



UNITED STATES DEPARTMENT OF EDUCATION

THE SECRETARY

96-23-SL
DA

In the Matter of
**Student Loan Marketing
Association (Sallie Mae)**
Respondent.

Docket No. 96-23-SL
Student Financial
Assistant Proceeding

DECISION OF THE SECRETARY

Background

Sallie Mae is a federally chartered, for profit corporation that is publicly held and financed by private sector capital. Sallie Mae's charter is set forth in the Higher Education Act (HEA), 20 U.S.C. § 1087-2. Sallie Mae's main purpose is to provide a national secondary market for student loans. In 1972, Sallie Mae began purchasing student loans originated by other institutions under the Federal Family Education Loan Program (FFEL), (formerly Guaranteed Student Loan Program). Sallie Mae is a Fortune 500 company with assets in excess of \$50 billion. Sallie Mae owns almost one third of all FFEL loans currently outstanding.

Scholl College is a professional school and has been an eligible lender under the FFEL program since 1989. Under a current agreement, entitled Export, Sallie Mae processes student loan applications and performs loan origination activities on behalf of Scholl College. Sallie Mae also services loans originated under this agreement. Scholl College sells to Sallie Mae all loans originated under the Export agreement, generally before the 120th day (prior to the time the borrower enters repayment at a previously agreed upon price, which is profitable for Scholl College). For each portfolio of loans it purchases, Sallie Mae pays Scholl College 100 percent of the principal balance, accrued interest, and an amount up to 2.50 percent over par value.

Sallie Mae and Scholl College are also parties in a Revolving Financing Agreement. Pursuant to this agreement, Scholl College has a line of credit with Sallie Mae, used to fund FFEL loans. Sallie Mae makes advances in an aggregate amount of up to twenty million dollars to Scholl College to finance lending activities, and Scholl College pays quarterly interest on any advances.

Rule of Law & Procedure

The Higher Education Act (HEA), § 435(d)(5)(A) prohibits lenders from offering directly or *indirectly*, "points, premiums, payments, or other inducements, to any

educational institutions or individuals in order to secure applicants” for FFEL loans. (Emphasis added.) Schools are authorized to act as eligible FFEL lenders by the HEA, § 435 (d)(2), 20 U.S.C. § 1085 (d)(2).

On July 14, 1995, the Office of Student Financial Assistance Programs (SFAP), issued a notice of intent to limit the eligibility of Sallie Mae to participate as a lender in the FFEL program. SFAP’s action alleged that the contracts describe above violate the Higher Education Act of 1965, as amended, 20 U.S.C. § 1085 (d)(5)(A) because they provide Scholl College with an improper financial inducement to solicit FFEL loan applications from its students. In response to SFAP’s actions, pursuant to 34 C.F.R. § 682.706, Sallie Mae filed a request for an oral hearing. An evidentiary hearing was held on August 6, 1996, before Judge Richard O’Hair. On September 26, 1996, Judge O’Hair issued an Initial Decision in favor of Sallie Mae. Judge O’Hair refused to limit Sallie Mae’s participation as a lender in the FFEL program and stated that “the prohibited conduct does not apply to Sallie Mae because it does not secure loan applicants, but only secures the final product, consummated loans.” Decision at 5. I disagree.

Following the Initial Decision, I remanded this case and requested that Judge O’Hair re-examine the facts of the case to determine whether he might characterize Sallie Mae as the lender under the contracts involving Scholl College based on the substance of the transactions involved, instead of their form. On July 18, 1997, Judge O’Hair issued a Decision Upon Remand, concluding that “Sallie Mae’s rights and obligations under its forward financing and loan servicing agreements with Scholl College should not be viewed as a fiction which negates Scholl College’s role as the lender of its student’s FFEL program loans.” Decision Upon Remand at 4. SFAP now appeals.

Argument & Findings

SFAP contends that the Administrative Decision is contrary to the applicable statutes, regulations and rules governing the FFEL program and fails to substantively examine the agreements at issue. The authority of a government agency to ignore the form of a transaction or business relationship to serve legislative or regulatory purposes has been found in a number of different cases. Student Loan Marketing Ass’n v. Riley, 104 F.3d 397 (1997); Capital Telephone Co. v. FCC, 498 F.2d 734, 738 (D.C. Cir. 1974); H.P. Lambert Co. v. Secretary of Treasury, 354 F.2d 819 (1st Cir. 1965). In the FFEL program there is a clear intent to separate the role of the lender and the school. 34 C.F.R. § 682.601(a). In light of these distinct roles and the need to ensure that borrowers receive full and complete information from their school, it is appropriate for the Department to ignore the form of Scholl College’s role under the contracts and evaluate the actual responsibilities of each party.

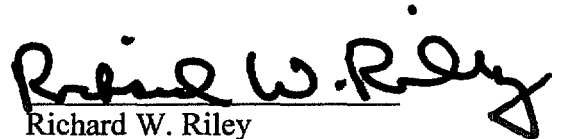
Under the said agreements, Sallie Mae performs all the functions of a lender in relation to the loans formally made by Scholl College, except for initially marketing the loans to students. To secure these loans, Sallie Mae performs an array of responsibilities. Sallie Mae receives, reviews and approves the loan application and arranges for the guarantee from the agency. Sallie Mae disburses the loans from a bank account that it

maintains and controls. Sallie Mae is responsible for all the servicing and collection activity on the loans, and Sallie Mae solicits additional loans from borrowers. Pursuant to the contracts, Scholl College's only responsibility is to market the loans to the students and prepare and distribute student loan application packages for the Scholl College/Sallie Mae program. However, the loan packages identify Sallie Mae as the contact party.

Considering the substantive functions of the two parties, the classification of Scholl College as the lender may not stand. The responsibilities performed by Sallie Mae give rise to the finding that it is the actual lender under these agreements. Accordingly, the payments made by Sallie Mae (the actual lender), to Scholl College (an educational institution) constitute improper inducements made to secure loan applicants in violation of the HEA, § 435(d)(5)(A).

For the forgoing reasons, it is hereby ordered that Sallie Mae be limited from participating as a lender in the Scholl College FFEL program, and the Administrative Decision is reversed.

Washington, DC
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Administrative Judge
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