third quarter 2006 pre-tax income of $468 million was a 20 percent decrease from $582 million earned in the third quarter of 2005. The larger percentage increase in current quarter over year-ago quarter, after-tax net income versus pre-tax net income is driven by the permanent impact of excluding from taxable income all non-taxable gains and losses on equity forward contracts in the Company's stock. Under SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," we are required to mark the equity forward contracts to market each quarter and recognize the change in their value in income. Conversely, these unrealized gains and losses are not recognized on a tax basis. In the third quarter of 2006, the unrealized loss on our outstanding equity forward contracts was $99 million versus an unrealized gain of $163 million in the third quarter of 2005. Excluding these gains and losses from taxable income increased the effective tax rate from 26 percent in the third quarter of 2005 to 44 percent in the third quarter of 2006.

The decrease in the pre-tax results of the third quarter of 2006 versus the year-ago quarter is due primarily to a $447 million decrease in the net gain on derivative and hedging activities. The decrease in net gains and losses on derivative and hedging activities is primarily due to equity forwards (as mentioned above) and Floor Income Contracts. During the third quarter of 2006, the SLM stock price decreased versus an increase in the prior year period, resulting in a loss of $99 million on the equity forward contracts in the third quarter of 2006 versus a gain of $163 million in the prior year period. In the third quarter of



2006, we had a $90 million unrealized loss on our Floor Income Contracts due to declining forward interest rates, while in the year-ago period, rising forward interest rates resulted in an unrealized gain of $257 million.

Offsetting the unrealized losses discussed above were securitization gains in the third quarter of 2006 of $201 million that were primarily the result of a $182 million gain on a $1.1 billion Private Education Loan securitization. In the third quarter of 2005, we did not complete an off-balance sheet securitization transaction. Also, servicing and securitization income increased $203 million over the year-ago quarter. This increase can primarily be attributed to $171 million of impairments to our Retained Interests in securitizations recorded in the third quarter of 2005. Among other factors, these impairments were primarily caused by the effect of higher than expected Consolidation Loan activity on our off-balance sheet FFELP Stafford loan securitizations. In anticipation of continued high levels of Consolidation Loan activity, in the second quarter of 2006 we increased our CPR assumption used in valuing our Residuals and as a result there were minimal impairments in the third quarter of 2006.

Net interest income decreased by $46 million, or 12 percent year-over-year, due to a 39 basis point decrease in the net interest margin. The year-over-year decrease in the net interest margin is due to a lower on-balance sheet student loan spread that was primarily caused by higher interest rates which reduced Floor Income by $35 million. The net interest margin was also negatively impacted by higher on-balance sheet funding levels built up to finance the record Consolidation Loan activity in the third and fourth quarters of 2006.

In the third quarter of 2006, fee and other income and collections revenue totaled $307 million, an increase of 25 percent over the year-ago quarter. This increase was primarily driven by the $29 million or 31 percent increase in debt management fees.

**Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005**

For the nine months ended September 30, 2006, net income was $1.1 billion ($2.56 diluted earnings per share), a 20 percent increase from the $951 million in net income ($2.10 diluted earnings per share) for the nine months ended September 30, 2005. On a pre-tax basis, year-to-date 2006 net income of $1.9 billion represents a 27 percent increase from the $1.5 billion in pre-tax net income earned in the first nine months of 2005. The lower percentage increase in year-over-year, after-tax net income versus pre-tax net income is driven by the permanent impact of excluding non-taxable gains and losses on equity forward contracts as described above, which increased the effective tax rate from 35 percent in the nine months ended September 30, 2005 to 39 percent in the nine months ended September 30, 2006. In the first nine months of 2006, the unrealized loss on our outstanding equity forward contracts was $182 million versus an unrealized gain of $65 million in the first nine months of 2005.

The increase in year-over-year, pre-tax results is primarily due to a $590 million increase in securitization gains in the nine months ended September 30, 2006 versus 2005. The securitization gains in the first nine months of 2006 were primarily driven by the three Private Education Loan securitizations, which had total pre-tax gains of $830 million or 16 percent of the amount securitized, versus the year-ago period in which there was only one Private Education Loan securitization, which had a pre-tax gain of $231 million or 15 percent of the amount securitized. We recorded pre-tax impairments on our Retained Interests in securitizations of $148 million for the nine months ended September 30, 2006 and $195 million for the nine months ended September 30, 2005. The year-over-year reduction in the impairments was the primary reason for the $92 million year-over-year increase in servicing and securitization revenue.

The pre-tax $271 million decrease in the net gains and losses on derivative and hedging activities primarily relates to a $473 million decrease in unrealized gains on derivatives that do not receive hedge accounting treatment, partially offset by a $202 million reduction in realized losses on derivatives and hedging activities, for the nine months ended September 30, 2006 versus the year-ago period. The decrease



in unrealized gains was primarily due to the impact of the SLM stock price on our equity forward contracts which resulted in a mark-to-market unrealized loss of $182 million versus an unrealized gain of $65 million in the year-ago period, and to a decrease of $237 million in unrealized gains on Floor Income Contracts. The smaller unrealized gains on our Floor Income Contracts were primarily caused by higher interest rates in 2006 versus 2005. The impact from the equity forward contracts was due to the SLM stock price decreasing during the first nine months of 2006 versus an increase in the first nine months of 2005.

Our Managed student loan portfolio grew by $16.3 billion, from $120.6 billion at September 30, 2005 to $136.9 billion at September 30, 2006. This growth was driven by the acquisition of $27.8 billion of student loans, including $6.4 billion in Private Education Loans, in the nine months ended September 30, 2006, a 17 percent increase over the $23.7 billion acquired in the year-ago period, of which $4.9 billion were Private Education Loans. In the nine months ended September 30, 2006, we originated $18.6 billion of student loans through our Preferred Channel, an increase of 11 percent over the $16.8 billion originated in the year-ago period.

**NET INTEREST INCOME**

Net interest income, including interest income and interest expense, is derived primarily from our portfolio of student loans that remain on-balance sheet and to a lesser extent from other loans, cash and investments. The "Taxable Equivalent Net Interest Income" analysis below is designed to facilitate a comparison of non-taxable asset yields to taxable yields on a similar basis. Additional information regarding the return on our student loan portfolio is set forth under "Student Loan Spread—*Student Loan Spread Analysis—On-Balance Sheet.*" Information regarding the provisions for losses is included in Note 3 to the consolidated financial statements, "Allowance for Student Loan Losses."

***Taxable Equivalent Net Interest Income***

The amounts in the following table are adjusted for the impact of certain tax-exempt and tax-advantaged investments based on the marginal federal corporate tax rate of 35 percent.

| | Three Months Ended September 30, 2006 | | Increase (Decrease) | | Nine Months Ended September 30, 2006 | | Increase (Decrease) | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | 2005 | $ | % | 2006 | 2005 | $ | % |
| Interest income: | | | | | | | | |
| Student loans | $ 1,536 | $ 1,121 | $415 | 37% | $ 4,309 | $ 2,869 | $ 1,440 | 50% |
| Other loans | 24 | 22 | 2 | 9 | 71 | 62 | 9 | 15 |
| Cash and investments | 141 | 70 | 71 | 101 | 362 | 187 | 175 | 94 |
| Taxable equivalent adjustment | 1 | 1 | — | — | 2 | 3 | (1) | (33) |
| Total taxable equivalent interest income | 1,702 | 1,214 | 488 | 40 | 4,744 | 3,121 | 1,623 | 52 |
| Interest expense | 1,363 | 829 | 534 | 64 | 3,660 | 2,057 | 1,603 | 78 |
| Taxable equivalent net interest income | $ 339 | $ 385 | $ (46) | (12)% | $ 1,084 | $ 1,064 | $ 20 | 2% |

*Average Balance Sheets*

The following table reflects the rates earned on interest earning assets and paid on interest bearing liabilities for the three and nine months ended September 30, 2006 and 2005. This table reflects the net interest margin for the entire Company on a consolidated basis.

| | Three Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Balance | Rate | Balance | Rate |
| **Average Assets** | | | | |
| FFELP Stafford and Other Student Loans | $ 21,194 | 6.83% | $ 21,574 | 4.97% |
| Consolidation Loans | 54,968 | 6.61 | 48,774 | 5.51 |
| Private Education Loans | 8,079 | 12.51 | 7,193 | 9.57 |
| Other loans | 1,133 | 8.63 | 1,036 | 8.40 |
| Cash and investments | 9,915 | 5.67 | 6,621 | 4.26 |
| Total interest earning assets | 95,289 | 7.09% | 85,198 | 5.65% |
| Non-interest earning assets | 8,707 | | 6,898 | |
| Total assets | $ 103,996 | | $ 92,096 | |
| **Average Liabilities and Stockholders' Equity** | | | | |
| Short-term borrowings | $ 3,994 | 5.70% | $ 4,765 | 3.95% |
| Long-term borrowings | 91,668 | 5.65 | 80,125 | 3.87 |
| Total interest bearing liabilities | 95,662 | 5.65% | 84,890 | 3.87% |
| Non-interest bearing liabilities | 4,110 | | 3,596 | |
| Stockholders' equity | 4,224 | | 3,610 | |
| Total liabilities and stockholders' equity | $ 103,996 | | $ 92,096 | |
| Net interest margin | | 1.41% | | 1.80% |

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Balance | Rate | Balance | Rate |
| **Average Assets** | | | | |
| FFELP Stafford and Other Student Loans | $ 20,433 | 6.54% | $ 20,268 | 4.62% |
| Consolidation Loans | 53,829 | 6.41 | 45,081 | 5.16 |
| Private Education Loans | 8,348 | 11.69 | 6,615 | 8.69 |
| Other loans | 1,132 | 8.49 | 1,061 | 7.96 |
| Cash and investments | 8,618 | 5.63 | 6,523 | 3.86 |
| Total interest earning assets | 92,360 | 6.87% | 79,548 | 5.25% |
| Non-interest earning assets | 8,442 | | 6,639 | |
| Total assets | $ 100,802 | | $ 86,187 | |
| **Average Liabilities and Stockholders' Equity** | | | | |
| Short-term borrowings | $ 4,186 | 5.18% | $ 4,515 | 3.72% |
| Long-term borrowings | 88,803 | 5.27 | 75,044 | 3.44 |
| Total interest bearing liabilities | 92,989 | 5.26% | 79,559 | 3.46% |
| Non-interest bearing liabilities | 3,772 | | 3,378 | |
| Stockholders' equity | 4,041 | | 3,250 | |
| Total liabilities and stockholders' equity | $ 100,802 | | $ 86,187 | |
| Net interest margin | | 1.57% | | 1.79% |



*Rate/Volume Analysis*

The following rate/volume analysis illustrates the relative contribution of changes in interest rates and asset volumes.

| | Taxable Equivalent Increase (Decrease) | Increase (Decrease) Attributable to Change in | |
|---|---|---|---|
| | | Rate | Volume |
| **Three months ended September 30, 2006 vs. three months ended September 30, 2005** | | | |
| Taxable equivalent interest income | $ 488 | $ 348 | $ 140 |
| Interest expense | 534 | 430 | 104 |
| Taxable equivalent net interest income | $ (46) | $ (82) | $ 36 |

| | Taxable Equivalent Increase (Decrease) | Increase (Decrease) Attributable to Change in | |
|---|---|---|---|
| | | Rate | Volume |
| **Nine months ended September 30, 2006 vs. nine months ended September 30, 2005** | | | |

| | | | |
|---|---|---|---|
| Taxable equivalent interest income | $1,623 | $1,102 | $521 |
| Interest expense | 1,603 | 1,259 | 344 |
| Taxable equivalent net interest income | $ 20 | $ (157) | $177 |

The decrease in the net interest margin for both the three and nine months ended September 30, 2006 versus the year-ago periods is primarily due to fluctuations in the student loan spread as discussed under "Student Loan Spread—*Student Loan Spread Analysis—On-Balance Sheet*," and to the build-up of funding in anticipation of record Consolidation Loan activity as at the end of the second quarter, borrowers locked in lower interest rates before the July 1 reset on FFELP Stafford loans.

**Student Loans**

For both federally insured and Private Education Loans, we account for premiums paid, discounts received and certain origination costs incurred on the origination and acquisition of student loans in accordance with SFAS No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases." The unamortized portion of the premiums and discounts is included in the carrying value of the student loan on the consolidated balance sheet. We recognize income on our student loan portfolio based on the expected yield of the student loan after giving effect to the amortization of purchase premiums and the accretion of student loan discounts, as well as interest rate reductions and rebates expected to be earned through Borrower Benefits programs. Discounts on Private Education Loans are deferred and accreted to income over the lives of the student loans. In the table below, this accretion of discounts is netted with the amortization of the premiums.

**Student Loan Spread**

An important performance measure closely monitored by management is the student loan spread. The student loan spread is the difference between the income earned on the student loan assets and the interest paid on the debt funding those assets. A number of factors can affect the overall student loan spread such as:

- the mix of student loans in the portfolio, with Consolidation Loans having the lowest spread and Private Education Loans having the highest spread;



- the premiums paid, borrower fees charged and capitalized costs incurred to acquire student loans which impact the spread through subsequent amortization;
- the type and level of Borrower Benefits programs for which the student loans are eligible;
- the level of Floor Income and, when considering the "Core Earnings" basis student loan spread, the amount of Floor Income-eligible loans that have been hedged through Floor Income Contracts; and
- funding and hedging costs.

The student loan spread is highly susceptible to liquidity, funding and interest rate risk. These risks are discussed separately in our 2005 Annual Report on Form 10-K at "LIQUIDITY AND CAPITAL RESOURCES" and in the "RISK FACTORS" discussion.

***Student Loan Spread Analysis—On-Balance Sheet***

The following table analyzes the reported earnings from student loans on-balance sheet. For an analysis of our student loan spread for the entire portfolio of Managed student loans on a similar basis to the on-balance sheet analysis, see "LENDING BUSINESS SEGMENT—Student Loan Spread Analysis —'Core Earnings' Basis."

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| **On-Balance Sheet** | | | | |
| Student loan yield, before Floor Income | 8.17% | 6.39% | 7.86% | 5.94% |
| Gross Floor Income | .02 | .20 | .04 | .30 |
| Consolidation Loan Rebate Fees | (.68) | (.65) | (.67) | (.65) |
| Borrower Benefits | (.13) | (.04) | (.12) | (.11) |
| Premium and discount amortization | (.15) | (.16) | (.14) | (.15) |
| Student loan net yield | 7.23 | 5.74 | 6.97 | 5.33 |
| Student loan cost of funds | (5.64) | (3.85) | (5.25) | (3.43) |
| Student loan spread | 1.59% | 1.89% | 1.72% | 1.90% |
| **Average Balances** | | | | |
| On-balance sheet student loans | $84,241 | $77,541 | $82,610 | $71,964 |

*Discussion of Student Loan Spread—Effects of Floor Income and Derivative Accounting*

One of the primary drivers of fluctuations in our on-balance sheet student loan spread is the level of gross Floor Income (Floor Income earned before payments on Floor Income Contracts) earned in the period. For the three months ended September 30, 2006 and 2005, we earned gross Floor Income of $5 million (2 basis points) and $40 million (20 basis points), respectively. The reduction in gross Floor Income is primarily due to the increase in short-term interest rates. We believe that we have economically hedged all of the Floor Income through the sale of Floor Income Contracts, under which we receive an upfront fee and agree to pay the counterparty the Floor Income earned on a notional amount of student loans. These contracts do not qualify for hedge accounting treatment and as a result the payments on the Floor Income Contracts are included on the income statement with "gains (losses) on derivative and hedging activities, net" rather than in student loan interest income. Payments on Floor Income Contracts associated with on-balance sheet student loans for the three months ended September 30, 2006 and 2005 totaled $6 million (3 basis points) and $38 million (19 basis points), respectively.

In addition to Floor Income Contracts, we also extensively use basis swaps to manage our basis risk associated with interest rate sensitive assets and liabilities. These swaps generally do not qualify as accounting hedges and are likewise required to be accounted for in the "gains (losses) on derivative and hedging activities, net" line on the income statement. As a result, they are not considered in the calculation of the cost of funds in the above table.

*Discussion of Student Loan Spread—Other Quarter-over-Quarter Fluctuations*

In the third quarter of 2005, we revised our method for estimating the qualification for Borrower Benefits and updated our estimates to account for programmatic changes as well as the effect of continued high levels of consolidations. These updates resulted in a reduction of $16 million or 8 basis points in our Borrower Benefits liability in the third quarter.

After giving effect to the items discussed above, the third quarter of 2006 on-balance sheet spread decreased slightly as compared to the prior year primarily due to the proportional increase in lower yielding Consolidation Loans outweighing the increase in Private Education Loans.

***Floor Income***

For on-balance sheet student loans, gross Floor Income is included in student loan income whereas payments on Floor Income Contracts are included in the "gains (losses) on derivative and hedging activities, net" line in other income. The following table summarizes the components of Floor Income from on-balance sheet student loans, net of payments under Floor Income Contracts, for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended | | | | | |
|---|---|---|---|---|---|---|
| | September 30, 2006 | | | September 30, 2005 | | |
| | Fixed Borrower Rate | Variable Borrower Rate | Total | Fixed Borrower Rate | Variable Borrower Rate | Total |
| **Floor Income:** | | | | | | |
| Gross Floor Income | $ 5 | $— | $ 5 | $ 40 | $— | $ 40 |
| Payments on Floor Income Contracts | (6) | — | (6) | (38) | — | (38) |
| Net Floor Income | $ (1) | $— | $ (1) | $ 2 | $— | $ 2 |
| Net Floor Income in basis points | — | — | — | 1 | — | 1 |

| | Nine Months Ended | | | | | |
|---|---|---|---|---|---|---|
| | September 30, 2006 | | | September 30, 2005 | | |
| | Fixed Borrower Rate | Variable Borrower Rate | Total | Fixed Borrower Rate | Variable Borrower Rate | Total |
| **Floor Income:** | | | | | | |
| Gross Floor Income | $ 27 | $— | $ 27 | $ 162 | $— | $ 162 |
| Payments on Floor Income Contracts | (28) | — | (28) | (150) | — | (150) |
| Net Floor Income | $ (1) | $— | $ (1) | $ 12 | $— | $ 12 |
| Net Floor Income in basis points | — | — | — | 2 | — | 2 |

Floor Income is primarily earned on fixed rate Consolidation Loans. During the first six months of 2006, FFELP lenders reconsolidated Consolidation Loans using the Direct Loan program as a pass-through entity. This reconsolidation has left us in a slightly oversold position on our Floor Income Contracts and as a result net Floor Income was a loss of $1 million for the quarter. The Higher Education Act of 2005 has severely restricted the use of reconsolidation as of July 1, so we do not foresee any material impact on our Floor Income in the future.

As discussed in more detail under "LIQUIDITY AND CAPITAL RESOURCES—Securitization Activities," when we securitize a portfolio of student loans, we estimate the future Fixed Rate Embedded Floor Income earned on off-balance sheet student loans using a discounted cash flow option pricing model and recognize the fair value of such cash flows in the initial gain on sale and subsequent valuations of the



Residual Interest. Variable Rate Embedded Floor Income is recognized as earned in servicing and securitization revenue.

**Special Allowance Payments on 9.5 Percent Loans**

The Company maintains a portfolio of loans that, in accordance with the Higher Education Act ("HEA") and other regulatory guidance, is entitled to receive Special Allowance Payment ("SAP") equal to a minimum rate of return of 9.5 percent ("9.5 percent SAP loans"). In the third quarter of 2006, the Company earned $2.9 million in interest income in excess of income based upon the standard special allowance rate on this portfolio, as compared to $12.2 million in the third quarter of 2005. Our portfolio of loans subject to the 9.5 percent minimum rate totaled approximately $550 million and $1.4 billion as of September 30, 2006 and 2005, respectively. (See "RECENT DEVELOPMENTS—Inspector General Audit of Nelnet on Special Allowance Payments.")

**FEDERAL AND STATE TAXES**

The Company is subject to federal and state income taxes. Our effective tax rate for the three months ended September 30, 2006 was 44 percent versus 26 percent for the three months ended September 30, 2005 and for the nine months ended September 30, 2006 was 39 percent versus 35 percent for the nine months ended September 30, 2005. The effective tax rate reflects the permanent impact of the exclusion of the gains or losses on equity forward contracts recognized under SFAS No. 150.

**BUSINESS SEGMENTS**

The results of operations of the Company's Lending and Debt Management Operations ("DMO") operating segments are presented below. These defined business segments operate in distinct business environments and are considered reportable segments under SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," based on quantitative thresholds applied to the Company's financial statements. In addition, we provide other complementary products and services, including guarantor and student loan servicing, through smaller operating segments that do not meet such thresholds and are aggregated in the Corporate and Other reportable segment for financial reporting purposes.

The management reporting process measures the performance of the Company's operating segments based on the management structure of the Company as well as the methodology used by management to evaluate performance and allocate resources. In accordance with the Rules and Regulations of the Securities and Exchange Commission ("SEC"), we prepare financial statements in accordance with generally accepted accounting principles in the United States of America ("GAAP"). In addition to evaluating the Company's GAAP-based financial information, management, including the Company's chief operation decision maker, evaluates the performance of the Company's operating segments based on their profitability on a basis that, as allowed under SFAS No. 131, differs from GAAP. We refer to management's basis of evaluating our segment results as "Core Earnings" presentations for each business segment and we refer to these performance measures in our presentations with credit rating agencies and lenders. Accordingly, information regarding the Company's reportable segments is provided herein based on "Core Earnings," which are discussed in detail below.

Our "Core Earnings" are not defined terms within GAAP and may not be comparable to similarly titled measures reported by other companies. "Core Earnings" net income reflects only current period adjustments to GAAP net income as described below. Unlike financial accounting, there is no comprehensive, authoritative guidance for management reporting and as a result, our management reporting is not necessarily comparable with similar information for any other financial institution. The Company's operating segments are defined by the products and services they offer or the types of customers they serve, and they reflect the manner in which financial information is currently evaluated by



management. Intersegment revenues and expenses are netted within the appropriate financial statement line items consistent with the income statement presentation provided to management. Changes in management structure or allocation methodologies and procedures may result in changes in reported segment financial information.

"Core Earnings" are the primary financial performance measures used by management to develop the Company's financial plans, track results, and establish corporate performance targets and incentive compensation. While "Core Earnings" are not a substitute for reported results under GAAP, the Company relies on "Core Earnings" in operating its business because "Core Earnings" permit management to make meaningful period-to-period comparisons of the operational and performance indicators that are most closely assessed by management. Management believes this information provides additional insight into the financial performance of the core business activities of our operating segments. Accordingly, the tables presented below reflect "Core Earnings" which is reviewed and utilized by management to manage the business for each of the Company's reportable segments. A further discussion regarding "Core Earnings" is included under "Limitations of 'Core Earnings'" and *"Pre-tax Differences between 'Core Earnings' and GAAP by Business Segment."*

The Lending operating segment includes all discussion of income and related expenses associated with the net interest margin, the student loan spread and its components, the provisions for loan losses, and other fees earned on our Managed portfolio of student loans. The DMO operating segment reflects the fees earned and expenses incurred in providing accounts receivable management and collection services. Our Corporate and Other reportable segment includes our remaining fee businesses and other corporate expenses that do not pertain directly to the primary segments identified above.

| | Three Months Ended September 30, 2006 | | |
|---|---|---|---|
| | **Lending** | **DMO** | **Corporate and Other** |
| Interest income: | | | |
| FFELP Stafford and Other Student Loans | $ 702 | $ — | $ — |
| Consolidation Loans | 1,242 | — | — |
| Private Education Loans | 558 | — | — |
| Other loans | 24 | — | — |
| Cash and investments | 207 | — | 3 |
| Total interest income | 2,733 | — | 3 |
| Total interest expense | 2,124 | 6 | 4 |
| Net interest income | 609 | (6) | (1) |
| Less: provisions for losses | 80 | — | — |
| Net interest income after provisions for losses | 529 | (6) | (1) |
| Fee income | — | 122 | 39 |
| Collections revenue | — | 58 | — |
| Other income | 46 | — | 41 |
| Operating expenses[(1)] | 156 | 91 | 70 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 419 | 83 | 9 |
| Income tax expense[(2)] | 155 | 31 | 3 |
| Minority interest in net earnings of subsidiaries | — | 1 | — |
| "Core Earnings" net income | $ 264 | $ 51 | $ 6 |

(1) Operating expenses for the Lending, DMO, and Corporate and Other business segments include $8 million, $4 million, and $4 million, respectively, of stock-based compensation expense due to the implementation of SFAS No. 123(R) in the first quarter of 2006.

(2) Income taxes are based on a percentage of net income before tax for the individual reportable segment.



| | Three Months Ended September 30, 2005 | | |
|---|---|---|---|
| | **Lending** | **DMO** | **Corporate and Other** |
| Interest income: | | | |
| FFELP Stafford and Other Student Loans | $ 586 | $ — | $ — |
| Consolidation Loans | 833 | — | — |
| Private Education Loans | 312 | — | — |
| Other loans | 22 | — | — |

| | | | |
|---|---|---|---|
| Cash and investments | 112 | — | 1 |
| Total interest income | 1,865 | — | 1 |
| Total interest expense | 1,299 | 6 | 1 |
| Net interest income | 566 | (6) | — |
| Less: provisions for losses | — | — | — |
| Net interest income after provisions for losses | 566 | (6) | — |
| Fee income | — | 93 | 36 |
| Collections revenue | — | 42 | — |
| Other income | — | — | 36 |
| Operating expenses[(1)] | 134 | 72 | 65 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 432 | 57 | 7 |
| Income tax expense[(2)] | 160 | 21 | 2 |
| Minority interest in net earnings of subsidiaries | — | 1 | — |
| "Core Earnings" net income | $ 272 | $ 35 | $ 5 |

(1) In the first quarter of 2006, the Company changed its method for allocating certain overhead and other expenses between our business segments. Balances for the three months ending September 30, 2005 have been updated to reflect the new allocation methodology.

(2) Income taxes are based on a percentage of net income before tax for the individual reportable segment.



| | Nine Months Ended September 30, 2006 | | |
|---|---|---|---|
| | Lending | DMO | Corporate and Other |
| Interest income: | | | |
| FFELP Stafford and Other Student Loans | $2,070 | $ — | $ — |
| Consolidation Loans | 3,385 | — | — |
| Private Education Loans | 1,472 | — | — |
| Other loans | 71 | — | — |
| Cash and investments | 507 | — | 5 |
| Total interest income | 7,505 | — | 5 |
| Total interest expense | 5,687 | 17 | 6 |
| Net interest income | 1,818 | (17) | (1) |
| Less: provisions for losses | 215 | — | — |
| Net interest income after provisions for losses | 1,603 | (17) | (1) |
| Fee income | — | 304 | 99 |
| Collections revenue | — | 182 | — |
| Other income | 138 | — | 95 |
| Operating expenses[(1)] | 481 | 266 | 178 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 1,260 | 203 | 15 |
| Income tax expense[(2)] | 466 | 75 | 6 |
| Minority interest in net earnings of subsidiaries | — | 4 | — |
| "Core Earnings" net income | $ 794 | $124 | $ 9 |

(1) Operating expenses for the Lending, DMO, and Corporate and Other business segments include $26 million, $9 million, and $13 million, respectively, of stock-based compensation expense due to the implementation of SFAS No. 123(R) in the first quarter of 2006.

(2) Income taxes are based on a percentage of net income before tax for the individual reportable segment.



| | Nine Months Ended September 30, 2005 | | |
|---|---|---|---|
| | Lending | DMO | Corporate and Other |
| Interest income: | | | |
| FFELP Stafford and Other Student Loans | $1,678 | $ — | $ — |
| Consolidation Loans | 2,080 | — | — |
| Private Education Loans | 787 | — | — |
| Other loans | 62 | — | — |
| Cash and investments | 268 | — | 3 |
| Total interest income | 4,875 | — | 3 |
| Total interest expense | 3,291 | 14 | 4 |
| Net interest income | 1,584 | (14) | (1) |
| Less: provisions for losses | 69 | — | — |
| Net interest income after provisions for losses | 1,515 | (14) | (1) |
| Fee income | — | 261 | 94 |
| Collections revenue | — | 119 | — |
| Other income | 72 | — | 97 |
| Operating expenses[(1)] | 408 | 204 | 179 |

| | | | |
|---|---|---|---|
| Income before income taxes and minority interest in net earnings of subsidiaries | 1,179 | 162 | 11 |
| Income tax expense[2] | 437 | 60 | 3 |
| Minority interest in net earnings of subsidiaries | 2 | 3 | — |
| "Core Earnings" net income | $ 740 | $ 99 | $ 8 |

(1) In the first quarter of 2006, the Company changed its method for allocating certain overhead and other expenses between our business segments. Balances for the nine months ending September 30, 2005 have been updated to reflect the new allocation methodology.

(2) Income taxes are based on a percentage of net income before tax for the individual reportable segment.

**Limitations of "Core Earnings"**

While GAAP provides a uniform, comprehensive basis of accounting, for the reasons described above, management believes that "Core Earnings" are an important additional tool for providing a more complete understanding of the Company's results of operations. Nevertheless, "Core Earnings" are subject to certain general and specific limitations that investors should carefully consider. For example, as stated above, unlike financial accounting, there is no comprehensive, authoritative guidance for management reporting. Our "Core Earnings" are not defined terms within GAAP and may not be comparable to similarly titled measures reported by other companies. Unlike GAAP, "Core Earnings" reflect only current period adjustments to GAAP. Accordingly, the Company's "Core Earnings" presentation does not represent a comprehensive basis of accounting. Investors, therefore, may not compare our Company's performance with that of other financial services companies based upon "Core Earnings." "Core Earnings" results are only meant to supplement GAAP results by providing additional information regarding the operational and performance indicators that are most closely used by management, the Company's board of directors, rating agencies and lenders to assess performance.

Other limitations arise from the specific adjustments that management makes to GAAP results to derive "Core Earnings" results. For example, in reversing the unrealized gains and losses that result from SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," on derivatives that do not qualify for "hedge treatment," as well as on derivatives that do qualify but are in part ineffective because they are not perfect hedges, we focus on the long-term economic effectiveness of those instruments relative to the underlying hedged item and isolate the effects of interest rate volatility, changing credit spreads and



changes in our stock price on the fair value of such instruments during the period. Under GAAP, the effects of these factors on the fair value of the derivative instruments (but not on the underlying hedged item) tend to show more volatility in the short term. While our presentation of our results on a "Core Earnings" basis provides important information regarding the performance of our Managed portfolio, a limitation of this presentation is that we are presenting the ongoing spread income on loans that have been sold to a trust managed by us. While we believe that our "Core Earnings" presentation presents the economic substance of our Managed loan portfolio, it understates earnings volatility from securitization gains. Our "Core Earnings" results exclude certain Floor Income, which is real cash income, from our reported results and therefore may understate earnings in certain periods. Management's financial planning and valuation of operating results, however, does not take into account Floor Income because of its inherent uncertainty, except when it is economically hedged through Floor Income Contracts.

***Pre-tax differences between "Core Earnings" and GAAP by Business Segment***

Our "Core Earnings" are the primary financial performance measures used by management to evaluate performance and to allocate resources. Accordingly, financial information is reported to management on a "Core Earnings" basis by reportable segment, as these are the measures used regularly by our chief operating decision maker. Our "Core Earnings" are used in developing our financial plans and tracking results, and also in establishing corporate performance targets and determining incentive compensation. Management believes this information provides additional insight into the financial performance of the Company's core business activities. "Core Earnings" net income reflects only current period adjustments to GAAP net income, as described in the more detailed discussion of the differences between "Core Earnings" and GAAP that follows, which includes further detail on each specific adjustment required to reconcile our "Core Earnings" segment presentation to our GAAP earnings.

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | | 2005 | | |
| | Lending | DMO | Corporate and Other | Lending | DMO | Corporate and Other |
| "Core Earnings" adjustments to GAAP: | | | | | | |
| Net impact of securitization accounting | $ 160 | $— | $ — | $ (253) | $— | $ — |
| Net impact of derivative accounting | (14) | — | (99) | 246 | — | 163 |
| Net impact of Floor Income | (53) | — | — | (54) | — | — |
| Amortization of acquired intangibles | (30) | (5) | (2) | (12) | (3) | (1) |
| Total "Core Earnings" adjustments to GAAP | $ 63 | $ (5) | $ (101) | $ (73) | $ (3) | $ 162 |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | | 2005 | | |
| | Lending | DMO | Corporate and Other | Lending | DMO | Corporate and Other |
| "Core Earnings" adjustments to GAAP: | | | | | | |
| Net impact of securitization accounting | $ 600 | $ — | $ — | $ (178) | $— | $ — |
| Net impact of derivative accounting | 195 | — | (182) | 423 | — | 65 |
| Net impact of Floor Income | (158) | — | — | (148) | — | — |
| Amortization of acquired intangibles | (51) | (13) | (4) | (33) | (4) | (8) |
| Total "Core Earnings" adjustments to GAAP | $ 586 | $ (13) | $ (186) | $ 64 | $ (4) | $ 57 |

1) **Securitization:** Under GAAP, certain securitization transactions in our Lending operating segment are accounted for as sales of assets. Under the Company's "Core Earnings" presentation for the Lending operating segment, we present all securitization transactions on a "Core Earnings" basis as long-term non-recourse financings. The upfront "gains" on sale from securitization transactions as well as ongoing "servicing and securitization revenue" presented in accordance with GAAP are

excluded from “Core Earnings” net income and replaced by the interest income, provisions for loan losses, and interest expense as they are earned or incurred on the securitization loans. We also exclude transactions with our off-balance sheet trusts from “Core Earnings” net income as they are considered intercompany transactions on a “Core Earnings” basis.

The following table summarizes the securitization adjustments in our Lending operating segment for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| **“Core Earnings” securitization adjustments:** | | | | |
| Net interest income on securitized loans, after provisions for losses | $ (216) | $ (225) | $ (647) | $ (740) |
| Gains on student loan securitizations | 201 | — | 902 | 312 |
| Servicing and securitization revenue | 187 | (16) | 369 | 277 |
| Intercompany transactions with off-balance sheet trusts | (12) | (12) | (24) | (27) |
| Total “Core Earnings” securitization adjustments | $ 160 | $ (253) | $ 600 | $ (178) |

2) **Derivative Accounting:** “Core Earnings” net income excludes periodic unrealized gains and losses arising primarily in our Lending operating segment, and to a lesser degree in our Corporate and Other reportable segment, that are caused primarily by the one-sided mark-to-market derivative valuations prescribed by SFAS No. 133 on derivatives that do not qualify for “hedge treatment” under GAAP. Under the Company’s “Core Earnings” presentation, we recognize the economic effect of these hedges, which generally results in any cash paid or received being recognized ratably as an expense or revenue over the hedged item’s life. “Core Earnings” also excludes the gain or loss on equity forward contracts that under SFAS No. 133, are required to be accounted for as derivatives and are marked-to-market through earnings.

SFAS No. 133 requires that changes in the fair value of derivative instruments be recognized currently in earnings unless specific hedge accounting criteria, as specified by SFAS No. 133, are met. We believe that our derivatives are effective economic hedges, and as such, are a critical element of our interest rate risk management strategy. However, some of our derivatives, primarily Floor Income Contracts, certain Eurodollar futures contracts and certain basis swaps and equity forward contracts (discussed in detail below), do not qualify for “hedge treatment” as defined by SFAS No. 133, and the stand-alone derivative must be marked-to-market in the income statement with no consideration for the corresponding change in fair value of the hedged item. The gains and losses described in “gains (losses) on derivative and hedging activities, net” are primarily caused by interest rate volatility, changing credit spreads and changes in our stock price during the period as well as the volume and term of derivatives not receiving hedge treatment.

Our Floor Income Contracts are written options that must meet more stringent requirements than other hedging relationships to achieve hedge effectiveness under SFAS No. 133. Specifically, our Floor Income Contracts do not qualify for hedge accounting treatment because the paydown of principal of the student loans with the embedded Floor Income does not exactly match the change in the notional amount of our written Floor Income Contracts. Under SFAS No. 133, the upfront payment is deemed a liability and changes in fair value are recorded through income throughout the life of the contract. The change in the value of Floor Income Contracts is primarily caused by changing interest rates that cause the amount of Floor Income earned on the underlying student loans and paid to the counterparties to vary. This is economically offset by the change in value of the student loan portfolio, including our Retained Interests, earning Floor Income but that offsetting



change in value is not recognized under SFAS No. 133. We believe the Floor Income Contracts are economic hedges because they effectively fix the amount of Floor Income earned over the contract period, thus eliminating the timing and uncertainty that changes in interest rates can have on Floor Income for that period. Prior to SFAS No. 133, we accounted for Floor Income Contracts as hedges and amortized the upfront cash compensation ratably over the lives of the contracts.

Basis swaps are used to convert floating rate debt from one interest rate index to another to better match the interest rate characteristics of the assets financed by that debt. We primarily use basis swaps to change the index of our floating rate debt to better match the cash flows of our student loan assets that are primarily indexed to a commercial paper, Prime or Treasury bill index. SFAS No. 133 requires that when using basis swaps, the change in the cash flows of the hedge effectively offset both the change in the cash flows of the asset and the change in the cash flows of the liability. Our basis swaps hedge variable interest rate risk, however they do not meet this effectiveness test because our FFELP student loans can earn at either a variable or a fixed interest rate depending on market interest rates. We also have basis swaps that do not meet the SFAS No. 133 effectiveness test that economically hedge off-balance sheet instruments. As a result, under GAAP these swaps are recorded at fair value with changes in fair value reflected in the income statement.

Generally, a decrease in current interest rates and the respective forward interest rate curves results in an unrealized loss related to our written Floor Income Contracts which is offset by an increase in the value of the economically hedged student loans. This increase is not recognized in income. We will experience unrealized gains/losses related to our basis swaps if the two underlying indices (and related forward curve) do not move in parallel.

Under SFAS No. 150, equity forward contracts that allow a net settlement option either in cash or the Company’s stock are required to be accounted for as derivatives in accordance with SFAS No. 133. As a result, we account for our equity forward contracts as derivatives in accordance with SFAS No. 133 and mark them to market through earnings. They do not qualify as effective SFAS No. 133 hedges, as a requirement to achieve hedge accounting is the hedged item must impact net income and the settlement of these contracts through the purchase of our own stock does not impact net income.

The table below quantifies the adjustments for derivative accounting under SFAS No. 133 on our net income for the three and nine months ended September 30, 2006 and 2005 when compared with the accounting principles employed in all years prior to the SFAS No. 133 implementation.

| | Three Months Ended September 30, | Nine Months Ended September 30, |
|---|---|---|

| | 2006 | 2005 | 2006 | 2005 |
|---|---|---|---|---|
| **"Core Earnings" derivative adjustments:** | | | | |
| Gains (losses) on derivative and hedging activities, net included in other income[1] | $ (131) | $ 316 | $ (95) | $ 176 |
| Less: Realized losses on derivative and hedging activities, net[1] | 18 | 93 | 107 | 309 |
| Unrealized gains (losses) on derivative and hedging activities, net[1] | (113) | 409 | 12 | 485 |
| Other pre-SFAS No. 133 accounting adjustments | — | — | 1 | 3 |
| Total net impact of SFAS No. 133 derivative accounting | $ (113) | $ 409 | $ 13 | $ 488 |

(1) See *"Reclassification of Realized Gains (Losses) on Derivative and Hedging Activities"* below for a detailed breakdown of the components of both the realized and unrealized losses on derivative and hedging activities.

*Reclassification of Realized Gains (Losses) on Derivative and Hedging Activities*

SFAS No. 133 requires net settlement income/expense on derivatives and realized gains/losses related to derivative dispositions (collectively referred to as "realized gains (losses) on derivative and hedging



activities") that do not qualify as hedges under SFAS No. 133 to be recorded in a separate income statement line item below net interest income. The table below summarizes the realized losses on derivative and hedging activities, and where they are reclassified to on a "Core Earnings" basis for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| **Reclassification of realized losses on derivative and hedging activities:** | | | | |
| Net settlement expense on Floor Income Contracts reclassified to net interest income | $ (8) | $ (57) | $ (41) | $ (222) |
| Net settlement expense on interest rate swaps reclassified to net interest income | (10) | (36) | (66) | (82) |
| Net realized losses on closed Eurodollar futures contracts and terminated derivative contracts reclassified to other income | — | — | — | (5) |
| **Total reclassifications of realized losses on derivative and hedging activities** | (18) | (93) | (107) | (309) |
| Add: Unrealized gains (losses) on derivative and hedging activities, net[1] | (113) | 409 | 12 | 485 |
| Gains (losses) on derivative and hedging activities, net | $ (131) | $ 316 | $ (95) | $ 176 |

(1) "Unrealized gains (losses) on derivative and hedging activities, net" is comprised of the following unrealized mark-to-market gains (losses):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Floor Income Contracts | $ (90) | $ 257 | $ 142 | $ 379 |
| Equity forward contracts | (99) | 163 | (182) | 65 |
| Basis swaps | 98 | (19) | 30 | 48 |
| Other | (22) | 8 | 22 | (7) |
| Total unrealized gains (losses) on derivative and hedging activities, net | $ (113) | $ 409 | $ 12 | $ 485 |

3) **Floor Income:** The timing and amount (if any) of Floor Income earned in our Lending operating segment is uncertain and in excess of expected spreads. Therefore, we exclude such income from "Core Earnings" net income when it is not economically hedged. We employ derivatives, primarily Floor Income Contracts and futures, to economically hedge Floor Income. As discussed above in "Derivative Accounting," these derivatives do not qualify as effective accounting hedges and therefore, under GAAP, they are marked-to-market through the "gains (losses) on derivative and hedging activities, net" line on the income statement with no offsetting gain or loss recorded for the economically hedged items. For "Core Earnings" net income, we reverse the fair value adjustments on the Floor Income Contracts and futures economically hedging Floor Income and include the amortization of net premiums received (net of Eurodollar futures contracts' realized gains or losses) in income.



The following table summarizes the Floor Income adjustments in our Lending operating segment for the three and nine months ended September 30, 2006 and 2005.

| | Three Month Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| **"Core Earnings" Floor Income adjustments:** | | | | |
| Floor Income earned on Managed loans, net of payments on Floor Income Contracts | $ — | $ 2 | $ — | $ 19 |
| Amortization of net premiums on Floor Income Contracts and futures in net interest income | (53) | (56) | (158) | (167) |
| Total "Core Earnings" Floor Income adjustments | $ (53) | $ (54) | $ (158) | $ (148) |

4) **Acquired Intangibles:** We exclude goodwill and intangible impairment and amortization of acquired intangibles. These amounts totaled $37 million and $16 million, respectively, for the three months ended September 30, 2006 and 2005, and $68 million and $45 million, respectively, for the nine months ended September 30, 2006 and 2005. In the third quarter of 2006, we recognized an intangible impairment of $21 million due to changes in projected interest rates used to initially value the intangible asset and to a regulatory change that restricts the loans on which the Company is entitled to earn a 9.5 percent yield.

**LENDING BUSINESS SEGMENT**

In our Lending business segment, we originate and acquire federally guaranteed student loans, which are administered by the U.S. Department of Education ("ED"), and Private Education Loans, which are not federally or privately guaranteed. The majority of our Private Education Loans is made in conjunction with a FFELP Stafford loan and as a result is marketed through the same marketing channels as FFELP Stafford Loans. While FFELP student loans and Private Education Loans have different overall risk profiles due to the federal guarantee of the FFELP student loans, they share many of the same characteristics such as similar repayment terms, the same marketing channel and sales force, and are originated and serviced on the same servicing platform. Finally, where possible, the borrower receives a single bill for both the federally guaranteed and privately underwritten loans.



The following table summarizes the "Core Earnings" results of operations for our Lending business segment.

| | Three Months Ended September 30, 2006 | Three Months Ended September 30, 2005 | % Increase (Decrease) 2006 vs. 2005 | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2005 | % Increase (Decrease) 2006 vs. 2005 |
|---|---|---|---|---|---|---|
| "Core Earnings" interest income: | | | | | | |
| FFELP Stafford and Other Student Loans | $ 702 | $ 586 | 20% | $ 2,070 | $ 1,678 | 23% |
| Consolidation Loans | 1,242 | 833 | 49 | 3,385 | 2,080 | 63 |
| Private Education Loans | 558 | 312 | 79 | 1,472 | 787 | 87 |
| Other loans | 24 | 22 | 9 | 71 | 62 | 15 |
| Cash and investments | 207 | 112 | 85 | 507 | 268 | 89 |
| Total "Core Earnings" interest income | 2,733 | 1,865 | 47 | 7,505 | 4,875 | 54 |
| Total "Core Earnings" interest expense | 2,124 | 1,299 | 64 | 5,687 | 3,291 | 73 |
| Net "Core Earnings" interest income | 609 | 566 | 8 | 1,818 | 1,584 | 15 |
| Less: provisions for losses | 80 | — | 100 | 215 | 69 | 212 |
| Net "Core Earnings" interest income after provisions for losses | 529 | 566 | (7) | 1,603 | 1,515 | 6 |
| Other income | 46 | — | 100 | 138 | 72 | 92 |
| Operating expenses[(1)(2)] | 156 | 134 | 16 | 481 | 408 | 18 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 419 | 432 | (3) | 1,260 | 1,179 | 7 |
| Income taxes | 155 | 160 | (3) | 466 | 437 | 7 |
| Income before minority interest in net earnings of subsidiaries | 264 | 272 | (3) | 794 | 742 | 7 |
| Minority interest in net earnings of subsidiaries | — | — | — | — | 2 | (100) |
| **"Core Earnings" net income** | $ 264 | $ 272 | (3)% | $ 794 | $ 740 | 7% |

(1) The three and nine months ended September 30, 2006 operating expenses for the Lending segment include $8 million and $26 million, respectively, of stock-based compensation expense due to the implementation of SFAS No. 123(R) in the first quarter of 2006.

(2) In the first quarter of 2006, the Company changed its method for allocating certain overhead and other expenses between our business segments. Balances for the three and nine months ending September 30, 2005 have been updated to reflect the new allocation methodology.



**Summary of our Managed Student Loan Portfolio**

The following tables summarize the components of our Managed student loan portfolio and show the changing composition of our portfolio.

***Ending Balances (net of allowance for loan losses):***

| | September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[(1)] | Consolidation Loans | Total FFELP | Private Education Loans | Total |
| On-balance sheet: | | | | | |
| In-school | $ 8,900 | $ — | $ 8,900 | $ 3,566 | $ 12,466 |
| Grace and repayment | 13,248 | 56,356 | 69,604 | 5,252 | 74,856 |
| Total on-balance sheet, gross | 22,148 | 56,356 | 78,504 | 8,818 | 87,322 |
| On-balance sheet unamortized premium/(discount) | 473 | 857 | 1,330 | (321) | 1,009 |
| On-balance sheet allowance for losses | (7) | (11) | (18) | (275) | (293) |
| Total on-balance sheet, net | 22,614 | 57,202 | 79,816 | 8,222 | 88,038 |
| Off-balance sheet: | | | | | |
| In-school | 2,380 | — | 2,380 | 4,261 | 6,641 |
| Grace and repayment | 14,536 | 18,254 | 32,790 | 9,104 | 41,894 |

| | | | | | |
|---|---|---|---|---|---|
| Total off-balance sheet, gross | 16,916 | 18,254 | 35,170 | 13,365 | 48,535 |
| Off-balance sheet unamortized premium/(discount) | 268 | 495 | 763 | (286) | 477 |
| Off-balance sheet allowance for losses | (11) | (4) | (15) | (100) | (115) |
| Total off-balance sheet, net | 17,173 | 18,745 | 35,918 | 12,979 | 48,897 |
| Total Managed | $ 39,787 | $ 75,947 | $ 115,734 | $ 21,201 | $ 136,935 |
| % of on-balance sheet FFELP | 28% | 72% | 100% | | |
| % of Managed FFELP | 34% | 66% | 100% | | |
| % of total | 29% | 56% | 85% | 15% | 100% |

| | December 31, 2005 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[1] | Consolidation Loans | Total FFELP | Private Education Loans | Total |
| On-balance sheet: | | | | | |
| In-school | $ 6,910 | $ — | $ 6,910 | $ 3,432 | $ 10,342 |
| Grace and repayment | 12,705 | 54,033 | 66,738 | 4,834 | 71,572 |
| Total on-balance sheet, gross | 19,615 | 54,033 | 73,648 | 8,266 | 81,914 |
| On-balance sheet unamortized premium/(discount) | 379 | 835 | 1,214 | (305) | 909 |
| On-balance sheet allowance for losses | (6) | (9) | (15) | (204) | (219) |
| Total on-balance sheet, net | 19,988 | 54,859 | 74,847 | 7,757 | 82,604 |
| Off-balance sheet: | | | | | |
| In-school | 2,962 | — | 2,962 | 2,540 | 5,502 |
| Grace and repayment | 17,410 | 10,272 | 27,682 | 6,406 | 34,088 |
| Total off-balance sheet, gross | 20,372 | 10,272 | 30,644 | 8,946 | 39,590 |
| Off-balance sheet unamortized premium/(discount) | 306 | 305 | 611 | (188) | 423 |
| Off-balance sheet allowance for losses | (8) | (2) | (10) | (78) | (88) |
| Total off-balance sheet, net | 20,670 | 10,575 | 31,245 | 8,680 | 39,925 |
| Total Managed | $ 40,658 | $ 65,434 | $ 106,092 | $ 16,437 | $ 122,529 |
| % of on-balance sheet FFELP | 27% | 73% | 100% | | |
| % of Managed FFELP | 38% | 62% | 100% | | |
| % of total | 33% | 54% | 87% | 13% | 100% |

(1) FFELP category is primarily Stafford loans, but also includes federally insured PLUS and HEAL loans.



***Average Balances:***

| | Three Months Ended September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[1] | Consolidation Loans | Total FFELP | Private Education Loans | Total |
| On-balance sheet | $ 21,194 | $ 54,968 | $ 76,162 | $ 8,079 | $ 84,241 |
| Off-balance sheet | 18,558 | 17,538 | 36,096 | 12,130 | 48,226 |
| Total Managed | $ 39,752 | $ 72,506 | $ 112,258 | $ 20,209 | $ 132,467 |
| % of on-balance sheet FFELP | 28% | 72% | 100% | | |
| % of Managed FFELP | 35% | 65% | 100% | | |
| % of Total | 30% | 55% | 85% | 15% | 100% |

| | Three Months Ended September 30, 2005 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[1] | Consolidation Loans | Total FFELP | Private Education Loans | Total |
| On-balance sheet | $ 21,574 | $ 48,774 | $ 70,348 | $ 7,193 | $ 77,541 |
| Off-balance sheet | 22,250 | 11,094 | 33,344 | 7,398 | 40,742 |
| Total Managed | $ 43,824 | $ 59,868 | $ 103,692 | $ 14,591 | $ 118,283 |
| % of on-balance sheet FFELP | 31% | 69% | 100% | | |
| % of Managed FFELP | 42% | 58% | 100% | | |
| % of Total | 37% | 51% | 88% | 12% | 100% |

| | Nine Months Ended September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[1] | Consolidation Loans | Total FFELP | Private Education Loans | Total |
| On-balance sheet | $ 20,432 | $ 53,830 | $ 74,262 | $ 8,348 | $ 82,610 |
| Off-balance sheet | 20,791 | 14,706 | 35,497 | 10,530 | 46,027 |
| Total Managed | $ 41,223 | $ 68,536 | $ 109,759 | $ 18,878 | $ 128,637 |
| % of on-balance sheet FFELP | 28% | 72% | 100% | | |
| % of Managed FFELP | 38% | 62% | 100% | | |
| % of Total | 32% | 53% | 85% | 15% | 100% |

| | Nine Months Ended September 30, 2005 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[1] | Consolidation Loans | Total FFELP | Private Education Loans | Total |
| On-balance sheet | $ 20,268 | $ 45,081 | $ 65,349 | $ 6,615 | $ 71,964 |
| Off-balance sheet | 25,783 | 9,481 | 35,264 | 6,873 | 42,137 |

| | | | | | |
|---|---|---|---|---|---|
| Total Managed | $ 46,051 | $ 54,562 | $ 100,613 | $ 13,488 | $ 114,101 |
| % of on-balance sheet FFELP | 31% | 69% | 100% | | |
| % of Managed FFELP | 46% | 54% | 100% | | |
| % of Total | 40% | 48% | 88% | 12% | 100% |

(1) FFELP category is primarily Stafford loans, but also includes federally insured PLUS and HEAL loans.

**Student Loan Spread Analysis—"Core Earnings" Basis**

The following table analyzes the earnings from our portfolio of Managed student loans on a "Core Earnings" basis (see "BUSINESS SEGMENTS—*Pre-tax differences between 'Core Earnings' and GAAP by Business Segment")*. The "Core Earnings" Basis Student Loan Spread Analysis presentation and certain components used in the calculation differ from the On-Balance Sheet Student Loan Spread Analysis



presentation. The "Core Earnings" basis presentation, when compared to our on-balance sheet presentation, is different in that it:

- includes the net interest margin related to our off-balance sheet student loan securitization trusts. This includes any related fees or costs such as the Consolidation Loan Rebate Fees, premium/discount amortization and Borrower Benefits yield adjustments;
- includes the reclassification of certain derivative net settlement amounts. The net settlements on certain derivatives that do not qualify as SFAS No. 133 hedges are recorded as part of the gain (loss) on derivative and hedging activities, net for GAAP purposes are reclassified to the line item on the income statement that such derivative is economically hedging for the "Core Earnings" basis presentation. For our "Core Earnings" basis student loan spread, this would primarily include: (a) reclassifying the net settlement amounts related to our written Floor Income Contracts to student loan interest income and (b) reclassifying the net settlement amounts related to certain of our basis swaps to debt interest expense;
- excludes unhedged Floor Income earned on the Managed student loan portfolio; and
- includes the amortization of upfront payments on Floor Income Contracts in student loan income that we believe are economically hedging the Floor Income.

As discussed above, these differences result in the "Core Earnings" basis student loan spread not being a GAAP-basis presentation. Management relies on this measure to manage our Lending business segment. Specifically, management uses the "Core Earnings" basis student loan spread to evaluate the overall economic effect that certain factors have on all student loans either on- or off-balance sheet. These factors include the overall mix of student loans in our portfolio, acquisition costs, Borrower Benefits program costs, Floor Income and funding and hedging costs. Management believes that it is important to evaluate all of these factors on a Managed Basis to gain additional information about the economic effect of these factors on all student loans under management. Management believes that this additional information assists us in making strategic decisions about the Company's business model for the Lending business segment, including among other factors, how we acquire or originate student loans, how we fund acquisitions and originations, what Borrower Benefits we offer and what type of loans we purchase or originate. While management believes that the "Core Earnings" basis student loan spread is an important tool for evaluating the Company's performance for the reasons described above, it is subject to certain general and specific limitations that investors should carefully consider. See "BUSINESS SEGMENTS—Limitations of 'Core Earnings.'" One specific limitation is that the "Core Earnings" basis student loan spread includes the spread on loans that we have sold to securitization trusts.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| "Core earnings" basis student loan yield | 8.33% | 6.55% | 7.99% | 6.04% |
| Consolidation Loan Rebate Fees | (.57) | (.52) | (.55) | (.49) |
| Borrower Benefits | (.11) | (.04) | (.08) | (.06) |
| Premium and discount amortization | (.16) | (.18) | (.16) | (.17) |
| "Core earnings" basis student loan net yield | 7.49 | 5.81 | 7.20 | 5.32 |
| "Core earnings" basis student loan cost of funds | (5.70) | (4.00) | (5.36) | (3.54) |
| "Core earnings" basis student loan spread | 1.79% | 1.81% | 1.84% | 1.78% |
| **Average Balances** | | | | |
| On-balance sheet student loans | $ 84,241 | $ 77,541 | $ 82,610 | $ 71,964 |
| Off-balance sheet student loans | 48,226 | 40,742 | 46,027 | 42,137 |
| Managed student loans | $ 132,467 | $ 118,283 | $ 128,637 | $ 114,101 |



*Discussion of "Core Earnings" Basis Student Loan Spread—Quarter-over-Quarter Fluctuations*

In the third quarter of 2005, we updated our estimates for the qualification for Borrower Benefits to account for programmatic changes as well as the effect of continued high levels of consolidations. These updates resulted in a reduction of $21 million or 7 basis points in our Borrower Benefits liability. Absent this 2005 adjustment, the increase in the "Core Earnings" basis student loan spread for the three months ended September 30, 2006 versus the year-ago period is due to the increase of higher yielding Private Education Loans as a percentage of the portfolio, outweighing the negative effect of the increase of lower yielding Consolidation Loans as a percentage of the overall student loan portfolio.

**"Core Earnings" Basis Student Loan Spreads by Loan Type**

The student loan spread continues to reflect the changing mix of loans in our portfolio, specifically the shift from FFELP Stafford loans to Consolidation Loans and the higher overall growth rate in Private Education Loans as a percentage of the total portfolio. (See "LENDING BUSINESS SEGMENT—Summary of our Managed Student Loan Portfolio—Average Balances.")

The following table reflects the "Core Earnings" basis student loan spreads by product, excluding the effect of non-recurring items, for the three months ended September 30, 2006 and 2005 and for the nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| **FFELP Loan Spreads ("Core Earnings" Basis):** | | | | |
| Stafford | 1.26% | 1.38% | 1.33% | 1.46% |
| Consolidation | 1.12 | 1.27 | 1.19 | 1.29 |
| Managed FFELP Loan Spread | 1.17 | 1.31 | 1.24 | 1.37 |
| **Private Education Loan Spreads ("Core Earnings" Basis):** | | | | |
| Before provision | 5.25% | 4.75% | 5.07% | 4.71% |
| After provision | 3.83 | 3.04 | 3.70 | 3.27 |

***Floor Income—Managed Basis***

The following table analyzes the ability of the FFELP student loans in our Managed student loan portfolio to earn Floor Income after September 30, 2006 and 2005.

| | September 30, 2006 | | | September 30, 2005 | | |
|---|---|---|---|---|---|---|
| (Dollars in billions) | Fixed Borrower Rate | Variable Borrower Rate | Total | Fixed Borrower Rate | Variable Borrower Rate | Total |
| Student loans eligible to earn Floor Income: | | | | | | |
| On-balance sheet student loans | $ 56.9 | $ 18.8 | $ 75.7 | $ 49.6 | $ 17.9 | $ 67.5 |
| Off-balance sheet student loans | 18.2 | 16.6 | 34.8 | 10.6 | 18.7 | 29.3 |
| Managed student loans eligible to earn Floor Income | 75.1 | 35.4 | 110.5 | 60.2 | 36.6 | 96.8 |
| Less: notional amount of Floor Income Contracts | (24.7) | — | (24.7) | (26.0) | — | (26.0) |
| Net Managed student loans eligible to earn Floor Income | $ 50.4 | $ 35.4 | $ 85.8 | $ 34.2 | $ 36.6 | $ 70.8 |
| Net Managed student loans earning Floor Income | $ 3.8 | $ — | $ 3.8 | $ .9 | $ — | $ .9 |

The reconsolidation of Consolidation Loans has had an unanticipated impact on Consolidation Loans underlying Floor Income Contracts. The Floor Income Contracts are economically hedging the fixed



borrower interest rate earned on Consolidation Loans. Generally, Consolidation Loans are eligible to earn Floor Income, and over time we have sold Floor Income Contracts to hedge the potential Floor Income from specifically identified pools of Consolidation Loans. The balance of the Floor Income Contracts did not anticipate the reconsolidation of Consolidation Loans and as a consequence, higher rate Consolidation Loans that underlie certain contracts have been reconsolidated with lower fixed rates that no longer match the underlying Floor Income Contract. As a result, as of September 30, 2006, the notional amount of Floor Income Contracts is slightly higher than the outstanding balance of the Consolidation Loans that the Floor Income Contracts were hedging. The Higher Education Act of 2005 has severely restricted the use of reconsolidation as of July 1, so we do not foresee any material impact on our Floor Income in the future.

The following table presents a projection of the average Managed balance of Consolidation Loans whose Fixed Rate Floor Income has already been economically hedged through Floor Income Contracts for the period October 1, 2006 to June 30, 2010. These loans are both on- and off-balance sheet and the related hedges do not qualify under SFAS No. 133 accounting as effective hedges.

| (Dollars in billions) | October 1, 2006 to December 31, 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| Average balance of Consolidation Loans whose Floor Income is economically hedged (Managed Basis) | $ 24 | $ 16 | $ 15 | $ 10 | $ 2 |

**Private Education Loans**

Substantially all Private Education Loans are originated by Sallie Mae Bank, a wholly-owned Utah industrial bank subsidiary of SLM Corporation. All Private Education Loans are initially originated or acquired on-balance sheet. When we securitize Private Education Loans, we no longer own the loans and they are accounted for off-balance sheet. For our Managed presentation in the table below, we reduce the on-balance sheet allowance for amounts previously provided and then provide for these loans in the off-balance sheet section with the total of both on and off-balance sheet residing in the Managed presentation.

When Private Education Loans in the majority of our securitized trusts become 180 days delinquent, we typically exercise our contingent call option to repurchase these loans at par value out of the trust and record a loss for the difference in the par value paid and the fair market value of the loan at the time of purchase. If these loans reach the 212-day delinquency, a charge-off for the remaining balance of the loan is triggered. On a Managed Basis, the losses recorded under GAAP for loans repurchased at day 180 are reversed and the full amount is charged off in the month in which the loan is 212 days delinquent.

The off-balance sheet allowance is increasing as more loans are securitized but is lower than the on-balance sheet percentage when measured as a percentage of ending loans in repayment because of the different mix of loans on-balance sheet and off-balance sheet, and due to how we administratively handle delinquent loans repurchased from our securitized trusts, as described above. Additionally, a larger percentage of the off-balance sheet loan borrowers are still in-school status and not required to make payments on their loans. Once repayment begins, the allowance requirements increase to reflect the increased risk of loss as loans enter repayment.

*Activity in the Allowance for Private Education Loan Losses*

The provision for student loan losses represents the periodic expense of maintaining an allowance sufficient to absorb losses, net of recoveries, inherent in the portfolio of Private Education Loans.

The following table summarizes changes in the allowance for Private Education Loan losses for the three and nine months ended September 30, 2006 and 2005.

| | Activity in Allowance for Private Education Loan Losses | | | | | |
|---|---|---|---|---|---|---|
| | On-Balance Sheet | | Off-Balance Sheet | | Managed Basis | |
| | Three Months Ended | | Three Months Ended | | Three Months Ended | |
| | September 30, 2006 | September 30, 2005 | September 30, 2006 | September 30, 2005 | September 30, 2006 | September 30, 2005 |
| Allowance at beginning of period | $ 252 | $ 228 | $ 92 | $ 91 | $ 344 | $ 319 |
| Provision for Private Education Loan losses | 58 | 56 | 14 | 4 | 72 | 60 |
| Change in recovery estimate | — | (49) | — | (16) | — | (65) |
| Total provision | 58 | 7 | 14 | (12) | 72 | (5) |
| Charge-offs | (37) | (47) | (10) | — | (47) | (47) |
| Recoveries | 6 | 5 | — | — | 6 | 5 |
| Net charge-offs | (31) | (42) | (10) | — | (41) | (42) |
| Balance before securitization of Private Education Loans | 279 | 193 | 96 | 79 | 375 | 272 |
| Reduction for securitization of Private Education Loans | (4) | — | 4 | — | — | — |
| Allowance at end of period | $ 275 | $ 193 | $ 100 | $ 79 | $ 375 | $ 272 |
| Net charge-offs as a percentage of average loans in repayment (annualized) | 3.19% | 5.35% | .68% | —% | 1.70% | 2.42% |
| Allowance as a percentage of the ending total loan balance | 3.24% | 2.34% | .77% | 1.07% | 1.74% | 1.74% |
| Allowance as a percentage of ending loans in repayment | 6.91% | 6.00% | 1.79% | 2.13% | 3.92% | 3.93% |
| Average coverage of net charge-offs (annualized) | 2.22 | 1.15 | 2.62 | — | 2.32 | 1.62 |
| Average total loans | $ 8,079 | $ 7,193 | $ 12,130 | $ 7,398 | $ 20,209 | $ 14,591 |
| Ending total loans | $ 8,497 | $ 8,272 | $ 13,079 | $ 7,391 | $ 21,576 | $ 15,663 |
| Average loans in repayment | $ 3,879 | $ 3,150 | $ 5,667 | $ 3,814 | $ 9,546 | $ 6,964 |
| Ending loans in repayment | $ 3,980 | $ 3,220 | $ 5,603 | $ 3,705 | $ 9,583 | $ 6,925 |

In general the provision for loans can fluctuate quarter to quarter due to the seasonality of loans entering repayment. The majority of loans typically enter repayment in the second and fourth quarters. This increase in loans entering repayment often leads to a near-term increase in early-stage delinquencies, or forbearance usage in the first and third quarters with some residual effect in the fourth quarter for the affected borrowers. This in turn, leads to higher provisions for those quarters. Therefore, all other factors being equal, the provision for loan losses in the third quarter will be higher.



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The Managed Basis allowance ratios are virtually unchanged from September 30, 2005 to September 30, 2006, as the allowance has grown in proportion to the balance of our Private Education Loan portfolio.

| | Activity in Allowance for Private Education Loan Losses | | | | | |
|---|---|---|---|---|---|---|
| | On-Balance Sheet | | Off-Balance Sheet | | Managed Basis | |
| | Nine Months Ended | | Nine Months Ended | | Nine Months Ended | |
| | September 30, 2006 | September 30, 2005 | September 30, 2006 | September 30, 2005 | September 30, 2006 | September 30, 2005 |
| Allowance at beginning of period | $ 204 | $ 172 | $ 78 | $ 143 | $ 282 | $ 315 |
| Provision for Private Education Loan losses | 175 | 135 | 19 | 9 | 194 | 144 |
| Change in estimate | — | 40 | — | (60) | — | (20) |
| Change in recovery estimate | — | (49) | — | (16) | — | (65) |
| Total provision | 175 | 126 | 19 | (67) | 194 | 59 |
| Charge-offs | (105) | (113) | (14) | (3) | (119) | (116) |
| Recoveries | 18 | 14 | — | — | 18 | 14 |
| Net charge-offs | (87) | (99) | (14) | (3) | (101) | (102) |
| Balance before securitization of Private Education Loans | 292 | 199 | 83 | 73 | 375 | 272 |
| Reduction for securitization of Private Education Loans | (17) | (6) | 17 | 6 | — | — |
| Allowance at end of period | $ 275 | $ 193 | $ 100 | $ 79 | $ 375 | $ 272 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net charge-offs as a percentage of average loans in repayment (annualized) | 3.06% | 4.37% | .36% | .09% | 1.51% | 2.07% |
| Allowance as a percentage of the ending total loan balance | 3.24% | 2.34% | .77% | 1.07% | 1.74% | 1.74% |
| Allowance as a percentage of ending loans in repayment | 6.91% | 6.00% | 1.79% | 2.13% | 3.92% | 3.93% |
| Average coverage of net charge-offs (annualized) | 2.35 | 1.46 | 5.44 | 24.00 | 2.77 | 2.01 |
| Average total loans | $ 8,348 | $ 6,615 | $ 10,530 | $ 6,873 | $ 18,878 | $ 13,488 |
| Ending total loans | $ 8,497 | $ 8,272 | $ 13,079 | $ 7,391 | $ 21,576 | $ 15,663 |
| Average loans in repayment | $ 3,821 | $ 3,031 | $ 5,127 | $ 3,529 | $ 8,948 | $ 6,560 |
| Ending loans in repayment | $ 3,980 | $ 3,220 | $ 5,603 | $ 3,705 | $ 9,583 | $ 6,925 |

The increase in the Managed Basis Private Education Loan provision and allowance for the nine months ended September 30, 2006 over the year-ago period is consistent with the growth in both the total balance of the portfolio, as well as, the balance of loans in repayment.



### *Delinquencies*

The table below presents our Private Education Loan delinquency trends as of September 30, 2006 and 2005. Delinquencies have the potential to adversely impact earnings through increased servicing and collection costs in the event the delinquent accounts charge off.

| | On-Balance Sheet Private Education Loan Delinquencies | | | |
|---|---|---|---|---|
| | September 30, 2006 | | September 30, 2005 | |
| | Balance | % | Balance | % |
| Loans in-school/grace/deferment[1] | $4,497 | | $5,042 | |
| Loans in forbearance[2] | 341 | | 311 | |
| Loans in repayment and percentage of each status: | | | | |
| Loans current | 3,462 | 87.0% | 2,873 | 89.2% |
| Loans delinquent 31-60 days[3] | 209 | 5.3 | 145 | 4.5 |
| Loans delinquent 61-90 days[3] | 121 | 3.0 | 75 | 2.3 |
| Loans delinquent greater than 90 days[3] | 188 | 4.7 | 127 | 4.0 |
| Total Private Education Loans in repayment | 3,980 | 100% | 3,220 | 100% |
| Total Private Education Loans, gross | 8,818 | | 8,573 | |
| Private Education Loan unamortized discount | (321) | | (301) | |
| Total Private Education Loans | 8,497 | | 8,272 | |
| Private Education Loan allowance for losses | (275) | | (193) | |
| Private Education Loans, net | $8,222 | | $8,079 | |
| Percentage of Private Education Loans in repayment | 45.1% | | 37.6% | |
| Delinquencies as a percentage of Private Education Loans in repayment | 13.0% | | 10.8% | |

| | Off-Balance Sheet Private Education Loan Delinquencies | | | |
|---|---|---|---|---|
| | September 30, 2006 | | September 30, 2005 | |
| | Balance | % | Balance | % |
| Loans in-school/grace/deferment[1] | $ 6,861 | | $3,272 | |
| Loans in forbearance[2] | 901 | | 552 | |
| Loans in repayment and percentage of each status: | | | | |
| Loans current | 5,281 | 94.3% | 3,514 | 94.9% |
| Loans delinquent 31-60 days[3] | 164 | 2.9 | 94 | 2.5 |
| Loans delinquent 61-90 days[3] | 68 | 1.2 | 38 | 1.0 |
| Loans delinquent greater than 90 days[3] | 90 | 1.6 | 59 | 1.6 |
| Total Private Education Loans in repayment | 5,603 | 100% | 3,705 | 100% |
| Total Private Education Loans, gross | 13,365 | | 7,529 | |
| Private Education Loan unamortized discount | (286) | | (138) | |
| Total Private Education Loans | 13,079 | | 7,391 | |
| Private Education Loan allowance for losses | (100) | | (79) | |
| Private Education Loans, net | $12,979 | | $7,312 | |
| Percentage of Private Education Loans in repayment | 41.9% | | 49.2% | |
| Delinquencies as a percentage of Private Education Loans in repayment | 5.7% | | 5.1% | |

(1) Loans for borrowers who still may be attending school or engaging in other permitted educational activities and are not yet required to make payments on the loans, e.g., residency periods for medical students or a grace period for bar exam preparation.

(2) Loans for borrowers who have requested extension of grace period or who have temporarily ceased making full payments due to hardship or other factors. When loans exit forbearance status and enter repayment, they are initially included in current status.

(3) The period of delinquency is based on the number of days scheduled payments are contractually past due.

| | Managed Private Education Loan Delinquencies | | | |
|---|---|---|---|---|
| | September 30, 2006 | | September 30, 2005 | |
| | Balance | % | Balance | % |
| Loans in-school/grace/deferment[1] | $ 11,358 | | $ 8,314 | |
| Loans in forbearance[2] | 1,242 | | 863 | |
| Loans in repayment and percentage of each status: | | | | |
| Loans current | 8,743 | 91.2% | 6,387 | 92.2% |
| Loans delinquent 31-60 days[3] | 373 | 3.9 | 239 | 3.5 |
| Loans delinquent 61-90 days[3] | 189 | 2.0 | 113 | 1.6 |
| Loans delinquent greater than 90 days[3] | 278 | 2.9 | 186 | 2.7 |
| Total Private Education Loans in repayment | 9,583 | 100% | 6,925 | 100% |
| Total Private Education Loans, gross | 22,183 | | 16,102 | |
| Private Education Loan unamortized discount | (607) | | (439) | |
| Total Private Education Loans | 21,576 | | 15,663 | |
| Private Education Loan allowance for losses | (375) | | (272) | |
| Private Education Loans, net | $ 21,201 | | $ 15,391 | |
| Percentage of Private Education Loans in repayment | 43.2% | | 43.0% | |
| Delinquencies as a percentage of Private Education Loans in repayment | 8.8% | | 7.8% | |

(1) Loans for borrowers who still may be attending school or engaging in other permitted educational activities and are not yet required to make payments on the loans, e.g., residency periods for medical students or a grace period for bar exam preparation.

(2) Loans for borrowers who have requested extension of grace period or who have temporarily ceased making full payments due to hardship or other factors. When loans exit forbearance status and enter repayment, they are initially included in current status.

(3) The period of delinquency is based on the number of days scheduled payments are contractually past due.

***Forbearance—Managed Basis Private Education Loans***

The tables below present the composition and status of the Managed Private Education Loan portfolio by number of months aged from the first date of repayment. As indicated in the tables, forbearance is used most heavily immediately after the loan enters repayment, with the percentage of loans in forbearance decreasing the longer the loans have been in repayment. At September 30, 2006, loans in forbearance as a percentage of loans in repayment and forbearance was 14.7 percent for loans that have been in repayment one to twenty-four months. The percentage declined to 4.5 percent for loans that have been in repayment more than 48 months. Approximately 77 percent of our Managed Private Education Loans in forbearance have been in repayment less than 24 months. These borrowers are essentially extending their grace period as they transition to the workforce. Forbearance continues to be a positive collection tool for the Private Education Loans as we believe it can provide the borrower with sufficient time to obtain employment and income to support his or her obligation. We consider the potential impact of forbearance in the determination of the loan loss reserves.



| | Months Since Initially Entering Repayment | | | | |
|---|---|---|---|---|---|
| | 1 to 24 Months | 25 to 48 Months | More than 48 Months | After Sept. 30, 2006[1] | Total |
| **September 30, 2006** | | | | | |
| Loans in-school/grace/deferment | $ — | $ — | $ — | $ 11,358 | $ 11,358 |
| Loans in forbearance | 956 | 203 | 83 | — | 1,242 |
| Loans in repayment—current | 5,055 | 2,050 | 1,638 | — | 8,743 |
| Loans in repayment—delinquent 31-60 days | 208 | 94 | 71 | — | 373 |
| Loans in repayment—delinquent 61-90 days | 120 | 41 | 28 | — | 189 |
| Loans in repayment—delinquent greater than 90 days | 156 | 77 | 45 | — | 278 |
| Total | $ 6,495 | $ 2,465 | $ 1,865 | $ 11,358 | 22,183 |
| Unamortized discount | | | | | (607) |
| Allowance for loan losses | | | | | (375) |
| Total Managed Private Education Loans, net | | | | | $ 21,201 |
| Loans in forbearance as a percentage of loans in repayment and forbearance | 14.7% | 8.2% | 4.5% | —% | 11.5% |

| | Months Since Initially Entering Repayment | | | | |
|---|---|---|---|---|---|
| | 1 to 24 Months | 25 to 48 Months | More than 48 Months | After Sept. 30 2005[1] | Total |
| **September 30, 2005** | | | | | |
| Loans in-school/grace/deferment | $ — | $ — | $ — | $ 8,314 | $ 8,314 |
| Loans in forbearance | 630 | 150 | 83 | — | 863 |
| Loans in repayment—current | 3,635 | 1,485 | 1,267 | — | 6,387 |
| Loans in repayment—delinquent 31-60 days | 131 | 62 | 46 | — | 239 |
| Loans in repayment—delinquent 61-90 days | 72 | 26 | 15 | — | 113 |
| Loans in repayment—delinquent greater than 90 days | 100 | 58 | 28 | — | 186 |
| Total | $ 4,568 | $ 1,781 | $ 1,439 | $ 8,314 | 16,102 |
| Unamortized discount | | | | | (439) |
| Allowance for loan losses | | | | | (272) |
| Total Managed Private Education Loans, net | | | | | $ 15,391 |

| | | | | | |
|---|---|---|---|---|---|
| Loans in forbearance as a percentage of loans in repayment and forbearance | 13.8% | 8.4% | 5.8% | —% | 11.1% |

(1) Includes all loans in-school/grace/deferment.



The table below stratifies the portfolio of Managed Private Education Loans in forbearance by the cumulative number of months the borrower has used forbearance as of the dates indicated. As detailed in the table below, 7 percent of loans currently in forbearance have deferred their loan repayment more than 24 months, which is equivalent to the year-ago period.

| | September 30, | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Forbearance Balance | % of Total | Forbearance Balance | % of Total |
| **Cumulative number of months borrower has used forbearance** | | | | |
| Up to 12 months | $ 902 | 72% | $ 646 | 75% |
| 13 to 24 months | 259 | 21 | 154 | 18 |
| 25 to 36 months | 58 | 5 | 40 | 4 |
| More than 36 months | 23 | 2 | 23 | 3 |
| Total | $ 1,242 | 100% | $ 863 | 100% |

### Total Loan Net Charge-offs

The following tables summarize the net charge-offs for all loan types on both an on-balance sheet basis and a Managed Basis for the three and nine months ended September 30, 2006 and 2005. Almost all Private Education Loan charge-offs occur on-balance sheet due to the contingent call feature in a majority of the off-balance sheet securitization trusts, which is discussed in more detail at “LENDING BUSINESS SEGMENT—Private Education Loans.”

*Total on-balance sheet loan net charge-offs*

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Private Education Loans | $ 31 | $ 42 | $ 87 | $ 99 |
| FFELP Stafford and Other Student Loans | 1 | 1 | 3 | 3 |
| Mortgage and consumer loans | 1 | 1 | 4 | 4 |
| Total on-balance sheet loan net charge-offs | $ 33 | $ 44 | $ 94 | $ 106 |

*Total Managed loan net charge-offs*

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Private Education Loans | $ 41 | $ 42 | $ 101 | $ 102 |
| FFELP Stafford and Other Student Loans | 1 | 1 | 3 | 3 |
| Mortgage and consumer loans | 1 | 1 | 4 | 4 |
| Total Managed loan net charge-offs | $ 43 | $ 44 | $ 108 | $ 109 |



### Student Loan Premiums as a Percentage of Principal

The following table presents student loan premiums paid as a percentage of the principal balance of student loans acquired for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | September 30, 2006 | | September 30, 2005 | | September 30, 2006 | | September 30, 2005 | |
| | Volume | Rate | Volume | Rate | Volume | Rate | Volume | Rate |
| Student loan premiums paid: | | | | | | | | |
| Sallie Mae brands | $ 4,393 | 1.05% | $ 3,148 | .23% | $ 9,368 | .81% | $ 6,442 | .26% |
| Lender partners | 2,361 | 1.83 | 2,545 | 1.89 | 10,178 | 1.81 | 10,588 | 1.75 |
| Total Preferred Channel | 6,754 | 1.32 | 5,693 | .97 | 19,546 | 1.33 | 17,030 | 1.18 |
| Other purchases(1) | 2,183 | 4.05 | 860 | 4.00 | 2,851 | 3.95 | 1,963 | 3.77 |
| Subtotal base purchases | 8,937 | 1.99 | 6,553 | 1.37 | 22,397 | 1.66 | 18,993 | 1.45 |
| Consolidations from third parties | 1,682 | 2.22 | 1,306 | 2.66 | 3,432 | 2.44 | 3,145 | 2.49 |
| Total | $ 10,619 | 2.03% | $ 7,859 | 1.58% | $ 25,829 | 1.77% | $ 22,138 | 1.60% |

(1) Primarily includes spot purchases, other commitment clients, and subsidiary acquisitions.

The increase in premiums paid as a percentage of principal balance for Sallie Mae brands is primarily due to the increase in loans where we pay the origination fee on behalf of borrowers, a practice we call zero-fee lending. The borrower origination fee will be gradually phased out by the Reconciliation Legislation from 2007 to 2010. The Consolidations rate includes the 50 basis point Consolidation Loan fee paid on loans that we consolidate, including loans that are already in our Managed portfolio. The Consolidation Loan premium paid percentage is calculated on only consolidation volume that is incremental to our portfolio. This percentage is largely driven by the mix of FFELP Stafford loans consolidated in each quarter. The increase in the third quarter 2006 volume from other purchases is primarily due to spot purchases of $1.4 billion Consolidation Loans. Spot purchases are incremental volume on transactions outside our normal lending channels and generally command higher premiums. Going forward the Company plans to continue to purchase Consolidation Loans in the spot market when it is economically advantageous to do so.

**Student Loan Acquisitions**

In the nine months ended September 30, 2006, 70 percent of our Managed student loan acquisitions were originated through our Preferred Channel. The following tables summarize the components of our student loan acquisition activity for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, 2006 | | |
|---|---|---|---|
| | FFELP | Private | Total |
| Preferred Channel | $ 4,146 | $ 2,608 | $ 6,754 |
| Other commitment clients | 195 | 61 | 256 |
| Spot purchases | 1,927 | — | 1,927 |
| Consolidations from third parties | 1,648 | 34 | 1,682 |
| Acquisitions from off-balance sheet securitized trusts, primarily consolidations | 2,377 | 74 | 2,451 |
| Capitalized interest, premiums and discounts | 448 | 22 | 470 |
| Total on-balance sheet student loan acquisitions | 10,741 | 2,799 | 13,540 |
| Consolidations to SLM Corporation from off-balance sheet securitized trusts | (2,377) | (74) | (2,451) |
| Capitalized interest, premiums and discounts—off-balance sheet securitized trusts | 151 | 79 | 230 |
| Total Managed student loan acquisitions | $ 8,515 | $ 2,804 | $ 11,319 |



| | Three Months Ended September 30, 2005 | | |
|---|---|---|---|
| | FFELP | Private | Total |
| Preferred Channel | $ 3,455 | $ 2,238 | $ 5,693 |
| Other commitment clients | 148 | — | 148 |
| Spot purchases | 669 | — | 669 |
| Consolidations from third parties | 1,306 | — | 1,306 |
| Acquisitions from off-balance sheet securitized trusts, primarily consolidations | 3,207 | — | 3,207 |
| Acquisition of Idaho Transfer Corporation | 43 | — | 43 |
| Capitalized interest, premiums and discounts | 340 | (20) | 320 |
| Total on-balance sheet student loan acquisitions | 9,168 | 2,218 | 11,386 |
| Consolidations to SLM Corporation from off-balance sheet securitized trusts | (3,207) | — | (3,207) |
| Capitalized interest, premiums and discounts—off-balance sheet securitized trusts | 131 | 42 | 173 |
| Total Managed student loan acquisitions | $ 6,092 | $ 2,260 | $ 8,352 |

| | Nine Months Ended September 30, 2006 | | |
|---|---|---|---|
| | FFELP | Private | Total |
| Preferred Channel | $ 13,557 | $ 5,989 | $ 19,546 |
| Other commitment clients | 397 | 64 | 461 |
| Spot purchases | 2,390 | — | 2,390 |
| Consolidations from third parties | 3,389 | 43 | 3,432 |
| Acquisitions from off-balance sheet securitized trusts, primarily consolidations | 5,813 | 90 | 5,903 |
| Capitalized interest, premiums and discounts | 1,170 | 74 | 1,244 |
| Total on-balance sheet student loan acquisitions | 26,716 | 6,260 | 32,976 |
| Consolidations to SLM Corporation from off-balance sheet securitized trusts | (5,813) | (90) | (5,903) |
| Capitalized interest, premiums and discounts—off-balance sheet securitized trusts | 475 | 256 | 731 |
| Total Managed student loan acquisitions | $ 21,378 | $ 6,426 | $ 27,804 |



| | Nine Months Ended September 30, 2005 | | |
|---|---|---|---|
| | FFELP | Private | Total |
| Preferred Channel | $ 12,229 | $ 4,801 | $ 17,030 |
| Other commitment clients | 395 | — | 395 |
| Spot purchases | 1,568 | — | 1,568 |
| Consolidations from third parties | 3,145 | — | 3,145 |
| Acquisitions from off-balance sheet securitized trusts, primarily consolidations | 7,455 | — | 7,455 |
| Acquisition of Idaho Transfer Corporation | 43 | — | 43 |
| Capitalized interest, premiums and discounts | 1,011 | (36) | 975 |
| Total on-balance sheet student loan acquisitions | 25,846 | 4,765 | 30,611 |

| | | | |
|---|---|---|---|
| Consolidations to SLM Corporation from off-balance sheet securitized trusts | (7,455) | — | (7,455) |
| Capitalized interest, premiums and discounts—off-balance sheet securitized trusts | 386 | 145 | 531 |
| Total Managed student loan acquisitions | $ 18,777 | $ 4,910 | $ 23,687 |

As shown on the above table, off-balance sheet FFELP Stafford loans that consolidate with us become an on-balance sheet interest earning asset. This activity results in impairments of our Retained Interests in securitizations, but this is offset by an increase in on-balance sheet interest earning assets, for which we do not record an offsetting gain.

The following table includes on-balance sheet asset information for our Lending business segment.

| | September 30, 2006 | December 31, 2005 |
|---|---|---|
| FFELP Stafford and Other Student Loans, net | $ 22,614 | $ 19,988 |
| Consolidation Loans, net | 57,202 | 54,859 |
| Private Education Loans, net | 8,222 | 7,757 |
| Other loans, net | 1,257 | 1,138 |
| Investments[1] | 7,809 | 7,748 |
| Retained Interest in off-balance sheet securitized loans | 3,613 | 2,406 |
| Other[2] | 3,977 | 3,576 |
| Total assets | $ 104,694 | $ 97,472 |

(1) Investments include cash and cash equivalents, investments, restricted cash and investments, leveraged leases, and municipal bonds.

(2) Other assets include accrued interest receivable, goodwill and acquired intangible assets and other non-interest earning assets.



### Preferred Channel Originations

We originated $7.8 billion in student loan volume through our Preferred Channel in the three months ended September 30, 2006, versus $7.2 billion in the three months ended September 30, 2005.

For the three months ended September 30, 2006, our internal lending brands grew 35 percent over the year-ago quarter, and comprised 59 percent of our Preferred Channel Originations, up from 47 percent in the year-ago quarter. Our internal lending brands combined with our other lender partners comprised 87 percent of our Preferred Channel Originations for the current quarter, versus 76 percent for the year-ago quarter; together these two segments of our Preferred Channel grew 24 percent over the year-ago quarter. Our Managed loan acquisitions for the current quarter totaled $11.3 billion, an increase of 36 percent over the year-ago quarter. The following tables further break down our Preferred Channel Originations by type of loan and source.

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2006 | September 30, 2005 | September 30, 2006 | September 30, 2005 |
| **Preferred Channel Originations—Type of Loan** | | | | |
| Stafford | $ 4,257 | $ 3,966 | $ 10,559 | $ 9,879 |
| PLUS | 856 | 863 | 2,087 | 2,046 |
| GradPLUS | 144 | — | 144 | — |
| Total FFELP | 5,257 | 4,829 | 12,790 | 11,925 |
| Private Education Loans | 2,574 | 2,399 | 5,829 | 4,839 |
| Total | $ 7,831 | $ 7,228 | $ 18,619 | $ 16,764 |

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | | 2005 | | |
| | FFELP | Private | Total | FFELP | Private | Total |
| **Preferred Channel Originations—Source** | | | | | | |
| Internal lending brands | $ 2,402 | $ 2,223 | $ 4,625 | $ 1,619 | $ 1,811 | $ 3,430 |
| JPMorgan Chase | 893 | 89 | 982 | 1,427 | 279 | 1,706 |
| Other lender partners | 1,962 | 262 | 2,224 | 1,783 | 309 | 2,092 |
| Total | $ 5,257 | $ 2,574 | $ 7,831 | $ 4,829 | $ 2,399 | $ 7,228 |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 | | | 2005 | | |
| | FFELP | Private | Total | FFELP | Private | Total |
| **Preferred Channel Originations—Source** | | | | | | |
| Internal lending brands | $ 5,257 | $ 4,680 | $ 9,937 | $ 3,636 | $ 3,233 | $ 6,869 |
| JPMorgan Chase | 2,848 | 386 | 3,234 | 4,071 | 866 | 4,937 |
| Other lender partners | 4,685 | 763 | 5,448 | 4,218 | 740 | 4,958 |
| Total | $ 12,790 | $ 5,829 | $ 18,619 | $ 11,925 | $ 4,839 | $ 16,764 |

GradPLUS is a new federal program aimed at graduate school borrowers. These loans primarily replace Private Education Loans for these borrowers as they are guaranteed by the federal government and carry lower interest rates.

### Student Loan Activity

The following tables summarize the activity in our on-balance sheet, off-balance sheet and Managed portfolios of FFELP student loans and Private Education Loans and highlight the effects of Consolidation Loan activity on our FFELP portfolios.

| | On-Balance Sheet Three Months Ended September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[(1)] | Consolidation Loans | Total FFELP | Total Private Education Loans | Total On-Balance Sheet Portfolio |
| Beginning balance | $ 21,391 | $ 54,055 | $ 75,446 | $ 6,833 | $ 82,279 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | 1,648 | 1,648 | 34 | 1,682 |
| Consolidations to third parties | (729) | (367) | (1,096) | (4) | (1,100) |
| Net consolidations | (729) | 1,281 | 552 | 30 | 582 |
| Acquisitions | 5,014 | 1,702 | 6,716 | 2,691 | 9,407 |
| Net acquisitions | 4,285 | 2,983 | 7,268 | 2,721 | 9,989 |
| Internal consolidations[(2)] | (2,397) | 4,813 | 2,416 | 83 | 2,499 |
| Off-balance sheet securitizations | — | (4,066) | (4,066) | (1,008) | (5,074) |
| Repayments/claims/resales/other | (665) | (583) | (1,248) | (407) | (1,655) |
| Ending balance | $ 22,614 | $ 57,202 | $ 79,816 | $ 8,222 | $ 88,038 |

| | Off-Balance Sheet Three Months Ended September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[(1)] | Consolidation Loans | Total FFELP | Total Private Education Loans | Total Off-Balance Sheet Portfolio |
| Beginning balance | $ 20,535 | $ 15,140 | $ 35,675 | $ 12,190 | $ 47,865 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | — | — | — | — |
| Consolidations to third parties | (726) | (119) | (845) | (11) | (856) |
| Net consolidations | (726) | (119) | (845) | (11) | (856) |
| Acquisitions | 96 | 55 | 151 | 79 | 230 |
| Net acquisitions | (630) | (64) | (694) | 68 | (626) |
| Internal consolidations[(2)] | (2,185) | (231) | (2,416) | (83) | (2,499) |
| Off-balance sheet securitizations | — | 4,066 | 4,066 | 1,008 | 5,074 |
| Repayments/claims/resales/other | (547) | (166) | (713) | (204) | (917) |
| Ending balance | $ 17,173 | $ 18,745 | $ 35,918 | $ 12,979 | $ 48,897 |

| | Managed Portfolio Three Months Ended September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[(1)] | Consolidation Loans | Total FFELP | Total Private Education Loans | Total Managed Basis Portfolio |
| Beginning balance | $ 41,926 | $ 69,195 | $ 111,121 | $ 19,023 | $ 130,144 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | 1,648 | 1,648 | 34 | 1,682 |
| Consolidations to third parties | (1,455) | (486) | (1,941) | (15) | (1,956) |
| Net consolidations | (1,455) | 1,162 | (293) | 19 | (274) |
| Acquisitions | 5,110 | 1,757 | 6,867 | 2,770 | 9,637 |
| Net acquisitions | 3,655 | 2,919 | 6,574 | 2,789 | 9,363 |
| Internal consolidations[(2)] | (4,582) | 4,582 | — | — | — |
| Off-balance sheet securitizations | — | — | — | — | — |
| Repayments/claims/resales/other | (1,212) | (749) | (1,961) | (611) | (2,572) |
| Ending balance | $ 39,787 | $ 75,947 | $ 115,734 | $ 21,201 | $ 136,935 |
| Total Managed Purchases[(3)] | $ 5,110 | $ 3,405 | $ 8,515 | $ 2,804 | $ 11,319 |

(1) FFELP category is primarily Stafford loans and also includes PLUS and HEAL loans.
(2) Represents FFELP/Stafford loans that we either own on-balance sheet or in our off-balance sheet securitization trusts that we consolidate.
(3) Includes incremental consolidations from third parties and acquisitions.



| | On-Balance Sheet Three Months Ended September 30, 2005 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[(1)] | Consolidation Loans | Total FFELP | Total Private Education Loans | Total On-Balance Sheet Portfolio |
| Beginning balance | $ 22,093 | $ 44,641 | $ 66,734 | $ 6,097 | $ 72,831 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | 1,306 | 1,306 | — | 1,306 |
| Consolidations to third parties | (397) | (235) | (632) | (2) | (634) |
| Net consolidations | (397) | 1,071 | 674 | (2) | 672 |
| Acquisitions | 3,908 | 744 | 4,652 | 2,219 | 6,871 |
| Net acquisitions | 3,511 | 1,815 | 5,326 | 2,217 | 7,543 |
| Internal Consolidations[(2)] | (2,144) | 5,250 | 3,106 | — | 3,106 |
| Off-balance sheet securitizations | — | — | — | — | — |
| Repayments/claims/resales/other | (1,106) | (513) | (1,619) | (235) | (1,854) |
| Ending balance | $ 22,354 | $ 51,193 | $ 73,547 | $ 8,079 | $ 81,626 |

| | Off-Balance Sheet Three Months Ended September 30, 2005 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other[(1)] | Consolidation Loans | Total FFELP | Total Private Education Loans | Total Off-Balance Sheet Portfolio |
| Beginning balance | $ 25,033 | $ 11,234 | $ 36,267 | $ 7,402 | $ 43,669 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | — | — | — | — |
| Consolidations to third parties | (582) | (85) | (667) | (4) | (671) |
| Net consolidations | (582) | (85) | (667) | (4) | (671) |

| | | | | | |
|---|---|---|---|---|---|
| Acquisitions | 86 | 48 | 134 | 41 | 175 |
| Net acquisitions | (496) | (37) | (533) | 37 | (496) |
| Internal Consolidations(2) | (3,106) | — | (3,106) | — | (3,106) |
| Off-balance sheet securitizations | — | — | — | — | — |
| Repayments/claims/resales/other | (703) | (229) | (932) | (127) | (1,059) |
| Ending balance | $ 20,728 | $ 10,968 | $ 31,696 | $ 7,312 | $ 39,008 |

| | Managed Portfolio Three Months Ended September 30, 2005 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other(1) | Consolidation Loans | Total FFELP | Total Private Education Loans | Total Managed Basis Portfolio |
| Beginning balance | $ 47,126 | $ 55,875 | $ 103,001 | $ 13,499 | $ 116,500 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | 1,306 | 1,306 | — | 1,306 |
| Consolidations to third parties | (979) | (320) | (1,299) | (6) | (1,305) |
| Net consolidations | (979) | 986 | 7 | (6) | 1 |
| Acquisitions | 3,994 | 792 | 4,786 | 2,260 | 7,046 |
| Net acquisitions | 3,015 | 1,778 | 4,793 | 2,254 | 7,047 |
| Internal Consolidations(2) | (5,250) | 5,250 | — | — | — |
| Off-balance sheet securitizations | — | — | — | — | — |
| Repayments/claims/resales/other | (1,809) | (742) | (2,551) | (362) | (2,913) |
| Ending balance | $ 43,082 | $ 62,161 | $ 105,243 | $ 15,391 | $ 120,634 |
| Total Managed Purchases(3) | $ 3,994 | $ 2,098 | $ 6,092 | $ 2,260 | $ 8,352 |

(1) FFELP category is primarily Stafford loans and also includes PLUS and HEAL loans.

(2) Represents FFELP/Stafford loans that we either own on-balance sheet or in our off-balance sheet securitization trusts that we consolidate.

(3) Includes incremental consolidations from third parties and acquisitions.



| | On-Balance Sheet Nine Months Ended September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other(1) | Consolidation Loans | Total FFELP | Total Private Education Loans | Total On-Balance Sheet Portfolio |
| Beginning balance | $ 19,988 | $ 54,859 | $ 74,847 | $ 7,757 | $ 82,604 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | 3,389 | 3,389 | 43 | 3,432 |
| Consolidations to third parties | (1,422) | (1,775) | (3,197) | (11) | (3,208) |
| Net consolidations | (1,422) | 1,614 | 192 | 32 | 224 |
| Acquisitions | 15,114 | 2,401 | 17,515 | 6,127 | 23,642 |
| Net acquisitions | 13,692 | 4,015 | 17,707 | 6,159 | 23,866 |
| Internal consolidations | (4,772) | 9,914 | 5,142 | 203 | 5,345 |
| Off-balance sheet securitizations | (5,034) | (9,638) | (14,672) | (4,737) | (19,409) |
| Repayments/claims/resales/other | (1,260) | (1,948) | (3,208) | (1,160) | (4,368) |
| Ending balance | $ 22,614 | $ 57,202 | $ 79,816 | $ 8,222 | $ 88,038 |

| | Off-Balance Sheet Nine Months Ended September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other(1) | Consolidation Loans | Total FFELP | Total Private Education Loans | Total Off-Balance Sheet Portfolio |
| Beginning balance | $ 20,670 | $ 10,575 | $ 31,245 | $ 8,680 | $ 39,925 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | — | — | — | — |
| Consolidations to third parties | (1,591) | (574) | (2,165) | (21) | (2,186) |
| Net consolidations | (1,591) | (574) | (2,165) | (21) | (2,186) |
| Acquisitions | 302 | 172 | 474 | 256 | 730 |
| Net acquisitions | (1,289) | (402) | (1,691) | 235 | (1,456) |
| Internal consolidations | (4,634) | (508) | (5,142) | (203) | (5,345) |
| Off-balance sheet securitizations | 5,034 | 9,638 | 14,672 | 4,737 | 19,409 |
| Repayments/claims/resales/other | (2,608) | (558) | (3,166) | (470) | (3,636) |
| Ending balance | $ 17,173 | $ 18,745 | $ 35,918 | $ 12,979 | $ 48,897 |

| | Managed Portfolio Nine Months Ended September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other(1) | Consolidation Loans | Total FFELP | Total Private Education Loans | Total Managed Basis Portfolio |
| Beginning balance | $ 40,658 | $ 65,434 | $ 106,092 | $ 16,437 | $ 122,529 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | 3,389 | 3,389 | 43 | 3,432 |
| Consolidations to third parties | (3,013) | (2,349) | (5,362) | (32) | (5,394) |
| Net consolidations | (3,013) | 1,040 | (1,973) | 11 | (1,962) |
| Acquisitions | 15,416 | 2,573 | 17,989 | 6,383 | 24,372 |
| Net acquisitions | 12,403 | 3,613 | 16,016 | 6,394 | 22,410 |
| Internal consolidations | (9,406) | 9,406 | — | — | — |
| Off-balance sheet securitizations | — | — | — | — | — |
| Repayments/claims/resales/other | (3,868) | (2,506) | (6,374) | (1,630) | (8,004) |
| Ending balance | $ 39,787 | $ 75,947 | $ 115,734 | $ 21,201 | $ 136,935 |
| Total Managed Purchases(3) | $ 15,416 | $ 5,962 | $ 21,378 | $ 6,426 | $ 27,804 |

(1) FFELP category is primarily Stafford loans and also includes PLUS and HEAL loans.

(2) Represents FFELP/Stafford loans that we either own on-balance sheet or in our off-balance sheet securitization trusts that we consolidate.

(3) Includes incremental consolidations from third parties and acquisitions.



| | On-Balance Sheet Nine Months Ended September 30, 2005 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other(1) | Consolidation Loans | Total FFELP | Total Private Education Loans | Total On-Balance Sheet Portfolio |
| Beginning balance | $ 18,965 | $ 41,596 | $ 60,561 | $ 5,420 | $ 65,981 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | 3,145 | 3,145 | — | 3,145 |
| Consolidations to third parties | (729) | (484) | (1,213) | (6) | (1,219) |
| Net consolidations | (729) | 2,661 | 1,932 | (6) | 1,926 |
| Acquisitions | 13,936 | 1,311 | 15,247 | 4,761 | 20,008 |
| Net acquisitions | 13,207 | 3,972 | 17,179 | 4,755 | 21,934 |
| Internal consolidations | (4,195) | 11,099 | 6,904 | — | 6,904 |
| Off-balance sheet securitizations | (3,542) | (4,044) | (7,586) | (1,407) | (8,993) |
| Repayments/claims/resales/other | (2,081) | (1,430) | (3,511) | (689) | (4,200) |
| Ending balance | $ 22,354 | $ 51,193 | $ 73,547 | $ 8,079 | $ 81,626 |

| | Off-Balance Sheet Nine Months Ended September 30, 2005 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other(1) | Consolidation Loans | Total FFELP | Total Private Education Loans | Total Off-Balance Sheet Portfolio |
| Beginning balance | $ 27,825 | $ 7,570 | $ 35,395 | $ 6,062 | $ 41,457 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | — | — | — | — |
| Consolidations to third parties | (1,224) | (176) | (1,400) | (12) | (1,412) |
| Net consolidations | (1,224) | (176) | (1,400) | (12) | (1,412) |
| Acquisitions | 252 | 137 | 389 | 145 | 534 |
| Net acquisitions | (972) | (39) | (1,011) | 133 | (878) |
| Internal consolidations | (6,895) | (9) | (6,904) | — | (6,904) |
| Off-balance sheet securitizations | 3,542 | 4,044 | 7,586 | 1,407 | 8,993 |
| Repayments/claims/resales/other | (2,772) | (598) | (3,370) | (290) | (3,660) |
| Ending balance | $ 20,728 | $ 10,968 | $ 31,696 | $ 7,312 | $ 39,008 |

| | Managed Portfolio Nine Months Ended September 30, 2005 | | | | |
|---|---|---|---|---|---|
| | FFELP Stafford and Other(1) | Consolidation Loans | Total FFELP | Total Private Education Loans | Total Managed Basis Portfolio |
| Beginning balance | $ 46,790 | $ 49,166 | $ 95,956 | $ 11,482 | $ 107,438 |
| Net consolidations: | | | | | |
| Incremental consolidations from third parties | — | 3,145 | 3,145 | — | 3,145 |
| Consolidations to third parties | (1,953) | (660) | (2,613) | (18) | (2,631) |
| Net consolidations | (1,953) | 2,485 | 532 | (18) | 514 |
| Acquisitions | 14,188 | 1,448 | 15,636 | 4,906 | 20,542 |
| Net acquisitions | 12,235 | 3,933 | 16,168 | 4,888 | 21,056 |
| Internal consolidations | (11,090) | 11,090 | — | — | — |
| Off-balance sheet securitizations | — | — | — | — | — |
| Repayments/claims/resales/other | (4,853) | (2,028) | (6,881) | (979) | (7,860) |
| Ending balance | $ 43,082 | $ 62,161 | $ 105,243 | $ 15,391 | $ 120,634 |
| Total Managed Purchases(3) | $ 14,188 | $ 4,593 | $ 18,781 | $ 4,906 | $ 23,687 |

(1) FFELP category is primarily Stafford loans and also includes PLUS and HEAL loans.

(2) Represents FFELP/Stafford loans that we either own on-balance sheet or in our off-balance sheet securitization trusts that we consolidate.

(3) Includes incremental consolidations from third parties and acquisitions.



The increase in consolidations to third parties during the nine months ended September 30, 2006 reflects FFELP lenders reconsolidating Consolidation Loans using the Direct Loan program as a pass-through entity to circumvent the statutory prohibition on the reconsolidation of Consolidation Loans. On March 17, 2006, ED issued a ‘‘Dear Colleague’’ letter that prohibited this ‘‘two-step’’ process unless the FFELP consolidation borrower applied for a Direct Loan consolidation by March 31, 2006. Accordingly, in the second quarter of 2006, there was a temporary increase in the reconsolidation of Consolidation Loans to process the back log of FDLP applications. In the third quarter of 2006, consolidation activity had returned to recent historical levels. The Higher Education Reconciliation Act of 2005 restricted further reconsolidation. Specifically, as of July 1, 2006, borrowers with a FFELP Consolidation Loan may only reconsolidate with the FDLP if they are delinquent, referred to the guaranty agency for default aversion activity, and enter into the income contingent repayment program (‘‘ICR’’) in the FDLP. Borrowers may also reconsolidate an existing Consolidation Loan with a new FFELP Stafford loan.

### Other Income—Lending Business Segment

The following table summarizes the components of other income, net, for our Lending business segment for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, 2006 | 2005 | Nine Months Ended September 30, 2006 | 2005 |
|---|---|---|---|---|
| Late fees | $ 26 | $ 23 | $ 77 | $ 67 |
| Gains on sales of mortgages and other loan fees | 5 | 6 | 12 | 14 |
| Other | 15 | (29) | 49 | (9) |
| Total other income, net | $ 46 | $ — | $ 138 | $ 72 |

The other category includes losses on investments, which in the year-ago period included a $39 million leveraged lease impairment reserve. That impairment primarily related to an aircraft leased to Northwest Airlines, who declared bankruptcy in September 2005.

### Operating Expense—Lending Business Segment

The following table summarizes the components of operating expenses for our Lending business segment for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, 2006 | 2005 | Nine Months Ended September 30, 2006 | 2005 |
|---|---|---|---|---|
| Sales and originations | $ 81 | $ 68 | $ 244 | $ 212 |
| Servicing and information technology | 49 | 49 | 151 | 145 |
| Corporate overhead | 26 | 17 | 86 | 51 |
| Total operating expenses | $ 156 | $ 134 | $ 481 | $ 408 |

Operating expenses for our Lending business segment include costs incurred to service our Managed student loan portfolio and acquire student loans, as well as other general and administrative expenses. The increase in third quarter operating expenses is primarily due to the increase in sales expenses in connection with the shift of more volume to our internal brands and higher servicing costs consistent with the growth in borrowers. For the three and nine months ended September 30, 2006, operating expenses for the Lending business segment also include $8 million and $26 million, respectively, of stock-based compensation expense, due to the implementation of SFAS No. 123(R) (see Note 1, "Significant



Accounting Policies—Accounting for Stock-Based Compensation," and Note 8, "Stock-Based Compensation Plans" to the consolidated financial statements).

### DEBT MANAGEMENT OPERATIONS ("DMO") BUSINESS SEGMENT

The following table includes the "Core Earnings" results of operations for our DMO business segment.

| | Three Months Ended September 30, 2006 | 2005 | % Increase (Decrease) 2006 vs. 2005 | Nine Months Ended September 30, 2006 | 2005 | % Increase (Decrease) 2006 vs. 2005 |
|---|---|---|---|---|---|---|
| Total interest income | $ — | $ — | —% | $ — | $ — | —% |
| Total interest expense | 6 | 6 | — | 17 | 14 | 21 |
| Net interest income | (6) | (6) | — | (17) | (14) | (21) |
| Less provisions for losses | — | — | — | — | — | — |
| Net interest income after provisions for losses | (6) | (6) | — | (17) | (14) | (21) |
| Fee income | 122 | 93 | 31 | 304 | 261 | 16 |
| Collections revenue | 58 | 42 | 38 | 182 | 119 | 53 |
| Total other income | 180 | 135 | 33 | 486 | 380 | 28 |
| Operating expenses(1)(2) | 91 | 72 | 26 | 266 | 204 | 30 |
| Income before income taxes and minority interest in net earnings of subsidiaries | 83 | 57 | 46 | 203 | 162 | 25 |
| Income taxes | 31 | 21 | 48 | 75 | 60 | 25 |
| Income before minority interest in net earnings of subsidiaries | 52 | 36 | 44 | 128 | 102 | 25 |
| Minority interest in net earnings of subsidiaries | 1 | 1 | — | 4 | 3 | 33 |
| "Core Earnings" net income | $ 51 | $ 35 | 46% | $ 124 | $ 99 | 25% |

(1) The three and nine months ended September 30, 2006 operating expenses for the DMO segment include $4 million and $9 million, respectively, of stock-based compensation expense due to the implementation of SFAS No. 123(R) in the first quarter of 2006.

(2) In the first quarter of 2006, the Company changed its method for allocating certain overhead and other expenses between our business segments. Balances for the three and nine months ending September 30, 2005 have been updated to reflect the new allocation methodology.



### DMO Revenue by Product

| | Three Months Ended September 30, 2006 | 2005 | Nine Months Ended September 30, 2006 | 2005 |
|---|---|---|---|---|
| Purchased paper collections revenue | $ 58 | $ 42 | $ 182 | $ 119 |

| | | | | |
|---|---|---|---|---|
| Contingency: | | | | |
| Student loans | 94 | 66 | 233 | 195 |
| Other | 9 | 9 | 28 | 28 |
| Total contingency | 103 | 75 | 261 | 223 |
| Other | 19 | 18 | 43 | 38 |
| Total | $180 | $135 | $486 | $380 |
| USA Funds(1) | $ 65 | $ 47 | $158 | $136 |
| % of total DMO revenue | 36% | 35% | 32% | 36% |

(1) United Student Aid Funds, Inc. ("USA Funds")

The $45 million, or 33 percent, increase in DMO revenue for the third quarter of 2006 compared to the third quarter of 2005 can be attributed to the year-over-year growth in the purchased paper business of Arrow Financial Services ("AFS") and to revenue generated by GRP Financial Services ("GRP") (acquired in August 2005). The year-over-year growth in contingency fee revenue was primarily driven by a change in the federal regulations governing the rehabilitated loan policy which reduced the number of payments to qualify for a rehabilitated loan from twelve to nine months adding incremental revenue due to the accelerated process.

**Purchased Paper—Non-Mortgage**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Face value of purchases for the period | $865 | $330 | $1,857 | $1,746 |
| Purchase price for the period | 79 | 25 | 154 | 90 |
| % of face value purchased | 9.2% | 7.5% | 8.3% | 5.2% |
| Gross Cash Collections ("GCC") | $ 81 | $ 61 | $ 263 | $ 179 |
| Collections revenue | 49 | 39 | 152 | 116 |
| % of GCC | 61% | 65% | 58% | 65% |
| Carrying value of purchases | $182 | $ 81 | $ 182 | $ 81 |

The amount of face value of purchases in any quarter is a function of a combination of factors including the amount of receivables available for purchase in the marketplace, average age of each portfolio, the asset class of the receivables, and competition in the marketplace. As a result, the percentage of face value purchased will vary from quarter to quarter. The decrease in collections revenue as a percentage of GCC versus the prior year can primarily be attributed to the increase in new portfolio purchases in the second half of 2005. Typically, revenue recognition based on a portfolio's effective interest rate is a lower percentage of cash collections in the early stages of servicing a portfolio.



**Purchased Paper—Mortgage/Properties**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Face value of purchases for the period | $140 | $ 34 | $463 | $ 34 |
| Collections revenue | 9 | 3 | 30 | 3 |
| Collateral value of purchases | 147 | 42 | 510 | 42 |
| Purchase price for the period | 114 | 32 | 388 | 32 |
| % of collateral value | 78% | 76% | 76% | 76% |
| Carrying value of purchases | $503 | $238 | $503 | $238 |

GRP was purchased in August 2005. Prior to this acquisition, the Company was not in the mortgage purchased paper business. The purchase price for sub-performing and non-performing mortgage loans is generally determined as a percentage of the underlying collateral. Fluctuations in the purchase price as a percentage of collateral value can be caused by a number of factors including the percentage of second mortgages in the portfolio and the level of private mortgage insurance associated with particular assets.

**Contingency Inventory**

The following table presents the outstanding inventory of receivables that are currently being serviced through our DMO business.

| | September 30, 2006 | December 31, 2005 |
|---|---|---|
| Contingency: | | |
| Contingency—Student loans | $6,736 | $ 7,205 |
| Contingency—Other | 1,477 | 2,178 |
| Total | $8,213 | $ 9,383 |

**Operating Expenses—DMO Business Segment**

For the three months ended September 30, 2006 and 2005, operating expenses for our DMO business segment totaled $91 million and $72 million, respectively. The increase in operating expenses of $19 million or 26 percent versus the year-ago quarter was primarily due to increased expenses for outsourced collections and overall growth in the purchased paper business. Also in the third quarter of 2006, the Company accrued expenses related to the shutdown of a facility.

For the three and nine months ended September 30, 2006, operating expenses for the DMO business segment also include $4 million and $9 million, respectively, of stock-based compensation expense, due to the implementation of SFAS No. 123(R) (see Note 1, "Significant Accounting Policies—

Accounting for Stock-Based Compensation," and Note 8, "Stock-Based Compensation Plans" to the consolidated financial statements).

At September 30, 2006 and December 31, 2005, the DMO business segment had total assets of $1.4 billion and $1.1 billion, respectively.



## CORPORATE AND OTHER BUSINESS SEGMENT

The following table includes "Core Earnings" results of operations for our Corporate and Other business segment.

| | Three Months Ended September 30, | | % Increase (Decrease) | Nine Months Ended September 30, | | % Increase (Decrease) |
|---|---|---|---|---|---|---|
| | 2006 | 2005 | 2006 vs. 2005 | 2006 | 2005 | 2006 vs. 2005 |
| Total interest income | $ 3 | $ 1 | 200% | $ 5 | $ 3 | 67% |
| Total interest expense | 4 | 1 | 300 | 6 | 4 | 50 |
| Net interest income | (1) | — | — | (1) | (1) | — |
| Less provisions for losses | — | — | — | — | — | — |
| Net interest income after provisions for losses | (1) | — | — | (1) | (1) | — |
| Fee income | 39 | 36 | 8 | 99 | 94 | 5 |
| Other income | 41 | 36 | 14 | 95 | 97 | (2) |
| Total revenue | 80 | 72 | 11 | 194 | 191 | 2 |
| Operating expenses(1)(2) | 70 | 65 | 8 | 178 | 179 | (1) |
| Income before income taxes | 9 | 7 | 29 | 15 | 11 | 36 |
| Income tax expense | 3 | 2 | 50 | 6 | 3 | 100 |
| **"Core Earnings" net income** | $ 6 | $ 5 | 20% | $ 9 | $ 8 | 13% |

(1) For the three and nine months ended September 30, 2006, operating expenses for the Corporate and Other Business segment include $4 million and $13 million, respectively, of stock-based compensation expense due to the implementation of SFAS No. 123(R) in the first quarter of 2006.

(2) In the first quarter of 2006, the Company changed its method for allocating certain overhead and other expenses between our business segments. Balances for the three and nine months ending September 30, 2005 have been updated to reflect the new allocation methodology.

### Fee and Other Income—Corporate and Other Business Segment

The following table summarizes the components of fee and other income for our Corporate and Other business segment for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Guarantor servicing fees | $ 39 | $ 36 | $ 99 | $ 94 |
| Loan servicing fees | 8 | 11 | 23 | 36 |
| Other income | 33 | 25 | 72 | 61 |
| Total fee and other income | $ 80 | $ 72 | $ 194 | $ 191 |

Other income in the third quarter of 2006 reflects two months of fees of Upromise, acquired in August 2006.

USA Funds, the nation's largest guarantee agency, accounted for 81 percent and 79 percent, respectively, of guarantor servicing fees and 24 percent and 34 percent, respectively, of revenues associated with other products and services for the three months ended September 30, 2006 and 2005.



### Operating Expenses—Corporate and Other Business Segment

The following table summarizes the components of operating expenses for our Corporate and Other Business segment for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Operating expenses | $ 48 | $ 39 | $ 115 | $ 110 |
| Corporate overhead | 22 | 26 | 63 | 69 |
| Total operating expenses | $ 70 | $ 65 | $ 178 | $ 179 |

Operating expenses for our Corporate and Other business segment include direct costs incurred to service loans for unrelated third parties and to perform guarantor servicing on behalf of guarantor agencies, as well as information technology expenses related to these functions. For the three and nine months ended September 30, 2006, operating expenses for our Corporate and Other business segment also include $4 million and $13 million, respectively, of stock-based compensation expense, due to the implementation of SFAS No. 123(R) (see Note 1, "Significant Accounting Policies—Accounting for Stock-Based Compensation," and Note 8, "Stock-Based Compensation Plans" to the consolidated financial statements). Also, the third quarter of 2006 reflects two months of expenses of Upromise, acquired in August 2006.

At September 30, 2006 and December 31, 2005, the Corporate and Other business segment had total assets of $993 million and $719 million, respectively.

## LIQUIDITY AND CAPITAL RESOURCES

Except in the case of acquisitions, which are discussed separately, our DMO and Corporate and Other business segments are not capital intensive businesses and as such a minimal amount of debt and equity capital is allocated to these segments. Therefore, the following "Liquidity and Capital Resources" discussion relates primarily to our Lending business segment.

We depend on the debt capital markets to support our business plan. To meet business plan objectives, we must maintain cost effective liquidity to fund the growth in our Managed portfolio of student loans as well as to refinance previously securitized loans when borrowers choose to refinance their loans through a Consolidation Loan with the Company. At the same time, we must continue to control interest rate risk. Our main source of funding is from the securitization of student loans. We securitized $25.6 billion in student loans in eleven transactions in the nine months ended September 30, 2006, versus $18.5 billion securitized in nine transactions in the year-ago period. FFELP securitizations are unique securities in the asset-backed market in that they are collateralized by student loans with an explicit federal guarantee on 99 percent of principal and interest upon default. This guarantee is subject to service compliance and the Company retaining its EP designation. Securitizations comprised 68 percent of our financing at September 30, 2006 versus 67 percent at September 30, 2005 related to our Managed portfolio.

In addition to securitizations, we also fund our operations by accessing the corporate debt markets on a regular basis. In the nine months ended September 30, 2006, we issued $7.7 billion in SLM Corporation term, unsecured debt. At September 30, 2006, on-balance sheet debt, exclusive of on-balance sheet securitizations and secured indentured trusts, totaled $45.1 billion versus $40.2 billion at September 30, 2005.



Liquidity is important to the Company in that it enables us to effectively fund our student loan acquisitions, meet maturing debt obligations, and fund operations. The following table details our sources of liquidity and the available capacity.

| | September 30, 2006 Available Capacity | December 31, 2005 Available Capacity |
|---|---|---|
| Sources of primary liquidity: | | |
| Unrestricted cash and liquid investments | $ 3,623 | $ 3,928 |
| Unused commercial paper and bank lines of credit | 5,500 | 5,500 |
| ABCP borrowing capacity | 33 | 41 |
| Total sources of primary liquidity | 9,156 | 9,469 |
| Sources of stand-by liquidity: | | |
| Unencumbered FFELP student loans | 28,105 | 24,530 |
| Total sources of primary and stand-by liquidity | $ 37,261 | $ 33,999 |

We believe our unencumbered FFELP student loan portfolio provides an additional source of potential or stand-by liquidity because the maturation of government guaranteed student loan securitizations has created a wide and deep marketplace for such transactions. The wholesale market for FFELP student loans provides an additional potential source of stand-by liquidity. At September 30, 2006, we had $486 million of investments on our balance sheet that were pledged as collateral related to certain derivative positions and $140 million of other non-liquid investments, neither of which were included in the above table.

In addition to liquidity, a major objective when financing our business is to minimize interest rate risk by matching the interest rate and reset characteristics of our Managed assets and liabilities, generally on a pooled basis, to the extent practicable. In this process we use derivative financial instruments extensively to reduce our interest rate and foreign currency exposure. This interest rate risk management helps us to stabilize our student loan spread in various and changing interest rate environments. (See also "Interest Rate Risk Management" below.)

### Managed Borrowings

The following tables present the ending balances of our Managed borrowings at September 30, 2006 and 2005 and average balances and average interest rates of our Managed borrowings for the three and nine months ended September 30, 2006 and 2005. The average interest rates include derivatives that are economically hedging the underlying debt, but do not qualify for hedge accounting treatment under SFAS No. 133. (See "BUSINESS SEGMENTS—*Pre-tax differences Between 'Core Earnings' and GAAP by Business Segment—Reclassification of Realized Gains (Losses) on Derivative and Hedging Activities.*")

*Ending Balances*

| | As of September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2006 Ending Balance | | | 2005 Ending Balance | | |
| | Short Term | Long Term | Total Managed Basis | Short Term | Long Term | Total Managed Basis |
| Unsecured borrowings | $3,595 | $ 41,549 | $ 45,144 | $4,227 | $ 35,965 | $ 40,192 |
| Indentured trusts (on-balance sheet) | 75 | 3,109 | 3,184 | 425 | 3,455 | 3,880 |
| Securitizations (on-balance sheet) | — | 49,806 | 49,806 | — | 44,951 | 44,951 |
| Securitizations (off-balance sheet) | — | 54,153 | 54,153 | — | 43,372 | 43,372 |
| Total | $3,670 | $ 148,617 | $ 152,287 | $4,652 | $ 127,743 | $ 132,395 |



*Average Balances*

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | 2005 | | 2006 | | 2005 | |
| | Average Balance | Average Rate | Average Balance | Average Rate | Average Balance | Average Rate | Average Balance | Average Rate |
| Unsecured borrowings | $ 44,743 | 5.75% | $ 39,302 | 4.13% | $ 42,955 | 5.42% | $ 36,746 | 3.72% |
| Indentured trusts (on-balance sheet) | 3,224 | 4.74 | 4,250 | 3.47 | 3,309 | 4.49 | 5,186 | 3.17 |
| Securitizations (on-balance sheet) | 47,695 | 5.68 | 41,338 | 3.90 | 46,725 | 5.30 | 37,627 | 3.43 |
| Securitizations (off-balance sheet) | 52,986 | 5.73 | 45,278 | 3.97 | 49,702 | 5.40 | 45,372 | 3.52 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total | $ 148,648 | 5.70% | $ 130,168 | 3.98% | $ 142,691 | 5.35% | $ 124,931 | 3.54% |

### Unsecured On-Balance Sheet Financing Activities

The following table presents the senior unsecured credit ratings on our debt from major rating agencies.

| | S&P | Moody's | Fitch |
|---|---|---|---|
| Short-term unsecured debt | A-1 | P-1 | F1+ |
| Long-term unsecured debt | A | A2 | A+ |

The table below presents our unsecured on-balance sheet term funding by funding source for the three and nine months ended September 30, 2006 and 2005.

| | Debt Issued for the Three Months Ended September 30, | | Debt Issued for the Nine Months Ended September 30, | | Outstanding at September 30, | |
|---|---|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Convertible debentures | $ — | $ — | $ — | $ — | $ 1,996 | $ 1,991 |
| Retail notes | 148 | 81 | 415 | 661 | 4,018 | 3,491 |
| Foreign currency denominated notes(1) | 794 | 1,151 | 2,269 | 2,150 | 11,039 | 6,933 |
| Extendible notes | — | 499 | 999 | 999 | 5,246 | 5,246 |
| Global notes (Institutional) | 2,054 | 3,281 | 3,999 | 4,465 | 21,044 | 20,726 |
| Medium-term notes (Institutional) | — | — | — | — | 1,799 | 1,803 |
| Other | — | — | — | — | 2 | 2 |
| Total | $2,996 | $ 5,012 | $ 7,682 | $ 8,275 | $ 45,144 | $ 40,192 |

(1) All foreign currency denominated notes are hedged using derivatives that exchange the foreign denomination for U.S. dollars.

In addition to the term issuances reflected in the table above, we also use our commercial paper program for short-term liquidity purposes. The average balance of commercial paper outstanding during the three months ended September 30, 2006 and 2005 was $0 and $503 million, respectively, and during the nine months ended September 30, 2006 and 2005 was $109 million and $440 million, respectively. The maximum daily amount outstanding for the three months ended September 30, 2006 and 2005 was $0 and $2.8 billion, respectively, and for the nine months ended September 30, 2006 and 2005 was $2.2 billion and $2.8 billion, respectively.



### *Contingently Convertible Debentures*

At September 30, 2006, we have approximately $2 billion Contingently Convertible Debentures ("Co-Cos") outstanding. The Co-Cos are eligible to be called at par on or after July 25, 2007, under certain circumstances. The following table provides the historical effect of our Co-Cos on our common stock equivalents ("CSEs") and after-tax interest expense.

| (In thousands) | Three Months Ended September 30, 2006 | Nine Months Ended September 30, 2006 | Year Ended December 31, 2005 | Three Months Ended December 31, 2005 | Three Months Ended September 30, 2005 | Three Months Ended June 30, 2005 | Three Months Ended March 31, 2005 |
|---|---|---|---|---|---|---|---|
| CSE impact of Co-Cos (shares) | 30,312 | 30,312 | 30,312 | 30,312 | 30,312 | 30,312 | 30,312 |
| Co-Cos after-tax interest expense | $ 17,962 | $ 49,239 | $ 44,572 | $ 13,685 | $ 11,971 | $ 10,297 | $ 8,619 |

The table below outlines the effect of the Co-Cos on the numerators and denominators for the diluted EPS calculations for the three and nine months ended September 30, 2006 and 2005. The net effect of the Co-Cos on diluted EPS will vary with the period to period changes in net income of the Company.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| **Numerator:** | | | | |
| Net income attributable to common stock | $ 254,251 | $ 424,062 | $ 1,112,542 | $ 937,178 |
| Adjusted for debt expense of convertible debentures ("Co-Cos"), net of taxes(1) | 17,962 | 11,971 | 49,239 | 30,887 |
| Adjusted for non-taxable unrealized gains on equity forwards(2) | (707) | — | (3,528) | — |
| Net income attributable to common stock, adjusted | $ 271,506 | $ 436,033 | $ 1,158,253 | $ 968,065 |
| **Denominator *(shares in thousands):*** | | | | |
| Weighted average shares used to compute basic EPS | 410,034 | 417,235 | 411,212 | 419,205 |
| Effect of dilutive securities: | | | | |
| Dilutive effect of Co-Cos | 30,312 | 30,312 | 30,312 | 30,312 |
| Dilutive effect of stock options, nonvested deferred compensation, nonvested restricted stock, restricted stock units, Employee Stock Purchase Plan ("ESPP") and equity forwards(3)(4) | 9,495 | 11,251 | 10,488 | 11,705 |
| Dilutive potential common shares(5) | 39,807 | 41,563 | 40,800 | 42,017 |
| Weighted average shares used to compute diluted EPS | 449,841 | 458,798 | 452,012 | 461,222 |
| **Net earnings per share:** | | | | |
| Basic EPS | $ .62 | $ 1.02 | $ 2.71 | $ 2.24 |
| Dilutive effect of Co-Cos(1) | — | (.04) | (.07) | (.08) |
| Dilutive effect of equity forwards(2)(4) | (.01) | — | (.01) | — |
| Dilutive effect of stock options, nonvested deferred compensation, nonvested restricted stock, restricted stock units, and ESPP(3) | (.01) | (.03) | (.07) | (.06) |
| Diluted EPS | $ .60 | $ .95 | $ 2.56 | $ 2.10 |

(1) Emerging Issues Task Force ("EITF") Issue No. 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share," requires the shares underlying Co-Cos to be included in diluted EPS computations regardless of whether the market price trigger or the conversion price has been met, using the "if-converted" method.

(2) SFAS No. 128, "Earnings per Share," and the additional guidance provided by EITF Topic No. D-72, "Effect of Contracts That May Be Settled in Stock or Cash on the Computation of Diluted Earnings per Share," require both the denominator and the numerator to be adjusted in calculating the potential impact of the Company's equity forward contracts on diluted EPS. Under this guidance, when certain conditions are satisfied, the impact can be dilutive when: (1) the average share price during the period is lower than the respective strike prices on the Company's equity forward contracts, and (2) the Company recorded an unrealized gain or loss on derivative and hedging activities related to its equity forward contracts.



(3) Reflects the potential dilutive effect of additional common shares that are issuable upon exercise of outstanding stock options, nonvested deferred compensation, nonvested restricted stock, restricted stock units, and the outstanding commitment to issue shares under the ESPP, determined by the treasury stock method.

(4) Reflects the potential dilutive effect of equity forward contracts, determined by the reverse treasury stock method.

(5) For the three months ended September 30, 2006 and 2005, stock options and equity forwards of approximately 60 million shares and 50 million shares, respectively, and for the nine months ended September 30, 2006 and 2005, stock options and equity forwards of approximately 54 million shares and 19 million shares, respectively, were outstanding but not included in the computation of diluted earnings per share because they were antidilutive.

## Securitization Activities

### *Securitization Program*

The following table summarizes our securitization activity for the three and nine months ended September 30, 2006 and 2005. Those securitizations listed as sales are off-balance sheet transactions and those listed as financings remain on-balance sheet.

| | Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | | | 2005 | | | |
| (Dollars in millions) | No. of Transactions | Loan Amount Securitized | Pre-Tax Gain | Gain % | No. of Transactions | Loan Amount Securitized | Pre-Tax Gain | Gain % |
| FFELP Stafford/PLUS loans | — | $ — | $ — | —% | — | $ — | $— | —% |
| Consolidation Loans | 2 | 4,001 | 19 | .5 | — | — | — | — |
| Private Education Loans | 1 | 1,088 | 182 | 16.7 | — | — | — | — |
| Total securitizations—sales | 3 | 5,089 | $ 201 | 4.0% | — | — | $— | —% |
| Consolidation Loans(1) | 1 | 3,001 | | | 3 | 7,276 | | |
| Total securitizations—financings | 1 | 3,001 | | | 3 | 7,276 | | |
| Total securitizations | 4 | $ 8,090 | | | 3 | $ 7,276 | | |

| | Nine Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | | | 2005 | | | |
| (Dollars in millions) | No. of Transactions | Loan Amount Securitized | Pre-Tax Gain | Gain % | No. of Transactions | Loan Amount Securitized | Pre-Tax Gain | Gain % |
| FFELP Stafford/PLUS loans | 2 | $ 5,004 | $ 17 | .3% | 2 | $ 3,530 | $ 50 | 1.4% |
| Consolidation Loans | 4 | 9,503 | 55 | .6 | 2 | 4,011 | 31 | .8 |
| Private Education Loans | 3 | 5,088 | 830 | 16.3 | 1 | 1,505 | 231 | 15.3 |
| Total securitizations—sales | 9 | 19,595 | $ 902 | 4.6% | 5 | 9,046 | $ 312 | 3.4% |
| Consolidation Loans(1) | 2 | 6,002 | | | 4 | 9,502 | | |
| Total securitizations—financings | 2 | 6,002 | | | 4 | 9,502 | | |
| Total securitizations | 11 | $ 25,597 | | | 9 | $ 18,548 | | |

(1) In certain Consolidation Loan securitizations there are certain terms within the deal structure that result in such securitizations not qualifying for sale treatment and accordingly, they are accounted for on-balance sheet as variable interest entities ("VIEs"). The terms that are present within these structures that prevent sale treatment are: (1) we may hold certain rights that can affect the remarketing of certain bonds, (2) the trust may enter into interest rate cap agreements after the initial settlement of the securitization which do not relate to the reissuance of third party beneficial interests and (3) we may hold an unconditional call option related to a certain percentage of the securitized assets.

The decrease in the FFELP Stafford/PLUS gain as a percentage of loans securitized from 1.4 percent for the nine months ended September 30, 2005 to .3 percent for the nine months ended September 30, 2006 is primarily due to: 1) an increase in the CPR assumption to account for continued high levels of Consolidation Loan activity; 2) an increase in the discount rate to reflect higher long term interest rates; 3) the re-introduction of Risk Sharing with the Reconciliation Legislation reauthorizing the student loan programs of the Higher Education Act; and 4) an increase in the amount of student loan premiums included in the carrying value of the loans sold. The higher premiums also affected Consolidation Loans



and both were primarily due to the allocation of the purchase price to student loan portfolios acquired through the acquisitions of several companies in the student loan industry in 2004. Higher premiums were also due to loans acquired through zero-fee lending and the school-as-lender channel.

The increase in the Private Education gain as a percentage of loans securitized from 15.3 percent for the nine months ended September 30, 2005 to 16.3 percent for the nine months ended September 30, 2006 is primarily due to a higher spread earned on the assets securitized.

### *Off-Balance Sheet Net Assets*

The following table summarizes our off-balance sheet net assets at September 30, 2006 and December 31, 2005 on a basis equivalent to our GAAP on-balance sheet trusts, which presents the assets and liabilities in the off-balance sheet trusts as if they were being accounted for on-balance sheet rather than off-balance sheet. This presentation, therefore, includes a theoretical calculation of the premiums on student loans, the allowance for loan losses, and the discounts and deferred financing costs on the debt. This presentation is not, nor is it intended to be, a liquidation basis of accounting. (See also "LENDING BUSINESS SEGMENT—Summary of our Managed Loan Portfolio—*Ending Balances (net of allowance for loan losses)*" and "LIQUIDITY AND CAPITAL RESOURCES—Managed Borrowings—*Ending Balances*," earlier in this section.)

| | September 30, 2006 | December 31, 2005 |
|---|---|---|
| **Off-Balance Sheet Assets:** | | |
| Total student loans, net | $ 48,897 | $ 39,925 |
| Restricted cash and investments | 5,812 | 3,761 |
| Accrued interest receivable | 1,537 | 937 |

| | | |
|---|---|---|
| Total off-balance sheet assets | 56,246 | 44,623 |
| **Off-Balance Sheet Liabilities:** | | |
| Debt, par value | 54,361 | 43,331 |
| Debt unamortized discount and deferred issuance costs | (207) | (193) |
| Total debt | 54,154 | 43,138 |
| Accrued interest payable | 435 | 250 |
| Total off-balance sheet liabilities | 54,589 | 43,388 |
| **Off-Balance Sheet Net Assets** | $ 1,657 | $ 1,235 |

**Liquidity Risk and Funding—Long-Term**

With the dissolution of the GSE, our long-term funding, credit spread and liquidity exposure to the corporate and asset-backed capital markets has increased significantly. A major disruption in the fixed income capital markets that limits our ability to raise funds or significantly increases the cost of those funds could have a material impact on our ability to acquire student loans, or on our results of operations. Going forward, securitizations will continue to be the primary source of long-term financing and liquidity. Our securitizations are structured such that we are not obligated to provide any material level of financial, credit or liquidity support to any of the trusts, thus limiting our exposure to the recovery of the Retained Interest asset on the balance sheet for off-balance sheet securitizations to the loss of the earnings spread for loans securitized on-balance sheet. While all of our Retained Interests are subject to some prepayment risk, Retained Interests from our FFELP Stafford securitizations have significant prepayment risk primarily arising from borrowers opting to consolidate their Stafford/PLUS loans. When consolidation activity is higher than projected, the increase in prepayment could materially impair the value of our Retained Interest. However, this negative effect on our Retained Interest is somewhat offset by the loans that consolidate back on our balance sheet, which we view as trading one interest bearing asset for another, whereas loans that consolidate with third parties represent a complete economic loss to the Company. We discuss our short-term liquidity risk, including a table of our sources of liquidity at the beginning of this "LIQUIDITY AND CAPITAL RESOURCES" section.



***Retained Interest in Securitized Receivables***

The following tables summarize the fair value of the Company's Residual Interests, included in the Company's Retained Interest (and the assumptions used to value such Residual Interests), along with the underlying off-balance sheet student loans that relate to those securitizations in transactions that were treated as sales as of September 30, 2006 and December 31, 2005.

| | As of September 30, 2006 | | | |
|---|---|---|---|---|
| (Dollars in millions) | FFELP Stafford and PLUS | Consolidation Loan Trusts(1) | Private Education Loan Trusts | Total |
| Fair value of Residual Interests(2) | $ 777 | $ 735 | $ 2,101 | $ 3,613 |
| Underlying securitized loan balance(3) | 16,916 | 18,254 | 13,365 | 48,535 |
| Weighted average life | 2.6 yrs. | 8.0 yrs. | 8.1 yrs | |
| Prepayment speed (annual rate)(4) | 10%-30%(5) | 6% | 4% | |
| Expected credit losses (% of student loan principal) | .06% | .07% | 4.67% | |
| Residual cash flows discount rate | 12.6% | 10.5% | 12.6% | |

| | As of December 31, 2005 | | | |
|---|---|---|---|---|
| (Dollars in millions) | FFELP Stafford and PLUS | Consolidation Loan Trusts(1) | Private Education Loan Trusts | Total |
| Fair value of Residual Interests(2) | $ 773 | $ 483 | $ 1,150 | $ 2,406 |
| Underlying securitized loan balance(3) | 20,372 | 10,272 | 8,946 | 39,590 |
| Weighted average life | 2.7 yrs. | 8.0 yrs. | 7.8 yrs | |
| Prepayment speed (annual rate)(4) | 10%-20%(5) | 6% | 4% | |
| Expected credit losses (% of student loan principal) | .14% | .23% | 4.74% | |
| Residual cash flows discount rate | 12.3% | 10.3% | 12.4% | |

(1) Includes $176 million and $235 million related to the fair value of the Embedded Floor Income as of September 30, 2006 and December 31, 2005, respectively. Changes in the fair value of the Embedded Floor Income are primarily due to changes in the interest rates and the paydown of the underlying loans.

(2) At September 30, 2006 and December 31, 2005, the Company had unrealized gains (pre-tax) in accumulated other comprehensive income of $574 million and $370 million, respectively, that related to the Retained Interests, primarily those associated with off-balance sheet Private Education Loan trusts.

(3) In addition to student loans in off-balance sheet trusts, the Company had $43.0 billion and $40.9 billion of securitized student loans outstanding (face amount) as of September 30, 2006 and December 31, 2005, respectively, in on-balance sheet securitization trusts.

(4) The prepayment speed assumptions include the impact of projected defaults.

(5) 30% for the fourth quarter of 2006, 15% for 2007 and 10% thereafter for September 30, 2006 valuations and 20% for 2006, 15% for 2007 and 10% thereafter for December 31, 2005 valuations.

***Servicing and Securitization Revenue***

Servicing and securitization revenue, the ongoing revenue from securitized loan pools accounted for off-balance sheet as QSPEs, includes the interest earned on the Residual Interest asset and the revenue we receive for servicing the loans in the securitization trusts. Interest income recognized on the Residual Interest is based on our anticipated yield determined by estimating future cash flows each quarter.

The following table summarizes the components of servicing and securitization revenue for the three and nine months ended September 30, 2006 and 2005.

| | Three Months Ended September 30, 2006 | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2005 |
|---|---|---|---|---|
| Servicing revenue | $ 87 | $ 79 | $ 254 | $ 250 |
| Securitization revenue, before Embedded Floor Income and impairment | 103 | 68 | 257 | 203 |
| Servicing and securitization revenue, before Embedded Floor Income and impairment | 190 | 147 | 511 | 453 |
| Embedded Floor Income | 2 | 19 | 12 | 69 |
| Less: Floor Income previously recognized in gain calculation | (1) | (11) | (6) | (50) |
| Net Embedded Floor Income | 1 | 8 | 6 | 19 |
| Servicing and securitization revenue, before impairment | 191 | 155 | 517 | 472 |
| Retained Interest impairment | (4) | (171) | (148) | (195) |
| Total servicing and securitization revenue | $ 187 | $ (16) | $ 369 | $ 277 |
| Average off-balance sheet student loans | $ 48,226 | $ 40,742 | $ 46,027 | $ 42,137 |
| Average balance of Retained Interest | $ 3,381 | $ 2,530 | $ 2,965 | $ 2,476 |
| Servicing and securitization revenue as a percentage of the average balance of off-balance sheet student loans (annualized) | 1.54% | (.16)% | 1.07% | .88% |

Servicing and securitization revenue is primarily driven by the average balance of off-balance sheet student loans and the amount of and the difference in the timing of Embedded Floor Income recognition on off-balance sheet student loans. The increase in securitization revenue, before net Embedded Floor Income and impairment, from the second quarter of 2006 to the third quarter of 2006 is primarily due to (1) an increase in the amount of off-balance sheet loans in the third quarter of 2006 and (2) an increase in the proportion of Private Education Loan Residual Interests which generate a higher yield than FFELP loan Residual Interests.

Servicing and securitization revenue can also be negatively impacted by impairments of the value of our Retained Interest, caused primarily by the effect of higher than expected Consolidation Loan activity on FFELP Stafford/PLUS student loan securitizations and the effect of market interest rates on the Embedded Floor Income included in the Retained Interest. The majority of the consolidations bring the loans back on-balance sheet so for those loans we retain the value of the asset on-balance sheet versus in the trust. For the three months ended September 30, 2006 and 2005, we recorded impairments to the Retained Interests of $4 million and $171 million, respectively, and for the nine months ended September 30, 2006 and 2005, we recorded impairments of $148 million and $195 million, respectively. These impairment charges were primarily the result of FFELP Stafford loans prepaying faster than projected through loan consolidation ($97 million and $191 million for the nine months ended September 30, 2006 and 2005, respectively), and the effect of market interest rates on the Embedded Floor Income which is part of the Retained Interest ($51 million and $4 million for the nine months ended September 30, 2006 and 2005, respectively). The level and timing of Consolidation Loan activity is highly volatile, and in response we continue to revise our estimates of the effects of Consolidation Loan activity on our Retained Interests and it may result in additional impairment recorded in future periods if Consolidation Loan activity remains higher than projected.

We are constantly monitoring our assumptions used to estimate the fair market value of our Retained Interests. We have recently experienced consolidation activity in our Private Education Loan trusts. While



this activity has had a minimal impact to date and has not necessitated a change in our Private Education Loan CPR assumption, we are closely following this trend. If this trend continues to grow, it may require an update in the assumption.

**Interest Rate Risk Management**

***Asset and Liability Funding Gap***

The tables below present our assets and liabilities (funding) arranged by underlying indices as of September 30, 2006. In the following GAAP presentation, the funding gap only includes derivatives that qualify as effective SFAS No. 133 hedges (those derivatives which are reflected in net interest margin, as opposed to in the derivative market value adjustment). The difference between the asset and the funding is the funding gap for the specified index. This represents our exposure to interest rate risk in the form of basis risk and repricing risk, which is the risk that the different indices may reset at different frequencies or may not move in the same direction or at the same magnitude.

Management analyzes interest rate risk on a Managed Basis, which consists of both on-balance sheet and off-balance sheet assets and liabilities and includes all derivatives that are economically hedging our debt whether they qualify as effective hedges under SFAS No. 133 or not. Accordingly, we are also presenting the asset and liability funding gap on a Managed Basis in the table that follows the GAAP presentation.

*GAAP Basis*

| Index (Dollars in billions) | Frequency of Variable Resets | Assets | Funding[1] | Funding Gap |
|---|---|---|---|---|
| 3 month Commercial paper | daily | $ 69.0 | $ — | $ 69.0 |
| 3 month Treasury bill | weekly | 7.6 | .3 | 7.3 |
| Prime | annual | .6 | — | .6 |
| Prime | quarterly | 1.3 | — | 1.3 |
| Prime | monthly | 6.5 | — | 6.5 |
| PLUS Index | annual | 2.0 | .3 | 1.7 |
| 3-month LIBOR | daily | — | — | — |
| 3-month LIBOR | quarterly | 1.6 | 80.3 | (78.7) |

| | | | | |
|---|---|---|---|---|
| 1-month LIBOR | monthly | .1 | 2.5 | (2.4) |
| CMT/CPI index | monthly/quarterly | — | 3.6 | (3.6) |
| Non discreet reset[(2)] | monthly | — | 7.8 | (7.8) |
| Non discreet reset[(3)] | daily/weekly | 6.3 | — | 6.3 |
| Fixed Rate[(4)] | | 12.1 | 12.3 | (.2) |
| Total | | $ 107.1 | $ 107.1 | $ — |

(1) Includes all derivatives that qualify as hedges under SFAS No. 133.

(2) Consists of asset-backed commercial paper and auction rate securities, which are discount note type instruments that generally roll over monthly.

(3) Includes restricted and non-restricted cash equivalents and other overnight type instruments.

(4) Includes receivables/payables, other assets (including Retained Interest), other liabilities and stockholders' equity (excluding Series B Preferred Stock).



The funding gaps in the above table are primarily interest rate mismatches in short-term indices between our assets and liabilities. We address this issue primarily through the use of basis swaps that primarily convert quarterly 3-month LIBOR to other indices that are more correlated to our asset indices. These basis swaps do not qualify as effective hedges under SFAS No. 133 and as a result the effect on the funding index is not included in our interest margin and is therefore excluded from the GAAP presentation.

*Managed Basis*

| Index (Dollars in billions) | Frequency of Variable Resets | Assets | Funding[(1)] | Funding Gap |
|---|---|---|---|---|
| 3 month Commercial paper | daily | $ 96.3 | $ 10.4 | $ 85.9 |
| 3 month Treasury bill | weekly | 14.7 | 12.8 | 1.9 |
| Prime | annual | 1.0 | — | 1.0 |
| Prime | quarterly | 7.4 | 4.0 | 3.4 |
| Prime | monthly | 12.4 | 10.7 | 1.7 |
| PLUS Index | annual | 3.6 | 5.8 | (2.2) |
| 3-month LIBOR | daily | — | 82.5 | (82.5) |
| 3-month LIBOR | quarterly | 1.5 | 11.0 | (9.5) |
| 1-month LIBOR | monthly | .1 | 1.5 | (1.4) |
| Non discreet reset[(2)] | monthly | — | 10.1 | (10.1) |
| Non discreet reset[(3)] | daily/weekly | 12.2 | — | 12.2 |
| Fixed Rate[(4)] | | 10.1 | 10.5 | (.4) |
| Total | | $ 159.3 | $ 159.3 | $ — |

(1) Includes all derivatives that management considers economic hedges of interest rate risk and reflects how we internally manage our interest rate exposure.
(2) Consists of asset-backed commercial paper and auction rate securities, which are discount note type instruments that generally roll over monthly.
(3) Includes restricted and non-restricted cash equivalents and other overnight type instruments.
(4) Includes receivables/payables, other assets, other liabilities and stockholders' equity (excluding Series B Preferred Stock).

To the extent possible, we generally fund our assets with debt (in combination with derivatives) that has the same underlying index (index type and index reset frequency). When it is more economical, we also fund our assets with debt that has a different index and/or reset frequency than the asset, but only in instances where we believe there is a high degree of correlation between the interest rate movement of the two indices. For example, we use daily reset 3-month LIBOR to fund a large portion of our daily reset 3-month commercial paper indexed assets. In addition, we use quarterly reset 3-month LIBOR to fund a portion of our quarterly reset Prime rate indexed Private Education Loans. We also use our monthly Non Discreet reset funding (asset-backed commercial paper program and auction rate securities) to fund various asset types. In using different index types and different index reset frequencies to fund our assets, we are exposed to interest rate risk in the form of basis risk and repricing risk, which is the risk that the different indices that may reset at different frequencies will not move in the same direction or at the same magnitude. We believe that this risk is low as all of these indices are short-term with rate movements that are highly correlated over a long period of time. We use interest rate swaps and other derivatives to achieve our risk management objectives.

When compared with the GAAP presentation, the Managed Basis presentation includes all of our off-balance sheet assets and funding, and also includes basis swaps that primarily convert quarterly 3-month LIBOR to other indices that are more correlated to our asset indices. Our basis swaps do not qualify for GAAP hedge accounting treatment and are therefore not considered in the GAAP Asset and Liability Funding GAP table.



***Interest Rate Gap Analysis***

In the table below, the Company's variable rate assets and liabilities are categorized by reset date of the underlying index. Fixed rate assets and liabilities are categorized based on their maturity dates. An interest rate gap is the difference between volumes of assets and volumes of liabilities maturing or repricing during specific future time intervals. The following gap analysis reflects rate-sensitive positions at September 30, 2006 and is not necessarily reflective of positions that existed throughout the period.

| | Interest Rate Sensitivity Period | | | | | |
|---|---|---|---|---|---|---|
| | 3 Months or Less | 3 Months to 6 Months | 6 Months to 1 Year | 1 to 2 Years | 2 to 5 Years | Over 5 Years |
| **Assets** | | | | | | |
| Student loans | $ 85,071 | $ 103 | $ 2,798 | $ 8 | $ 55 | $ 3 |
| Other loans | 354 | 54 | 107 | 5 | 4 | 733 |
| Cash and investments, including restricted | 6,548 | 31 | 100 | 883 | 404 | 240 |
| Other assets | 2,767 | 85 | 169 | 484 | 750 | 5,297 |
| Total assets | 94,740 | 273 | 3,174 | 1,380 | 1,213 | 6,273 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Liabilities and Stockholders' Equity** | | | | | | |
| Short-term borrowings | 2,457 | 10 | 1,203 | — | — | — |
| Long-term borrowings | 69,359 | 72 | — | 2,682 | 10,214 | 12,490 |
| Other liabilities | 1,738 | — | — | — | — | 2,316 |
| Minority interest in subsidiaries | — | — | — | — | — | 9 |
| Stockholders' equity | — | — | — | — | — | 4,503 |
| Total liabilities and stockholders' equity | 73,554 | 82 | 1,203 | 2,682 | 10,214 | 19,318 |
| Period gap before adjustments | 21,186 | 191 | 1,971 | (1,302) | (9,001) | (13,045) |
| **Adjustments for Derivatives and Other Financial Instruments** | (16,479) | 52 | (5,623) | 632 | 9,046 | 12,372 |
| Interest rate swaps | (1,675) | — | 1,675 | — | — | — |
| Total derivatives and other financial instruments | (18,154) | 52 | (3,948) | 632 | 9,046 | 12,372 |
| Period gap | $ 3,032 | $ 243 | $ (1,977) | $ (670) | $ 45 | $ (673) |
| Cumulative gap | $ 3,032 | $ 3,275 | $ 1,298 | $ 628 | $ 673 | $ — |
| Ratio of cumulative gap to total assets | 2.8% | 3.1% | 1.2% | .6% | .6% | —% |

***Weighted Average Life***

The following table reflects the weighted average life for our Managed earning assets and liabilities at September 30, 2006.

| (Averages in Years) | On-Balance Sheet | Off-Balance Sheet | Managed |
|---|---|---|---|
| **Earning assets** | | | |
| Student loans | 9.8 | 5.9 | 9.6 |
| Other loans | 6.4 | — | 6.4 |
| Cash and investments | .9 | .1 | .5 |
| Total earning assets | 9.0 | 5.3 | 8.7 |
| **Borrowings** | | | |
| Short-term borrowings | .4 | — | .4 |
| Long-term borrowings | 6.7 | 5.9 | 6.4 |
| Total borrowings | 6.5 | 5.9 | 6.3 |



In the above table, Treasury receipts, although generally liquid assets, extend the weighted average remaining term to maturity of cash and investments to .5 years. Long-term debt issuances likely to be called by us or putable by the investor have been categorized according to their call or put dates rather than their maturity dates. In recent years the shift in the composition of our FFELP student loan portfolio from Stafford loans to Consolidation Loans has lengthened the Managed weighted average life of the student loan portfolio from 8.2 years at December 31, 2004, to 9.6 years at September 30, 2006.

## COMMON STOCK

The following table summarizes our common share repurchases, issuances and equity forward activity for the three and nine months ended September 30, 2006 and 2005.

| (Shares in millions) | Three Months Ended September 30, 2006 | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2005 |
|---|---|---|---|---|
| Common shares repurchased: | | | | |
| Open market | 2.2 | — | 2.2 | — |
| Equity forwards | .9 | 2.9 | 5.4 | 9.4 |
| Benefit plans(1) | .1 | .5 | 1.4 | 1.0 |
| Total shares repurchased | 3.2 | 3.4 | 9.0 | 10.4 |
| Average purchase price per share | $ 48.76 | $ 50.12 | $ 52.55 | $ 49.67 |
| Common shares issued | .8 | 1.8 | 5.2 | 5.3 |
| Equity forward contracts: | | | | |
| Outstanding at beginning of period | 45.9 | 51.7 | 42.7 | 42.8 |
| New contracts | 3.1 | 1.4 | 10.8 | 16.8 |
| Exercises | (.9) | (2.9) | (5.4) | (9.4) |
| Outstanding at end of period | 48.1 | 50.2 | 48.1 | 50.2 |
| Authority remaining at end of period to repurchase or enter into equity forwards | 5.7 | 19.0 | 5.7 | 19.0 |

(1) Includes shares withheld from stock option exercises and vesting of performance stock to satisfy minimum statutory tax withholding obligations and shares tendered by employees to satisfy option exercise costs.

As of September 30, 2006, the expiration dates and purchase prices for outstanding equity forward contracts were as follows:

| Year of Maturity (Contracts in millions of shares) | Outstanding Contracts | Range of Purchase Prices | Average Purchase Price |
|---|---|---|---|
| 2007 | 7.3 | $54.74 | $ 54.74 |
| 2008 | 14.7 | 54.74 | 54.74 |
| 2009 | 15.0 | 54.74 | 54.74 |
| 2010 | 9.0 | 50.30 – 53.76 | 52.72 |
| 2011 | 2.1 | $ 46.30 – 46.70 | 46.40 |
| | 48.1 | | $54.00 |

The closing price of the Company's common stock on September 30, 2006 was $51.98.



## RECENT DEVELOPMENTS

### Extension of the Higher Education Act

On September 30, 2006, the President signed into law P.L. 109-292, the Third Extension of the HEA, temporarily authorizing the portions of HEA yet to be reauthorized until June 30, 2007. Included in the extension were several modifications to provisions passed in the Deficit Reduction Act of 2005. The first provision further limited the ability of schools to act as lenders in the FFELP, requiring that the statutory restrictions on "school as lender" apply to schools using "eligible lender trusts." Another provision clarified the rate for the Account Maintenance Fee paid to guaranty agencies.

### Inspector General Audit of Nelnet on Special Allowance Payments

On September 29, 2006, the U.S. Department of Education's Office of Inspector General ("OIG") issued a Final Audit Report on "Special Allowance Payments to Nelnet for Loans Funded by Tax-Exempt Obligations." In the report, the OIG concluded that Nelnet may have been improperly paid more than $278 million in SAP from January 1, 2003 to June 30, 2005. Under the HEA, FFELP student loans funded by tax-exempt obligations originally issued before October 1, 1993 are only eligible to receive one-half of the SAP rate that would otherwise be payable, but the quarterly SAP rate must not be less than 9.5 percent, less the interest the lender receives from the borrower or the government ("9.5 percent SAP"). In the report, the OIG claims that the loans were not acquired with funds from an eligible source in compliance with the HEA or the regulations or guidance issued by the Department of Education ("ED"). We believe that the OIG's legal analysis is incorrect and is inconsistent with well established ED guidance. The Secretary of ED may reject the OIG's findings. In May 2005, the OIG issued a Final Audit Report on 9.5 percent SAP payments to New Mexico Educational Assistance Foundation that contained findings on different issues but that were also inconsistent with well established guidance; the Secretary subsequently rejected those findings. Nevertheless, there can be no assurance that the Secretary will reject the OIG's findings and recommendations that Nelnet return past and forgo prospective 9.5 percent SAP payments. In the event the Secretary accepts the OIG's finding regarding Nelnet, it is possible that other holders of 9.5 percent SAP loans, including Sallie Mae, could be directed to calculate SAP in accordance with the OIG's interpretation and return funds to ED. As of September 30, 2006 and 2005, Sallie Mae held approximately $550 million and $1.4 billion, respectively, in 9.5 percent SAP loans, which were inherited by acquiring four non-profit lending agencies. At this time, we cannot predict the likelihood of such an outcome or the time period it might cover.

### Upromise, Inc. Acquisition

On August 23, 2006, the Company completed the acquisition of Upromise, Inc. ("Upromise"). Upromise's popular rewards service—one of the largest rewards marketing coalitions in the U.S.—has more than seven million members who have joined Upromise to save for college when they and their families buy gas or groceries, dine out, or purchase other goods and services from more than 450 participating companies. Upromise is also the largest administrator of direct-to-consumer 529 college savings plans, administering nearly one million college savings accounts and over $10 billion in assets with tax-advantaged 529 investment options through partnerships with seven states. Upromise offers its rewards service members the opportunity to link their Upromise account to a participating 529 plan so that their savings can be transferred automatically into their plan on a periodic basis. Under the terms of the transaction, Upromise became a wholly owned subsidiary of SLM Corporation. Upromise, which employs more than 300 individuals, will retain its separate brand identity, management team and operations in Needham, MA.



## Item 3. Quantitative and Qualitative Disclosures about Market Risk

### *Interest Rate Sensitivity Analysis*

The effect of short-term movements in interest rates on our results of operations and financial position has been limited through our interest rate risk management. The following tables summarize the effect on earnings for the three and nine months ended September 30, 2006 and 2005 and the effect on fair values at September 30, 2006 and December 31, 2005, based upon a sensitivity analysis performed by management assuming a hypothetical increase in market interest rates of 100 basis points and 300 basis points while funding spreads remain constant.

| | Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | | | | 2005 | | | |
| | Interest Rates: | | | | Interest Rates: | | | |
| | Change from Increase of 100 Basis Points | | Change from Increase of 300 Basis Points | | Change from Increase of 100 Basis Points | | Change from Increase of 300 Basis Points | |
| **(Dollars in millions, except per share amounts)** | $ | % | $ | % | $ | % | $ | % |
| **Effect on Earnings** | | | | | | | | |
| Increase/(decrease) in pre-tax net income before unrealized gains (losses) on derivative and hedging activities | $ 1 | —% | $ 3 | 0% | $ 2 | 1% | $ (8) | (5)% |
| Unrealized gains (losses) on derivative and hedging activities | 144 | 127 | 236 | 209 | 243 | 60 | 437 | 107 |
| Increase in net income before taxes | $ 145 | 31% | $ 239 | 51% | $ 245 | 42% | $ 429 | 74% |
| Increase in diluted earnings per common share | $ .21 | 35% | $ .36 | 60% | $ .35 | 37% | $ .62 | 65% |

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Interest Rates: | | Interest Rates: | |
| | Change from Increase of 100 Basis Points | Change from Increase of 300 Basis Points | Change from Increase of 100 Basis Points | Change from Increase of 300 Basis Points |

| (Dollars in millions, except per share amounts) | $ | % | $ | % | $ | % | $ | % |
|---|---|---|---|---|---|---|---|---|
| **Effect on Earnings** | | | | | | | | |
| Increase/(decrease) in pre-tax net income before unrealized gains (losses) on derivative and hedging activities | $ (6) | —% | $ (24) | (1)% | $ 16 | 2% | $ 24 | 2% |
| Unrealized gains (losses) on derivative and hedging activities | 144 | 1163 | 236 | 1913 | 243 | 50 | 437 | 90 |
| Increase in net income before taxes | $ 138 | 7% | $ 212 | 11% | $ 259 | 18% | $ 461 | 31% |
| Increase in diluted earnings per common share | $ .21 | 8% | $ .36 | 14% | $ .38 | 18% | $ .70 | 33% |



| (Dollars in millions) | At September 30, 2006 | | | | |
|---|---|---|---|---|---|
| | | Interest Rates: | | | |
| | | Change from Increase of 100 Basis Points | | Change from Increase of 300 Basis Points | |
| | Fair Value | $ | % | $ | % |
| **Effect on Fair Values** | | | | | |
| Assets | | | | | |
| Total FFELP student loans | $ 81,461 | $ (169) | —% | $ (300) | —% |
| Private Education Loans | 10,122 | — | — | — | — |
| Other earning assets | 9,502 | (43) | — | (122) | (1) |
| Other assets | 9,551 | (361) | (4) | (568) | (6) |
| Total assets | $ 110,636 | $ (573) | (1)% | $ (990) | (1)% |
| Liabilities | | | | | |
| Interest bearing liabilities | $ 98,623 | $ (1,437) | (1)% | $ (3,624) | (4)% |
| Other liabilities | 4,054 | 941 | 23 | 2,749 | 68 |
| Total liabilities | $ 102,677 | $ (496) | —% | $ (875) | (1)% |

| (Dollars in millions) | At December 31, 2005 | | | | |
|---|---|---|---|---|---|
| | | Interest Rates: | | | |
| | | Change from Increase of 100 Basis Points | | Change from Increase of 300 Basis Points | |
| | Fair Value | $ | % | $ | % |
| **Effect on Fair Values** | | | | | |
| Assets | | | | | |
| Total FFELP student loans | $ 76,492 | $ (215) | —% | $ (385) | (1)% |
| Private Education Loans | 9,189 | — | — | — | — |
| Other earning assets | 9,344 | (57) | (1) | (164) | (2) |
| Other assets | 7,429 | (292) | (4) | (377) | (5) |
| Total assets | $ 102,454 | $ (564) | (1)% | $ (926) | (1)% |
| Liabilities | | | | | |
| Interest bearing liabilities | $ 92,026 | $ (1,437) | (2)% | $ (3,612) | (4)% |
| Other liabilities | 3,609 | 975 | 27 | 2,863 | 79 |
| Total liabilities | $ 95,635 | $ (462) | —% | $ (749) | (1)% |

A primary objective in our funding is to minimize our sensitivity to changing interest rates by generally funding our floating rate student loan portfolio with floating rate debt. However, as discussed under "LENDING BUSINESS SEGMENT—Summary of our Managed Student Loan Portfolio—*Floor Income—Managed Basis*," we can have a fixed versus floating mismatch in funding if the student loan earns at the fixed borrower rate and the funding remains floating, which results in us earning Floor Income.

During the three and nine months ended September 30, 2006 and 2005, certain FFELP student loans were earning Floor Income and we locked in a portion of that Floor Income through the use of futures and Floor Income Contracts that converted a portion of the fixed rate nature of student loans to variable rate. These hedging transactions also fixed the relative spread between the student loan asset rate and the variable rate liability.

In the above table, under the scenario where interest rates increase 100 and 300 basis points, the changes in pre-tax net income before the unrealized gains (losses) on derivative and hedging activities is primarily due to the impact of (i) our off-balance sheet hedged Consolidation Loan securitizations and the



related Embedded Floor Income recognized as part of the gain on sale, which results in a decrease in payments on the written Floor contracts that more than offset impairment losses on the Embedded Floor Income in the Residual Interest; (ii) our unhedged on-balance sheet loans not currently having significant Floor Income due to the recent increase in interest rates, which results in these loans being more variable rate; and (iii) a portion of our fixed rate assets being funded with variable debt. The first item will generally cause income to increase when interest rates increase from a low interest rate environment, whereas, the second and third items will generally offset this increase. In the 100 and 300 basis point scenario for the three months ended September 30, 2006, there was little impact to pre-tax net income because most loans were predominately in a variable rate mode and there was minimal variable funding of fixed rate assets. Whereas, for the nine months ended September 30, 2006, item (iii) had a greater impact. In the prior year periods, item (i) had a bigger impact in both scenarios for the nine months ended September 30, 2005 due to the lower interest rate environment that existed relative to 2006. By the third quarter of 2005, interest rates had risen to a level which in the 300 basis point scenario, caused the impact of the Floor Income Contracts to be minimal, leaving item (iii) to result in an overall negative change in pre-tax net income.

In addition to interest rate risk addressed in the preceding tables, the Company is also exposed to risks related to foreign currency exchange rates and the equity price of its own stock. Foreign currency exchange risk is primarily the result of foreign denominated debt issued by the Company. As it relates to the Company's corporate unsecured and securitization debt programs used to fund the Company's business, the Company's policy is to use cross currency interest rate swaps to swap all foreign denominated debt payments (fixed and floating) to U.S. dollar LIBOR using a fixed exchange rate. In the tables above, there would be an immaterial impact on earnings if exchange rates were to decrease or increase, due to the terms of the hedging instrument and hedged items matching. The balance sheet interest bearing liabilities would be affected by a change in exchange rates, however, the change would be materially offset by the cross currency interest rate swaps in other assets or other liabilities. In addition, the Company has foreign exchange risk as a result of international operations, however, the exposure is minimal at this time.

Equity price risk of the Company's own stock is due to equity forward contracts used in the Company's share repurchase program. A hypothetical decrease in the Company's stock price per share of $5.00 and $10.00 would result in a $241 million and $482 million unrealized loss on derivative and hedging, respectively. In addition to the net income impact, other liabilities would increase by the aforementioned amounts. Stock price decreases can also result in the counterparty exercising its right to demand early settlement on a portion of or the total contract depending on trigger prices set in each contract. With the $5.00 and $10.00 decrease in unit stock price above, none of these triggers would be met and no counterparty would have the right to early settlement.



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### Item 4. Controls and Procedures

**Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of September 30, 2006. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer, concluded that, as of September 30, 2006, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (a) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (b) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control Over Financial Reporting**

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) occurred during the fiscal quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



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## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

The Company was named as a defendant in a putative class action lawsuit brought by three Wisconsin residents on December 20, 2001 in the Superior Court for the District of Columbia. The lawsuit sought to bring a nationwide class action on behalf of all borrowers who allegedly paid "undisclosed improper and excessive" late fees over the past three years. The plaintiffs sought damages of $1,500 per violation plus punitive damages and claimed that the class consisted of two million borrowers. In addition, the plaintiffs alleged that the Company charged excessive interest by capitalizing interest quarterly in violation of the promissory note. On February 27, 2003, the Superior Court granted the Company's motion to dismiss the complaint in its entirety. On March 4, 2004, the District of Columbia Court of Appeals affirmed the Superior Court's decision granting the Company's motion to dismiss the complaint, but granted plaintiffs leave to re-plead the first count, which alleged violations of the D.C. Consumer Protection Procedures Act. On September 15, 2004, the plaintiffs filed an amended class action complaint. On October 15, 2004, the Company filed a motion to dismiss the amended complaint with the Superior Court for failure to state a claim and non-compliance with the Court of Appeals' ruling. On December 27, 2004, the Superior Court granted the Company's motion to dismiss the plaintiffs' amended complaint. Plaintiffs appealed the Superior Court's dismissal order to the Court of Appeals. On June 8, 2006, the Court of Appeals issued an opinion reversing the order of the trial court dismissing the amended complaint. The Court of Appeals did not address the merits of the complaint but concluded that the trial court improperly relied upon facts extrinsic to the complaint. The Court of Appeals noted in its decision that the plaintiffs failed to file a motion for class certification within the time required by the District of Columbia rules. The trial court conducted a status conference on August 18, 2006, and set a briefing schedule for the issue of whether plaintiffs have waived their right to move for class certification. Sallie Mae filed its answer and on September 1, 2006, Sallie Mae filed its opening brief, plaintiffs have opposed and Sallie Mae filed a reply. This motion is pending. Plaintiff also filed a motion to strike Sallie Mae's answer on September 1, 2006. Sallie Mae opposed this motion and it is pending. While these motions have been pending, the trial judge recused herself and the case will be reassigned to another Superior Court Judge. The Company does not believe that it is reasonably likely that a nationwide class will be certified.

The Company is also subject to various claims, lawsuits and other actions that arise in the normal course of business. Most of these matters are claims by borrowers disputing the manner in which their loans have been processed or the accuracy of the Company's reports to credit bureaus. In addition, the collections subsidiaries in the Company's debt management operation group are occasionally named in individual plaintiff or class action lawsuits in which the plaintiffs allege that the Company has violated a federal or state law in the process of collecting their account. Management believes that these claims, lawsuits and other actions will not have a material adverse effect on its business, financial condition or results of operations.

### Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2005.



**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table summarizes the Company's common share repurchases during the third quarter of 2006 pursuant to the stock repurchase program (see Note 6, "Stockholders' Equity," to the consolidated financial statements) first authorized in September 1997 by the Board of Directors. Since the inception of the program, which has no expiration date, the Board of Directors has authorized the purchase of up to 308 million shares as of September 30, 2006.

| (Common shares in millions) | Total Number of Shares Purchased[1] | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs[2] |
|---|---|---|---|---|
| **Period:** | | | | |
| July 1 – July 31, 2006 | .9 | $ 54.65 | .9 | 10.0 |
| August 1 – August 31, 2006 | 2.2 | 46.33 | 2.2 | 5.7 |
| September 1 – September 30, 2006 | .1 | 50.12 | — | 5.7 |
| Total third quarter | 3.2 | $ 48.76 | 3.1 | |

(1) The total number of shares purchased includes: i) shares purchased under the stock repurchase program discussed above, and ii) shares purchased in connection with the exercise of stock options and vesting of performance stock to satisfy minimum statutory tax withholding obligations and shares tendered by employees to satisfy option exercise costs (which combined totaled .1 million shares for the third quarter of 2006).

(2) Reduced by outstanding equity forward contracts.

**Item 3. Defaults Upon Senior Securities**

Nothing to report.

**Item 4. Submission of Matters to a Vote of Security Holders**

Nothing to report.

**Item 5. Other Information**

Nothing to report.

**Item 6. Exhibits**

The following exhibits are furnished or filed, as applicable:

| | |
|---|---|
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

SLM CORPORATION
(Registrant)

By: /s/ C.E. ANDREWS

C.E. Andrews
*Executive Vice President and*
*Chief Financial Officer*
*(Principal Accounting Officer and*
*Duly Authorized Officer)*

Date: November 7, 2006

**Exhibit 31.1**

**Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Thomas J. Fitzpatrick, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SLM Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ THOMAS J. FITZPATRICK

Thomas J. Fitzpatrick
*Chief Executive Officer*
November 7, 2006

**Exhibit 31.2**

**Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, C.E. Andrews, certify that:

1. I have reviewed this quarterly report on Form 10-Q of SLM Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ C.E. ANDREWS

C.E. Andrews
*Chief Financial Officer*
November 7, 2006

**Exhibit 32.1**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of SLM Corporation (the “Company”) on Form 10-Q for the period ended September 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Thomas J. Fitzpatrick, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ THOMAS J. FITZPATRICK
Thomas J. Fitzpatrick
Chief Executive Officer
November 7, 2006

**Exhibit 32.2**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of SLM Corporation (the “Company”) on Form 10-Q for the period ended September 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, C.E. Andrews, Executive Vice President, Finance, Accounting and Risk Management of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ C.E. ANDREWS
C.E. Andrews
Chief Financial Officer
November 7, 2006