RECEIVED
09 SEP -3 PM 10: 39
U.S. DISTRICT COURT
S.D.N.Y.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re SLM Corporation Securities Litigation	:	Case No. 08 Civ. 1029 (WHP)

SECOND AMENDED CLASS ACTION COMPLAINT

TABLE OF CONTENTS

Lead Plaintiff SLM Venture and additional plaintiff Sheet Metal Workers' Local No. 80 Pension Trust Fund, by their undersigned attorneys, individually and on behalf of a class of similarly situated persons, for their Second Amended Class Action Complaint, allege the following upon personal knowledge as to themselves and their own acts, and upon information and belief as to all other matters.

Plaintiffs' information and belief as to allegations concerning matters other than their own acts is based upon, among other things: (i) review and analysis of documents filed publicly by SLM Corporation ("SLM," "Sallie Mae," or the "Company") and certain affiliates thereof with the Securities Exchange Commission ("SEC"); (ii) review and analysis of press releases, news articles, conference call transcripts and other public statements issued by or concerning SLM and other Defendants named herein; (iii) review and analysis of research reports issued by financial analysts concerning SLM's common stock and business; (iv) discussions with consulting experts; (v) other publicly available information and data concerning SLM and its common stock; (vi) an investigation conducted by and through Plaintiffs' attorneys in this action; (vii) review and analysis of news articles, media reports and other publications concerning the student loan industry; and (viii) review and analysis of certain pleadings filed in other litigation naming SLM or certain subsidiaries or affiliates as a party. Plaintiffs believe that substantial additional evidentiary support for the allegations herein exists and will be developed after Plaintiffs have had a reasonable opportunity for discovery.

I. NATURE AND SUMMARY OF THE ACTION

1. Plaintiffs bring this action on behalf of themselves and all other persons and entities who bought or otherwise acquired SLM common stock between January 18, 2007 and January 23, 2008, inclusive ("Class Period") against Defendants SLM, Albert Lord and Charles

Andrews.

2. SLM is the nation's leading provider of student loans. SLM originates, acquires, services and collects student loans, primarily loans made through the Federal Family Education Loan Program (commonly known as FFELP loans) and private education loans, which SLM calls "PELs." Before the Class Period, SLM's profits derived largely from its portfolio of FFELP loans, which comprised the bulk of its lending business.

3. Students typically assume PELs when they have borrowed all they can under federally-sponsored lending programs or if they are attending schools that are not eligible for federally-guaranteed loans. Unlike FFELP loans, which are guaranteed by the federal government and are virtually risk-free to the lender, the nonpayment risk associated with a PEL falls entirely on the lender or the entity who acquires the loan. PELs carry higher interest rates and fees to account for the greater risk to the lender.

4. PELs also offer the lender the possibility of profiting from higher lending margins and fees. While the federal government caps the interest rate for FFELP loans, SLM is free to charge whatever interest rate and fees the market will bear for PELs. As a result, the spread (the difference between SLM's cost of borrowing and the interest rate it can earn) and fees on PELs are usually much higher than on FFELP loans.

5. In fall 2006, the prospects of new legislation and the overall declining prospects of SLM's FFELP business prompted Defendants to undertake a sale of SLM to private equity investors. In November 2006, then-Chairman of the Board Albert Lord initiated negotiations with a group led by private equity firm J.C. Flowers & Co, Bank of America and JP Morgan Chase. A sale of SLM on favorable terms to the Flowers group or another buyer depended on

Defendants' ability to persuade investors that SLM remained an attractive acquisition target despite SLM's declining prospects.

6. In an attempt to secure a sale of SLM at an attractive price, Defendants devised and implemented a scheme to boost short-term profits by sharply expanding SLM's PEL portfolio through aggressive and indiscriminate lending, thereby allowing SLM to book favorable near-term financial results. Simultaneously, SLM used a series of accounting manipulations to defer recognition of the loan losses implicated by its high risk lending strategy. Between June 2006 and December 2007, SLM's PEL portfolio more than doubled, growing from $7 billion to $15.8 billion.

7. Defendants achieved the increase in SLM's PEL portfolio by relaxing SLM's underwriting standards for PELs and writing "non-traditional" loans to students with low credit ratings or who were attending proprietary (private, for-profit) schools with low graduation rates and high default rates. Defendants also implemented new internal rules for putting delinquent loans into "forbearance," without attempting to determine if forbearance would increase the likelihood of future payment. Loans in forbearance were considered "current" and continued to accrue interest that SLM recorded as income.

8. Defendants did not disclose their scheme to investors or reveal that SLM had relaxed its loan underwriting standards and changed its forbearance practices. On the contrary, Defendants falsely reported in SEC filings that SLM managed the higher risk of PELs through certain defined loan underwriting standards and extended loans only to students who met SLM's strict financial requirements. Defendants also falsely represented that SLM had well-established forbearance practices for PELs and that borrowers who were granted forbearance were screened to ensure that forbearance would improve their ability to repay. Finally, Defendants falsely

represented that SLM's allowance for PEL losses was adequate and that SLM's financial statements were fairly presented in accordance with generally accepted accounting principles (GAAP).

9. In April 2007, SLM and the Flowers group entered into a merger agreement pursuant to which the Flowers group would pay approximately $25 billion, or $60 per share of common stock, for SLM. Consummation of the merger required the satisfaction of a number of conditions, including conditions tied to SLM's financial performance and outlook. These conditions gave Defendants a powerful incentive to continue to pursue their scheme to inflate the price of SLM stock.

10. As a result of Defendants' scheme, SLM stock traded at inflated levels throughout the Class Period, only to decline as it became increasingly apparent Defendants would be unable to consummate a sale of SLM and the truth about SLM's PEL portfolio began to emerge.

11. Defendants Lord and Andrews were personally motivated to continue the fraud and ensure that the merger was consummated. Lord stood to receive $225 million and Andrews stood to receive $16.6 million upon completion of the transaction. Lord and Andrews were both principal participants in meetings and conference calls with securities analysts and investors and each signed false or misleading filings with the SEC during the Class Period. Through their executive-level roles at SLM, the internal reports they received, and the visits they made to SLM's call and collection centers, Lord and Andrews knew that SLM's disclosures did not reveal the Company's actual policies and procedures during the Class Period or its true financial condition.

12. SLM was further motivated to continue and conceal its fraudulent conduct because of its potential liability under certain outstanding equity forward contracts. The

contracts allowed SLM to raise cash by selling its common stock and agreeing to buy it back at a future date at higher "strike prices." Although SLM avoided taking out a loan or issuing debt or equity, it risked financial liability of approximately $2 billion if the market price of its stock did not reach the strike levels of the equity forward contracts.

13. On December 12, 2007, SLM announced that the Flowers group had refused to consummate or renegotiate the merger because of cuts in federal subsidies for student loans that the Flowers group contended affected SLM's financials.

14. On December 19, 2007, Defendants admitted certain facts which undermined the accuracy of information Defendants had previously introduced into the marketplace. Defendant Lord revealed on a conference call with securities analysts and investors that SLM would be increasing its provision for PEL losses and acknowledged questions in the market about the credit quality of SLM's PEL portfolio—although he refused to answer any of those questions. After Lord's remarks, SLM's stock dropped by 21%, reportedly the greatest single-day drop in SLM's stock price since the Company went public.

15. SLM's stock dropped another 13% on January 4, 2008, after SLM announced its intention to be more selective in its origination of PELs and that the PELs would be subject to stricter underwriting standards, which would inhibit future growth and profitability of the PEL business.

16. Also in January 2008, SLM paid approximately $2 billion to settle its equity forward contracts, having failed to inflate its stock price to the levels those contracts required.

17. On January 23, 2008, SLM announced its financial results for the 2007 fiscal year. The Company's net income for 2007 was $560 million, a reduction of over 50% from the net income it reported for 2006. SLM reported a net loss of $139 million for the fourth quarter

of 2007, driven primarily by massive fourth quarter provisions for loan losses of $750 million on a "core earnings" basis (or $575 million on a GAAP basis). Provisions for loan losses in 2007 ultimately amounted to $1 billion. For 2007, SLM reported a 242% increase (year-over-year) in SLM's provision for loan losses, from $258 million to $883 million, vastly exceeding the 56% growth in the portfolio during the same period.

18. In an attempt to repair his credibility, Defendant Lord acknowledged in a conference call with securities analysts and investors later that day that SLM had been lending "too much money" to students at schools with poor graduation rates and to "lower tier credit borrowers." Lord admitted that these loans were "predictably not collectible."

19. During the Class Period, SLM common stock traded as high as $57.98 per share, and it traded at $28.85 per share just prior to the December 19, 2007 conference call. Over the next month, as the truth continued to emerge, SLM's common stock price plummeted to $18.69 per share on January 23, 2008. By the end of the Class Period, SLM's market capitalization had declined by more than $18.6 billion, or more than 70.7% of its value from its Class Period high just six months before.

20. Investors in SLM common stock have suffered losses as a result of Defendants' false statements and failure to disclose material facts, which caused SLM common stock to trade at inflated prices during the Class Period. Based on the conduct summarized above and described more fully below, Plaintiffs, on behalf of themselves and all others similarly situated, assert claims against Defendants SLM, Lord, and Andrews for violations of the Securities Exchange Act of 1934.

II. JURISDICTION AND VENUE

21. The claims asserted herein arise under Sections 10(b) and 20(a) of the Exchange

Act, 15 U.S.C. §§78j and 78t(a), and Rule 10b-5 promulgated thereunder by the SEC, 17 C.F.R. § 240.10b-5.

22. This Court has jurisdiction over the subject matter of this action pursuant to Section 27 of the Exchange Act, 15 U.S.C. §78aa, and 28 U.S.C. §1331.

23. Venue is proper in this Judicial District pursuant to Section 27 of the Exchange Act, 15 U.S.C. §78aa, and 28 US.C. §1391(b) and (c). SLM has operations in this District, false statements were made in this District, and acts giving rise to the violations complained of occurred in this District.

24. In connection with the acts and conduct alleged herein, Defendants, directly and indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the United States mails, interstate telephone communications, and the facilities of a national securities exchange.

III. THE PARTIES

A. Plaintiffs

25. By Court order dated April 1, 2009, SLM Venture was appointed Lead Plaintiff in accordance with the provisions of the Private Securities Litigation Reform Act of 1995. As set forth in the certification previously filed with the Court, SLM Venture purchased SLM common stock on the open market during the Class Period and suffered damages as a result of the misconduct alleged herein.

26. As set forth in the certification previously filed with the Court, Plaintiff Sheet Metal Workers' Local No. 80 Pension Trust Fund purchased SLM common stock on the open market during the Class Period and suffered damages as a result of the misconduct alleged herein.

B. Defendants

27. Defendant SLM is a corporation organized and existing under the laws of the State of Delaware, with its principal executive offices at 12061 Bluemont Way, Reston, Virginia. SLM was founded in 1972 as a federally chartered, government-sponsored enterprise. Pursuant to the Student Loan Marketing Association Reorganization Act of 1996, SLM began to privatize its operations in 1997, and the process was completed on December 29, 2004. SLM, through its subsidiaries, provides educational financing in the United States. It originates, owns, and manages student loans by providing funding, delivery, and servicing support for education loans through its participation in FFELP and by offering non-federally guaranteed private education loans, or PELs. SLM common stock trades under the symbol SLM on the New York Stock Exchange.

28. Defendant Lord currently serves as Vice Chairman of SLM's Board of Directors and as Chief Executive Officer of the Company. Lord joined SLM in 1981 as Controller and then served as Executive Vice President and Chief Operating Officer. He left the Company in 1994, but returned in 1995 as a member of the Board of Directors. He has been a member of the Board continuously since 1995. Lord was SLM's CEO from 1997 until mid-2005. In March 2005, Lord was appointed Chairman of the Board of Directors. Lord was appointed Executive Chairman on November 28, 2007 (the person to whom the CEO would report), and then re-appointed CEO in December 2007. He was named Vice Chairman of the Board in January 2008. Lord signed the Company's materially false and misleading Form 10-K Annual Report for 2006, filed with the SEC on March 1, 2007, and was a principal participant in the meetings and conference calls with securities analysts and investors described herein.

29. Defendant Andrews joined SLM in 2003 as Executive Vice President of

Accounting and Risk Management. From January 2006 to May 2007, Andrews served as SLM's Chief Financial Officer. From May 2007 until December 2007, Andrews served as CEO of SLM. He was named President of SLM in December 2007. On September 19, 2008, SLM announced that Andrews would be leaving the Company effective September 30, 2008. Andrews signed the Company's materially false and misleading Form 10-K Annual Report for 2006, filed with the SEC on March 1, 2007 and Form 10-Q Quarterly Report for the first quarter of 2007, filed with the SEC on May 10, 2007. He also signed the certifications accompanying these SEC filings made pursuant to the Sarbanes-Oxley Act of 2002 ("SOX"), along with the SOX certifications accompanying SLM's Form 10-Q Quarterly Reports for the second and third quarters of 2007, filed with the SEC on August 7 and November 9, 2007, respectively. Andrews signed the Company's materially false and misleading Form 8-Ks announcing SLM's fourth-quarter and year-end 2006 results and first-quarter 2007 results, filed with the SEC on January 18 and April 24, 2007, respectively. Andrews is quoted in the Company's false and misleading press releases discussing SLM's financial results and was a principal participant in the meetings and conference calls with securities analysts and investors described herein.

30. Defendants Lord and Andrews are referred to collectively as the "Individual Defendants." Both Individual Defendants, by virtue of their high-level positions with SLM, directly participated in the management of the Company, were directly involved in the day-to-day operations of the Company at the highest levels, and were privy to confidential proprietary information concerning the Company and its business, operations, growth, financial statements, and financial condition during their tenure with the Company, as alleged herein. As set forth below, the materially misstated information conveyed in the Company's SEC filings, press releases, and other public statements was the result of the collective actions of these individuals.

Both of these individuals, during their tenure with SLM, were involved in drafting, producing, reviewing, and/or disseminating the statements at issue in this case, approved or ratified these statements, or were aware or recklessly disregarded that these statements were being issued regarding the Company. Accordingly, it is appropriate to treat the Individual Defendants as a group for pleading purposes.

31. As officers and directors of a publicly held company whose common stock and other securities were, and are, registered with the SEC pursuant to the Exchange Act, and whose common stock was, and is, traded on the New York Stock Exchange, and governed by the federal securities laws, the Individual Defendants each had a duty to disseminate prompt, accurate, and truthful information with respect to the Company's business, operations, financial statements, and internal controls, and to correct any previously issued statements that had become materially misleading or untrue, so that the market price for SLM's common stock would be based on accurate information. The Individual Defendants each violated these requirements and obligations during the Class Period.

32. The Individual Defendants, because of their positions of control and authority as senior executive officers and/or directors of SLM, were able to and did control the content of the SEC filings, press releases, and other public statements issued by SLM during the Class Period. Both Individual Defendants were provided with copies of the statements at issue in this action before they were issued to the public and had the ability to prevent their issuance or cause them to be corrected. Accordingly, both Individual Defendants are responsible for the accuracy of the public statements detailed herein.

33. The Individual Defendants, because of their positions of control and authority as senior executive officers and/or directors of SLM, had access to the adverse undisclosed

information about SLM's business, operations, financial statements, and internal controls through access to internal corporate documents, conversations with other corporate officers and employees, attendance at management and Board of Directors meetings and committees thereof, and via reports and other information provided to them in connection therewith, and knew or recklessly disregarded that these adverse undisclosed facts rendered the positive representations made by or about SLM materially false and misleading.

34. Unless otherwise stated, "Defendants" refers to Defendants SLM, Lord, and Andrews.

IV. CLASS ACTION ALLEGATIONS

35. Plaintiffs bring this action on their own behalf and as a class action pursuant to Rules 23(a) and (b)(3) of the Federal Rules of Civil Procedure on behalf of all persons who purchased or otherwise acquired SLM common stock between January 18, 2007 and January 23, 2008, inclusive (the "Class"). Excluded from the Class are the Defendants; the members of the immediate families of the Individual Defendants; any entity in which any Individual Defendant has a controlling interest; any entity which is a parent or subsidiary of, or which is controlled by any Defendant; and the officers, directors, affiliates, legal representatives, heirs, predecessors, successors, and assigns of Defendants.

36. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, SLM's common stock was actively traded on the New York Stock Exchange in a well developed and efficient market. While the exact number of Class members is unknown to Plaintiffs at this time, and can be ascertained only through appropriate discovery, during the Class Period more than 466 million shares of SLM common stock were outstanding. Plaintiffs believe there are, at a minimum, hundreds if not thousands of

members of the Class. The disposition of their claims in a class action will provide substantial benefits to the parties and the Court. Record owners and other members of the Class may be identified from records maintained by SLM or its transfer agent and may be notified of the pendency of this action by mail, using a form similar to that customarily used in securities class actions.

37. Plaintiffs' claims are typical of the claims of members of the Class. All members of the Class were similarly affected by Defendants' allegedly wrongful conduct in violation of the Exchange Act as complained of herein.

38. Plaintiffs will fairly and adequately protect the interest of the members of the Class. Plaintiffs have retained counsel competent and experienced in class and securities litigation.

39. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. The questions of law and fact common to the Class include:

a. whether the federal securities laws were violated by Defendants' acts and omissions as alleged herein;

b. whether the SEC filings, press releases, and other public statements made to the investing public during the Class Period contained material misstatements or omitted to state material information;

c. whether and to what extent the Company's financial statements were not presented in conformity with generally accepted accounting principles, or GAAP, during the Class Period;

d. whether and to what extent the market price for SLM common stock was artificially inflated during the Class Period because of the material misrepresentations and/or omissions complained of herein;

e. whether, with respect to Plaintiffs' claims for violations of Section 10(b) of the Exchange Act, Defendants acted with the requisite level of scienter;

f. whether, with respect to Plaintiffs' claims for violations of Section 20(a) of the Exchange Act, the Individual Defendants were controlling persons of SLM;

g. whether reliance may be presumed pursuant to the fraud-on-the-market doctrine; and

h. whether Plaintiffs and the members of the Class have sustained damages as a result of the conduct complained of herein, and if so, the proper measure of damages.

40. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy because, among other things, joinder of all members of the Class is impracticable. Furthermore, because the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

V. FACTUAL BACKGROUND AND SUBSTANTIVE ALLEGATIONS

A. SLM and its Business

41. SLM, through its subsidiaries, provides education finance in the United States. SLM's primary business is to originate and hold student loans by providing funding, delivery, and servicing support for education loans through its participation in FFELP and through offering non-federally guaranteed PELs. During the Class Period, SLM also offered consolidation loans for both the FFELP and PEL markets. SLM is the largest student lender in

the United States. As of the end of 2006, the Company managed more than $142 billion in student loans.

42. FFELP loans are originated under the Higher Education Act of 1965 (Pub. L. No. 89-239), and ultimately are guaranteed by the government in case of default, death, disability, or bankruptcy of the borrower. Because FFELP loans are regulated by the Higher Education Act and carry almost no risk to a qualified lender, such as SLM, they have been far less profitable to SLM than PELs. In 2006, the average interest rate SLM charged on a FFELP loan was approximately 6.54%, and the student loan spread, which is the difference between the income earned on the loan and the interest paid on the debt to fund the loan, was 1.26%.

43. PELs are neither guaranteed by the government nor reinsured under any government or private student loan program. PELs include loans for traditional higher education, undergraduate and graduate degrees, and for alternative education, such as career training and tutorial schools. Because PELs are not guaranteed or insured by the government, they are riskier than FFELP loans and carry correspondingly higher costs and interest rates to account for the increased risk. As a result, PELs historically offered higher profit margins for SLM than FFELP loans. In 2006, the average interest rate SLM charged on a PEL was 11.9%, and the student loan spread (after accounting for loan losses) was 5.13%, compared with an average interest rate of 6.54% and a spread of 1.26% for FFELP loans. Although PELs accounted for only 16% of SLM's total managed loan portfolio in 2006 (which includes both on and off balance sheet loan portfolios), they generated 23% of SLM's core earnings.[1]

[1] "Core earnings" refers to an internal method used by SLM and its management to organize and present the Company's financial results, and differs from the reporting of financial results under GAAP. During the Class Period, SLM reported its financial results both as calculated using its "core earnings" method and (purportedly) as calculated using GAAP.

44. SLM primarily marketed its FFELP loans and PELs through on-campus financial aid offices. However, a significant portion of the PELs originated during the relevant time period were also offered directly to consumers by SLM through direct mail and web-based initiatives.

B. Defendants Shifted the Focus of SLM's Business From Low-Margin, Low-Risk FFELP Loans To High-Margin, High-Risk PELs

45. In 1997, at the same time that SLM was commencing its transition to a private company, SLM began to move away from its original model of providing federally guaranteed loans to students in favor of the more profitable PELs. In 1998, SLM again substantially expanded its portfolio of PELs. SLM Financial, a wholly owned subsidiary of SLM, began to offer private loans directly to borrowers who were enrolled in career training courses or a distance learning school (traditionally known as a correspondence school), attending two-year or four-year proprietary school (i.e., a private, for-profit school), attending a four-year college less than half-time, or who needed a computer loan. Such borrowers presented a significantly higher credit risk than those attending a four-year, non-profit college full-time.

46. In the third quarter of 2004, SLM continued its expansion into the PEL market by offering Tuition Answer loans. Tuition Answer loans were marketed by SLM to students through direct mail campaigns and web-based initiatives. These loans were made by a lender-partner and then sold to the Company. By the end of 2006, SLM had $1.9 billion of Tuition Answer loans outstanding.

47. In early 2006, the Higher Education Reconciliation Act of 2005 (Pub. L. No. 109-171) was signed by President George W. Bush, to become effective on July 1, 2006. SLM announced in its 2006 10-K that the Act contained a number of provisions that would reduce SLM's earnings on FFELP loans over time, including a requirement that SLM rebate certain

income on new loans and a reduction in lender reinsurance.

1. Defendants Took Undisclosed Risks To Expand SLM's PEL Business, To Compensate For Declining Margins And Slowing Growth In Its Traditional FFELP Loan Business

48. According to Defendant Lord, speaking during a January 23, 2008 conference call, "Sallie Mae's franchise is its market position. That is what our franchise is all about." SLM's franchise was threatened in 2006 by legislation that accelerated the declining margins and slowing growth in SLM's traditional FFELP loan business. Defendants sought to protect SLM's market-leading franchise by quickly expanding the PEL business to compensate for declines in the FFELP business. Between June 2006 and December 2007, SLM's PEL portfolio more than doubled, growing from $7 billion to $15.8 billion. This rapid growth in SLM's PEL business came at enormous cost to SLM's financial condition. In order to double the size of the PEL business in just 18 months, Defendants relaxed SLM's loan underwriting standards and began writing billions of dollars of loans to students who were not creditworthy, who were attending schools with low graduation rates and high default rates, and who were in programs that would not generate enough income after graduation (assuming the student even graduated) to repay the loans.

49. A statement by SLM's then CEO, Thomas Fitzpatrick, at an internal SLM executive meeting in early 2007 summarized SLM's PEL underwriting standards (or lack thereof) during the Class Period: "If the borrower can create condensation on a mirror, they need to get a loan this year."[2]

[2] Confidential Witness ("CW") 1 was an Education Loan Product Analyst from 2005 to May 2007 and a Senior Market Analyst from May 2007 to June 2008 in SLM's headquarters in Reston, Virginia. According to CW 1, this statement was attributed to Thomas Fitzpatrick by a manager of SLM's Signature Student Loan portfolio who attended the meeting.

50. This statement by SLM's CEO is consistent with other admissions made by Defendants and other SLM executives after the end of the Class Period. SLM applied more stringent underwriting standards and became more selective in pursuing origination activity for PELs. Defendants and other senior SLM executives have admitted that during the Class Period SLM lent too much money to students at schools with low graduation rates who were likely candidates for default; that SLM had lent to lower-tier credit borrowers; that SLM had lent to students who could not generate enough income from their education to repay their loans; that SLM was ignoring credit scores and lending with less selectivity; that SLM had gotten "sloppy" and engaged in "wishful thinking in [its] . . . underwriting practices"; and that by the end of 2007, 15% of SLM's portfolio consisted of loans to students who were "poor credit risks" attending the "wrong schools." These fundamental and material changes in SLM's business model and practices were not adequately disclosed before or during the Class Period.

2. Defendants Needed SLM To Show Continued Growth And Favorable Financial Trends During The Class Period

51. SLM and the Individual Defendants had considerable business and personal reasons for seeking to sustain SLM's continued growth and seemingly favorable financial results during the Class Period, notwithstanding the declining margins and slowing growth in SLM's traditional FFELP loan business.

a. Defendant Lord's desire to sell SLM

52. In the fall of 2006, SLM began the process of seeking a buyer to become a private (*i.e.*, non-publicly traded) company. In November 2006, just two months before the start of the Class Period, Defendant Lord initiated negotiations with J.C. Flowers, a private-equity firm, about the possible acquisition of SLM by a group led by J.C. Flowers, Bank of America and JP Morgan Chase. These negotiations continued throughout 2006 and into the beginning of 2007,

when the Class Period begins.

53. In April 2007, one month after SLM filed its 2006 10-K, SLM entered into a merger agreement with the Flowers group. Structured as a merger between SLM and a Flowers affiliate, the transaction would result in the Flowers group's acquisition of SLM.

54. On April 16, 2007, SLM issued a press release announcing the merger and stating that the Flowers group had agreed to purchase SLM for approximately $25 billion, or $60.00 per share of common stock. The agreed price represented a significant premium over the market price of SLM's common stock at the time, which had been trading in the low $40s per share before the announcement.

55. The merger agreement contained a number of conditions that needed to be satisfied for the merger to be consummated, including conditions tied to SLM's financial performance. SLM and the Individual Defendants had an incentive to ensure that the merger conditions tied to the Company's financial performance were fulfilled and to foster the Flowers group's belief the Company was worth buying at $60 per share of common stock.

56. On July 11, 2007, SLM announced that the Flowers group had "informed Sallie Mae that it believes that current legislative proposals pending before the U.S. House of Representatives and U.S. Senate 'could result in a failure of the conditions to the closing of the merger to be satisfied.'" The press release said that "Sallie Mae strongly disagrees with this assertion, intends to proceed towards the closing of the merger transaction as rapidly as possible, and will take all steps to protect shareholders' interests.'"

57. Following the July 11 announcement, Defendants stated that "[t]he Company reaffirms its confidence that legislative proposals currently being considered by the U.S. Congress would not, if enacted, constitute a Material Adverse Effect ('MAE') under the merger

agreement" (August 9, 2007); "[t]he company affirms that the College Cost Reduction Act, which is awaiting the President's signature, does not and will not constitute a Material Adverse Effect under the merger agreement" (September 20, 2007); "Sallie Mae firmly believes that the buyer group has no contractual basis to repudiate its obligations under the merger agreement and intends to pursue all remedies available to it to the fullest extent permitted by law" (September 26, 2007); "Our contract is with Bank of America and JPMorgan Chase, two of America's largest and strongest banks. We expect these banks to honor that contract, not breach the contract" (October 2, 2007); and suggested that even if a sale to the Flowers group was not consummated, other potential buyers existed (October 11, 2007). other potential buyers existed (October 11, 2007).

58. On October 8, 2007, SLM filed a lawsuit in Delaware Chancery Court against the Flowers group, announcing that "[t]he lawsuit seeks, among other things, a declaration that the members of the buyer group have repudiated the merger agreement, that no Material Adverse Effect has occurred under the merger agreement, and that Sallie Mae may terminate the merger agreement and collect damages of $900,000,000."

59. On December 12, 2007, SLM announced that the Flowers group had declined to consummate the merger on its original terms and had rejected an alternative transaction proposed by SLM. As part of this announcement, however, Defendants stated that "[t]he Board remains committed to protecting the rights of our shareholders, and will pursue all available recourse, including the company's existing lawsuit against the buyer's group."

60. On January 28, 2008, SLM dismissed its lawsuit against the Flowers group in exchange for commitments for $31 billion in financing from a consortium of banks led by Bank of America and JPMorgan Chase. SLM stated that "[t]his financing will replace the $30 billion

interim financing put in place by Bank of America and JPMorgan Chase as part of the proposed merger transaction."

b. The merger would enable the Individual Defendants to cash out their holdings of SLM stock and options

61. The Individual Defendants also had their own interests in presenting SLM in a positive light throughout 2007 to help ensure the merger conditions were satisfied and the merger completed.

62. The merger agreement provided that the Individual Defendants would be indemnified for any past misconduct and that, upon completion of the merger, they would receive $60 per share for their stock and restricted stock, as well as a cash payment for their options equal to the number of option shares multiplied by the amount by which $60 per share exceeded the exercise price of the option.

63. Completion of the merger would result in an enormous financial gain for the Individual Defendants. At the time the merger was announced, a significant portion of the Individual Defendants' equity interests in SLM consisted of stock options and restricted stock. Many of the options were worthless at the time because the exercise prices were well above SLM's stock price, and the restricted stock could not be sold before retirement or the occurrence of some other contingency. According to the May 25, 2007 Preliminary Proxy Statement that SLM filed in connection with the merger, at the completion of the merger, Defendant Lord would receive a cash payment of $225 million, and Defendant Andrews would receive a cash payment of $16.6 million.

c. SLM needed to maintain its stock price to avoid paying billions under its equity forward contracts

64. During the Class Period, SLM needed to keep its stock price above certain levels

to avoid a multi-billion-dollar contingent liability under a risky financing technique involving the use of equity forward contracts. Prior to the commencement of the Class Period, SLM had entered into equity forward contracts using the Company's securities as a way to raise money without borrowing. Under these contracts, SLM sold shares of its stock to the contract counterparties at certain prices and agreed to repurchase the shares at a future date certain at higher, specified "strike prices." Through the contracts, SLM was thus able to raise money without taking out a loan or issuing debt or equity, but risked substantial financial liability if the market price of its stock did not reach the strike levels at the time the contracts had to be settled.

65. Under its equity forward contracts, SLM was obligated to buy back approximately 48 million shares. Pursuant to amendments to the contracts in February 2007, the strike prices ranged from $46.30 to $54.74 per share. The total potential cash liability (*i.e.*, approximately 48 million shares multiplied by the strike prices) was approximately $2 billion.

66. The equity forward contracts also permitted the counterparty to terminate a portion of the contract and force SLM to make the resulting stock purchase if the share price of the stock fell below an "initial trigger price." The counterparty could continue to terminate portions of the contract if the share price fell to successively lower specified levels. If the share price reached the "final trigger price," the counterparty could terminate the entire contract. Pursuant to the February 2007 contract amendments, the trigger prices on SLM's outstanding equity forward contracts ranged from $23.93 to $30.11.

67. The desire to avoid having to pay up to $2 billion or more under the equity forward contracts gave SLM a particular motive to keep the market price of its stock as high as possible. SLM thus had a material incentive to engage in conduct that resulted in overstatement of its financial results, as favorable financial results typically have a positive effect on the market

price of an issuer's stock.

68. Despite amending the trigger prices again in early December, by the end of the Class Period, most of the trigger prices for SLM's equity forward contracts had been reached, meaning that Defendants had lost their bet on SLM's share value and that SLM would be required to settle its equity forward contracts at great expense to the Company's shareholders.

69. During a December 19, 2007 conference call with securities analysts and investors, Defendant Lord acknowledged that SLM would be settling its equity forward contracts because "[t]hose equity-forward contracts were struck in a way that were [sic] extraordinarily accretive to the buyers who didn't buy, but they are dilutive to our current owners when the stock price goes down."

70. On January 3, 2008, SLM filed a report on Form 8-K with the SEC in which it disclosed that the Company would pay $2 billion to settle the outstanding equity forward contracts.

3. Defendants Loosened SLM's Underwriting Standards To Boost SLM's Financial Results and Short-Term Business Prospects

71. During the Class Period, Defendants represented in SLM's filings with the SEC that the Company had certain defined loan underwriting standards in place for SLM's PELs and that SLM was managing the additional risk that the PELs entailed. *See, e.g.*, ¶¶ 232, 234 and 257 below. Defendants also represented that most PELs were made to borrowers who also qualified for and were obtaining a FFELP loan. *Id.*

72. Contrary to these representations, during the Class Period, SLM loosened its defined underwriting practices to boost SLM's financial results and short-term business prospects. After the Class Period, the Individual Defendants and other senior SLM executives admitted that during the Class Period: SLM had not been selective in pursuing new loan

business (stated in a January 3, 2008 press release) and that SLM had violated its longstanding policy of only lending to students who were creditworthy (January 23, 2008 conference call). Among other things, SLM relaxed lending standards during the Class Period by significantly reducing the credit score that a borrower needed to obtain a loan. A credit score is a number that is based on a statistical analysis of a person's credit report and is used to represent the likelihood that the person will pay his or her debt. The best known and most widely used credit score model is FICO, developed by Fair Isaac Corporation. FICO credit scores range from 300 (the lowest) to 850 (the highest). After the Class Period, SLM set an "absolute minimum" FICO score of 670 for borrowers attending for-profit schools. In July 2009, SLM disclosed that the average FICO score at origination for its non-traditional loans (written in large part during the Class Period) was only 618 without a co-signor and 633 with a co-signor.

73. The Individual Defendants and other senior SLM executives also disclosed that SLM had lent too much money to students at schools with low graduation rates who were going to default on their loans (January 23, 2008 conference call), that SLM had lent to "lower tier credit borrowers" (January 23, 2008 conference call and 2007 10-K), that SLM had lent to students who could not generate enough income from their education to repay their loans (January 23, 2008 conference call and 2007 10-K); that SLM had been ignoring credit scores and lending with less selectivity (June 5, 2008 *Wall Street Journal* article); that SLM had gotten "sloppy" and engaged in "wishful thinking in [its] . . . underwriting practices," and that by the end of 2007, 15% of SLM's portfolio consisted of loans to students who were "poor credit risks" attending the "wrong schools" (September 10, 2008 Lehman Brothers Global Financial Services Conference transcript). None of these facts about SLM's true underwriting practices were disclosed during the Class Period.

4. Defendants Relaxed SLM's Forbearance Practices To Reduce The Increasing Delinquencies And Defaults In SLM's PEL Portfolio

74. During the Class Period, SLM increased its use of forbearances in order to minimize the effect of increasing delinquencies and defaults in its PEL portfolio. A forbearance allows a PEL borrower, for a fee, to make no payments of principal or interest on a loan that had entered repayment for a specified period of time. During the forbearance period, interest accrues and is added to the amount owed by the borrower. This additional interest was recorded as income by SLM during the Class Period. The term of the loan is extended by the amount of the forbearance period.

75. In public disclosures, SLM said that it categorized delinquent PELs in 30-day groups, with the final group being those PELs that were between 180 and 212 days delinquent. After 212 days of non-payment, SLM would write-off (or charge-off) a delinquent loan as defaulted. SLM's delinquency and charge-off rates had a material effect on the Company's financial results, as the higher those rates, the higher the Company's allowance for PEL losses had to be, reducing reported income and earnings.

76. SLM's policy was to treat all loans in forbearance and exiting forbearance as current. Forbearance enabled SLM to avoid the negative financial consequences of reporting PELs as delinquent, because once a loan entered forbearance, regardless of how delinquent it was at the time, it was deemed current. Thus, if a loan was 180 days delinquent when it entered forbearance, during the forbearance period and upon entering repayment, that loan would be classified as current on SLM's financial statements. Forbearance also allowed SLM to record millions of dollars of additional interest income during the Class Period.

77. During the Class Period, Defendants represented in SLM's filings with the SEC that the Company had well-established forbearance practices for PELs, that borrowers who were

granted forbearance were screened to ensure that forbearance would improve their ability to repay, that SLM's forbearance practices increased the likelihood of repayment, and that these practices were a positive collection tool for the Company. *See*, *e.g.*, ¶236 below.

78. Defendants' representations during the Class Period concerning SLM's forbearance practices were materially false and misleading. During the Class Period, SLM was not complying with the forbearance practices set forth in the Company's SEC filings, and borrowers were routinely granted forbearance, sometimes repeatedly, without being screened to ensure that forbearance would improve their ability to repay the loans. SLM's actual forbearance practices for PELs during the Class Period did not increase the likelihood of repayment and were not a positive collection tool for the Company. Instead, forbearance became a means for Defendants to remove loans from delinquent status, without regard to the borrowers' ability to repay the loans, for the sole purpose of reducing reported loan delinquencies and defaults and recording additional interest income. The removal of loans from delinquent status allowed Defendants to reduce SLM's allowance for PEL losses, which in turn increased SLM's reported income and earnings.

79. After the end of the Class Period, the Individual Defendants and other senior SLM executives admitted that SLM's forbearance practices during the Class Period had failed to adequately screen borrowers who were granted forbearance (stated in an October 23, 2008 conference call); that forbearance did not increase the likelihood of repayment of the loans (October 23, 2008 and January 22, 2009 conference calls); and that the effect of SLM's practice of granting forbearances in violation of SLM's stated criteria was to reduce SLM's delinquency and default rates only in the short term, because the indiscriminate granting of forbearance merely delayed the inevitable delinquency and default for many borrowers (October 23, 2008

and January 22, 2009 conference calls).

80. An analysis and comparison of SLM's forbearance and delinquency rates from during and after the Class Period confirms that during the Class Period Defendants were using forbearance improperly to avoid reporting increased delinquencies and defaults in SLM's PEL portfolio. At the end of 2006, approximately $1.2 billion of SLM's PEL portfolio was in forbearance, representing 9% of total PELs in repayment and forbearance. These numbers increased dramatically during the Class Period, both in absolute terms and as a percentage. By the end of 2007, approximately $2.4 billion of SLM's PEL portfolio was in forbearance, representing 14% of total PELs in repayment and forbearance. After the Class Period, the numbers declined just as dramatically. By the end of 2008, approximately $1.6 billion of SLM's PEL portfolio was in forbearance, representing 7% of total PELs in repayment and forbearance. SLM's delinquency rates moved in the opposite direction as the forbearance rates. At the end of 2006, 8.7% of PELs in repayment were delinquent. By the end of 2007, only 8.3% of PELs in repayment were delinquent. However, by the end of 2008, 10.2% of PELs in repayment were delinquent.

81. Defendants' manipulation of SLM's forbearance practices during the Class Period is confirmed not only by Defendants' post-Class Period admissions and by the statistics above, but also by numerous confidential witnesses who were employed at SLM during the Class Period and experienced first-hand SLM's actual forbearance practices.

82. SLM operated call centers around the country that housed many of SLM's collections personnel. CW 2 was an SLM employee in the Las Vegas call center from September 2006 through April 2007 whose responsibility was to call borrowers with past due accounts. CW 3 was an SLM claims aversion specialist in the Fishers, Indiana and Castleton,

Indiana facilities from 1996 to 2005 for FFELP loans, and from 2005 to January 2008 for PELs. CW 4 was an SLM employee at the Las Vegas, Nevada call center from 2003 through late 2006 who worked as a collections representative, collections specialist, and then as a private credit team leader. CW 5 was an SLM claims aversion representative in the Fishers, Indiana facility from July 2007 to June 2008.

83. According to these confidential witnesses, SLM's call centers used automated dialing systems, which arranged calls to debtors by their length of delinquency (30, 60, 90 or over 180 days). When the SLM employee logged on to the computer system, the automatic dialer connected the SLM employee to a phone number and the borrower's account information was displayed on the screen. Although procedures varied slightly at different times and in different facilities, these confidential witnesses who worked in SLM call centers during the Class Period also reported that SLM's policy for collection of PELs gave borrowers only two options: bring payments current or enter forbearance.

84. CW 6 was an SLM collections employee in the Las Vegas call center from August 2006 to January 2008. CW 7 was an SLM customer service representative in the private credit department in Muncie, Indiana from January to June 2007. CW 8 was an SLM senior recovery investigator in the Malton, New Jersey facility from November 2004 to May 2008 who handled incoming and outgoing PEL collections for borrowers who were 180-212 days delinquent. CW 9 was an SLM employee in the Fishers, Indiana call center from 2005 through 2008, as a federal collections skip tracer and team leader who also handled PELs. CW 10 was an SLM PEL collection specialist in the Marlton, New Jersey office from 2003 through May 2008 on the team handling collections from borrowers who were 91 to 120 days delinquent.

85. According to CW 3, CW 6, CW 7, CW 8, CW 9 and CW 10, the sole criterion a

borrower had to meet in order to qualify for forbearance was to have forbearance time available. CW 5 confirmed that if a borrower could not make a payment on a delinquent loan to bring the account current, the borrower was urged to accept forbearance. While SLM's stated policy was that 24 months was the maximum amount of forbearance time per loan, CW 5 recalled frequently seeing accounts with significantly more forbearance time than this limit. For example, CW 5 recalled seeing an account with 88 months of forbearance.

86. CW 9 explained that the first thing a collections employee did was to determine whether the borrower had forbearance time available. CW9 then informed the borrower of the number of days he or she was late in making the loan payments and asked the borrower how the borrower would like to make payment. If the borrower said he or she could not make a payment, CW 9 asked why. CW 9 did not input the borrower's response into the computer because the only requirement for granting forbearance was the amount of forbearance time remaining for the loan.

87. According to CW 2 and CW 4, if a borrower wanted forbearance, an SLM prescribed script was read to the borrower. Once the script was read, forbearance could be granted automatically as long as the computer system showed that forbearance time remained available.

88. According to CW 2, CW 3 and CW 6, no inquiry was made by either the collections representative or the supervisor about the borrowers' financial resources or ability to repay the loan. CW 3 said that FICO credit scores were not checked by SLM call center employees when granting forbearance. CW 8 confirmed that even for SLM's tardiest and most at-risk borrowers, the only requirement for forbearance was the amount of forbearance time available to the borrower, and no consideration was given to FICO scores or other similar

quantitative information. According to CW 3, CW 5, CW 6, CW 9 and CW 10, this procedure was the same for all borrowers and in all locations.

89. Borrowers whose loans were put into forbearance were charged a $50 per loan transaction fee, which did not have to be paid at the time the forbearance was granted. According to CW 5, some supervisors would waive this fee to secure the forbearance. According to CW 6, forbearance was used so liberally that SLM even had a policy that once forbearance had been obtained three times and $150 in associated fees was paid, the fee was waived for future forbearances that were granted.

90. SLM's compensation structure rewarded employees for granting forbearances. CW 11 was an SLM training development specialist located in the Niles, Illinois facility from September 2007 through May 2008. CW 2, CW 3, CW 5, CW 6, CW 7 and CW 11 said that each call center employee had to meet a delinquency-elimination/forbearance quota to receive a bonus. The bonus formula was based on the dollar amount of delinquencies eliminated as a result of granting forbearances. As CW 2 explained, if a delinquent borrower who owed $50,000 was put into forbearance, the SLM employee would receive a greater bonus than if the employee granted forbearance to a delinquent borrower who owed $30,000.

91. CW 11 said the bonus structure in Muncie, Indiana, Las Vegas, Nevada and Niles, Illinois permitted $3,000 - $5,000 per-month bonus checks for meeting goals. SLM gave bonus credit for the entire balance of the loans that became current by being placed in forbearance.

92. Since SLM collections personnel received sizeable bonuses based on the dollar amount of forbearance they granted, especially when compared to their hourly pay, they were intent upon granting forbearance. For example, CW 7 said that his base salary was $8 per hour, but the bulk of his pay came from his bonus. CW 7 and the others in his department received

individual and departmental bonuses based upon the dollar amount of the loans they placed in forbearance. In peak months, CW 7 earned $2,900 in bonuses per month.

93. CW 3 chose to become a PEL collector to make more money because the bonus pay for moving PEL loans out of delinquency and into forbearance made that job more lucrative than working on FFELP loans. CW 3 said there was extreme pressure to perform as a PEL collector, and bonuses depended on reaching and exceeding the dollar goals assigned. Goals were measured by the dollar value of the loans brought from late to current (through collection or forbearance) with a typical daily goal of $1 million. If a collector failed to meet the goal, the collector was "written up" and terminated after three write-ups.

94. According to CW 4 and CW 8, SLM collections managers met monthly to discuss the statistics from each department. At these meetings, team leaders covered each collection statistic, *i.e.* the number and dollar volume of forbearance and the reduction in rolling forward delinquencies. These statistics were the basis for each call center's employee performance goals.

95. According to several confidential witnesses, changes in SLM policy and practice made it easier to grant forbearances in 2006 and 2007 than it had been previously. CW 8 said that from early 2007 to December 2007, CW 8 was able to offer seven months forbearance rather than six months, for an eight-month overdue account that should have been written off under the Company's 212-day default policy. According to CW 10, this new SLM policy was communicated to SLM employees via email, together with a new forbearance form. As a result, in the 212-day group, only a single payment was needed to bring an eight-month delinquent account current. The borrowers' ability to make the next payments was not an item a call center employee was required to confirm. SLM's internal guidelines described above remained unchanged during the Class Period, but became stricter in 2008.

5. Defendants Misrepresented The Reason For SLM's Increased Loan Losses And Charge-Offs In 2006 And The First And Second Quarters Of 2007 And Reduced Loan Losses And Charge-Offs In The Third Quarter Of 2007

96. At year end 2006 and in the first and second quarters of 2007, Defendants represented in SLM's filings with the SEC that the increases in the Company's allowance for PEL losses and the increased level of PEL charge-offs were due in large part to operational difficulties the Company had encountered in its transition of a call center from Las Vegas, Nevada to Muncie, Indiana, which supposedly resulted in reduced collections for PELs. *See, e.g.*, ¶¶ 242, 262, 279, 281, 310 and 312 below.

97. In the third quarter of 2007, Defendants represented that the decrease in SLM's allowance for PEL losses (as a percentage of outstanding loans) and the decrease in the amount of PEL charge-offs were due in large part to the Company's remediation of these operational difficulties relating to the transition of the call center. Defendants further represented that because the operational difficulties had been fixed, SLM expected the PEL allowance and charge-off trends to continue improving. *See, e.g.*, ¶¶ 291, 296 and 312 below.

98. Defendants' Class Period representations concerning purported operational difficulties SLM experienced during the transition of a call center from Nevada to Indiana were materially false and misleading. According to CW 12, a former SLM quality assurance analyst who worked in both the Las Vegas and Indiana call centers from 2004 through July 2008 and was specifically involved in the transition process, the transition from Nevada to Indiana did not create any operational problems. In fact, throughout 2007 and the beginning of 2008, the Muncie, Indiana facility was setting collection records. These collection records were based on actual collections made as well as accounts that were moved into current status.

99. CWs have confirmed that they were unaware of any significant operational

difficulties at the Muncie, Indiana facility. CW 13, a 23-year veteran of SLM located in Reston, who reported to Somsak Chivavibul (SLM's Senior Vice President, Financial Planning and Analysis), was unaware of any problems with the transfer of the Nevada call center to the Municie, Indiana facility. CW 12 was aware of no glitches that inhibited collections at the Muncie facility and never heard of a computer issue that interrupted collections at any other collection facility. CW 3 and CW 10 both confirmed that they were unaware of any computer glitches interfering with the collections process.

VI. SLM'S FINANCIAL STATEMENTS ISSUED DURING THE CLASS PERIOD WERE MATERIALLY MISTATED IN VIOLATION OF GAAP AND SEC REGULATIONS

A. Summary Of Accounting Violations

100. As set forth in detail below, SLM's publicly issued financial statements and related earnings releases for the 2006 fiscal year and for the first three quarters of 2007 were materially misstated in violation of GAAP and SEC regulations for the following reasons:

(1) Defendants failed to record adequate loan loss provisions for SLM's PEL portfolio, which resulted in a material understatement in the Company's allowance for loan losses and a material overstatement of net interest income after provision for loan losses, income before taxes, and net income;

(2) Defendants materially misrepresented SLM's forbearance practices and forbearance and delinquency rates;

(3) Defendants failed to disclose SLM's material concentration of credit risk in its PEL portfolio;

(4) Defendants failed to disclose known trends and uncertainties concerning SLM's PEL portfolio; and

(5) Defendants falsely represented that SLM had adequate and effective internal controls for financial reporting.

B. Applicable Accounting and Disclosure Rules

101. During the Class Period, SLM's financial statements were required to be prepared in conformity with generally accepted accounting principles, or GAAP. GAAP are those standards recognized by the accounting profession as the conventions, rules, and procedures necessary to define accepted accounting practices at a particular time. The SEC has the statutory authority for the promulgation of GAAP for public companies and has delegated that authority to the Financial Accounting Standards Board ("FASB"). SEC Regulation S-X, 17 C.F.R. §210.4-01(a)(1), provides that financial statements filed with the SEC that are not presented in conformity with GAAP will be presumed to be misleading, despite footnotes or other disclosures. The specific GAAP standards Defendants violated during the Class Period are set forth in the relevant sections below.

102. In addition, the American Institute of Certified Public Accountants ("AICPA") has issued industry-specific Audit & Accounting Guides to provide guidance in preparing financial statements in accordance with GAAP. The Audit and Accounting Guide entitled *Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies*, issued in May 2004, applied to SLM during the Class Period. The AICPA also issues Audit Risk Alerts particularized by industry, including financial institutions. The Audit Risk Alerts are intended for use by financial institutions, such as SLM, to address areas of concern and identify the significant business risks that may result in the material misstatement of financial statements. The AICPA guidance Defendants violated during the Class Period is set forth in the relevant sections below.

103. SLM's financial statements issued during the Class Period also were required to be prepared in accordance with the following fundamental accounting principles issued by the FASB:

(1) The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users of the financial reports for making rational investment, credit and similar decisions (Statement of Financial Concepts No. 1, ¶ 34);

(2) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources and the effects of transactions, events and circumstances that change resources and claims to those resources (Statement of Financial Concepts No. 1, ¶ 40);

(3) The principle that financial reporting should provide information about an enterprise's financial performance during a period because investors and creditors often use information about the past to help in assessing the prospects of an enterprise (Statement of Financial Concepts No. 1, ¶42);

(4) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it (Statement of Financial Concepts No. 1, ¶ 50);

(5) The principle that financial reporting should include explanations and interpretations to help users understand financial information provided. The usefulness of financial information as an aid to investors, creditors, and others in forming expectations about a business enterprise may be enhanced by management's explanations of the information. (Statement of Financial Concepts No. 1, ¶ 54);

(6) The principle that financial reporting should be reliable in that financial information represents what it purports to represent. The principle that information should be reliable as well as relevant is a notion that is central to accounting (Statement of Financial Concepts No. 2, ¶¶ 58-59);

(7) The principle of completeness, which means that nothing is left out of the information that may be necessary to insure that it validly represents underlying events and conditions (Statement of Financial Concepts No. 2, ¶ 79);

(8) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered (Statement of Financial Concepts No. 5, ¶ 83);

(9) The principle that if collectibility of assets received for products, services or other assets is doubtful, revenues may be recognized on the basis of cash received (Statement of Financial Concepts No. 5, ¶ 84); and

(10) The principle that losses when probable should be accrued in the financial statements. Therefore, SLM was required to provide for any loan losses inherent in its loan portfolios whether or not SLM could identify a specific delinquent loan. The conditions under which a receivable (such as a loan receivable) exists usually involves some degree of uncertainty as to its collectibility, and accordingly the provisions of SFAS No. 5 apply (Statement of Financial Accounting Standards No. 5, ¶¶ 22 and 23).

104. In addition to the foregoing, SLM was also required to comply with § 13(b)(2)-(7) of the Exchange Act, which required SLM to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflected the transactions and disposition of assets. SLM was required to devise and maintain internal accounting controls that were

sufficient to provide reasonable assurance that, among other things, transactions were recorded as necessary to permit the preparation of financial statements in conformity with GAAP and to maintain accountability of assets.

105. In summary, financial reporting should provide investors with timely, accurate, relevant and reliable information upon which they can base their investment decisions. Financial reporting encompasses more than the basic financial statements (balance sheet, income statement, cash flows) and includes the financial statement footnotes, which contain the narrative and explanations necessary to fully inform the reader. Accordingly, the financial statement footnotes are essential to understanding and interpreting the financial data presented in the basic financial statements. In conjunction with a fair presentation of financial information, management is responsible for disclosing in the footnotes significant estimates used in preparing the financial statements and for ensuring that those estimates are reasonable in light of known facts and circumstances. A fair presentation of financial information includes providing information as to the concentration of risk, credit risk and uncertainties inherent within that entity's financial information given its business and industry.

C. Defendants Materially Understated SLM's Allowance For Loan Losses For PELs

106. During the Class Period, Defendants failed to make or ensure that timely, accurate and complete provisions were made for SLM's loss allowances for its PELs, causing the Company's financial statements for 2006 and for the first three quarters of 2007 to be materially false and misleading in violation of GAAP and SEC regulations.

107. SLM's accounting for student loans, including the allowance for loan losses, was governed by SFAS No. 5, *Accounting for Contingencies*. SFAS No. 5 requires a lender, such as SLM, to account for losses inherent in its loan portfolio whether or not the lender can identify a

specific delinquent loan. As stated in SFAS No. 5, because the conditions under which a receivable (including a loan receivable) exists usually involves some degree of uncertainty as to its collectibility, the provisions of SFAS No. 5 apply. Under SFAS No. 5, SLM was required to have adequate reserves for: (1) estimated losses for loans specifically identified as being impaired; (2) estimated losses for loans or groups of loans with specific characteristics that indicated probable losses; and (3) estimated losses inherent in the remainder of the portfolio based on, among other things, current economic events and circumstances, borrower credit risk and loan concentrations.

108. In addition to the requirements of SFAS No. 5, SLM also was required to comply with SEC Staff Accounting Bulletin No. 102, *Selected Loan Loss Allowance Methodology and Documentation Issues* ("SAB 102"), issued in July 2001. SAB 102 provides that registrants must have a systematic methodology for establishing loan loss reserves that complies with GAAP. Pursuant to SAB 102, a registrant's loan loss allowance methodology should, among other things, consider all known relevant internal and external factors that may affect loan collectibility, and consider the particular risks inherent in different kinds of lending.

SAB 102 provides as follows:

> In developing loss measurements, registrants should consider the impact of current environmental factors and then document which factors were used in the analysis and how these factors affected loss measurements. Factors that should be considered in developing loss measurements include the following:
>
> - Levels of and trends in delinquencies and impaired loans;
> - Levels of and trends in charge-offs and recoveries;
> - Trends in volume and terms of loans;
> - Effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practices;

- Experience, ability, and depth of lending management and other relevant staff;
- National and local economic trends and conditions;
- Industry conditions; and
- Effects of changes in credit concentrations.

109. Also issued in July 2001 and applicable to SLM's calculation of its allowance for loan losses was the Federal Financial Institutions Examination Council's Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions. The Policy Statement stated that "an allowance for Loan and Lease Losses recorded pursuant to GAAP is an institution's best estimate of the probable amount of loans and lease-financing receivables that it will be unable to collect based on current information and events."

110. In summary, GAAP and SEC regulations required SLM to establish, on a systematic and rational basis, an allowance for loan losses in an amount sufficient to report its PEL portfolio at net realizable value, and to properly match reported interest income on the loans with the associated provision for loan losses. The establishment of an allowance for loan losses at SLM should have been based on, among other things, loan characteristics, historical loan trends, current economic conditions, concentration of borrowers, credit review, borrower credit risk, type of school, published student loan default information and trends, charge-offs and recoveries, loan status, and the adequacy of internal controls in place at SLM over its borrowing practices and loan portfolio.

111. SLM's Class Period SEC filings described the manner in which SLM's allowance for loan losses for PELs purportedly was calculated during the Class Period. A representative example from SLM's 2006 10-K is set forth in ¶¶ 238 and 240 below, and substantially similar

language appeared in SLM's three 2007 10-Q's. During the Class Period, Defendants represented that SLM was adhering to its stated policy and that SLM's allowance for loan losses for PELs was appropriate to cover probable losses inherent in the portfolio.

112. Despite SLM's stated policy and Defendants' repeated representations during the Class Period that SLM was adhering to its policy and that the Company's allowance for loan losses for PELs was appropriate to cover probable losses in the portfolio, SLM's allowance for PEL losses was materially understated in violation of GAAP and SEC regulations for the reasons set forth below.

1. Defendants' Use Of A Two-Year Loss Emergence Period To Calculate The Allowance For PEL Losses Materially Understated The Allowance

113. During the Class Period, Defendants calculated SLM's allowance for PEL losses using loss estimates based on a two-year "loss emergence period" that commenced immediately upon the issuance of the loan. A loss emergence period is the period of time during which defaults are measured for the purposes of calculating an appropriate allowance for loan losses. For example, if SLM issued 100 loans on January 1, 2005, and 50 of those loans defaulted within the next two years, the default rate for that portfolio of loans using SLM's two-year loss emergence period would be 50%, which should result in a 50% allowance for loan losses in a portfolio of similar loans.

114. SLM's two-year period was based on the two-year period used by the Department of Education to calculate the cohort default rates for FFELP loans. The cohort default rate is a legislated statistic calculated yearly by the Department of Education for each school participating in a Title IV loan program, and refers to the percentage of a school's federal student loan borrowers who enter repayment and then default within a two-fiscal-year period after entering

repayment. The official cohort default rates are published annually by the Department of Education and identify cohort default rates by school and category of school (private, public, proprietary).

115. There is a crucial difference between the two-year period used by the Department of Education, however, and the two-year period used by Defendants. The Department of Education's two-year period is measured only from the start of repayment obligations, whereas Defendants' two-year loss emergence period commenced immediately upon issuance of the loan. Because the two-year loss emergence period included the period when students were enrolled in school and their loans were not yet in repayment, any loss estimates based on default rates for this period would be artificially low (a student cannot default when that student's loan is not yet in repayment), and would bear no relation to the actual default rates that would exist once the students graduated and their loans entered repayment. Thus, Defendants' two-year loss emergence period to calculate SLM's allowance for PEL losses resulted in a material understatement of the portfolio's defaults and the corresponding allowance for loan losses in violation of GAAP and SEC regulations.

116. According to SLM's 2006 10-K, the repayment obligations of 90% of the PELs in SLM's portfolio were deferred while students were enrolled. Only 10% of the PELs in SLM's portfolio required repayment while students were enrolled. Yet, in calculating SLM's allowance for PEL losses, Defendants included the period when the borrowers did not yet have repayment obligations and by definition could not be in default. Defendants' inclusion of the period when students were enrolled and not yet in repayment resulted in an extraordinarily low loss allowance that bore no relation to actual, known default rates and was not consistent with the analysis used by the Department of Education in calculating cohort default rates (*i.e.*, the calculation of default

rates based on a period measured from the time repayment obligations started). In light of the foregoing, Defendants had no reasonable basis to believe that the manner in which SLM was calculating its allowance for PEL losses was reasonable or fairly reflected the actual default rates that would be experienced on these loans over the life of its PEL portfolio.

117. As a result of Defendants' use of a two-year loss emergence period that commenced immediately upon the issuance of a loan, SLM's allowance for PEL losses as a percentage of the outstanding private education loan portfolio was 3.16% as of December 31, 2006, and averaged just 4.26% during the entire Class Period. In contrast, according to the Department of Education, the average cohort default rate for all lower-risk FFELP loans (from all lenders) for 2006 was 4.63%. Thus, even though Defendants acknowledged in SLM's SEC filings that the Company's PELs were substantially riskier than FFELP loans, the allowance for PEL losses at SLM was below the published historical cohort default rate for less risky FFELP loans.

118. As discussed above, SLM's percentage allowance for PEL losses should not have been lower than the cohort default rate for FFELP loans, as SLM's PELs were considerably riskier than FFELP loans. Moreover, even the two-year period used by the Department of Education to calculate cohort default rates for FFELP loans materially understated actual default rates for these loans, rendering SLM's two-year loss emergence period – measured from the time of loan issuance as opposed to the time repayment obligations started – all the more inadequate. During the Class Period, Defendants knew or recklessly ignored a number of studies confirming that use of a two-year period for calculating potential defaults on student loans materially understated the actual default rates for those loans.

119. In December 2003, the Department of Education's Office of Inspector released an audit report based on a study of student loan cohort default rates for the years 1996 through 1999. The audit was performed to determine if cohort default rates provided sufficient information on student loan defaults in Title IV loan programs. The audit report identified two significant findings related to cohort default rates: (1) cohort default rates did not appear to reflect general trends in defaults in the year following the two-year cohort period; and (2) borrowers in deferment and forbearance lowered a school's cohort default rate. The audit report also determined that the use of a two-year period versus a longer period to calculate default rates artificially lowered the loan default rate. The audit report recommended that "the Department calculate and publish a life-of-loan cohort default rate for each cohort, to better identify the trends in cohorts' defaults after the two-year cohort period has ended."

120. In June 2006, the Department of Education's National Center for Education Statistics released a report entitled, "Dealing with Debt: 1992-93 Bachelor's Degree Recipients 10 Years Later." The report looked at default rates stratified by the amount of debt based on a life-of-loan methodology. The findings revealed in the report were:

1. On average, defaults occurred four years after graduation.
2. The three year default rate was 27.3% higher than the two-year rate.
3. The life-of-loan default rate was 193.9% higher than the two-year default rate.

121. Finally, the Department of Education published both a "budget lifetime default rate," which was a projected percentage of the dollar amount of loans that may default during a projected 20-year life of the FFELP and Direct Loan Program periods, and a "cumulative lifetime default rate," which was the percentage of loans that enter repayment in the FFELP and

Direct Loan Programs for a particular fiscal year and that have defaulted through the most recent fiscal year. Unlike the cohort default rate, which is used as an administrative tool for schools and reflects a two-year indicator period, the cumulative lifetime default rate is a performance tool focused on the risk of default throughout the life of a loan. The budget lifetime default rate and the cumulative lifetime default rate data consistently showed that use of the two-year period to calculate the default rate materially underestimated actual default rates, even on the least risky student loans offered.

122. Using 2006 as an example, SLM's allowance for PEL losses was 3.06% of the ending total loan balance and the Department of Education's cohort default rate for less risky FFELP loans was 5.2%. For that same period, the budget lifetime default rate for FFELP loans was 11.9% and the cumulative lifetime default rate for FFELP loans was 6.5%. These statistics all demonstrate that SLM's allowance for loan losses from the riskier PELs was materially understated during the Class Period and that Defendants knew or recklessly disregarded that the manner in which SLM was calculating its allowance for PEL losses by utilizing artificially low default rates for those loans, materially understated probable losses that SLM would experience in that portfolio. In March 2009, SLM issued a research paper entitled "*Sallie Mae Helps Students Avoid Negative Impact of Default.*" In that research paper, SLM admitted that "[t]he cohort default rate is a snapshot of default performance after borrowers have been in repayment for two years. Although many of the defaults occur in the first two years, the life-of-loan default rate tends to be two to three times the cohort default rate, depending on the school sector."

123. After the end of the Class Period, SLM stopped using the two-year loss emergence period to calculate the allowance for PEL losses. As a result, the allowance for PEL

losses has increased significantly (by 50%), from approximately 4.0% during the Class Period to 6.0% after the end of the Class Period.

2. Defendants' Failure To Account For The Relaxation Of Underwriting Standards For PELs During The Class Period Materially Understated The Allowance For PEL Losses

124. During the Class Period, Defendants represented that SLM had certain defined underwriting practices in place for PELs to manage the additional risk that these loans entailed. *See, e.g.*, ¶¶ 232, 234 and 257 below. Defendants also represented during the Class Period that SLM had well-defined policies and procedures in place to manage the Company's credit risk arising from its PEL portfolio. *See, e.g.*, ¶ 232, 234, 244 and 257 below. However, as discussed above, these representations were false. During the Class Period, SLM violated its own stated underwriting standards, made loans with less selectivity, made loans to students who were not creditworthy, engaged in "wishful thinking" in its underwriting practices, and wrote loans that were "predictably not collectible."

125. Under SFAS No. 5, Defendants were required to estimate losses for loans or groups of loans with specific characteristics that indicated probable losses. SLM has acknowledged that the relaxation of SLM's underwriting standards resulted in a group of loans sharing the same characteristics that were predictably not collectible requiring special treatment under SFAS No. 5, yet during the Class Period Defendants failed to increase SLM's allowance for the probable losses that would arise from these loans.

126. Under SAB 102, Defendants were required to consider changes in SLM's risk selection and underwriting standards and lending policies in determining SLM's allowance for PEL losses. During the Class Period, During the Class Period, Defendants either failed to consider these changes when calculating SLM's allowance, or recklessly ignored the effect of

these changes on SLM's PEL portfolio and associated loan losses. SLM has acknowledged that these changes occurred during the Class Period, but Defendants failed to consider them because SLM's allowance was based solely on historical experience, and not on current trends or developments. As Defendant Lord admitted after the end of the Class Period, "[o]ur methodology in creating loan loss provisions tended to look backwards," and failed to consider changes in the portfolio. SLM's use of the methodology described by Defendant Lord was inconsistent with GAAP and resulted in a material understatement of SLM's allowance for PEL losses in violation of the requirements of GAAP.

127. When Defendants finally did consider these loans separately after the end of the Class Period, as they were required throughout the Class Period to do under SFAS No. 5 and SAB 102, SLM's allowance for PEL losses increased dramatically, from $308 million at December 31, 2006 to $1.2 billion at December 31, 2007.

3. Defendants' Failure to Account For The PELs To Students At "Non-Traditional" Schools Materially Understated The Allowance For PEL Losses

128. As discussed above, to continue the expansion of SLM's PEL business during the Class Period, Defendants caused SLM to issue loans in material amounts to students attending "non-traditional" schools, which were proprietary (i.e., private, for-profit) schools with low graduation rates and high default rates. The issuance of loans in such amounts, in which SLM had not engaged before the Class Period, constituted a material change in the Company's business and credit risk that Defendants failed to disclose during the Class Period. Not until after the end of the Class Period did SLM disclose the significant volume of loans that had been extended to students attending non-traditional schools, the materially increased risks from such

lending, and the materially adverse effect such lending had on the Company's financial condition during the Class Period.

129. Under SFAS No. 5, Defendants were required to estimate losses for loans or groups of loans with specific characteristics that indicated probable losses. SLM has acknowledged that the loans to students attending non-traditional schools resulted in a group of loans sharing the same characteristics that indicated potential losses, yet Defendants admit that during the Class Period they failed to consider, much less increase, SLM's allowance for the probable losses that would arise from these loans.

130. Under SAB 102, Defendants were required to consider the particular risks inherent in different kinds of lending, changes in SLM's risk selection and underwriting standards and lending policies, and the effects of any changes in credit concentrations in determining SLM's allowance for PEL losses. During the Class Period, Defendants failed to consider the particular risks inherent in SLM's non-traditional loan portfolio, the changes in SLM's underwriting and lending practices, or the effects of any changes in credit concentrations when calculating SLM's allowance for loan losses.

131. When SLM disclosed at the end of the Class Period that SLM had been lending to students at non-traditional schools and that SLM was, after the fact, substantially increasing its allowance for loan losses arising from these particular loans, SLM's management claimed that the loan loss allowance for these particular loans had not been increased earlier because it was not until after the end of the Class Period that SLM learned students attending non-traditional schools were less likely to graduate and more likely to default. The fact that loan losses and loan defaults are significantly higher for borrowers at non-traditional schools was well-known throughout the Class Period, however, and either knowingly or recklessly disregarded by

Defendants when, in setting SLM's loan loss allowances, they decided to estimate losses for PELs made to students at non-traditional schools using the same assumptions they used to estimate losses for PELs made to students at traditional schools.

132. The National Center for Education Statistics publishes data by school on an annual basis that shows, among other things, retention and graduation rates and FFELP loan default rates. This data shows that the non-traditional schools to whose students SLM was lending at increasing volumes during the Class Period had consistently low graduation rates and correspondingly high default rates when compared to traditional schools. For example, in 2004, DeVry and ITT, two of the non-traditional schools to whose students SLM was lending during the Class Period, had graduation rates of only 50% and 47%, respectively. Both of these schools also had above-average default rates of 6.5% and 8.3%, respectively, versus an overall default rate for all schools of 5.1%.

133. In June 2005, the National Consumer Law Center published a report entitled *"Making the Numbers Count: Why Proprietary School Performance Data Doesn't Add Up And What Can Be Done About It."* The report provided examples of the poor completion rates at proprietary, for-profit schools and noted the strikingly low completion rate for four-year programs at a number of the non-traditional schools to whose students SLM was lending, including Apollo Group (University of Phoenix), with a 7% completion rate; Corinthian, 31%; Education Management Corporation, 47%; ITT, 49%; and Career Education Corporation, 59%.

134. A number of pre-Class Period studies show that there was a direct correlation between graduation rates and defaults rates and that schools with low graduation rates had correspondingly high default rates. *See* Robin McMillion, *Student Loan Default Literature Review,* TG RESEARCH AND ANALYTICAL SERVICES, Dec. 22, 2004. For example, a

study from 1998 demonstrated that students who attended proprietary schools had high default rates and that the highest default rates were among those borrowers who left school without a degree. J. Fredericks Volkwein, et al: *Factors Associated with Student Loan Default Among Different Racial and Ethnic Groups,* 69 Journal of Higher Education: 206-37 (1998). A student's failure to complete an academic program was closely correlated with student loan default. Jennie H Woo, *Factors Affecting the Probability of Default: Student Loans In California* 32 NASFAA JOURNAL OF STUDENT FINANCIAL AID, (2002).

135. After the end of the Class Period, Defendants accounted separately for loans to students attending non-traditional schools, as they had been required to do all along under SFAS No. 5 and SAB 102. SLM's allowance for PEL losses more than doubled, increasing by $826 million to $1.2 billion at December 31, 2007. SLM acknowledged that the "bulk" of this increase was directly attributable to probable losses from loans made to students attending non-traditional schools.

4. Defendants' Improper Use Of Forbearances To Forestall Delinquencies Materially Understated the Allowance for PEL Losses

136. During the Class Period, Defendants manipulated SLM's forbearance practices to avoid reporting increased delinquencies and defaults in the Company's PEL portfolio. As a result of Defendants' manipulation of SLM's forbearance practices, which removed loans from delinquent status, SLM materially misrepresented its actual forbearance practices and forbearance and delinquency rates in its financial statements.

137. After the end of the Class Period, Defendants admitted that SLM's forbearance practices during the Class Period failed to adequately screen borrowers who were granted forbearance, that forbearance did not increase the likelihood of repayment of the loans, and that the effect of SLM's practice of granting forbearances in violation of SLM's stated criteria was to

reduce SLM's delinquency and default rates in the short term only, because the improper use of forbearance merely delayed the inevitable delinquency and default for a substantial percentage of borrowers.

138. Under SAB 102, Defendants were required to consider levels of and trends in delinquencies, impaired loans, and charge-offs (defaults) in calculating SLM's allowance for PEL losses during the Class Period. However, as a result of Defendants' manipulation of SLM's forbearance practices, SLM's financial statements did not accurately reflect the levels of and trends in delinquencies, impaired loans, and charge-offs that would have existed had SLM complied with the forbearance policies and procedures set forth in its financial statements and footnote disclosures.

139. Because Defendants were calculating SLM's allowance for PEL losses at least in part on the delinquency and default data as reported in SLM's Class Period financial statements, and because those financial statements materially overstated forbearance rates and materially understated delinquency and default rates, SLM's allowance for PEL losses was materially understated throughout the Class Period as a result. After the end of the Class Period, when Defendants were no longer manipulating SLM's forbearance practices, the Company's forbearance rates declined; its delinquency and default rates increased; and its allowance for PEL losses rose.

D. Defendants Materially Misrepresented SLM's Forbearance Practices And Forbearance And Delinquency Rates For Its Education Loans

140. As described above, during the Class Period Defendants manipulated SLM's forbearance practices to avoid reporting increased delinquencies and defaults in the Company's education loan portfolio. As a result of Defendants' manipulation of SLM's forbearance practices, which removed loans from delinquent status, SLM materially misrepresented its actual

forbearance practices and forbearance and delinquency rates in its financial statements, in violation of the GAAP and SEC regulations set forth below.

141. Forbearance and delinquency rates and related delinquency statistics, such as defaults and charge-offs, were important factors used to determine the credit quality of SLM's student loan portfolios. Credit quality, in turn, directly affected SLM's financial results as well as the Company's ability to raise cash through securitizations of the loans in question and similar transactions. As Defendants acknowledged in SLM's 2006 10-K (and in other SEC filings during the Class Period), "[d]elinquencies have the potential to adversely impact earnings if the account charges off and results in increased servicing and collection costs."

142. In each of its Class Period financial statements and footnote disclosures, SLM disclosed the amount of loans in forbearance and the amount in each delinquency category (e.g., current, 31-60 days past due, 61-90 days past due, and greater than 90 days past due), and provided management discussion and analysis explaining trends in these statistics and changes from prior periods. Defendants also discussed this information during conferences and conference calls with securities analysts and investors.

143. SLM's financial statement and footnote disclosures pertaining to its forbearance practices stated that the Company had policies and procedures in place to carefully regulate the use of forbearance, that forbearance was used only when it would increase the likelihood of repayment, and that SLM obtained evidence of a borrower's ability to pay prior to adjusting the delinquency status of the loan, among other things. As set forth in detail above, these disclosures did not accurately reflect SLM's actual forbearance practices, and therefore were materially misleading in violation of the GAAP set forth below because the disclosures failed to provide a reasonable understanding of SLM's business and economic activities, failed to include all

information about SLM's resources and obligations, failed to accurately set forth SLM's financial performance, and were neither reliable nor complete.

144. SLM's financial statement and footnote disclosures concerning its forbearance and delinquency rates were also materially misleading in violation of GAAP during the Class Period, because they did not reflect the rates that would have been calculated had SLM complied with the forbearance policies and procedures set forth in its financial statements and footnote disclosures. After the end of the Class Period, Defendants admitted that SLM's forbearance practices during the Class Period failed to adequately screen borrowers who were granted forbearance, that forbearance did not increase the likelihood of repayment of the loans, and that the effect of SLM's practice of granting forbearances in violation of SLM's stated criteria was to suppress SLM's delinquency and default rates in the short term only, because the improper use of forbearance merely delayed the inevitable delinquency and default for many borrowers.

145. During a January 22, 2009 conference call with securities analysts and investors to discuss SLM's 2008 earnings and results, Defendant Lord admitted that SLM had reduced the availability of forbearance in certain cases and that the Company expected these borrowers would default and be charged-off earlier as a result. After the end of the Class Period, SLM's forbearance rates declined and its delinquency and default rates increased correspondingly, reflecting the Company's belated adherence to its stated forbearance policies.

146. Calculating the forbearance loan value in SLM's PEL portfolio as a percentage of total 30-day, 60-day and 90-or-more-day delinquent loans on a managed basis illustrates how forbearance concealed the true delinquency problem at SLM. The following chart, which is in millions of dollars, demonstrates the increase in forbearance loans as a percentage of delinquent loans:

Quarter Ending	Forbearance (F)	30/60/90+Delinquent (D)	F/D
12/31/06	$1181	$1010	117%
3/31/07	$1641	$971	169%
6/30/07	$1637	$965	170%
9/30/07	$1952	$1089	179%
12/31/07	$2391	$1227	196%

As this chart shows, delinquent loans in SLM's PEL portfolio grew by only $79 million, or 8%, from the end of 2006 to the end of the third quarter of 2007, while loans in forbearance grew by $871 million, or 73%. Loans in forbearance, which were already somewhat larger in amount than all delinquencies at year-end 2006, far exceeded delinquencies by the end of the third quarter of 2007.

147. SLM's financial statement and footnote disclosures during the Class Period concerning its forbearance practices, forbearance rates, and delinquency rates violated the GAAP provisions set forth below.

148. FASB Statement of Concepts No. 1, ¶ 34, required that SLM provide useful information to present and potential investors and creditors and other users and that the information be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence. Defendants' manipulation of SLM's forbearance practices resulted in SLM's materially misrepresenting its actual forbearance practices and forbearance and delinquency rates in its financial statements. As a result, the information presented in those financial statements was not

useful to investors and did not provide them with a reasonable understanding of SLM's true business and economic activities.

149. FASB Statement of Concepts No. 1, ¶ 40, required that SLM's financial statements include information about the Company's economic resources, its obligations and the events that would change any of those resources or any claims to those resources. Defendants' manipulation of SLM's forbearance practices resulted in SLM's materially misrepresenting its actual forbearance practices and forbearance and delinquency rates in its financial statements. As a result, those financial statements did not include accurate information about SLM's economic resources and obligations.

150. FASB Statement of Concepts No. 1, ¶ 42, required that SLM's financial reporting provide accurate information about the Company's financial performance during a fiscal period. Defendants' manipulation of SLM's forbearance practices resulted in SLM's materially misrepresenting its actual forbearance practices and forbearance and delinquency rates in its financial statements. As a result, those financial statements did not provide accurate information about SLM's financial performance during each relevant fiscal period.

151. FASB Statement of Concepts No. 2, ¶¶ 58-59, 62, required that the information set forth in SLM's financial statements be reliable and that the information have representational faithfulness and be verifiable and neutral. As defined by FASB Statement Concept No. 2, reliability is the "quality of information that assures that information is reasonably free from error and bias and faithfully represents what it purports to represent." Defendants' manipulation of SLM's forbearance practices resulted in SLM's materially misrepresenting its actual forbearance practices and forbearance and delinquency rates in its financial statements. As a

result, those financial statements were not reliable, verifiable or neutral and were not reasonably free from error or bias.

152. FASB Statement of Concepts No. 2, ¶ 79, required that SLM's financial statements be complete and that nothing material be left out that may be necessary to ensure that the financial statements validly represent underlying events and conditions. Materiality is defined as the "magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, make it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement." Defendants' manipulation of SLM's forbearance practices resulted in SLM's materially misrepresenting its actual forbearance practices and forbearance and delinquency rates in its financial statements. As a result, those financial statements were not complete, and omitted material information that was necessary to ensure that the financial statements validly represented underlying events and conditions.

153. Footnote disclosures are an essential element of financial statements prepared in accordance with GAAP. SFAS No. 5 specifically states, in relevant part:

> Information disclosed in notes...amplifies or explains information recognized in the financial statements. That sort of information is essential to understanding the information recognized in financial statements and has long been viewed as all integral part of financial statements prepared in accordance with generally accepted accounting principles.

SLM's footnote disclosures concerning its forbearance practices and forbearance and delinquency rates were materially misleading and therefore failed to comply with SFAS No. 5.

154. The Accounting Principles Board ("APB") has provided extensive guidance to companies about the disclosure of accounting policies. APB Opinion No. 22, *Disclosure of Accounting Policies,* provides that when financial statements are issued purporting to present

fairly financial position, cash flows, and results of operations in accordance with GAAP, a description of all significant accounting policies of the reporting entity should be included as an integral part of the financial statements.

155. Pursuant to APB Opinion No. 22, the accounting policies should identify and describe the accounting principles followed by the reporting entity and the methods used. In general, the disclosure should encompass important judgments as to appropriateness of principles relating to recognition of revenue and allocation of asset costs to current and future periods. The disclosure should encompass those accounting principles and methods that involve (i) a selection from existing acceptable alternatives, (ii) principles and methods peculiar to the industry in which the reporting entity operates, even if such principles and methods are predominately followed in the industry, and (iii) unusual or innovative applications of GAAP.

156. Defendants violated APB Opinion No. 22 by failing to disclose SLM's actual accounting practices and policies with respect to the Company's forbearance practices and the manner in which the Company calculated its forbearance and delinquency rates.

E. Defendants Failed To Disclose SLM's Concentration Of Credit Risk

157. During the Class Period, Defendants failed to disclose SLM's material concentration of credit risk arising from the "non-traditional" loans in its PEL portfolio, in violation of GAAP and SEC regulations. In SLM's words, non-traditional loans were those loans made to borrowers "that have or are expected to have a high default rate as a result of a number of factors, including having a lower tier credit rating, low program completion and graduation rates or, where the borrower is expected to graduate, a low expected income relative to the borrower's cost of attendance." As set forth in the AICPA Audit and Accounting Guide entitled *Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions,*

Finance Companies, and Mortgage Companies, the overriding factor in making a loan is the amount of credit risk associated with the loan. Furthermore, a high concentration of loans to a single borrower type would constitute a concentration of risk. In the *Bank, Credit Union, and Other Depository and Lending Institution Industry Developments – 2004/05* Audit Risk Alert (issued in February 2005), the AICPA identified "subprime" loans as an area of increased concern. "It is important for institutions to have evaluated whether their loan programs are subprime or prime." Whether a portfolio or segment is to be classified as "subprime" is determined by loan portfolio performance. Given the performance of SLM's non-traditional loans as a group, they could reasonably be classified as subprime.

158. Statement of Financial Accounting Standards No. 107, *Disclosure about Fair Value of Financial Instruments* ("FAS 107"), required SLM to disclose "all significant concentrations of credit risk arising from all financial instruments, whether from an individual counterparty or groups of counterparties." Group concentrations of credit risk exist if a number of counterparties have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. As alleged herein, the many non-traditional loans in SLM's PEL portfolio had similar economic characteristics and represented a significant concentration of credit risk. The traits of the borrowers to whom non-traditional loans were made were known to Defendants during the Class Period. As Defendant Lord admitted after the end of the Class Period, these loans were "predictably not collectible," and when SLM finally decided to account for them in accordance with GAAP, the Company was able to identify the borrowers who were not likely to graduate.

159. AICPA Statement of Position No. 94-6, *Disclosure of Certain Risks and Uncertainties* ("SOP 94-6"), requires disclosures to be made in financial statements regarding

any concentrations in revenue from particular products, including loan products. Vulnerability from concentrations exists because the business is exposed to certain risks and uncertainties that might have a "severe impact" on future operations. SOP 94-6 defines "severe impact" as a "significant financially disruptive effect on the functioning of the entity." Moreover, SOP 94-6 required SLM's disclosure of concentrations to have included information that was adequate to inform users of the general nature of the risk associated with the concentration. For SLM, the non-traditional loans in its PEL portfolio presented a group concentration of credit risk that threatened to, and ultimately did, severely harm the Company's financial results. As set forth in the previous paragraph, all the facts necessary for Defendants to conclude that SLM's portfolio of non-traditional loans represented a concentration of credit risk that needed to be disclosed were known to Defendants during the Class Period.

160. Subsequent to SOP 94-6, FASB Staff Position 94-6-1, *Terms of Loan Products That May Give Rise to a Concentration of Credit Risk* ("FSP SOP 94-6-1"), was issued in December 2005. FSP SOP 94-6-1 was intended to emphasize the requirement to assess the adequacy of disclosures for all lending products and the effect of changes in market or economic conditions on the adequacy of those disclosures. Accordingly, the terms of certain loan products may increase a reporting entity's exposure to credit risk and thereby may result in a concentration of credit risk as that term is used in FAS 107, either as an individual product type or as a group of products with similar features. Such terms include principal payment deferral (*e.g.*, forbearance terms).

161. If a significant concentration of risk represents a material contingency, the risk must be disclosed in a company's interim financial statements in accordance with Accounting Principles Board Opinion No. 28, *Interim Financial Reporting*. The purpose behind these GAAP

provisions is to warn investors about concentrations of risk that may result in losses under changed conditions – not to wait until those losses become substantial and then disclose the concentration of risk after the losses have already harmed investors.

162. Defendants' failure during the Class Period to disclose the significant concentration of credit risk arising from SLM's non-traditional loans and the maximum amount of loss SLM would incur if the borrowers defaulted constituted a material violation of GAAP and caused SLM's Class Period financial statements and footnote disclosures to be materially false, misleading and misstated.

F. Defendants Failed To Disclose Known Trends And Uncertainties In SLM's Business

163. During the Class Period, Defendants failed to disclose in the Management Discussion and Analysis ("MD&A") section of SLM's financial statements known trends and uncertainties concerning SLM's PEL portfolio, in violation of GAAP and SEC regulations.

164. Item 303 of Regulation S-K, 17 C.F.R. § 229.303, provides that in the MD&A section of the financial statements, "[t]he discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition." Pursuant to Item 303 of Regulation S-K, during the Class Period, SLM was required to:

> Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed.

17 C.F.R. § 229.303(a)(3)(i)-(ii).

165. The SEC has issued a number of releases providing further guidance to registrants as to what information must be disclosed in the MD&A section of financial statements with respect to known trends and uncertainties. SLM was required to follow the guidance set forth in these releases as follows. Securities Act Release Nos. 33-8182 and 34-47264 provide:

> The disclosure in MD&A is of paramount importance in increasing the transparency of a company's financial performance and providing investors with the disclosure necessary to evaluate a company and to make informed investment decisions. MD&A also provides a unique opportunity for management to provide investors with an understanding of its view of the financial performance and condition of the company, an appreciation of what the financial statements show and do not show, as well as important trends and risks that have shaped the past or are reasonably likely to shape the future.
>
> . . . [MD&A is] designed to cover a wide range of corporate events, including events, variables and uncertainties not otherwise required to be disclosed under [GAAP].

Securities Act Release No. 33-6711 states:

> The Commission has long recognized the need for a narrative explanation of the financial statements, because a numerical presentation and brief accompanying footnotes alone may be insufficient for an investor to judge the quality of earnings and the likelihood that past performance is indicative of future performance. MD&A is intended to give the investor an opportunity to look at the company through the eyes of management by providing both a short and long-term analysis of the business of the company.

166. In its May 18, 1989 Interpretive Release No. 34-26831, the SEC indicated that registrants should employ the following two-step analysis in determining when a known trend or uncertainty is required to be included in the MD&A disclosure pursuant to Item 303 of Regulation S-K:

> A disclosure duty exists where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial condition or results of operation.

The SEC stated the following in SEC Release Nos. 33-8056 and 34-45321:

> Registrants are reminded that identification of circumstances that could materially affect liquidity is necessary if they are "reasonably likely" to occur. This disclosure threshold is lower than "more likely than not." Market price changes, economic downturns, defaults on guarantees, or contractions of operations that have material consequences for the registrant's financial position or operating results can be reasonably likely to occur under some conditions.

167. Defendants failed to comply with the foregoing requirements. SLM's financial statements for the 2006 fiscal year and for the first three quarters of 2007 failed to include any warning or other disclosure of the material negative trends and uncertainties associated with SLM's PEL portfolio, including, among other things, the relaxation of underwriting standards, SLM's writing of non-traditional loans and the increasing percentage of such loans, the increased likelihood of default in the portfolio, the manipulation of forbearance practices to cover up what would otherwise be defaults, and the concentration of credit risk within the PEL portfolio.

168. Not until the after end of the Class Period did Defendants belatedly disclose the existence of material negative trends and uncertainties that existed with respect to SLM's PEL portfolio. In February 2008, SLM first disclosed the breakdown of its PELs between "non-traditional" and other loans. As stated above, SLM described the non-traditional loans as those loans made to borrowers "that have or are expected to have a high default rate as a result of a number of factors, including having a lower tier credit rating, low program completion and graduation rates or, where the borrower is expected to graduate, a low expected income relative to the borrower's cost of attendance." SLM's failure to disclose its practice of making non-traditional PELs, the amount of such loans and the probable losses inherent in the loans was a violation of Item 303, as this practice was a known trend that SLM reasonably knew would have a materially unfavorable impact on SLM's reported earnings. Defendants disclosed in February 2008 changes in SLM's business practices (enhanced underwriting standards, no more non-

traditional loans and no more loans to students at schools with low graduation rates) that would ameliorate these material negative trends and uncertainties in the future.

G. Defendants Falsely Represented That SLM's Internal Controls Were Effective

169. During the Class Period, Defendants represented in the Company's SEC filings that SLM's disclosure controls and procedures were effective to ensure that information required to be disclosed was disclosed and that the disclosure controls provided reasonable assurance that the Company's financial reporting was reliable and its financial statements prepared in accordance with GAAP. These representations were set forth in SLM's 2006 10-K, the quarterly reports on 10-Q for the first three quarters of 2007, and in the SOX certifications signed by Defendant Andrews during the Class Period.

170. The representations about the effectiveness of SLM's internal reporting controls were materially false and misleading. During the Class Period, Defendants concealed the fact that SLM lacked effective internal controls, enabling the Company to abandon its underwriting standards to write high-risk, non-traditional loans, manipulate its forbearance practices to suppress delinquency and default rates, materially understate its allowance for PEL losses, and materially overstate income. SLM's ineffective internal controls also allowed Defendants to materially misstate SLM's financial results issued during the Class Period.

171. SEC Release No. 33-8238, which was in effect during the Class Period, defines "internal controls over financial reporting" as follows:

> The term internal controls over financial reporting is defined as a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persona performing similar functions, and effected by the company's board of directors, management, and other personnel, 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 and includes those policies and procedures that:

1. Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

2. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

3. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material affect on the financial statements.

172. Section 404 of the Sarbanes-Oxley Act of 2002 required SLM's management to assess the effectiveness of the Company's internal control structure and the financial reporting for procedures. SLM's management was responsible for performing this assessment in the context of a top-down risk assessment, which required management to base both the scope of its assessment and the evidence gathered on risk. SLM's management's conclusion as a result of that assessment, about whether the Company's internal control was effective, was required to be included in the Company' annual report.

173. SEC Release No. 33-8238 required SLM's management to report publicly all material weaknesses in the Company's internal controls. "A material weakness is a significant deficiency, or combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected." Public Company Accounting Oversight Board (PCAOB) Auditing Standards No. 2, ¶ 10.

174. The internal-control environment at SLM shaped by the Individual Defendants, principally Defendant Andrews, resulted in ineffective controls with respect to the Company's