SLM CORP
Form 10-K
March 01, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006 or

o **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file numbers 001-13251

SLM Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**52-2013874**
(State of Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
12061 Bluemont Way, Reston, Virginia	**20190**
(Address of Principal Executive Offices)	*(Zip Code)*

(703) 810-3000
(Registrant s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, par value $.20 per share.

Name of Exchange on which Listed:
New York Stock Exchange

6.97% Cumulative Redeemable Preferred Stock, Series A, par value $.20 per share
Floating Rate Non-Cumulative Preferred Stock, Series B, par value $.20 per share

Name of Exchange on which Listed:
New York Stock Exchange

Medium Term Notes, Series A, CPI-Linked Notes due 2017
Medium Term Notes, Series A, CPI-Linked Notes due 2018
6% Senior Notes due December 15, 2043

Name of Exchange on which Listed:
New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None.

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No þ

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2006 was approximately $21,566,572,748 (based on closing sale price of $52.92 per share as reported for the New York Stock Exchange Composite Transactions).

As of January 31, 2007, there were 410,478,252 shares of voting common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement relating to the registrant s Annual Meeting of Shareholders scheduled to be held May 17, 2007 are incorporated by reference into Part III of this Report.

TABLE OF CONTENTS

GLOSSARY
PART I.
Item 1. Business
Item 1A. Risk Factors
Item 1B. Unresolved Staff Comments
Item 2. Properties
Item 3. Legal Proceedings
Item 4. Submission of Matters to a Vote of Security Holders
PART II.
Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
Item 6. Selected Financial Data
Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations
Item 7A. Quantitative and Qualitative Disclosures About Market Risk
Item 8. Financial Statements and Supplementary Data
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
Item 9A. Controls and Procedures
Disclosure Controls and Procedures
Item 9B. Other Information
PART III.
Item 10. Directors, Executive Officers and Corporate Guidance
Item 11. Executive Compensation
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters
Item 13. Certain Relationships and Related Transactions, and Director Independence
Item 14. Principal Accounting Fees and Services
PART IV.
Item 15. Exhibits, Financial Statement Schedules
SIGNATURES
CONSOLIDATED FINANCIAL STATEMENTS INDEX
MANAGEMENT S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
Report of Independent Registered Public Accounting Firm
CONSOLIDATED BALANCE SHEETS
CONSOLIDATED STATEMENTS OF INCOME
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
CONSOLIDATED STATEMENTS OF CASH FLOWS
SLM CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollars in thousands, except per share amounts, unless otherwise stated)
APPENDIX A
EX-23
EX-31.1
EX-31.2
EX-32.1
EX-32.2

Table of Contents

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

GLOSSARY

Listed below are definitions of key terms that are used throughout this document. See also APPENDIX A, FEDERAL FAMILY EDUCATION LOAN PROGRAM, for a further discussion of the FFELP.

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

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

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

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

Our Core Earnings performance measures are the primary financial performance measures used by management to evaluate performance and to allocate resources. Accordingly, financial information is reported to management on a Core Earnings basis by reportable segment, as these are the measures used regularly by our chief operating decision maker. Our Core Earnings performance measures are used in developing our financial plans and tracking results, and also in establishing corporate performance targets and determining incentive compensation. Management believes this information provides additional insight into the financial performance of the Company s core business activities. Our Core Earnings performance measures are not defined terms within GAAP and may not be comparable to similarly titled measures reported by other companies. Core Earnings net income reflects only current period adjustments to GAAP net income. Accordingly, the Company s Core Earnings presentation does not represent another comprehensive basis of accounting.

See NOTE 18 TO THE CONSOLIDATED FINANCIAL STATEMENTS Segment Reporting and MANAGEMENT S DISCUSSION AND ANALYSIS BUSINESS SEGMENTS Limitations of Core Earnings for further discussion of the differences between Core Earnings and GAAP, as well as reconciliations between Core

Earnings and GAAP.

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

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

ED The U.S. Department of Education.

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

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

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

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

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

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

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

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

SAP formula, our student loans earn at a fixed rate while the interest on our floating rate debt continues to decline. In these interest rate environments, we earn additional spread income that we refer to as Floor Income. Depending on the type of the student loan and when it was originated, the borrower rate is either fixed to term or is reset to a market rate each July 1. As a result, for loans where the borrower rate is fixed to term, we may earn Floor Income for an extended period of time, and for those loans

Table of Contents

where the borrower interest rate is reset annually on July 1, we may earn Floor Income to the next reset date. In accordance with new legislation enacted in 2006, lenders are required to rebate Floor Income to ED for all new FFELP loans disbursed on or after April 1, 2006.

The following example shows the mechanics of Floor Income for a typical fixed rate FFELP Consolidation Loan (with a commercial paper-based SAP spread of 2.64 percent):

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

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

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

Graphic Depiction of Floor Income:

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

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

HEA The Higher Education Act of 1965, as amended.

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

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

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

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

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

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

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

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

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

2006.

Special Allowance Payment (SAP) FFELP student loans originated prior to April 1, 2006 generally earn interest at the greater of the borrower rate or a floating rate determined by reference to the average of the applicable floating rates (91-day Treasury bill rate or commercial paper) in a calendar quarter, plus a fixed spread that is dependent upon when the loan was originated and the loan s repayment status. If the resulting floating rate exceeds the borrower rate, ED pays the difference directly to us. This payment is referred to as the Special Allowance Payment or SAP and the formula used to determine the floating rate is the SAP

Table of Contents

formula. We refer to the fixed spread to the underlying index as the SAP spread. For loans disbursed after April 1, FFELP loans effectively only earn at the SAP rate, as the excess interest earned when the borrower rate exceeds the SAP rate (Floor Income) must be refunded to ED.

Variable rate PLUS Loans and SLS Loans earn SAP only if the variable rate, which is reset annually, exceeds the applicable maximum borrower rate. For PLUS loans disbursed on or after January 1, 2000, this limitation on SAP was repealed effective April 1, 2006.

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

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

Wholesale Consolidation Channel During 2006, we implemented a new loan acquisition strategy under which we began purchasing a significant amount of FFELP Consolidation Loans, primarily via the spot market, which augments our traditional FFELP Consolidation Loan origination process. We refer to this new loan acquisition strategy as our Wholesale Consolidation Channel. FFELP Consolidation Loans acquired through this channel are considered incremental volume to our core acquisition channels, which are focused on the retail marketplace with an emphasis on our brand strategy.

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

Table of Contents

PART I.

Item 1. Business

INTRODUCTION TO SLM CORPORATION

SLM Corporation, more commonly known as Sallie Mae, is the market leader in education finance. SLM Corporation is a holding company that operates through a number of subsidiaries. (References in this Annual Report to the Company refer to SLM Corporation and its subsidiaries). At December 31, 2006, we had approximately 11,000 employees.

Our primary business is to originate and hold student loans by providing funding, delivery and servicing support for education loans in the United States through our participation in the Federal Family Education Loan Program (FFELP) and through offering non-federally guaranteed Private Education Loans. We primarily market our FFELP Stafford and Private Education Loans through on-campus financial aid offices. In recent years, the industry has moved toward a direct-to-consumer marketing model as evidenced by the surge in FFELP Consolidation Loans which are marketed directly to FFELP Stafford borrowers. We have also expanded our direct-to-consumer marketing of Private Education Loans.

We have used both internal growth and strategic acquisitions to attain our leadership position in the education finance marketplace. Our sales force, which delivers our products on campuses across the country, is the largest in the student loan industry. The core of our marketing strategy is to promote our on-campus brands, which generate student loan originations through our Preferred Channel. Loans generated through our Preferred Channel are more profitable than loans acquired through other acquisition channels because we own them earlier in the student loan s life and generally incur lower costs to acquire such loans. We have built brand leadership through the Sallie Mae name, the brands of our subsidiaries and those of our lender partners. These sales and marketing efforts are supported by the largest and most diversified servicing capabilities in the industry, providing an unmatched array of services to financial aid offices.

We have expanded into a number of fee-based businesses, most notably, our Debt Management Operations (DMO) business, which is presented as a distinct segment in accordance with the Financial Accounting Standards Board s (FASB) Statement of Financial Accounting Standards (SFAS) No. 131, Disclosures about Segments of an Enterprise and Related Information. Our DMO business provides a wide range of accounts receivable and collections services including student loan default aversion services, defaulted student loan portfolio management services, contingency collections services for student loans and other asset classes, and accounts receivable management and collection for purchased portfolios of receivables that are delinquent or have been charged off by their original creditors. We also purchase and manage portfolios of sub-performing and non-performing mortgage loans.

We also earn fees for a number of services including student loan and guarantee servicing, 529 Savings Plan Administration services, and for providing processing capabilities and information technology to educational institutions. We also operate a consumer savings network through Upromise, Inc. (Upromise) loyalty service.

In December 2004, we completed the Wind-Down of the GSE through the defeasance of all remaining GSE debt obligations and dissolution of the GSE s federal charter. The liquidity provided to the Company by the GSE has been replaced primarily by securitizations. In addition to securitizations, we have access to a number of additional sources of liquidity including an asset-backed commercial paper program, unsecured revolving credit facilities, and other unsecured corporate debt and equity security issuances.

On August 22, 2006, the Company completed the acquisition of Upromise. Upromise is the leading provider of saving for college programs. Through its Upromise affiliates, the company administers 529 college-savings plans and assists its members with automatic savings through rebates on everyday purchases.

BUSINESS SEGMENTS

We provide our array of credit products and related services to the higher education and consumer credit communities and others through two primary business segments: our Lending business segment and our DMO business segment. These defined business segments operate in distinct business environments and have unique characteristics and face different opportunities and challenges. They are considered reportable segments under the FASB s SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, based on quantitative thresholds applied to the Company s financial statements. In addition, within our Corporate and Other business segment, we provide a number of complementary products and services to financial aid offices and schools that are managed within smaller operating segments, the most prominent being our Guarantor Servicing and Loan Servicing businesses. In accordance with SFAS No. 131, we include in Note 18 to our consolidated financial statements, Segment Reporting, separate financial information about our operating segments.

Management, including the Company s chief operating decision maker, evaluates the performance of the Company s operating segments based on their profitability as measured by Core Earnings. Accordingly, we provide information regarding the Company s reportable segments in this report based on Core Earnings. Core Earnings are the primary financial performance measures used by management to develop the Company s financial plans, track results, and establish corporate performance targets and incentive compensation. While Core Earnings are not a substitute for reported results under generally accepted accounting principles in the United States (GAAP), the Company relies on Core Earnings in operating its business because Core Earnings permit management to make meaningful period-to-period comparisons of the operational and performance indicators that are most closely assessed by management. Management believes this information provides additional insight into the financial performance of the core business activities of our operating segments. (See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS BUSINESS SEGMENTS for a detailed discussion of our Core Earnings, including a table that summarizes the pre-tax differences between Core Earnings and GAAP by business segment and the limitations to this presentation.)

We generate most of our earnings in our Lending business from the spread between the yield we receive on our Managed portfolio of student loans and the cost of funding these loans less the provisions for loan losses. We incur servicing, selling and administrative expenses in providing these products and services, and provide for loan losses. On our income statement, prepared in accordance with GAAP, this spread income is reported as net interest income for on-balance sheet loans, and as gains on student loan securitizations and servicing and securitization revenue for off-balance sheet loans in which we maintain a Retained Interest. Total Core Earnings revenues for this segment were $2.4 billion in 2006.

In our DMO business segment, we provide a wide range of accounts receivable and collections services including student loan default aversion services, defaulted student loan portfolio management services, contingency collections services for student loans and other asset classes, and accounts receivable management and collection for purchased portfolios of receivables that are delinquent or have been charged off by their original creditors as well as sub-performing and non-performing mortgage loans. In the purchased receivables business, we focus on a variety of consumer debt types with emphasis on charged-off credit card receivables and distressed mortgage receivables. We purchase these portfolios at a discount to their face value, and then use both our internal collection operations coupled with third party collection agencies to maximize the recovery on these receivables. In 2006, we began purchasing charged-off consumer receivables in Europe through our United Kingdom subsidiary, Arrow Global Ltd.

LENDING BUSINESS SEGMENT

In our Lending business segment, we originate and acquire both federally guaranteed student loans, which are administered by the U.S. Department of Education (ED), and Private Education Loans, which are not federally guaranteed. Borrowers use Private Education Loans primarily to supplement guaranteed loans in meeting the cost of education. We manage the largest portfolio of FFELP and Private Education Loans in the student loan industry, serving nearly 10 million student and parent customers through our ownership and

---

management of $142.1 billion in Managed student loans as of December 31, 2006, of which $119.5 billion or 84 percent are federally insured. We serve a diverse range of clients that includes over 6,000 educational and financial institutions and state agencies. We are the largest servicer of FFELP student loans, servicing a portfolio of $115.2 billion of FFELP student loans. We also service $25 billion of Private Education Loans as of December 31, 2006. We also market student loans, both federal and private, directly to the consumer. In addition to education lending, we also originate mortgage and consumer loans with the intent of selling most of these loans. In 2006 we originated $1.6 billion in mortgage and consumer loans. Our mortgage and consumer loan portfolio totaled $612 million at December 31, 2006, of which $119 million are mortgages in the held-for-sale portfolio.

Student Lending Marketplace

The following chart shows the estimated sources of funding for attending two-year and four-year colleges for the academic year (AY) ending June 30, 2007 (AY 2006-2007). Approximately 42 percent of the funding comes from federally guaranteed student loans and Private Education Loans. The parent/student contributions come from savings/investments, current period earnings and other loans obtained without going through the normal financial aid process.

Sources of Funding for College Attendance AY 2006-2007[(1)]

Total Projected Cost $229 Billion
(dollars in billions)

(1) Source: Based on estimates by Octameron Associates, Don t Miss Out, 30th Edition, by College Board, 2006 Trends in Student Aid and Sallie Mae. Includes tuition, room, board, transportation and miscellaneous costs for two and four year college degree-granting programs.

Federally Guaranteed Student Lending Programs

There are two competing programs that provide student loans where the ultimate credit risk lies with the federal government: the FFELP and the Federal Direct Lending Program (FDLP). FFELP loans are provided by private sector institutions and are ultimately guaranteed by ED. FDLP loans are funded by taxpayers and provided to borrowers directly by ED on terms similar to student loans in the FFELP. In addition to these government guaranteed programs, Private Education Loans are made by financial institutions where the lender or holder assumes the credit risk of the borrower.

For the federal fiscal year (FFY) ended September 30, 2006 (FFY 2006), ED estimated that the FFELP s market share in federally guaranteed student loans was 79 percent, up from 77 percent in FFY 2005.

(See LENDING BUSINESS SEGMENT Competition.) Total FFELP and FDLP volume for FFY 2006 grew by seven percent, with the FFELP portion growing nine percent.

The Higher Education Act (the HEA) includes regulations that cover every aspect of the servicing of a federally guaranteed student loan, including communications with borrowers, loan originations and default aversion. Failure to service a student loan properly could jeopardize the guarantee on federal student loans. This guarantee generally covers 98 and 97 percent of the student loan s principal and accrued interest for loans disbursed before and after July 1, 2006, respectively, except when the servicer has been designated by ED as an Exceptional Performer (EP) in which case the guarantee covers 99 percent. In the case of death, disability or bankruptcy of the borrower, the guarantee covers 100 percent of the student loan s principal and accrued interest.

Effective for a renewable one-year period beginning in October 2005, the Company s loan servicing division, Sallie Mae Servicing, was designated as an EP by ED in recognition of meeting certain performance standards set by ED in servicing FFELP loans. As a result of this designation, the Company received 100 percent reimbursement through June 30, 2006 and 99 percent reimbursement on and after July 1, 2006 on default claims on federally guaranteed student loans that are serviced by Sallie Mae Servicing for a period of at least 270 days before the date of default. The Company is entitled to receive this benefit as long as the Company remains in compliance with the required servicing standards, which are assessed on an annual and quarterly basis through compliance audits and other criteria. The EP designation applies to all FFELP loans that are serviced by the Company as well as default claims on federally guaranteed student loans that the Company owns but are serviced by other service providers with the EP designation. As of February 28, 2007, ED has not renewed Sallie Mae Servicing as an EP pending resolution of outstanding issues with ED concerning certain fees we charge certain borrowers. The Company believes these fees are charged consistent with prior ED guidance. Until the outstanding issues with ED are resolved, Sallie Mae Servicing s EP designation remains in effect.

FFELP student loans are guaranteed by state agencies or non-profit companies called guarantors, with ED providing reinsurance to the guarantor. Guarantors are responsible for performing certain functions necessary to ensure the program s soundness and accountability. These functions include reviewing loan application data to detect and prevent fraud and abuse and to assist lenders in preventing default by providing counseling to borrowers. Generally, the guarantor is responsible for ensuring that loans are being serviced in compliance with the requirements of the HEA. When a borrower defaults on a FFELP loan, we submit a claim form to the guarantor who reimburses us for principal and accrued interest subject to the Risk Sharing and EP criteria discussed above (See APPENDIX A, FEDERAL FAMILY EDUCATION LOAN PROGRAM, to this document for a more complete description of the role of guarantors.)

Private Education Loan Products

In addition to federal loan programs, which have statutory limits on annual and total borrowing, we sponsor a variety of Private Education Loan programs and purchase loans made under such programs to bridge the gap between the cost of education and a student s resources. The majority of our higher education Private Education Loans are made in conjunction with a FFELP Stafford loan, so they are marketed to schools through the same marketing channels and by the same sales force as FFELP loans. In 2004, we expanded our direct-to-consumer loan marketing channel with our Tuition Answer^{sm} loan program under which we originate and purchase loans outside of the traditional financial aid process. We also originate and purchase Private Education Loans marketed by our SLM Financial subsidiary to career training, technical and trade schools, tutorial and learning centers, and private kindergarten through secondary education schools. These loans are primarily made at schools not eligible for Title IV loans. Private Education Loans are discussed in more detail below.

Drivers of Growth in the Student Loan Industry

The growth in our Managed student loan portfolio is driven by the growth in the overall student loan marketplace, as well as by our own market share gains. Rising enrollment and college costs have resulted in a

doubling in the size of the federally insured student loan market over the last 10 years. Student loan originations grew from $17.8 billion in FFY 1996 to $47.3 billion in FFY 2006.

According to the College Board, tuition and fees at four-year public institutions and four-year private institutions have increased 51 percent and 32 percent, respectively, in constant, inflation-adjusted dollars, since AY 1996-1997. Under the FFELP, there are limits to the amount students can borrow each academic year. The first loan limit increases since 1992 will be implemented July 1, 2007 when freshman and sophomore limits will be increased to $3,500 and $4,500 from $2,625 and $3,500, respectively. The fact that guaranteed student loan limits have not kept pace with tuition increases has driven more students and parents to Private Education Loans to meet an increasing portion of their education financing needs. Loans both federal and private as a percentage of total student aid have increased from 55 percent of total student aid in AY 1996-1997 to 56 percent in AY 2005-2006. Private Education Loans accounted for 20 percent of total student loans both federally guaranteed and Private Education Loans in AY 2005-2006, compared to six percent in AY 1996-1997.

ED predicts that the college-age population will increase approximately 13 percent from 2006 to 2015. Demand for education credit will also increase due to the rise in non-traditional students (those not attending college directly from high school) and adult education.

The following charts show the projected enrollment and average tuition and fee growth for four-year public and private colleges and universities.

Projected Enrollment

Source: National Center for Education Statistics (NCES)

Cost of Attendance[1]
Cumulative % Increase from AY 1996-1997

Source: The College Board

[1] Cost of attendance is in current dollars and includes tuition, fees and on-campus room and board.

Sallie Mae s Lending Business

Our primary marketing point-of-contact is the school s financial aid office where we focus on delivering flexible and cost-effective products to the school and its students. Our sales force, which works with financial aid administrators on a daily basis, is the largest in the industry and currently markets the following internal lender brands: Academic Management Services (AMS), Nellie Mae, Sallie Mae Educational Trust, SLM Financial, Student Loan Funding Resources (SLFR), Southwest Student Services (Southwest) and Student Loan Finance Association (SLFA). We also actively market the loan guarantee of United Student Aid Funds, Inc. (USA Funds) and its affiliate, Northwest Education Loan Association (NELA), through a separate sales force.

We acquire student loans from three principal sources:

- our Preferred Channel;
- FFELP Consolidation Loans; and
- strategic acquisitions.

Over the past several years, we have successfully changed our business model from a wholesale purchaser of loans on the secondary market to a direct origination model where we control the front-end origination process. This provides us with higher yielding loans with lower acquisition costs that have a longer duration because we originate or purchase them at or immediately after full disbursement.

In 2006, we originated $23.4 billion in student loans through our Preferred Channel, of which a total of $13.1 billion or 56 percent was originated through our internal lending brands. The mix of Preferred Channel Originations marks a significant shift from the past, when our internal lending brands were the smallest component of our Preferred Channel Originations. Internal lending brand growth is a key factor to our long-term market penetration. In 2006, internal lending brands grew 43 percent to $13.1 billion. This positions us to control our future volume as well as the costs to originate new assets. Our internal lending brand loans are our most valuable loans because we do not pay a premium other than to ED to originate them. Our strategic lender partners continue to represent an important loan acquisition channel for assets flowing through loan purchase commitments as well as assets purchased in the retail secondary markets.

Our Preferred Channel Originations growth has been fueled by both new business from schools leaving the FDLP or other FFELP lending relationships, same school sales growth, and growth in the for-profit sector. Since 1999, we have partnered with over 300 schools that have chosen to return to the FFELP from the FDLP. Our FFELP originations at these schools totaled over $2.1 billion in 2006. In addition to winning new schools, we have also forged broader relationships with many of our existing school clients. Our FFELP and private originations at for-profit schools have grown faster than at traditional higher education schools due to enrollment trends as well as our increased market share of lending to these institutions.

Consolidation Loans

Over the past three years, we have seen a surge in consolidation activity as a result of aggressive marketing and historically low interest rates. This growth has contributed to the changing composition of our student loan portfolio. FFELP Consolidation Loans earn a lower yield than FFELP Stafford Loans due primarily to the Consolidation Loan Rebate Fee. This negative impact is somewhat mitigated by the longer average life of FFELP Consolidation Loans. We have made a substantial investment in consolidation marketing to protect our asset base and grow our portfolio,

including targeted direct mail campaigns and web-based initiatives for borrowers. Weighing against this investment is a recent practice by which some FFELP lenders use the Direct Lending program as a pass-through vehicle to circumvent the statutory prohibition on refinancing an existing FFELP Consolidation Loan in cases where the borrower is not eligible to consolidate his or her loans. This practice has since been prohibited under the student loan Reconciliation Legislation, but had a negative impact on our portfolio through the third quarter of 2006. In 2006, these developments resulted in a net Managed portfolio loss of $3.1 billion from consolidation activity. During 2006, $15.8 billion of FFELP Stafford loans in our Managed loan portfolio consolidated either with us ($11.3 billion) or with other

lenders ($4.5 billion). FFELP Consolidation Loans now represent 71 percent of our on-balance sheet federally guaranteed student loan portfolio and over 66 percent of our Managed federally guaranteed portfolio.

During 2006, we implemented a new loan acquisition strategy under which we began purchasing a significant amount of FFELP Consolidation Loans, primarily via the spot market, which augments our traditional FFELP Consolidation Loan origination process. We refer to this new loan acquisition strategy as our Wholesale Consolidation Channel. The decision to implement this strategy stems from the repeal of the Single Holder Rule in 2006 which allowed the industry to compete for student loans held by one lender. This has caused many originators to sell loans sooner and more frequently. At December 31, 2006, Wholesale Consolidation Loans totaled $3.6 billion.

The increased activity in FFELP Consolidation Loans has led to demand for the consolidation of Private Education loans. Private Education Consolidation Loans provide an attractive refinancing opportunity to certain borrowers because they allow borrowers to lower their monthly payments and extend the life of the loan. During 2006, we internally consolidated $300 million of our Managed Private Education loans, and added net $50 million in new volume.

GradPLUS

The Deficit Reduction Act of 2005 expanded the existing Federal PLUS loan to graduate and professional students (GradPLUS Loans). Previously, PLUS loans were restricted to parents of dependent, undergraduate students.

GradPLUS Loans have a lower rate of interest than our Private Education Loans and they allow graduate and professional students to borrow up to the full cost of their education (tuition, room and board), less other financial aid received. We therefore expect that over time GradPLUS Loans will supplant a significant amount of our Private Education Loans to graduate and professional students. In 2006, GradPLUS loans represented one percent of Preferred Channel Originations or $246 million.

Private Education Loans

The rising cost of education has led students and their parents to seek additional private credit sources to finance their education. Private Education Loans are often packaged as supplemental or companion products to FFELP loans and priced and underwritten competitively to provide additional value for our school relationships. In certain situations, a for-profit school shares the borrower credit risk. Over the last several years, the growth of Private Education Loans has accelerated due to tuition increasing faster than the rate of inflation coupled with stagnant FFELP lending limits. This rapid growth combined with the relatively higher spreads has led to Private Education Loans contributing a higher percentage of our net interest margin in each of the last four years. We expect this trend to continue in the foreseeable future. In 2006, Private Education Loans contributed 23 percent of the overall Core Earnings net interest income after provisions, up from 17 percent in 2005. The Higher Education Reconciliation Act of 2005 increased FFELP loan limits in AY 2006-2007. This, along with the introduction of GradPLUS Loans discussed above, will reduce the rate of growth in Private Education Loans in the future. We believe this loss of future Private Education Loan volume for graduate students will be replaced by an increase in federally insured loans.

Since we bear the full credit risk for Private Education Loans, they are underwritten and priced according to credit risk based upon standardized consumer credit scoring criteria. We mitigate some of this credit risk by providing price and eligibility incentives for students to obtain a credit-worthy co-borrower, and approximately 50 percent of our Private Education Loans have a co-borrower. Due to their higher risk profile, Private Education Loans earn higher spreads than their FFELP loan counterparts. In 2006, Private Education Loans earned an average Core Earnings spread, before provisions for loan losses, of 5.13 percent versus an average Core Earnings spread of 1.26 percent for FFELP loans, excluding the impact of the Wholesale Consolidation portfolio.

Our largest Private Education Loan program is the Signature Loan®, which is offered to undergraduates and graduates through the financial aid offices of colleges and universities and packaged with traditional

Table of Contents

FFELP loans. We also offer specialized loan products to graduate and professional students primarily through our MBALoans®, LAWLOANS® and MEDLOANS^{sm} programs. Generally, these loans do not require borrowers to begin repaying their loans until after graduation and allow a grace period from six to nine months.

In the third quarter of 2004 we began to offer Tuition Answer^{sm} loans directly to the consumer through targeted direct mail campaigns and web-based initiatives. Under the Tuition Answer loan program, creditworthy parents, sponsors and students may borrow between $1,500 and $40,000 per year to cover any college-related expense. No school certification is required, although a borrower must provide enrollment documentation. At December 31, 2006, we had $1.9 billion of Tuition Answer loans outstanding.

We also offer alternative Private Education Loans for information technology, cosmetology, mechanics, medical/dental/lab, culinary and broadcasting. On average, these career training programs typically last fewer than 12 months. Generally, these loans require the borrower to begin repaying the loan immediately; however, students can opt to make relatively small payments while enrolled. At December 31, 2006, we had $2.3 billion of career training loans outstanding.

Acquisitions

We have acquired several companies in the student loan industry that have increased our sales and marketing capabilities, added significant new brands and greatly enhanced our product offerings. The following table provides a timeline of strategic acquisitions that have played a major role in the growth of our Lending business.

Sallie Mae Timeline   Student Lending

Financing

We fund our operations through the issuance of student loan asset-backed securities (securitizations) and unsecured debt securities. We issue these securities in both the domestic and overseas capital markets using both public offerings and private placements. The major objective when financing our business is to find low cost financing that also minimizes interest rate risk by matching the interest rate and reset characteristics of our Managed assets and liabilities, generally on a pooled basis, to the extent practicable. As part of this process, we use derivative financial instruments extensively to reduce our interest rate and foreign currency exposure. This helps in stabilizing our student loan spread in various interest rate environments. We are always looking for ways to minimize funding costs and to provide liquidity for our student loan acquisitions. To that end, we are continually expanding and diversifying our pool of investors by establishing debt programs in multiple markets that appeal to varied investor bases and by educating potential investors about our business. Finally, we take appropriate steps to ensure sufficient liquidity by financing in multiple markets, which include the institutional, retail, floating-rate, fixed-rate, unsecured, asset-backed, domestic and international markets.

Table of Contents

Securitization is currently and is likely to continue to be our principal source of financing. We expect approximately 75 percent of our funding needs in 2007 will be satisfied by securitizing our loan assets and issuing asset-backed securities.

Sallie Mae Bank

On November 3, 2005, we announced that the Utah Department of Financial Institutions approved our application for an industrial bank charter. Beginning in February and August 2006, Sallie Mae Bank began funding and originating Private Education Loans and FFELP Consolidation Loans, respectively, made by Sallie Mae to students and families nationwide. This allows us to capture the full economics of these loans from origination. In addition, the industrial bank charter allows us to expand the products and services we can offer to students and families. In addition to using Sallie Mae Bank to fund and originate Private Education Loans, we expect to continue to originate a significant portion of our Private Education Loans through our strategic lending partners. In addition, we have deposited custodial funds from AMS and Upromise in Sallie Mae Bank. These funds are used for low cost financing for Sallie Mae Bank.

Competition

Our primary competitor for federally guaranteed student loans is the FDLP, which in its first four years of existence (FFYs 1994-1997) grew market share from four percent in FFY 1994 to a peak of 34 percent in FFY 1997, but has steadily declined since then to a 21 percent market share in FFY 2006 for the total federally sponsored student loan market. We also face competition for both federally guaranteed and non-guaranteed student loans from a variety of financial institutions including banks, thrifts and state-supported secondary markets. In addition, we face competition for FFELP Consolidation Loans from a number of direct-to-consumer firms that entered the market for FFELP Consolidation Loans over the past few years in response to the increased borrower demand for FFELP Consolidation Loans and low barriers to entry (see Risk Factors GENERAL). Our FFY 2006 FFELP Preferred Channel Originations totaled $16 billion, representing a 27 percent market share.

In November 2005, we launched a zero-fee pricing initiative on all FFELP Stafford Loans on a trial basis. For AY 2006-2007 we expanded this competitive initiative nationwide, such that we pay the federally mandated two percent origination fee on behalf of the borrower. While the goal of this pricing initiative is to grow our FFELP loan volume, this strategy will reduce our margins on the affected student loans until the origination fee is completely eliminated by legislation in 2010.

DEBT MANAGEMENT OPERATIONS BUSINESS SEGMENT

We have used strategic acquisitions to build our DMO business and now have six operating units that comprise our DMO business segment. In our DMO segment, we provide a wide range of accounts receivable and collections services including student loan default aversion services, defaulted student loan portfolio management services, contingency collections services for student loans and other asset classes, primarily a contingency or pay for performance business. We also provide accounts receivable management and collections services on consumer and mortgage receivable portfolios that we purchase. The table below presents a timeline of key acquisitions that have fueled the growth of our DMO business.

In recent years we have diversified our DMO contingency revenue stream away from student loans into the purchase of distressed and defaulted receivables marketplace. We now have the expertise to acquire and manage portfolios of sub-performing and non-performing mortgage loans, substantially all of which are secured by one-to-four family residential real estate. We also have a servicing platform and a disciplined portfolio pricing approach to several

consumer debt asset classes. We are now in the position to offer the purchase of distressed or defaulted debt to our partner schools as an additional method of enhancing their receivables management strategies. The diversification into purchased paper has lowered student loan contingency fees to 48 percent of total DMO revenue in 2006, versus 75 percent in 2004.

Table of Contents

Sallie Mae Timeline   DMO

In 2006, our DMO business segment had revenues totaling $636 million and net income of $157 million, which represented increases of 21 percent and 16 percent over 2005, respectively. Our largest customer, USA Funds, accounted for 32 percent of our revenue in 2006.

Products and Services

Student Loan Default Aversion Services

We provide default aversion services for five guarantors, including the nation s largest, USA Funds. These services are designed to prevent a default once a borrower s loan has been placed in delinquency status.

Defaulted Student Loan Portfolio Management Services

Our DMO business segment manages the defaulted student loan portfolios for six guarantors under long-term contracts. DMO s largest customer, USA Funds, represents approximately 17 percent of defaulted student loan portfolios in the market. Our portfolio management services include selecting collection agencies and determining account placements to those agencies, processing loan consolidations and loan rehabilitations, and managing federal and state offset programs.

Contingency Collection Services

Our DMO business segment is also engaged in the collection of defaulted student loans and other debt on behalf of various clients including guarantors, federal agencies, credit card issuers, utilities, and other retail clients. We earn fees that are contingent on the amounts collected. We also provide collection services for ED and now have approximately 11 percent of the total market for such services. We also have relationships with more than 900 colleges and universities to provide collection services for delinquent student loans and other receivables from various campus-based programs.

Collection of Purchased Receivables

In our DMO business, we also purchase delinquent and defaulted receivables from credit originators and other holders of receivables at a significant discount from the face value of the debt instruments. In addition, we purchase sub-performing and non-performing mortgage receivables at a discount usually calculated as a percentage of the underlying collateral. We use a combination of internal collectors and outside collection agencies to collect on these portfolios, seeking to attain the highest cost/benefit for our overall collection strategy. We recognize revenue primarily using the effective yield method, though we do use the cost recovery method when appropriate, primarily in the mortgage receivable business. A major success factor in the purchased receivables business is the ability to effectively price the portfolios. We conduct both quantitative and qualitative analysis to appropriately price each portfolio to yield a return consistent with our DMO financial targets.

Competition

The private sector collections industry is highly fragmented with few large companies and a large number of small scale companies. The DMO businesses that provide third party collections services for ED, FFELP guarantors and other federal holders of defaulted debt are highly competitive. In addition to competing with other collection enterprises, we also compete with credit grantors who each have unique mixes of internal collections, outsourced collections, and debt sales. Although the scale, diversification, and performance of our DMO business has been a competitive advantage, the trend in the collections industry is for credit grantors to sell portfolios rather than to manage contingency collections.

In the purchased paper business, the marketplace is trending more toward open market competitive bidding rather than solicitation by sellers to a select group of potential buyers. Price inflation and the availability of capital in the sector contribute to this trend. Unlike many of our competitors, our DMO business does not rely solely on purchased portfolio revenue. This enables us to maintain pricing discipline and purchase only those portfolios that are expected to meet our profitability and strategic goals. Portfolios are purchased individually on a spot basis or through contractual relationships with sellers to periodically purchase portfolios at set prices. We compete primarily on price, but also on the basis of our reputation, industry experience and relationships.

CORPORATE AND OTHER BUSINESS SEGMENT

Guarantor Services

We earn fees for providing a full complement of administrative services to FFELP guarantors. FFELP student loans are guaranteed by these agencies, with ED providing reinsurance to the guarantor. The guarantors are non-profit institutions or state agencies that, in addition to providing the primary guarantee on FFELP loans, are responsible for other activities including:

- guarantee issuance   the initial approval of loan terms and guarantee eligibility;
- account maintenance   maintaining and updating of records on guaranteed loans; and
- guarantee fulfillment   review and processing of guarantee claims.

Currently, we provide a variety of these services to nine guarantors and, in AY 2005-2006, we processed $15.1 billion in new FFELP loan guarantees, of which $11.6 billion was for USA Funds, the nation s largest guarantor. We processed guarantees for approximately 29 percent of the FFELP loan market in AY 2005-2006.

Guarantor servicing fee revenue, which included guarantee issuance and account maintenance fees, was $132 million for the year ended December 31, 2006, 83 percent of which we earned from services performed on behalf of USA Funds. Under some of our guarantee services agreements, including our agreement with USA Funds, we receive certain scheduled fees for the services that we provide under such agreements. The payment for these services includes a contractually agreed upon set percentage of the account maintenance fees that the guarantors receive from ED.

Our primary non-profit competitors in guarantor servicing are state and non-profit guarantee agencies that provide third party outsourcing to other guarantors.

(See APPENDIX A, FEDERAL FAMILY EDUCATION LOAN PROGRAM Guarantor Funding for details of the fees paid to guarantors.)

Acquisitions

On August 22, 2006, the Company completed the acquisition of Upromise. Upromise s popular rewards service one of the largest rewards marketing coalitions in the U.S. has more than seven million members who have joined Upromise to save for college when they and their families buy gas or groceries, dine out, or purchase other goods and services from more than 450 participating companies. Upromise s subsidiary, Upromise Investments, Inc., is also the largest administrator of direct-to-consumer 529 college savings plans, administering approximately 1.2 million college savings accounts and over $15 billion in assets with tax-

advantaged 529 investment options through partnerships with nine states. Upromise offers its rewards service members the opportunity to link their Upromise account to a participating 529 plan so that their savings can be transferred automatically into their plan on a periodic basis.

This acquisition broadens our scope in higher education access to include education savings and enhances our competitive advantage in the student loan industry as the Company builds a relationship with potential borrowers earlier. The savings earned through Upromise are in addition to other lender-sponsored savings programs that may include zero origination fees, zero default fee and various repayment status borrower benefit programs.

REGULATION

Like other participants in the FFELP program, the Company is subject to the HEA and, from time to time, to review of its student loan operations by ED and guarantee agencies. ED is authorized under its regulations to limit, suspend or terminate lenders from participating in the FFELP, as well as impose civil penalties if lenders violate program regulations. The laws relating to the FFELP program are subject to revision. In addition, Sallie Mae, Inc., as a servicer of federal student loans, is subject to certain ED regulations regarding financial responsibility and administrative capability that govern all third party servicers of insured student loans. Failure to satisfy such standards may result in the loss of the government guarantee of the payment of principal and accrued interest on defaulted FFELP loans. Also, in connection with our guarantor servicing operations, the Company must comply with, on behalf of its guarantor servicing customers, certain ED regulations that govern guarantor activities as well as agreements for reimbursement between the Secretary of Education and the Company s guarantor servicing customers. Failure to comply with these regulations or the provisions of these agreements may result in the termination of the Secretary of Education s reimbursement obligation.

The Company s originating or servicing of federal and private student loans also subjects it to federal and state consumer protection, privacy and related laws and regulations. Some of the more significant federal laws and regulations that are applicable to our student loan business include:

- the Truth-In-Lending Act;
- the Fair Credit Reporting Act;
- the Equal Credit Opportunity Act;
- the Gramm-Leach Bliley Act; and
- the U.S. Bankruptcy Code.

Our DMO s debt collection and receivables management activities are subject to federal and state consumer protection, privacy and related laws and regulations. Some of the more significant federal laws and regulations that are applicable to our DMO business include:

- the Fair Debt Collection Practices Act;
- the Fair Credit Reporting Act;
- the Gramm-Leach-Bliley Act; and
- the U.S. Bankruptcy Code.

In addition, our DMO business is subject to state laws and regulations similar to the federal laws and regulations listed above. Finally, certain DMO subsidiaries are subject to regulation under the HEA and under the various laws and regulations that govern government contractors.

Sallie Mae Bank is subject to Utah banking regulations as well as regulations issued by the Federal Deposit Insurance Corporation.

Finally, Upromise s affiliates, which administer 529 college savings plans, are subject to regulation by the Municipal Securities Rulemaking Board, the National Association of Securities Dealers, Inc. and the Securities and Exchange Commission (SEC) through the Investment Advisers Act of 1940.

AVAILABLE INFORMATION

The SEC maintains an Internet site (http://www.sec.gov) that contains periodic and other reports such as annual, quarterly and current reports on Forms 10-K, 10-Q and 8-K, respectively, as well as proxy and information statements regarding SLM Corporation and other companies that file electronically with the SEC. Copies of our annual reports on Form 10-K and our quarterly reports on Form 10-Q are available on our website as soon as reasonably practicable after we electronically file such reports with the SEC. Investors and other interested parties can also access these reports at www.salliemae.com about/investors.

Our Code of Business Conduct, which applies to Board members and all employees, including our Chief Executive Officer and Chief Financial Officer, is also available, free of charge, on our website at www.salliemae.com/about/business_code.htm. We intend to disclose any amendments to or waivers from our Code of Business Conduct (to the extent applicable to our Chief Executive Officer or Chief Financial Officer) by posting such information on our website.

In 2006, the Company submitted the annual certification of its Chief Executive Officer regarding the Company s compliance with the NYSE s corporate governance listing standards, pursuant to Section 303A.12(a) of the NYSE Listed Company Manual.

In addition, we filed as exhibits to the Company s Annual Report on Form 10-K for the year ended December 31, 2005 and to this Annual Report on Form 10-K, the certifications required under Section 302 of the Sarbanes-Oxley Act of 2002.

Table of Contents

Item 1A. Risk Factors

LENDING BUSINESS SEGMENT FFELP STUDENT LOANS

A larger than expected increase in third party consolidation activity may reduce our FFELP student loan spread, materially impair our Retained Interest, reduce our interest earning assets and otherwise materially adversely affect our results of operations.

If third party consolidation activity increases beyond management s expectations, our FFELP student loan spread may be adversely affected; our Retained Interest may be materially impaired; our future earnings may be reduced from the loss of interest earning assets; and our results of operations may be adversely affected. Our FFELP student loan spread may be adversely affected because third party consolidators generally target our highest yielding FFELP Consolidation Loans. Our Retained Interest may be materially impaired if consolidation activity reaches levels not anticipated by management. We may also incur impairment charges if we increase our expected future Constant Prepayment Rate (CPR) assumptions used to value the Residual Interest as a result of such unanticipated levels of consolidation. The potentially material adverse affect on our operating results relates principally to our hedging activities in connection with Floor Income. We enter into certain Floor Income Contracts under which we receive an upfront fee in exchange for our payment of the Floor Income earned on a notional amount of underlying FFELP Consolidation Loans over the life of the Floor Income Contract. If third party consolidation activity that involves refinancing an existing FFELP Consolidation Loan with a new FFELP Consolidation Loan increases substantially, then the Floor Income that we are obligated to pay under such Floor Income Contracts may exceed the Floor Income actually generated from the underlying FFELP Consolidation Loans, possibly to a material extent. In such a scenario, we would either close out the related Floor Income Contracts or purchase an offsetting hedge. In either case, the adverse impact on both our GAAP and Core Earnings could be material. (See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS LENDING BUSINESS SEGMENT *Floor Income Managed Basis.*)

Incorrect estimates and assumptions by management in connection with the preparation of our consolidated financial statements could adversely affect the reported amounts of assets and liabilities and the reported amounts of income and expenses.

The preparation of our consolidated financial statements requires management to make certain critical accounting estimates and assumptions that could affect the reported amounts of assets and liabilities and the reported amounts of income and expense during the reporting periods. (See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS CRITICAL ACCOUNTING POLICIES AND ESTIMATES.) For example, for both our federally insured and Private Education Loans, the unamortized portion of the premiums and the discounts is included in the carrying value of the student loan on the consolidated balance sheet. We recognize income on our student loan portfolio based on the expected yield of the student loan after giving effect to the amortization of purchase premiums and accretion of student loan income discounts, as well as the impact of Borrower Benefits. In arriving at the expected yield, we must make a number of estimates that when changed must be reflected as a cumulative student loan catch-up from the inception of the student loan. The most sensitive estimate for premium and discount amortization is the estimate of the CPR, which measures the rate at which loans in the portfolio pay before their stated maturity. The CPR is used in calculating the average life of the portfolio. A number of factors can affect the CPR estimate such as the rate of consolidation activity and default rates. If we make an incorrect CPR estimate, the previously recognized income on our student loan portfolio based on the expected yield of the student loan will need to be adjusted in the current period.

In addition, the impact of our Borrower Benefits programs, which provide incentives to borrowers to make timely payments on their loans by allowing for reductions in future interest rates as well as rebates on outstanding balances, is dependent on the number of borrowers who will eventually qualify for these benefits. The incentives are offered to attract new borrowers and to improve our borrowers payment behavior. For example, we offer borrowers an incentive program that reduces their interest rate by a specified percentage per year or reduces their loan balance after they have made a specified initial number of scheduled payments on

time and for so long as they continue to make subsequent scheduled payments on time. We regularly estimate the qualification rates for Borrower Benefits programs and book a level yield adjustment based upon that estimate. If our estimate of the qualification rates is lower than the actual rates, both the yield on our student loan portfolio and our net interest income will be lower than estimated and a cumulative adjustment will be made to reduce income, possibly to a material extent. Such an underestimation may also adversely affect the value of our Retained Interest because one of the assumptions made in assessing its value is the amount of Borrower Benefits expected to be earned by borrowers. Finally, we continue to look at new ways to attract new borrowers and to improve our borrowers payment behavior. These efforts as well as the actions of competing lenders may lead to the addition or modification of Borrower Benefits programs.

LENDING BUSINESS SEGMENT PRIVATE EDUCATION LOANS

Changes in the composition of our Managed student loan portfolio will increase the risk profile of our asset base and our capital requirements.

As of December 31, 2006, 16 percent of our Managed student loans were Private Education Loans. Private Education Loans are unsecured and are not guaranteed or reinsured under the FFELP or any other federal student loan program and are not insured by any private insurance program. Accordingly, we bear the full risk of loss on most of these loans if the borrower and co-borrower, if applicable, default. Events beyond our control such as a prolonged economic downturn could make it difficult for Private Education Loan borrowers to meet their payment obligations for a variety of reasons, including job loss and underemployment, which could lead to higher levels of delinquencies and defaults. Private Education Loans now account for 23 percent of our Core Earnings net interest income after provisions and 16 percent of our Managed student loan portfolio. We expect that Private Education Loans will become an increasingly higher percentage of both our margin and our Managed student loan portfolio, which will increase the risk profile of our asset base and raise our capital requirements because Private Education Loans have significantly higher capital requirements than FFELP loans. This may affect the availability of capital for other purposes. In addition, the comparatively larger spreads on Private Education Loans, which historically have compensated for the narrowing FFELP spreads, may narrow as competition increases.

As a component of our Private Education Loan program, we make available various tailored loan programs to numerous schools that are designed to help finance the education of students who are academically qualified but do not meet our standard credit criteria. Depending upon the loan program, schools share some portion of the risk of default. However, if the school experiences financial difficulty, we could bear the full risk of default. Management has taken specific steps to manage strategically the growth of its non-standard loan programs, instituted credit education programs to educate borrowers on how to improve their credit and shifted the focus to programs that are structured so that the Company will not bear the risk of a school s bankruptcy. However, there can be no assurance that the Company s non-standard student loan programs will not have an adverse effect on the overall credit quality of the Company s Managed Private Education Loan portfolio.

Past charge-off rates on our Private Education Loans may not be indicative of future charge-off rates because, among other things, we use forbearance policies and our failure to adequately predict and reserve for charge-offs may adversely impact our results of operations.

We have established forbearance policies for our Private Education Loans under which we provide to the borrower temporary relief from payment of principal or interest in exchange for a processing fee paid by the borrower, which is waived under certain circumstances. During the forbearance period, generally granted in three-month increments, interest that the borrower otherwise would have paid is typically capitalized at the end of the forbearance term. At December 31, 2006, approximately nine percent of our Managed Private Education Loans in repayment and forbearance were in forbearance. Forbearance is used most heavily when the borrower s loan enters repayment;

however, borrowers may apply for forbearance multiple times and a significant number of Private Education Loan borrowers have taken advantage of this option. When a borrower ends forbearance and enters repayment, the account is considered current. Accordingly, a borrower who may have been delinquent in his payments or may not have made any recent payments on his account will be

accounted for as a borrower in a current repayment status when the borrower exits the forbearance period. In addition, past charge-off rates on our Private Education Loans may not be indicative of future charge-off rates because of, among other things, the use of forbearance and the effect of future changes to the forbearance policies. If our forbearance policies prove over time to be less effective on cash collections than we expect or if we limit the circumstances under which forbearance may be granted under our forbearance policies, they could have a material adverse effect on the amount of future charge-offs and the ultimate default rate used to calculate loan loss reserves which could have a material adverse effect on our results of operations. (See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS LENDING BUSINESS SEGMENT Total Loan Net Charge-offs.)

In addition, our loss estimates include losses to be incurred generally over a two-year loss emergence period. The two-year estimate of the allowance for loan losses is subject to a number of assumptions about future borrower behavior that may prove incorrect. For example, we use a migration analysis of historical charge-off experience and combine that with qualitative measures to project future trends. However, future charge-off rates can be higher than anticipated due to a variety of factors such as downturns in the economy, regulatory or operational changes in debt management operations effectiveness, and other unforeseeable future trends. If actual future performance in charge-offs and delinquency is worse than estimated, this could materially affect our estimate of the allowance for loan losses and the related provision for loan losses on our income statement.

DEBT MANAGEMENT OPERATIONS BUSINESS SEGMENT

Our growth in our DMO business segment is dependent in part on successfully identifying, consummating and integrating strategic acquisitions.

Since 2000, we have acquired five companies that are now successfully integrated within our Debt Management Operations group. Each of these acquisitions has contributed to DMO s substantial growth. Future growth in the DMO business segment is dependent in part on successfully identifying, consummating and integrating strategic acquisitions. There can be no assurance that we will be successful in doing so. In addition, certain of these acquisitions have expanded our operations into businesses and asset classes that pose substantially more business and litigation risks than our core FFELP student loan business. For example, on September 16, 2004, we acquired a 64 percent (now 88 percent) interest in AFS Holdings, LLC, commonly known as Arrow Financial Services, a company that, among other services, purchases non-performing receivables. In addition, on August 31, 2005, we purchased GRP, a company that purchases distressed mortgage receivables. While both companies purchase such assets at a discount and have sophisticated analytical and operational tools to price and collect on portfolio purchases, there can be no assurance that the price paid for defaulted portfolios will yield adequate returns, or that other factors beyond their control will not have a material adverse affect on their results of operations. Portfolio performance below original projections could result in impairments to the purchased portfolio assets. In addition, these businesses are subject to litigation risk under the Fair Debt Collection Practices Act, Fair Credit Reporting Act and various other federal, state and local laws in the normal course from private plaintiffs as well as federal and state regulatory authorities. Finally, we may explore additional business opportunities that may pose further or new risks.

Our DMO business segment may not be able to purchase defaulted consumer receivables at prices that management believes to be appropriate, and a decrease in our ability to purchase portfolios of receivables could adversely affect our net income.

If our DMO business segment is not able to purchase defaulted consumer receivables at planned levels and at prices that management believes to be appropriate, we could experience short-term and long-term decreases in income.

Table of Contents

The availability of receivables portfolios at prices which generate an appropriate return on our investment depends on a number of factors both within and outside of our control, including the following:

the continuation of current growth trends in the levels of consumer obligations;

sales of receivables portfolios by debt owners;

competitive factors affecting potential purchasers and credit originators of receivables; and

the ability to continue to service portfolios to yield an adequate return.

Because of the length of time involved in collecting defaulted consumer receivables on acquired portfolios and the volatility in the timing of our collections, we may not be able to identify trends and make changes in our purchasing strategies in a timely manner.

LIQUIDITY AND CAPITAL RESOURCES

If our stock price falls significantly, we may be required to settle our equity forward positions in a manner that could have a materially dilutive effect on our common stock.

We repurchase our common stock through both open market purchases and equity forward contracts. At December 31, 2006, we had outstanding equity forward contracts to purchase 48.2 million shares of our common stock at prices ranging from $46.30 to $54.74 per share. The equity forward contracts permit the counterparty to terminate a portion of the equity forward contract if the common stock price falls below an initial trigger price and the counterparty can continue to terminate portions of the contract as the stock price reaches lower predetermined levels, until the stock price reaches the final trigger price whereby the entire contract can be terminated. The final trigger price is generally 50 percent of the strike price. For equity forward contracts in effect as of December 31, 2006, the initial trigger price ranged from approximately $25.93 to $35.58 and the final trigger price ranged from $20.84 to $27.37. In February 2007, the Company amended equity forward contracts with several counterparties under which the trigger prices were reduced. As of February 28, 2007, the highest trigger price on all outstanding equity forwards is $30.11. If the counterparty terminates a portion of the contract or the entire contract, we can satisfy any shortfall by paying cash or delivering common stock. If we issue common stock to settle the contracts in such circumstances, it could have a materially dilutive effect on our common stock. See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS COMMON STOCK.

We are exposed to interest rate risk in the form of basis risk and repricing risk because the interest rate characteristics of our earning assets do not always match exactly the interest rate characteristics of the funding.

Depending on economic and other factors, we may fund our assets with debt that has a different index and/or reset frequency than the asset, but generally only where we believe there is a high degree of correlation between the interest rate movement of the two indices. For example, we use daily reset 3-month LIBOR to fund a large portion of our daily reset 3-month commercial paper indexed assets. We also use different index types and index reset frequencies to fund various other assets. In using different index types and different index reset frequencies to fund our assets, we are exposed to interest rate risk in the form of basis risk and repricing risk, which is the risk that the different indices may reset at different frequencies, or will not move in the same direction or with the same magnitude. While these indices are short-term with rate movements that are highly correlated over a long period of time, there can be no assurance that this high correlation will not be disrupted by capital market dislocations or other factors not within our control. In such circumstances, our earnings could be adversely affected, possibly to a material extent.

We may face limited availability of financing, variation in our funding costs and uncertainty in our securitization financing.

In general, the amount, type and cost of our funding, including securitization and unsecured financing from the capital markets and borrowings from financial institutions, have a direct impact on our operating expenses and financial results and can limit our ability to grow our assets.

A number of factors could make such securitization and unsecured financing more difficult, more expensive or unavailable on any terms both domestically and internationally (where funding transactions may be on terms more or less favorable than in the United States), including, but not limited to, financial results and losses, changes within our organization, specific events that have an adverse impact on our reputation, changes in the activities of our business partners, disruptions in the capital markets, specific events that have an adverse impact on the financial services industry, counter-party availability, changes affecting our assets, our corporate and regulatory structure, interest rate fluctuations, ratings agencies actions, general economic conditions and the legal, regulatory, accounting and tax environments governing our funding transactions. In addition, our ability to raise funds is strongly affected by the general state of the U.S. and world economies, and may become increasingly difficult due to economic and other factors. Finally, we compete for funding with other industry participants, some of which are publicly traded. Competition from these institutions may increase our cost of funds.

We are dependent on the securitization markets for the long-term financing of student loans, which we expect to provide approximately 75 percent of our funding needs in 2007. If this market were to experience difficulties, if our asset quality were to deteriorate or if our debt ratings were to be downgraded, we may be unable to securitize our student loans or to do so on favorable terms, including pricing. If we were unable to continue to securitize our student loans at current levels or on favorable terms, we would use alternative funding sources to fund increases in student loans and meet our other liquidity needs. If we were unable to find cost-effective and stable funding alternatives, our funding capabilities and liquidity would be negatively impacted and our cost of funds could increase, adversely affecting our results of operations, and our ability to grow would be limited.

In addition, the occurrence of certain events such as consolidations and reconsolidations may cause the securitization transactions to amortize earlier than scheduled, which could accelerate the need for additional funding to the extent that we effected the refinancing.

The rating agencies could downgrade the ratings on our senior unsecured debt, which could increase our cost of funds.

Securitizations are the primary source of our long-term financing and liquidity. Our ability to access the securitization market and the ratings on our asset-backed securities are not directly or fully dependent upon the Company s general corporate credit ratings. However, the Company also utilizes senior unsecured long-term and short-term debt, which is dependent upon rating agency scoring. Our senior unsecured long-term debt is currently rated A2, A and A+ and senior unsecured short-term debt is currently rated P-1, A-1 and F1+ by Moody s Investors Service, Inc., Standard and Poor s Ratings Services, a division of The McGraw-Hill Companies, Inc., and Fitch Ratings, respectively. If any or all of these ratings were downgraded of if they were put on watch with negative implications for any reason, our overall cost of funds could increase.

GENERAL

Our business is subject to a number of risks, uncertainties and conditions, some of which are not within our control, including general economic conditions, increased competition, adverse changes in the laws and

regulations that govern our businesses and failure to successfully identify, consummate and integrate strategic acquisitions.

Our business is subject to a number of risks, uncertainties and conditions, some of which we cannot control. For example, if the U.S. economy were to sustain a prolonged economic downturn a number of our businesses including our fastest growing businesses, Private Education Loan business and Debt Management

Operations could be adversely affected. We bear the full risk of loss on our portfolio of Private Education Loans. A prolonged economic downturn could make it difficult for borrowers to meet their payment obligations for a variety of reasons, including job loss and underemployment. In addition, a prolonged economic downturn could extend the amortization period on DMO s purchased receivables.

We face strong competition in all of our businesses, particularly in our FFELP business. For example, a number of direct-to-consumer firms entered the market for FFELP Consolidation Loans in recent years in response to increased borrower demand and low barriers to entry. There can also be no assurance that significantly more such firms will not enter the market for FFELP Consolidation Loans, which could result in higher than expected prepayments on our FFELP loan portfolio. (See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS LENDING BUSINESS SEGMENT *Trends in the Lending Business Segment.*) Such prepayments would adversely impact our earnings. We also expect to see more competition in our Private Education Loan business. The strong margins that we currently maintain in this growing business that offset some of the margin erosion that we have experienced in our FFELP business may begin to weaken as more competitors offer competing products. If these competitive trends intensify, we could face further margin pressure.

Because we earn our revenues from federally insured loans under a federally sponsored loan program, we are subject to political and regulatory risk. As part of the HEA, the student loan program is periodically amended and must be reauthorized every six years. Past legislative changes included reduced loan yields paid to lenders (1986, 1992, 1995 and 1998), increased fees paid by lenders (1993), decreased level of the government guaranty (1993) and reduced fees to guarantors and collectors, among others. On February 8, 2006, the President signed the Reconciliation Legislation. The Reconciliation Legislation contains a number of provisions that over time will reduce our earnings on FFELP student loans, including a requirement that lenders rebate Floor Income on new loans and a reduction in lender reinsurance. In addition, since January 1, 2007, several bills have been introduced in both houses of Congress that would be, if enacted in their current forms, materially adverse to the profitability of the FFELP industry and create incentives for post-secondary schools to participate in the FDLP rather than the FFELP. The President s 2008 budget proposals also call for, among other things, a 50 basis point cut in special allowance payments. Finally, there can be no assurances that future reauthorizations and other political developments will not result in changes that have a materially adverse impact on the Company. (For further discussion see MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS RECENT DEVELOPMENTS .)

Our principal business is comprised of acquiring, originating, holding and servicing education loans made and guaranteed under the FFELP. Most significant aspects of our principal business are governed by the HEA. We must also meet various requirements of the guaranty agencies, which are private not-for-profit organizations or state agencies that have entered into federal reinsurance contracts with ED, to maintain the federal guarantee on our FFELP loans. These requirements establish origination and servicing requirements, procedural guidelines and school and borrower eligibility criteria. The federal guarantee of FFELP loans is conditioned on loans being originated, disbursed or serviced in accordance with ED regulations.

If we fail to comply with any of the above requirements, we could incur penalties or lose the federal guarantee on some or all of our FFELP loans. In addition, our marketing practices are subject to the HEA s prohibited inducement provision and our failure to comply with such regulation could subject us to a limitation, suspension or termination of our eligible lender status. Even if we comply with the above requirements, a failure to comply by third parties with whom we conduct business could result in us incurring penalties or losing the federal guarantee on some or all of our FFELP loans. If we experience a high rate of servicing deficiencies, we could incur costs associated with remedial servicing, and, if we are unsuccessful in curing such deficiencies, the eventual losses on the loans that are not cured could be material. Failure to comply with these laws and regulations could result in our liability to borrowers and potential class action suits, all of which could adversely affect our future growth rates. An additional consequence of servicing deficiencies would be the loss of our Exceptional Performer Designation.

25

Because of the risks, uncertainties and conditions described above, there can be no assurance that we can maintain our future growth rates at rates consistent with our historic growth rates.

Our GAAP earnings are highly susceptible to changes in interest rates because most of our derivatives do not qualify for hedge accounting treatment under SFAS No. 133.

Changes in interest rates can cause volatility in our GAAP earnings as a result of changes in the market value of our derivatives that do not qualify for hedge accounting treatment under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. Under SFAS No. 133, changes in derivative market values are recognized immediately in earnings. If a derivative instrument does not qualify for hedge accounting treatment under SFAS No. 133, there is no corresponding change in the fair value of the hedged item recognized in earnings. As a result, gain or loss recognized on a derivative will not be offset by a corresponding gain or loss on the underlying hedged item. Because most of our derivatives do not qualify for hedge accounting treatment, when interest rates change significantly, our GAAP earnings may fluctuate significantly.

For a discussion of operational, market and interest rate, and liquidity risks, see MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS RISKS.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The following table lists the principal facilities owned by the Company:

Location	**Function**	**Approximate Square Feet**
Reston, VA	Headquarters	240,000
Fishers, IN	Loan Servicing and Data Center	450,000
Wilkes Barre, PA	Loan Servicing Center	133,000
Killeen, TX	Loan Servicing Center	133,000
Lynn Haven, FL	Loan Servicing Center	133,000
Indianapolis, IN	Loan Servicing Center	100,000
Marianna, FL[1]	Back-up/Disaster Recovery Facility for Loan Servicing	94,000
Big Flats, NY	Debt Management and Collections Center	60,000
Gilbert, AZ	Southwest Student Services Headquarters	60,000
Arcade, NY[2]	Debt Management and Collections Center	46,000
Perry, NY[2]	Debt Management and Collections Center	45,000
Swansea, MA	AMS Headquarters	36,000

(1) Facility listed for sale in October 2006.

(2) In the first quarter of 2003, the Company entered into a ten year lease with the Wyoming County Industrial Development Authority with a right of reversion to the Company for the Arcade and Perry, New York

facilities.

In December 2003, the Company sold its prior Reston, Virginia headquarters and leased approximately 229,000 square feet of that building from the purchaser through August 31, 2004. The Company completed the construction of a new headquarters building in Reston, Virginia in August 2004 that has approximately 240,000 square feet of space. All Reston-based employees were moved into the new headquarters in August 2004.

Table of Contents

The following table lists the principal facilities leased by the Company as of December 31, 2006:

Location	Function	Approximate Square Feet
Niles, IL	AFS Headquarters	84,000
Summerlin, Nevada	Debt Management and Collections Center	71,000
Cincinnati, Ohio	GRC Headquarters and Debt Management and Collections Center	59,000
Muncie, IN	SLM DMO	54,000
Needham, MA	Upromise	49,000
Mt. Laurel, New Jersey	SLM Financial Headquarters and Operations	42,000
Novi, MI	Sallie Mae Home Loans	37,000
Seattle, WA	NELA	32,000
Moorestown, NJ	Pioneer Credit Recovery	30,000
Braintree, MA	Nellie Mae Headquarters	27,000
Whitewater, WI	AFS Operations	16,000
Centennial, CO	Noel-Levitz	16,000
White Plains, NY	GRP	15,400
West Valley, NY	Pioneer Credit Recovery	14,000
Batavia, NY	Pioneer Credit Recovery	13,000
Iowa City, IA	Noel-Levitz	13,000
Perry, NY	Pioneer Credit Recovery	12,000
Gainesville, FL	SLMLSC	11,000
Phoenix, AZ	Sallie Mae Home Loans	9,000
Cincinnati, OH	Student Loan Funding	9,000
Burlington, MA	Sallie Mae Home Loans	8,000
Washington, D.C.	Government Relations	5,000

None of the Company s facilities is encumbered by a mortgage. The Company believes that its headquarters, loan servicing centers data center, back-up facility and data management and collections centers are generally adequate to meet its long-term student loan and new business goals. The Company s principal office is currently in owned space at 12061 Bluemont Way, Reston, Virginia, 20190.

Item 3. Legal Proceedings

On January 25, 2007, the Attorney General of Illinois filed a lawsuit against one of the Company s subsidiaries, Arrow Financial Services, LLC (AFS), in the Circuit Court of Cook County, Illinois alleging that AFS violated the Illinois Consumer Fraud and Deceptive Practices Act and the federal Fair Debt Collections Practices Act. The lawsuit seeks to enjoin AFS from violating the Illinois Consumer Fraud and Deceptive Practices Act and from engaging in debt management and collection services in or from the State of Illinois. The lawsuit also seeks to rescind certain agreements to pay back debt between AFS and Illinois consumers, to pay restitution to all consumers who have been harmed by AFS s alleged unlawful practices, to impose a statutory civil penalty of $50,000 and to impose a civil penalty of $50,000 per violation ($60,000 per violation if the consumer is 65 years of age or older). The lawsuit alleges that as of January 25, 2007, 660 complaints against Arrow Financial have been filed with the Office of the Illinois Attorney General since 1999 and over 800 complaints have been filed with the Better Business Bureau. As of December 29, 2006, the Company owns 88 percent of the membership interests in AFS Holdings, LLC, the parent

company of AFS. Management cannot predict the outcome of this lawsuit or its effect on the Company s financial position or results of operations.

On December 28, 2006, the Company received an informal request for information and documents from New York s Office of the Attorney General concerning schools use of preferred lender lists for either FFELP

or Private Education Loans and the Company s marketing practices as they relate to preferred lender lists. The New York Attorney General s Office has also requested information from other lenders and schools that participate in the FFELP and FDLP. The Company is cooperating with the New York Attorney General s Office in order to provide information and documents responsive to their request. Management cannot predict the outcome of this request or its effect on the Company s financial position or results of operations.

We are also subject to various claims, lawsuits and other actions that arise in the normal course of business. Most of these matters are claims by borrowers disputing the manner in which their loans have been processed or the accuracy of our reports to credit bureaus. In addition, the collections subsidiaries in our debt management operation group are routinely named in individual plaintiff or class action lawsuits in which the plaintiffs allege that we have violated a federal or state law in the process of collecting their account. Management believes that these claims, lawsuits and other actions will not have a material adverse effect on our business, financial condition or results of operations. Finally, from time to time, we receive information and document requests from state attorney generals concerning certain of our business practices. Our practice has been and continues to be to cooperate with the state attorney generals and to be responsive to any such requests.

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

Nothing to report.

PART II.

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company s common stock is listed and traded on the New York Stock Exchange under the symbol SLM. The number of holders of record of the Company s common stock as of January 31, 2007 was 653. The following table sets forth the high and low sales prices for the Company s common stock for each full quarterly period within the two most recent fiscal years.

Common Stock Prices

		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2006	High	$ 58.35	$ 55.21	$ 53.07	$ 52.09
	Low	51.86	50.05	45.76	44.65
2005	High	$ 55.13	$ 51.46	$ 53.98	$ 56.48
	Low	46.39	45.56	48.85	51.32

The Company paid quarterly cash dividends of $.19 per share on the common stock for the first quarter of 2005, $.22 for the last three quarters of 2005 and for the first quarter of 2006, $.25 for the last three quarters of 2006, and declared a quarterly cash dividend of $.25 for the first quarter of 2007.

Issuer Purchases of Equity Securities

The following table summarizes the Company s common share repurchases during 2006 pursuant to the stock repurchase program (see Note 14 to the consolidated financial statements, Stockholders Equity) first authorized in September 1997 by the Board of Directors. Since the inception of the program, which has no expiration date, the Board of Directors has authorized the purchase of up to 317.5 million shares as of December 31, 2006. Included in this total are 10 million additional shares authorized for repurchase by the Board in October 2006.

	Total Number of Shares Purchased[1]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs[2]
(Common shares in millions)				
Period:				

January 1 March 31, 2006	3.3	$ 55.13	2.5	16.2
April 1 June 30, 2006	2.5	53.93	2.1	10.9
July 1 September 30, 2006	3.2	48.76	3.0	5.7
October 1 October 31, 2006				15.7
November 1 November 30, 2006	.2	47.35		15.7
December 1 December 31, 2006				15.7
Total fourth quarter	.2	47.72		
Year ended December 31, 2006	9.2	$ 52.41	7.6	

—

(1) The total number of shares purchased includes: i) shares purchased under the stock repurchase program discussed above, and ii) shares purchased in connection with the exercise of stock options and vesting of performance stock to satisfy minimum statutory tax withholding obligations and shares tendered by employees to satisfy option exercise costs (which combined totaled 1.6 million shares for 2006).

(2) Reduced by outstanding equity forward contracts.

Table of Contents

Stock Performance

The following graph compares the yearly percentage change in the Company s cumulative total shareholder return on its common stock to that of Standard & Poor s 500 Stock Index and Standard & Poor s Financials Index. The graph assumes a base investment of $100 at December 31, 2001 and reinvestment of dividends through December 31, 2006.

Five Year Cumulative Total Shareholder Return

Company/Index	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06
SLM Corporation	$ 100.0	$ 124.6	$ 137.6	$ 197.6	$ 207.1	$ 187.0
S&P Financials Index	100.0	85.5	111.7	123.6	131.4	156.2
S&P 500 Index	100.0	78.0	100.2	110.9	116.3	134.4

Source: Bloomberg Total Return Analysis

Item 6. Selected Financial Data

Selected Financial Data 2002-2006
(Dollars in millions, except per share amounts)

The following table sets forth selected financial and other operating information of the Company. The selected financial data in the table is derived from the consolidated financial statements of the Company. The data should be read in conjunction with the consolidated financial statements, related notes, and MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS included in this Form 10-K.

	2006	2005	2004	2003	2002
Operating Data:					
Net interest income	$ 1,454	$ 1,451	$ 1,299	$ 1,326	$ 1,425
Net income	1,157	1,382	1,914	1,534	792
Basic earnings per common share, before cumulative effect of accounting change	2.73	3.25	4.36	3.08	1.69
Basic earnings per common share, after cumulative effect of accounting change	2.73	3.25	4.36	3.37	1.69
Diluted earnings per common share, before cumulative effect of accounting change	2.63	3.05	4.04	2.91	1.64
Diluted earnings per common share, after cumulative effect of accounting change	2.63	3.05	4.04	3.18	1.64
Dividends per common share	.97	.85	.74	.59	.28
Return on common stockholders equity	32%	45%	73%	66%	46%
Net interest margin	1.54	1.77	1.92	2.53	2.92
Return on assets	1.22	1.68	2.80	2.89	1.60
Dividend payout ratio	37	28	18	19	17
Average equity/average assets	3.98	3.82	3.73	4.19	3.44
Balance Sheet Data:					
Student loans, net	$ 95,920	$ 82,604	$ 65,981	$ 50,047	$ 42,339
Total assets	116,136	99,339	84,094	64,611	53,175
Total borrowings	108,087	91,929	78,122	58,543	47,861
Stockholders equity	4,360	3,792	3,102	2,630	1,998
Book value per common share	9.24	7.81	6.93	5.51	4.00
Other Data:					
Off-balance sheet securitized student loans, net	$ 46,172	$ 39,925	$ 41,457	$ 38,742	$ 35,785

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS Years ended December 31, 2004-2006 (Dollars in millions, except per share amounts, unless otherwise stated)

FORWARD-LOOKING AND CAUTIONARY STATEMENTS

Some of the statements contained in this Annual Report discuss future expectations and business strategies or include other forward-looking information. Those statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. The forward-looking information is based on various factors and was derived using numerous assumptions.

OVERVIEW

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

We have used both internal growth and strategic acquisitions to attain our leadership position in the education finance marketplace. Our sales force, which delivers our products on campuses across the country, is the largest in the student loan industry. The core of our marketing strategy is to promote our on-campus brands, which generate student loan originations through our Preferred Channel. Loans generated through our Preferred Channel are more profitable than loans acquired through other acquisition channels because we own them earlier in the student loan s life and generally incur lower costs to acquire such loans. We have built brand leadership through the Sallie Mae name, the brands of our subsidiaries and those of our lender partners. These sales and marketing efforts are supported by the largest and most diversified servicing capabilities in the industry, providing an unmatched array of services to financial aid offices. In recent years, borrowers have been consolidating their FFELP Stafford loans into FFELP Consolidation Loans in much greater numbers such that FFELP Consolidation Loans now constitute 56 percent of our Managed loan portfolio. FFELP Consolidation Loans are marketed directly to consumers and we believe they will continue to be an important loan acquisition channel.

We have expanded into a number of fee-based businesses, most notably, our Debt Management Operations (DMO) business. Our DMO business provides a wide range of accounts receivable and collections services including student loan default aversion services, defaulted student loan portfolio management services, contingency collections services for student loans and other asset classes, and accounts receivable management and collection for purchased portfolios of receivables that are delinquent or have been charged off by their original creditors. We also purchase and managed portfolios of sub-performing and non-performing mortgage loans.

In December 2004, we completed the Wind-Down of the GSE through the defeasance of all remaining GSE debt obligations and dissolution of the GSE s federal charter. The liquidity provided to the Company by

Table of Contents

the GSE has been replaced primarily by securitizations. In addition to securitizations, we have access to a number of additional sources of liquidity including an asset-backed commercial paper program, unsecured revolving credit facilities, and other unsecured corporate debt and equity security issuances.

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management s Discussion and Analysis of Financial Condition and Results of Operations addresses our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP). The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of income and expenses during the reporting periods. We base our estimates and judgments on historical experience and on various other factors that we believe are reasonable under the circumstances. Actual results may differ from these estimates under varying assumptions or conditions. Note 2 to the consolidated financial statements, Significant Accounting Policies, includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements.

On a quarterly basis, management evaluates its estimates, particularly those that include the most difficult, subjective or complex judgments and are often about matters that are inherently uncertain. These estimates relate to the following accounting policies that are discussed in more detail below: application of the effective interest method for loans (premiums, discounts and Borrower Benefits), securitization accounting and Retained Interests, allowance for loan losses, and derivative accounting. In recent years, we have frequently updated a number of estimates to account for the continued high level of FFELP Consolidation Loan activity. Also, a number of these estimates affect life-of-loan calculations. Since our student loans have long average lives, the cumulative effect of relatively small changes in estimates can be material.

Premiums, Discounts and Borrower Benefits

For both federally insured and Private Education Loans, we account for premiums paid, discounts received, capitalized direct origination costs incurred on the origination of student loans, and the impact of Borrower Benefits in accordance with SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases. The unamortized portion of the premiums and the discounts is included in the carrying value of the student loans on the consolidated balance sheet. We recognize income on our student loan portfolio based on the expected yield of the student loan after giving effect to the amortization of purchase premiums and accretion of student loan discounts, as well as the impact of Borrower Benefits. Premiums, capitalized direct origination costs and discounts received are amortized over the estimated life of the loan, which includes an estimate of prepayment speeds. Estimates for future prepayments are incorporated in an estimated Constant Prepayment Rate (CPR), which is primarily based upon the historical prepayments due to consolidation and defaults, extensions from the utilization of forbearance, as well as, management s expectation of future prepayments and extensions. For Borrower Benefits, the estimates of their effect on student loan yield are based on analyses of historical payment behavior of borrowers who are eligible for the incentives, and the evaluation of the ultimate qualification rate for these incentives. We periodically evaluate the assumptions used to estimate the loan life and qualification rates, and in instances where there are modifications to the assumptions, amortization is adjusted on a

cumulative basis to reflect the change.

The estimate of the CPR measures the rate at which loans in the portfolio pay before their stated maturity. A number of factors can affect the CPR estimate such as the rate of consolidation activity and default rates. Changes in CPR estimates are discussed in more detail below. The impact of Borrower Benefits is dependent

on the estimate of the number of borrowers who will eventually qualify for these benefits. For competitive purposes, we occasionally change Borrower Benefits programs in both amount and qualification factors. These programmatic changes must be reflected in the estimate of the Borrower Benefits discount.

Securitization Accounting and Retained Interests

We regularly engage in securitization transactions as part of our financing strategy (see also LIQUIDITY AND CAPITAL RESOURCES Securitization Activities). In a securitization, we sell student loans to a trust that issues bonds backed by the student loans as part of the transaction. When our securitizations meet the sale criteria of SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a Replacement of SFAS No. 125, we record a gain on the sale of the student loans, which is the difference between the allocated cost basis of the assets sold and the relative fair value of the assets received. The primary judgment in determining the fair value of the assets received is the valuation of the Residual Interest.

The Residual Interests in each of our securitizations are treated as available-for-sale securities in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, and therefore must be marked-to-market with temporary unrealized gains and losses recognized, net of tax, in accumulated other comprehensive income in stockholders equity. Since there are no quoted market prices for our Residual Interests, we estimate their fair value both initially and each subsequent quarter using the key assumptions listed below:

- the projected net interest yield from the underlying securitized loans, which can be impacted by the forward yield curve, as well as the Borrower Benefits program;
- the calculation of the Embedded Floor Income associated with the securitized loan portfolio;
- the CPR;
- the discount rate used, which is intended to be commensurate with the risks involved; and
- the expected credit losses from the underlying securitized loan portfolio.

We recognize interest income and periodically evaluate our Residual Interests for other than temporary impairment in accordance with the Emerging Issues Task Force (EITF) Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased and Residual Beneficial Interests in Securitized Financial Assets. Under this standard, each quarter we estimate the remaining cash flows to be received from our Retained Interests and use these revised cash flows to prospectively calculate a yield for income recognition. In cases where our estimate of future cash flows results in a lower yield from that used to recognize interest income in the prior quarter, the Residual Interest is written down to fair value, first to the extent of any unrealized gain in accumulated other comprehensive income, then through earnings as an other than temporary impairment, and the yield used to recognize subsequent income from the trust is negatively impacted.

We also receive income for servicing the loans in our securitization trusts. We assess the amounts received as compensation for these activities at inception and on an ongoing basis to determine if the amounts received are adequate compensation as defined in SFAS No. 140. To the extent such compensation is determined to be no more or less than adequate compensation, no servicing asset or obligation is recorded.

Allowance for Loan Losses

We maintain an allowance for loan losses at an amount sufficient to absorb losses inherent in our FFELP and Private Education Loan portfolios at the reporting date based on a projection of estimated probable net credit losses. We analyze those portfolios to determine the effects that the various stages of delinquency have on borrower default behavior and ultimate charge-off. We estimate the allowance for loan losses and losses on accrued interest income for our Managed loan portfolio using a migration analysis of delinquent and current accounts. A migration analysis is a technique used to estimate the likelihood that a loan receivable may progress through the various delinquency stages and ultimately charge-off, and is a widely used reserving methodology in the consumer finance industry. We also use the migration analysis to estimate the amount of

uncollectible accrued interest on Private Education Loans and write off that amount against current period interest income.

When calculating the allowance for loan loses on Private Education Loan loss, we divide the portfolio into categories of similar risk characteristics based on loan program type, loan status (in-school, grace, repayment, forbearance, delinquency), underwriting criteria, existence or absence of a co-borrower, and aging. We then apply default and collection rate projections to each category. Our higher education Private Education Loan programs (90 percent of the Managed Private Education Loan portfolio at December 31, 2006) do not require the borrowers to begin repayment until six months after they have graduated or otherwise left school. Consequently, our loss estimates for these programs are minimal while the borrower is in school. Our career training and alternative Private Education Loan programs (10 percent of the Managed Private Education Loan portfolio at December 31, 2006) generally require the borrowers to start repaying their loans immediately. At December 31, 2006, 46 percent of the principal balance in the higher education Managed Private Education Loan portfolio is related to borrowers who are still in-school and not required to make payments. As the current portfolio ages, an increasing percentage of the borrowers will leave school and be required to begin payments on their loans. The allowance for losses will change accordingly with the percentage of borrowers in repayment.

Our loss estimates are based on a loss emergence period of two years. Similar to the rules governing FFELP payment requirements, our collection policies allow for periods of nonpayment for borrowers requesting additional payment grace periods upon leaving school or experiencing temporary difficulty meeting payment obligations. This is referred to as forbearance status and is considered separately in our allowance of loan losses. The majority of forbearance occurs early in the repayment term when borrowers are starting their careers (see LENDING BUSINESS SEGMENT Private Education Loans *Delinquencies*). At December 31, 2006, 9 percent of the Managed Private Education Loan portfolio in repayment and forbearance was in forbearance status. The loss emergence period is in alignment with our typical collection cycle and takes into account these periods of nonpayment.

In general, Private Education Loan principal is charged off against the allowance when the loan exceeds 212 days delinquency. Recoveries on loans charged off are considered when calculating the allowance for loan losses, and actual cash recoveries are therefore recorded directly to the allowance.

As a result of Sallie Mae Servicing s Exceptional Performer (EP) designation for ED, the Company received 100 percent reimbursement (declining to 99 percent on July 1, 2006 under the Reconciliation Legislation, discussed below) on default claims on federally guaranteed student loans that are serviced by Sallie Mae Servicing for a period of at least 270 days before the date of default. The Company is entitled to receive this benefit as long as the Company remains in compliance with the required servicing standards, which are assessed on an annual and quarterly basis through compliance audits and other criteria. The EP designation applies to all FFELP loans that are serviced by the Company as well as default claims on federally guaranteed student loans that the Company owns but are serviced by other service providers with the EP designation.

The Reconciliation Legislation, signed into law on February 8, 2006, reduced the level of default insurance from 98 percent to 97 percent (effectively increasing Risk Sharing from two percent to three percent) on loans disbursed after July 1, 2006 for lenders without the EP designation. Furthermore, the bill reduced the default insurance paid to lenders/servicers with the EP designation to 99 percent from 100 percent on claims filed on or after July 1, 2006. As a result of the amended insurance levels, we established a Risk Sharing allowance as of December 31, 2005 for an estimate of losses on FFELP student loans based on the one percent reduction in default insurance for servicers with the EP designation. The reserve was established using a migration analysis similar to that described above for the Private Education Loans before applying the appropriate Risk Sharing percentage.

The evaluation of the provisions for loan losses is inherently subjective, as it requires material estimates that may be susceptible to significant changes. Management believes that the allowance for loan losses is appropriate to cover probable losses in the student loan portfolio.

Table of Contents

Effects of Consolidation Activity on Estimates

Consolidation activity continued at high levels in 2006 and we expect it to continue as borrowers respond to aggressive marketing in the student loan industry and look to lengthen the term of their loans and lower their monthly payments. This, in turn, has had a significant effect on a number of accounting estimates in recent years. We have updated our assumptions that are affected primarily by consolidation activity and updated the estimates used in developing the cash flows and effective yield calculations as they relate to the amortization of student loan premiums and discounts, Borrower Benefits, residual interest income and the valuation of the Residual Interest.

Consolidation activity affects each estimate differently depending on whether the original loans being consolidated were on-balance sheet or off-balance sheet and whether the resulting consolidation is retained by us or consolidated with a third party. When we consolidate a loan that was in our portfolio, the term of that loan is generally extended and the term of the amortization of associated student loan premiums and discounts is likewise extended to match the new term of the loan. In that process, the unamortized premium balance must be adjusted to reflect the new expected term of the consolidated loan as if it had been in place from inception.

The estimate of the CPR also affects the estimate of the average life of securitized trusts and therefore affects the valuation of the Residual Interest. Prepayments shorten the average life of the trust, and if all other factors remain equal, will reduce the value of the Residual Interest, the securitization gain on sale and the effective yield used to recognize interest income. Prepayments on student loans in our securitized trusts are significantly impacted by the rate at which securitized loans are consolidated. When a loan is consolidated from the trust either by us or a third party, the loan is treated as a prepayment. In cases where the loan is consolidated by us, it will be recorded as an on-balance sheet asset. We discuss the effects of changes in our CPR estimates in LIQUIDITY AND CAPITAL RESOURCES Securitization Activities and Liquidity Risk and Funding Long-Term.

The increased activity in FFELP Consolidation Loans has led to demand for the consolidation of Private Education loans. Private Education Consolidation Loans provide an attractive refinancing opportunity to certain borrowers because they allow borrowers to lower their monthly payments and extend the life of the loan. Consolidation of Private Education Loans from off-balance sheet Private Education Loan trusts will increase the CPR used to value the Residual Interest.

Table of Contents

Effect of Consolidation Activity

The schedule below summarizes the impact of loan consolidation on each affected financial statement line item.

On-Balance Sheet Student Loans

Estimate	Consolidating Lender	Effect on Estimate	CPR	Accounting Effect
Premium	Sallie Mae	Term extension	Decrease	Estimate Adjustment[1] increase unamortized balance of premium. Reduced amortization expense going forward.
Premium	Other lenders	Loan prepaid	Increase	Estimate Adjustment[1] decrease unamortized balance of premium or accelerated amortization of premium.
Borrower Benefits	Sallie Mae	Term extension	N/A	Existing Borrower Benefits reserve reversed into income new FFELP Consolidation Loan benefit amortized over a longer term.[2]
Borrower Benefits	Other lenders	Loan prepaid	N/A	Borrower Benefits reserve reversed into income.[2]

(1) As estimates are updated, in accordance with SFAS No. 91, the premium balance must be adjusted from inception to reflect the new expected term of the loan, as if it had been in place from inception.

(2) Consolidation estimates also affect the estimates of borrowers who will eventually qualify for Borrower Benefits.

Off-Balance Sheet Student Loans

Estimate	Consolidating Lender	Effect on Estimate	CPR	Accounting Effect
Residual Interest	Sallie Mae or other lenders	Loan prepaid	Increase	Reduction in fair market value of Residual Interest resulting in either an impairment charge or reduction in prior unrealized market value gains recorded in other comprehensive income. Decrease in prospective effective yield used to

recognize interest income.

Derivative Accounting

We use interest rate swaps, foreign currency swaps, interest rate futures contracts, Floor Income Contracts and interest rate cap contracts as an integral part of our overall risk management strategy to manage interest rate and foreign currency risk arising from our fixed rate and floating rate financial instruments. We account for these instruments in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, which requires that every derivative instrument, including certain derivative instruments embedded in other contracts, be recorded at fair value on the balance sheet as either an asset or liability. We determine the fair value for our derivative instruments primarily by using pricing models that consider current market inputs and the contractual terms of the derivative contracts. The fair value of some derivatives are determined using counterparty valuations. Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized; the use of different pricing models or assumptions could produce different financial results. As a matter of policy, we compare the fair values of our derivatives that we

Table of Contents

calculate to those provided by our counterparties on a monthly basis. Any significant differences are identified and resolved appropriately.

SFAS No. 133 requires that changes in the fair value of derivative instruments be recognized currently in earnings unless specific hedge accounting criteria as specified by SFAS No. 133 are met. We believe that all of our derivatives are effective economic hedges and are a critical element of our interest rate risk management strategy. However, under SFAS No. 133, some of our derivatives, primarily Floor Income Contracts, certain Eurodollar futures contracts, basis swaps and equity forwards, do not qualify for hedge treatment under SFAS No. 133. Therefore, changes in market value along with the periodic net settlements must be recorded through the gains (losses) on derivative and hedging activities, net line in the income statement with no consideration for the corresponding change in fair value of the hedged item. The derivative market value adjustment is primarily caused by interest rate and foreign currency exchange rate volatility, changing credit spreads during the period, and changes in our stock price (related to equity forwards) as well as, the volume and term of derivatives not receiving hedge accounting treatment. See also BUSINESS SEGMENTS Limitations of Core Earnings *Pre-tax Differences between Core Earnings and GAAP by Business Segment* Derivative Accounting for a detailed discussion of our accounting for derivatives.

SELECTED FINANCIAL DATA

Condensed Statements of Income

				Increase (Decrease)			
	Years Ended December 31,			**2006 vs. 2005**		**2005 vs. 2004**	
	2006	**2005**	**2004**	**$**	**%**	**$**	**%**
Net interest income	$ 1,454	$ 1,451	$ 1,299	$ 3	%	$ 152	12%
Less: provisions for losses	287	203	111	84	41	92	83
Net interest income after provisions for losses	1,167	1,248	1,188	(81)	(6)	60	5
Gains on student loan securitizations	902	552	375	350	63	177	47
Servicing and securitization revenue	553	357	561	196	55	(204)	(36)
Losses on securities, net	(49)	(64)	(49)	(15)	(23)	15	31
Gains (losses) on derivative and hedging activities, net	(339)	247	849	(586)	(237)	(602)	(71)
Guarantor servicing fees	132	115	120	17	15	(5)	(4)
Debt management fees	397	360	300	37	10	60	20
Collections revenue	240	167	39	73	44	128	328
Other income	338	273	290	65	24	(17)	(6)
Operating expenses	1,346	1,138	895	208	18	243	27
Loss on GSE debt extinguishment			221			(221)	(100)
Income taxes	834	729	642	105	14	87	14
Minority interest in net earnings of subsidiaries	4	6	1	(2)		5	500
Net income	1,157	1,382	1,914	(225)	(16)	(532)	(28)

Preferred stock dividends	36	22	12	14	64	10	83
Net income attributable to common stock	$ 1,121	$ 1,360	$ 1,902	$ (239)	(18)%	$ (542)	(28)%
Basic earnings per common share	$ 2.73	$ 3.25	$ 4.36	$ (.52)	(16)%	$ (1.11)	(25)%
Diluted earnings per common share	$ 2.63	$ 3.05	$ 4.04	$ (.42)	(14)%	$ (.99)	(25)%
Dividends per common share	$ .97	$ .85	$ .74	$ .12	14%	$ .11	15%

Table of Contents

Condensed Balance Sheets

	December 31,		Increase (Decrease)			
			2006 vs. 2005		2005 vs. 2004	
	2006	2005	$	%	$	%
Assets						
FFELP Stafford and Other Student Loans, net	$ 24,841	$ 19,988	$ 4,853	24%	$ 1,023	5%
FFELP Consolidation Loans, net	61,324	54,859	6,465	12	13,263	32
Private Education Loans, net	9,755	7,757	1,998	26	2,337	43
Other loans, net	1,309	1,138	171	15	90	9
Cash and investments	5,185	4,868	317	7	(2,107)	(30)
Restricted cash and investments	3,423	3,300	123	4	1,089	49
Retained Interest in off-balance sheet securitized loans	3,341	2,406	935	39	90	4
Goodwill and acquired intangible assets, net	1,372	1,105	267	24	39	4
Other assets	5,586	3,918	1,668	43	(579)	(13)
Total assets	$ 116,136	$ 99,339	$ 16,797	17%	$ 15,245	18%
Liabilities and Stockholders Equity						
Short-term borrowings	$ 3,528	$ 3,810	$ (282)	(7)%	$ 1,603	73%
Long-term borrowings	104,559	88,119	16,440	19	12,204	16
Other liabilities	3,680	3,609	71	2	811	29
Total liabilities	111,767	95,538	16,229	17	14,618	18
Minority interest in subsidiaries	9	9			(63)	(88)
Stockholders equity before treasury stock	5,401	4,364	1,037	24	(765)	(15)
Common stock held in treasury	1,041	572	469	82	(1,455)	(72)
Total stockholders equity	4,360	3,792	568	15	690	22
Total liabilities and stockholders equity	$ 116,136	$ 99,339	$ 16,797	17%	$ 15,245	18%

RESULTS OF OPERATIONS

We present the results of operations first on a consolidated basis followed by a presentation of the net interest margin with accompanying analysis presented in accordance with GAAP. As discussed in detail above in the OVERVIEW section, we have two primary business segments, Lending and DMO, plus a Corporate and Other business segment. Since these business segments operate in distinct business environments, the discussion following the results of our operations is primarily presented on a segment basis. See BUSINESS SEGMENTS for further discussion on the components of each segment. Securitization gains and the ongoing servicing and securitization income are included in

LIQUIDITY AND CAPITAL RESOURCES Securitization Activities. The discussion of derivative market value gains and losses is under BUSINESS SEGMENTS Limitations of Core Earnings *Pre-tax Differences between Core Earnings and GAAP by Business Segment* Derivative Accounting .

CONSOLIDATED EARNINGS SUMMARY

The main drivers of our net income are the growth in our Managed student loan portfolio, which drives net interest income and securitization transactions, market value gains and losses on derivatives that do not receive hedge accounting treatment, the timing and size of securitization gains, growth in our fee-based business and expense control.

39

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

For the year ended December 31, 2006, net income was $1.2 billion ($2.63 diluted earnings per share), a 16 percent decrease from the $1.4 billion in net income ($3.05 diluted earnings per share) for the year ended December 31, 2005. On a pre-tax basis, year-to-date 2006 net income of $2.0 billion was a 6 percent decrease from the $2.1 billion in pre-tax net income earned in the year ended December 31, 2005. The larger percentage decrease in year-over-year, after-tax net income versus pre-tax net income is driven by the tax accounting permanent impact of excluding $360 million in unrealized equity forward losses from 2006 taxable income and excluding $121 million of unrealized equity forward gains from 2005 taxable income. Fluctuations in the effective tax rate are driven by the permanent impact of the exclusion of the gains and losses on equity forward contracts with respect to the Company s stock for tax purposes. Under SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, we are required to mark the equity forward contracts to market each quarter and recognize the change in their value in income. Conversely, these unrealized gains and losses are not recognized on a tax basis. The net effect from excluding non-taxable gains and losses on equity forward contracts from taxable income was an increase in the effective tax rate from 34 percent in the year ended December 31, 2005 to 42 percent in the year ended December 31, 2006.

Securitization gains increased by $350 million in the year ended December 31, 2006 versus 2005. The securitization gains for 2006 were primarily driven by the three off-balance sheet Private Education Loan securitizations, which had total pre-tax gains of $830 million or 16 percent of the amount securitized, versus two off-balance sheet Private Education Loan securitizations in 2005, which had pre-tax gains of $453 million or 15 percent of the amount securitized.

For the year ended December 31, 2006, servicing and securitization revenue increased by $196 million to $553 million. The increase in servicing and securitization revenue can be attributed to $103 million in lower impairments on our Retained Interests and the growth in the average balance of off-balance sheet student loans. Impairments are primarily caused by the effect of FFELP Consolidation Loan activity on our FFELP Stafford securitization trusts. Pre-tax impairments on our Retained Interests in securitizations totaled $157 million for the year ended December 31, 2006 versus $260 million for the year ended December 31, 2005.

In 2006, net losses on derivative and hedging activities were $339 million, a decrease of $586 million from the net gains of $247 million in 2005. This decrease primarily relates to $230 million of unrealized losses in 2006, versus unrealized gains of $634 million in the prior year, which resulted in a year-over-year reduction in pre-tax income of $864 million. The effect of the unrealized losses was partially offset by a $278 million reduction in realized losses on derivatives and hedging activities on instruments that were not accounted for as hedges. The decrease in unrealized gains was primarily due to the impact of a lower SLM stock price on our equity forward contracts which resulted in a mark-to-market unrealized loss of $360 million in 2006 versus an unrealized gain of $121 million in the year-ago period, and to a decrease of $305 million in unrealized gains on Floor Income Contracts. The smaller unrealized gains on our Floor Income Contracts were primarily caused by the relationship between the Floor Income Contracts strike prices versus the estimated forward interest rates during 2006 versus 2005.

Year-over-year interest income is roughly unchanged as the $12 billion increase in average interest earning assets was offset by a 23 basis point decrease in the net interest margin. The year-over-year decrease in the net interest margin is due to higher average interest rates which reduced gross Floor Income by $155 million, and to the increase in the average balance of lower yielding cash and investments.

Our Managed student loan portfolio grew by $19.6 billion (or 16 percent), from $122.5 billion at December 31, 2005 to $142.1 billion at December 31, 2006. In 2006 we acquired $37.4 billion of student loans, a 24 percent increase over

the $30.2 billion acquired in the year-ago period. The 2006 acquisitions included $8.4 billion in Private Education Loans, a 31 percent increase over the $6.4 billion acquired in 2005. In the year ended December 31, 2006, we originated $23.4 billion of student loans through our Preferred Channel, an increase of 9 percent over the $21.4 billion originated in the year-ago period.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

For the year ended December 31, 2005, our net income decreased by 26 percent to $1.4 billion ($3.05 diluted earnings per share) from net income of $1.9 billion ($4.04 diluted earnings per share) in 2004. On a pre-tax basis, income for the year ended December 31, 2005 decreased by 19 percent to $2.1 billion versus $2.6 billion in the year ended December 31, 2004. The larger percentage decrease in net income versus pre-tax income from 2004 to 2005 is primarily due to the increase in the effective tax rate from 25 percent in the year ended 2004 to 34 percent in the year ended 2005. In the year ended 2005, we recognized unrealized gains on our outstanding equity forward contracts of $121 million versus unrealized gains of $759 million in the year ended 2004.

The decrease in pre-tax income is primarily due to a $602 million decrease in the gain on derivative and hedging activities, which primarily relates to derivatives that do not receive hedge accounting treatment. Unrealized derivative gains and losses are primarily driven by the effect of changes in the fair market value of Floor Income Contracts and the effect of an increase in the value of our stock price on equity forward contracts. The smaller unrealized gains on our Floor Income Contracts in 2005 were due to fewer contracts being in the money to the counterparty due to spot interest rates, and to a smaller rise in forward interest rates in 2005 versus 2004. Our stock price increased in both 2005 and 2004, but the absolute increase was less in 2005 resulting in a smaller unrealized gain on our equity forward contracts in 2005.

The year-over-year decrease in servicing and securitization revenue was due primarily to impairments of our Retained Interests in securitizations of $260 million in 2005 versus $80 million in 2004. These impairments are largely driven by the continued rise in FFELP Consolidation Loan activity. The increase in impairment losses was partially offset by an increase in securitization gains of $177 million primarily caused by higher percentage gains on the two off-balance sheet Private Education Loan securitizations in 2005, versus the two off-balance sheet Private Education Loan securitizations in 2004.

The year-over-year increase in debt management fees and collections revenue of $188 million is primarily due to a full year impact of collections revenue from AFS, acquired in the third quarter of 2004, and overall growth in the contingency fee businesses. Positive impacts to pre-tax income were offset by the year-over-year increase in operating expenses of $243 million, primarily attributable to the expenses associated with three subsidiaries acquired in the second half of 2004: AFS, Southwest Student Services Corporation (Southwest) and Student Loan Finance Association (SLFA).

Net income for the year ended December 31, 2004 was also negatively impacted by a $221 million pre-tax loss related to the repurchase and defeasance of $3.0 billion of GSE debt in connection with the GSE Wind-Down in 2004.

Our Managed student loan portfolio grew by $15.1 billion, from $107.4 billion at December 31, 2004 to $122.5 billion at December 31, 2005. This growth was fueled by the acquisition of $30.2 billion of student loans in the year ended 2005, a 27 percent increase over the $23.7 billion acquired in 2004, exclusive of student loans acquired from the acquisition of Southwest and SLFA. In the year ended 2005, we originated $21.4 billion of student loans through our Preferred Channel, an increase of 19 percent over the $18.0 billion originated in the year ended 2004.

Table of Contents

Average Balance Sheets

The following table reflects the rates earned on interest earning assets and paid on interest bearing liabilities for the years ended December 31, 2006, 2005 and 2004. This table reflects the net interest margin for the entire Company on a consolidated basis. It is included in the Lending segment discussion because that segment includes substantially all interest earning assets and interest bearing liabilities.

	Years Ended December 31,					
	2006		2005		2004	
	Balance	Rate	Balance	Rate	Balance	Rate
Average Assets						
FFELP Stafford and Other Student Loans	$ 21,152	6.66%	$ 20,720	4.90%	$ 19,317	3.76%
FFELP Consolidation Loans	55,119	6.43	47,082	5.31	31,773	4.30
Private Education Loans	8,585	11.90	6,922	9.16	4,795	7.00
Other loans	1,155	8.53	1,072	8.04	1,004	7.72
Cash and investments	8,824	5.74	6,662	4.22	11,322	2.11
Total interest earning assets	94,835	6.94%	82,458	5.48%	68,211	4.02%
Non-interest earning assets	8,550		6,990		6,497	
Total assets	$ 103,385		$ 89,448		$ 74,708	
Average Liabilities and Stockholders Equity						
Short-term borrowings	$ 3,902	5.33%	$ 4,517	3.93%	$ 10,596	1.95%
Long-term borrowings	91,461	5.37	77,958	3.70	58,134	2.11
Total interest bearing liabilities	95,363	5.37%	82,475	3.71%	68,730	2.09%
Non-interest bearing liabilities	3,912		3,555		3,195	
Stockholders equity	4,110		3,418		2,783	
Total liabilities and stockholders equity	$ 103,385		$ 89,448		$ 74,708	
Net interest margin		1.54%		1.77%		1.92%

Table of Contents

Rate/Volume Analysis

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

	Increase (Decrease)	Increase (Decrease) Attributable to Change in	
		Rate	Volume
2006 vs. 2005			
Interest income	$ 2,065	$ 1,367	$ 698
Interest expense	2,064	1,589	475
Net interest income	$ 1	$ (222)	$ 223
2005 vs. 2004			
Interest income	$ 1,774	$ 1,008	$ 766
Interest expense	1,625	1,325	300
Net interest income	$ 149	$ (317)	$ 466

The decrease in the net interest margin in 2006 versus 2005 and 2005 versus 2004 is primarily due to fluctuations in the student loan spread as discussed under Student Loans *Student Loan Spread Analysis On-Balance Sheet*. The net interest margin was also negatively impacted by the increase in lower yielding cash and investments being held as collateral for on-balance sheet securitization trusts and by the higher average balance of non-interest earning assets. In 2004, the net interest margin was negatively impacted by the higher average balances of lower yielding short-term investments which were being built up during 2004 as additional liquidity in anticipation of the GSE Wind-Down.

Student Loans

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

Student Loan Spread

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

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

the premiums paid, borrower fees charged and capitalized costs incurred to acquire student loans which impact the spread through subsequent amortization;

the type and level of Borrower Benefits programs for which the student loans are eligible;

the level of Floor Income and, when considering the Core Earnings spread, the amount of Floor Income-eligible loans that have been hedged through Floor Income Contracts; and

funding and hedging costs.

Wholesale Consolidation Loans

During 2006, we implemented a new loan acquisition strategy under which we began purchasing FFELP Consolidation Loans outside of our normal origination channels, primarily via the spot market. We refer to this new loan acquisition strategy as our Wholesale Consolidation Channel. FFELP Consolidation Loans acquired through this channel are considered incremental volume to our core acquisition channels, which are focused on the retail marketplace with an emphasis on our internal brand strategy. Wholesale Consolidation Loans generally command significantly higher premiums than our originated FFELP Consolidation Loans, and as a result, Wholesale Consolidation Loans have lower spreads. Since Wholesale Consolidation Loans are acquired outside of our core loan acquisition channels and have different yields and return expectations than the rest of our FFELP Consolidation Loan portfolio, we have excluded the impact of the Wholesale Consolidation Loan volume from the student loan spread analysis to provide more meaningful period-over-period comparisons on the performance of our student loan portfolio. We will therefore discuss the volume and its effect on the spread of the Wholesale Consolidation Loan portfolio separately.

The student loan spread is highly susceptible to liquidity, funding and interest rate risk. These risks are discussed separately in LIQUIDITY AND CAPITAL RESOURCES and in the RISK FACTORS discussion.

Student Loan Spread Analysis On-Balance Sheet

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

	Years Ended December 31,		
	2006	**2005**	**2004**
On-Balance Sheet			
Student loan yield, before Floor Income	7.94%	6.22%	4.53%
Gross Floor Income	.04	.25	.73
Consolidation Loan Rebate Fees	(.67)	(.65)	(.58)
Offset Fees			(.03)
Borrower Benefits	(.12)	(.11)	(.18)
Premium and discount amortization	(.14)	(.16)	(.13)
Student loan net yield	7.05	5.55	4.34
Student loan cost of funds	(5.36)	(3.69)	(2.01)
Student loan spread[(1)]	1.69%	1.86%	2.33%
Average Balances			
On-balance sheet student loans[(1)]	$ 84,173	$ 74,724	$ 55,885

[1] Excludes the impact of the Wholesale Consolidation Loan portfolio on the student loan spread and average balance for the year ended December 31, 2006.

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

In low interest rate environments, one of the primary drivers of fluctuations in our on-balance sheet student loan spread is the level of gross Floor Income (Floor Income earned before payments on Floor Income

Table of Contents

Contracts) earned in the period. Since 2004, average short-term interest rates have steadily increased resulting in a significant reduction in the level of gross Floor Income earned since 2004. We believe that we have economically hedged most of the long-term Floor Income through the sale of Floor Income Contracts, under which we receive an upfront fee and agree to pay the counterparty the Floor Income earned on a notional amount of student loans. These contracts do not qualify for hedge accounting treatment and as a result the payments on the Floor Income Contracts are included on the income statement with gains (losses) on derivative and hedging activities, net rather than in student loan interest income, where the offsetting Floor Income is recorded.

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

Discussion of the Year-over-Year Effect of Changes in Accounting Estimates on the On-Balance Sheet Student Loan Spread

As discussed in detail and summarized in a table under CRITICAL ACCOUNTING POLICIES AND ESTIMATES, we periodically update our estimates for changes in the student loan portfolio. Under SFAS No. 91, these changes in estimates must be reflected in the balance of the student loan from inception. We have also updated our estimates to reflect programmatic changes in our Borrower Benefits and Private Education Loan programs and have made modeling refinements to better reflect current and future conditions. The cumulative effects of the changes in estimates on the student loan spread are summarized in the table below:

	Years ended December 31,					
	2006		**2005**		**2004**	
	Dollar Value	**Basis Points**	**Dollar Value**	**Basis Points**	**Dollar Value**	**Basis Points**
Cumulative effect of changes in critical accounting estimates:						
Premium and discount amortization	$		$		$ (8)	(1)
Borrower Benefits	10	1	23	3	5	1
Total cumulative effect of changes in estimates	$ 10	1	$ 23	3	$ (3)	

In 2006, we changed our policy related to Borrower Benefit qualification requirements and updated our assumptions to reflect this policy. In both 2005 and 2004, we updated our estimates for the qualification of Borrower Benefits to account for programmatic changes, as well as, the effect of continued high levels of consolidations.

Discussion of Student Loan Spread Effects of Significant Events in 2006 and 2005

In addition to changes in estimates discussed above, FFELP Consolidation Loan activity has the greatest effect on fluctuations in our premium amortization and Borrower Benefits as we write-off the balance of unamortized premium and the Borrower Benefit reserve when loans are consolidated away, in accordance with SFAS No. 91. See below for a further discussion of the effects of FFELP Consolidation Loans on the student loan spread versus Stafford Loans. Also see CRITICAL ACCOUNTING POLICIES AND ESTIMATES Effects of Consolidation Activity on Estimates.

Also, there were high levels of FFELP Consolidation Loan activity in the second quarter of both 2006 and 2005 caused primarily by FFELP Stafford borrowers locking in lower interest rates by consolidating their loans prior to the July 1 interest rate reset for FFELP Stafford loans. In addition, there were two new methods of consolidation practiced by the industry in 2005 and the first half of 2006 that increased the amount of FFELP Stafford loans consolidated out of our portfolio resulting in increased premium write-offs. First,

Table of Contents

borrowers were permitted for the first time to consolidate their loans while still in school. Second, a significant volume of our FFELP Consolidation Loans was reconsolidated with third party lenders through the FDLP, resulting in an increase in student loan premium write-offs. In addition, the repeal of the Single Holder Rule also increased the amount of loans that consolidated with third parties. Consolidation of student loans does benefit the student loan spread to a lesser extent through the write-off of Borrower Benefits reserves associated with these loans. Both in-school consolidation and reconsolidation with third party lenders through the FDLP were restricted as of July 1, 2006 through the Higher Education Act of 2005. While FFELP Consolidation Loan activity remained high in 2006, it was lower than 2005, which contributed to lower student loan premium amortization in 2006.

Discussion of Student Loan Spread Other Year-over-Year Fluctuations 2006 versus 2005

The decrease in the 2006 student loan spread versus 2005 is primarily due to the decrease in gross Floor Income discussed above. Additionally, a higher average balance of FFELP Consolidation Loans as a percentage of the on-balance sheet portfolio contributes to downward pressure on the spread. FFELP Consolidation Loans have lower spreads than other FFELP loans due to the 105 basis point Consolidation Loan Rebate Fee, higher Borrower Benefits, and funding costs due to their longer terms. These negative effects are partially offset by lower student loan premium amortization due to the extended term and a higher Special Allowance Payment (SAP) yield. The average balance of FFELP Consolidation Loans grew as a percentage of the average on-balance sheet FFELP student loan portfolio from 69 percent in 2005 to 72 percent in 2006.

Discussion of Student Loan Spread Other Year-over-Year Fluctuations 2005 versus 2004

The decrease in the 2005 student loan spread versus 2004 is primarily due to the decrease in gross Floor Income discussed above. Additionally, higher average balance of FFELP Consolidation Loans as a percentage of the on-balance sheet portfolio contributes to downward pressure on the spread. The average balance of FFELP Consolidation Loans grew as a percentage of the average on-balance sheet FFELP student loan portfolio from 62 percent in 2004 to 69 percent in 2005.

Other factors that impacted the student loan spread include higher spreads on our debt funding student loans as a result of the GSE Wind-Down, partially offset by lower Borrower Benefits costs, and the absence of Offset Fees on GSE financed loans. The increase in funding costs is due to the replacement of lower cost, primarily short-term GSE funding with longer term, higher cost funding. The negative effects on the spread were partially offset by the 43 percent increase in Private Education Loans in the on-balance sheet student loan portfolio.

Wholesale Consolidation Loans

As discussed above, the on-balance sheet student loan spread excludes the impact of our Wholesale Consolidation Loan portfolio whose average balance was $683 million for the year ended December 31, 2006. Had the impact of the Wholesale Consolidation Loan volume been included in the on-balance sheet student loan spread it would have reduced the spread by approximately 1 basis point for the year ended December 31, 2006. As of December 31, 2006, Wholesale Consolidation Loans totaled $3.6 billion, or 5.9 percent, of our total on-balance sheet FFELP Consolidation Loan portfolio.

Table of Contents

Floor Income

For on-balance sheet student loans, gross Floor Income is included in student loan income whereas payments on Floor Income Contracts are included in the gains (losses) on derivative and hedging activities, net line in other income. The following table summarizes the components of Floor Income from on-balance sheet student loans, net of payments under Floor Income Contracts, for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,								
	2006			2005			2004		
	Fixed Borrower Rate	Variable Borrower Rate	Total	Fixed Borrower Rate	Variable Borrower Rate	Total	Fixed Borrower Rate	Variable Borrower Rate	Total
Floor Income:									
Gross Floor Income	$ 32	$	$ 32	$ 187	$	$ 187	$ 406	$ 2	$ 408
Payments on Floor Income Contracts	(34)		(34)	(175)		(175)	(368)		(368)
Net Floor Income	$ (2)	$	$ (2)	$ 12	$	$ 12	$ 38	$ 2	$ 40
Net Floor Income in basis points				2		2	7		7

Floor Income is primarily earned on fixed rate FFELP Consolidation Loans. During the first nine months of 2006, FFELP lenders reconsolidated FFELP Consolidation Loans using the Direct Loan Program as a pass-through entity. This reconsolidation has left us in a slightly oversold position on our Floor Income Contracts and as a result net Floor Income in 2006 was a loss of $2 million. The Higher Education Act of 2005 has restricted the use of reconsolidation as of July 1, 2006, so we do not foresee any material impact on our Floor Income in the future. (See also RECENT DEVELOPMENTS for further discussion regarding the Higher Education Act of 2005.)

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

FEDERAL AND STATE TAXES

The Company is subject to federal and state income taxes, while the GSE was exempt from all state and local income taxes. Our effective tax rate for the years ended December 31, 2006, 2005 and 2004 was 42 percent, 34 percent and 25 percent, respectively. The effective tax rate reflects the permanent impact of the exclusion of gains and losses on equity forward contracts with respect to the Company s stock for tax purposes. These permanent differences were a $360 million loss in 2006, a $121 million gain in 2005 and a $759 million gain in 2004.

BUSINESS SEGMENTS

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

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

Our Core Earnings are not defined terms within GAAP and may not be comparable to similarly titled measures reported by other companies. Core Earnings net income reflects only current period adjustments to GAAP net income as described below. Unlike financial accounting, there is no comprehensive, authoritative guidance for management reporting and as a result, our management reporting is not necessarily comparable with similar information for any other financial institution. Our operating segments are defined by the products and services they offer or the types of customers they serve, and they reflect the manner in which financial information is currently evaluated by management. Intersegment revenues and expenses are netted within the appropriate financial statement line items consistent with the income statement presentation provided to management. Changes in management structure or allocation methodologies and procedures may result in changes in reported segment financial information.

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

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

	Year Ended December 31, 2006		
	Lending	DMO	Corporate and Other
Interest income:			
FFELP Stafford and Other Student Loans	$ 2,771	$	$
FFELP Consolidation Loans	4,690		
Private Education Loans	2,092		
Other loans	98		
Cash and investments	705		7
Total interest income	10,356		7
Total interest expense	7,877	23	12
Net interest income	2,479	(23)	(5)
Less: provisions for losses	303		
Net interest income after provisions for losses	2,176	(23)	(5)
Fee income		397	132
Collections revenue		239	
Other income	177		155
Total other income	177	636	287
Operating expenses[(1)]	645	358	250
Income before income taxes and minority interest in net earnings of subsidiaries	1,708	255	32
Income tax expense[(2)]	632	94	12
Minority interest in net earnings of subsidiaries		4	
Core Earnings net income	$ 1,076	$ 157	$ 20

(1) Operating expenses for the Lending, DMO, and Corporate and Other business segments include $34 million, $12 million, and $17 million, respectively, of stock option compensation expense due to the implementation of SFAS No. 123(R) in the first quarter of 2006.

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

	Year Ended December 31, 2005		
	Lending	DMO	Corporate and Other
Interest income:			
FFELP Stafford and Other Student Loans	$ 2,298	$	$
FFELP Consolidation Loans	3,014		
Private Education Loans	1,160		
Other loans	85		
Cash and investments	396		5
Total interest income	6,953		5
Total interest expense	4,798	19	6
Net interest income	2,155	(19)	(1)
Less: provisions for losses	138		
Net interest income after provisions for losses	2,017	(19)	(1)
Fee income		360	115
Collections revenue		167	
Other income	111		125
Total other income	111	527	240
Operating expenses	547	288	235
Income before income taxes and minority interest in net earnings of subsidiaries	1,581	220	4
Income tax expense[1]	586	81	1
Minority interest in net earnings of subsidiaries	2	4	
Core Earnings net income	$ 993	$ 135	$ 3

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

	Year Ended December 31, 2004		
	Lending	DMO	Corporate and Other
Interest income:			
FFELP Stafford and Other Student Loans	$ 1,715	$	$
FFELP Consolidation Loans	1,473		
Private Education Loans	613		
Other loans	74		

Cash and investments	264		3
Total interest income	4,139		3
Total interest expense	2,301	13	6
Net interest income	1,838	(13)	(3)
Less: provisions for losses	114		
Net interest income after provisions for losses	1,724	(13)	(3)
Fee income		300	120
Collections revenue		39	
Other income	131		130
Total other income	131	339	250
Loss on GSE debt and extinguishment	221		
Operating expenses	487	161	211
Income before income taxes and minority interest in net earnings of subsidiaries	1,147	165	36
Income tax expense (benefit)[1]	430	65	(15)
Minority interest in net earnings of subsidiaries		1	
Core Earnings net income	$ 717	$ 99	$ 51

[1] Income taxes are based on a percentage of net income before tax for the individual reportable segment.

Limitations of Core Earnings

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

Other limitations arise from the specific adjustments that management makes to GAAP results to derive Core Earnings results. For example, in reversing the unrealized gains and losses that result from SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, on derivatives that do not qualify for hedge treatment, as well as on derivatives that do qualify but are in part ineffective because they are not perfect hedges, we focus on the long-term economic effectiveness of those instruments relative to the underlying hedged item and isolate the effects of interest rate volatility, changing credit spreads and changes in our stock price on the fair value of such instruments during the period. Under GAAP, the effects of these factors on the fair value of the derivative instruments (but not on the underlying hedged item) tend to show more volatility in the short term. While our presentation of our results on a Core Earnings basis provides important information regarding the performance of our Managed portfolio, a limitation of this presentation is that we are presenting the ongoing spread income on loans that have been sold to a trust managed by us. While we believe that our Core Earnings presentation presents the economic substance of our Managed loan portfolio, it understates earnings volatility from securitization gains. Our Core Earnings results exclude certain Floor Income, which is real cash income, from our reported results and therefore may understate earnings in certain periods. Management s financial planning and valuation of operating results, however, does not take into account Floor Income because of its inherent uncertainty, except when it is economically hedged through Floor Income Contracts.

Pre-tax Differences between Core Earnings and GAAP by Business Segment

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

Table of Contents

which includes further detail on each specific adjustment required to reconcile our Core Earnings segment presentation to our GAAP earnings.

	Years Ended December 31,								
	2006			2005			2004		
	Lending	DMO	Corporate and Other	Lending	DMO	Corporate and Other	Lending	DMO	Corporate and Other
Core Earnings adjustments:									
Net impact of securitization accounting	$ 532	$	$	$ (60)	$	$	$ (152)	$	$
Net impact of derivative accounting	131		(360)	516		121	794		759
Net impact of Floor Income	(209)			(204)			(156)		
Net impact of acquired intangibles	(49)	(34)	(11)	(42)	(15)	(4)	(27)	(5)	(4)
Total Core Earnings adjustments to GAAP	$ 405	$ (34)	$ (371)	$ 210	$ (15)	$ 117	$ 459	$ (5)	$ 755

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

The following table summarizes Core Earnings securitization adjustments for the Lending operating segment for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,		
	2006	2005	2004
Core Earnings securitization adjustments:			
Net interest income on securitized loans, after provisions for losses	$ (880)	$ (935)	$ (1,065)
Gains on student loan securitizations	902	552	375
Servicing and securitization revenue	553	357	561
Intercompany transactions with off-balance sheet trusts	(43)	(34)	(23)
Total Core Earnings securitization adjustments	$ 532	$ (60)	$ (152)

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

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

currency exchange rate volatility, changing credit spreads and changes in our stock price during the period as well as the volume and term of derivatives not receiving hedge treatment.

Our Floor Income Contracts are written options that must meet more stringent requirements than other hedging relationships to achieve hedge effectiveness under SFAS No. 133. Specifically, our Floor Income Contracts do not qualify for hedge accounting treatment because the paydown of principal of the student loans underlying the Floor Income embedded in those student loans does not exactly match the change in the notional amount of our written Floor Income Contracts. Under SFAS No. 133, the upfront payment is deemed a liability and changes in fair value are recorded through income throughout the life of the contract. The change in the value of Floor Income Contracts is primarily caused by changing interest rates that cause the amount of Floor Income earned on the underlying student loans and paid to the counterparties to vary. This is economically offset by the change in value of the student loan portfolio, including our Retained Interests, earning Floor Income but that offsetting change in value is not recognized under SFAS No. 133. We believe the Floor Income Contracts are economic hedges because they effectively fix the amount of Floor Income earned over the contract period, thus eliminating the timing and uncertainty that changes in interest rates can have on Floor Income for that period. Prior to SFAS No. 133, we accounted for Floor Income Contracts as hedges and amortized the upfront cash compensation ratably over the lives of the contracts.

Basis swaps are used to convert floating rate debt from one floating interest rate index to another to better match the interest rate characteristics of the assets financed by that debt. We primarily use basis swaps to change the index of our floating rate debt to better match the cash flows of our student loan assets that are primarily indexed to a commercial paper, Prime or Treasury bill index. In addition, we use basis swaps to convert debt indexed to the Consumer Price Index to 3 month LIBOR debt. SFAS No. 133 requires that when using basis swaps, the change in the cash flows of the hedge effectively offset both the change in the cash flows of the asset and the change in the cash flows of the liability. Our basis swaps hedge variable interest rate risk, however they generally do not meet this effectiveness test because most of our FFELP student loans can earn at either a variable or a fixed interest rate depending on market interest rates. We also have basis swaps that do not meet the SFAS No. 133 effectiveness test that economically hedge off-balance sheet instruments. As a result, under GAAP these swaps are recorded at fair value with changes in fair value reflected currently in the income statement.

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

The table below quantifies the adjustments for derivative accounting under SFAS No. 133 on our net income for the years ended December 31, 2006, 2005 and 2004, when compared with the accounting principles employed in all years prior to the SFAS No. 133 implementation.

	Years Ended December 31,		
	2006	**2005**	**2004**
Core Earnings derivative adjustments:			
Gains (losses) on derivative and hedging activities, net, included in other income[1]	$ (339)	$ 247	$ 849
Less: Realized losses on derivative and hedging activities, net[1]	109	387	713

Unrealized gains (losses) on derivative and hedging activities, net	(230)	634	1,562
Other pre-SFAS No. 133 accounting adjustments	1	3	(9)
Total net impact of SFAS No. 133 derivative accounting	$ (229)	$ 637	$ 1,553

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

Table of Contents

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

SFAS No. 133 requires net settlement income/expense on derivatives and realized gains/losses related to derivative dispositions (collectively referred to as realized gains (losses) on derivative and hedging activities) that do not qualify as hedges under SFAS No. 133 to be recorded in a separate income statement line item below net interest income. The table below summarizes the realized losses on derivative and hedging activities, and the associated reclassification on a Core Earnings basis for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,		
	2006	**2005**	**2004**
Reclassification of realized gains (losses) on derivative and hedging activities:			
Net settlement expense on Floor Income Contracts reclassified to net interest income	$ (50)	$ (259)	$ (562)
Net settlement expense on interest rate swaps reclassified to net interest income	(59)	(123)	(88)
Net realized losses on terminated derivative contracts reclassified to other income		(5)	(63)
Total reclassifications of realized losses on derivative and hedging activities	(109)	(387)	(713)
Add: Unrealized gains (losses) on derivative and hedging activities, net[(1)]	(230)	634	1,562
Gains (losses) on derivative and hedging activities, net	$ (339)	$ 247	$ 849

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

	Years Ended December 31,		
	2006	**2005**	**2004**
Floor Income Contracts	$ 176	$ 481	$ 729
Equity forward contracts	(360)	121	759
Basis swaps	(58)	40	73
Other	12	(8)	1
Total unrealized gains (losses) on derivative and hedging activities, net	$ (230)	$ 634	$ 1,562

Unrealized gains and losses on Floor Income Contracts are primarily caused by changes in interest rates. In general, an increase in interest rates results in an unrealized gain and vice versa. Unrealized gains and losses on Equity Forward Contracts fluctuate with changes in the Company s stock price. Unrealized gains and losses on basis swaps result from changes in the spread between indices, primarily as it relates to Consumer Price Index (CPI) swaps economically hedging debt issuances indexed to CPI.

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

Table of Contents

The following table summarizes the Floor Income adjustments in our Lending operating segment for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,		
	2006	**2005**	**2004**
Core earnings Floor Income adjustments:			
Floor Income earned on Managed loans, net of payments on Floor Income Contracts	$	$ 19	$ 88
Amortization of net premiums on Floor Income Contracts and futures in net interest income	(209)	(223)	(194)
Net losses related to closed Eurodollar futures contracts economically hedging Floor Income			(50)
Total Core Earnings Floor Income adjustments	$ (209)	$ (204)	$ (156)

4) **Acquired intangibles:** Our Core Earnings exclude goodwill and intangible impairment and the amortization of acquired intangibles. For the years ended December 31, 2006, 2005 and 2004, goodwill and intangible impairment and the amortization of acquired intangibles totaled $94 million, $61 million and $36 million, respectively. In 2006, we recognized an intangible impairment of $21 million due to changes in projected interest rates and to a regulatory change related to our 9.5 percent SAP loans.

LENDING BUSINESS SEGMENT

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

The earnings growth in our Lending operating segment is primarily derived from the growth in our Managed portfolio of student loans. In 2006, the total Managed portfolio grew by $19.6 billion (16 percent) from $122.5 billion at December 31, 2005 to $142.1 billion at December 31, 2006. At December 31, 2006, our Managed FFELP student loan portfolio was $119.5 billion or 84 percent of our total Managed student loans. In addition, our Managed portfolio of Private Education Loans grew to $22.6 billion. Private Education Loans are not insured by the federal government and are underwritten in accordance with the Company s credit policies. Our Managed FFELP loans are high quality assets with minimal credit risk as they are 99 percent guaranteed by the federal government.

Trends in the Lending Business Segment

The growth in our Lending operating segment has been largely driven by the steady growth in the demand for post-secondary education in the United States over the last decade. This growth is evident in the $37.4 billion of student loans we originated or acquired in 2006 through our normal acquisition channels, a 24 percent increase over

the $30.2 billion of student loans acquired in 2005. Our normal acquisition channels exclude loans acquired in conjunction with business combinations. In 2006, we originated $23.4 billion of student loans through our Preferred Channel, an increase of 9 percent over the $21.4 billion of student loans originated through our Preferred Channel in 2005.

We expect the growth in the demand for post-secondary education to continue in the future due to a number of factors. First, the college age population will continue to grow as ED predicts that the college-age population will increase approximately 13 percent from 2006 to 2015. Second, we project an increase in non-traditional students (those not attending college directly from high school) and adult education. Third, tuition

Table of Contents

costs have risen 51 percent for four-year public institutions and 32 percent for four-year private institutions on a constant, inflation-adjusted basis since the academic year (AY) 1996-1997 and are projected to continue to rise at a pace greater than inflation. Management believes that these factors will drive growth in education financing well into the next decade.

On March 22, 2005, the Company announced that it extended both its JPMorgan Chase and Bank One student loan and loan purchase commitments to August 31, 2010. This comprehensive agreement provided for the dissolution of the joint venture between Chase and Sallie Mae.

JPMorgan Chase will continue to sell substantially all student loans to the Company (whether made under the Chase or Bank One brand) that are originated or serviced on our platforms. In addition, the agreement provides that substantially all Chase-branded education loans made for the July 1, 2005 to June 30, 2006 academic year (and future loans made to these borrowers) will be sold to us, including certain loans that are not originated or serviced on Sallie Mae platforms.

This agreement permits JPMorgan Chase to compete with us in the student loan marketplace and releases the Company from its commitment to market the Bank One and Chase brands on campus. We will continue to support its school customers through its comprehensive set of products and services, including its loan origination and servicing platforms, its family of lending brands and strategic lending partners.

Over the past three years, we have experienced a surge in FFELP Consolidation Loan activity as a result of historically low interest rates and aggressive marketing in the industry which has substantially changed the composition of our student loan portfolio. A number of new competitors have entered into the FFELP Consolidation Loan marketplace, as a result of very low barriers to entry for marketing and originating FFELP Consolidation Loans. For example, access to customers does not require an on-campus presence, and a ready and available secondary market exists for these loans. This, coupled with the repeal of the Single Holder Rule have made the FFELP Consolidation Loans marketplace more competitive and has shortened the average life of FFELP Stafford loans, making them less valuable.

FFELP Consolidation Loans earn a lower yield than FFELP Stafford loans due primarily to the 105 basis point Consolidation Loan Rebate Fee. This negative impact is somewhat mitigated by higher SAP spreads, the longer average life of FFELP Consolidation Loans and the greater potential to earn Floor Income. Since interest rates on FFELP Consolidation Loans originated prior to July 1, 2006 are fixed to term for the borrower, older FFELP Consolidation Loans with higher borrower rates can earn Floor Income over an extended period of time. In both 2005 and 2006, substantially all Floor Income was earned on FFELP Consolidation Loans. The Reconciliation Legislation requires lenders to rebate Floor Income on all FFELP loans originated on or after April 1, 2006, so this benefit will gradually decrease over time. During 2006, $15.8 billion of FFELP Stafford loans in our Managed loan portfolio consolidated either with us ($11.3 billion) or with other lenders ($4.5 billion). In addition, we consolidated $4.1 billion of loans from other lenders and had $2.7 billion of our FFELP Consolidation Loans reconsolidated with other lenders. The net result of consolidation activity in 2006 was a net portfolio loss of $3.1 billion. FFELP Consolidation Loans now represent 71 percent of our on-balance sheet federally guaranteed student loan portfolio and over 66 percent of our Managed federally guaranteed portfolio.

The increase in consolidations to third parties during 2006 is due to FFELP lenders reconsolidating FFELP Consolidation Loans using the Direct Loan Program as a pass-through entity to circumvent the statutory prohibition on the reconsolidation of FFELP Consolidation Loans and to the repeal of the Single Holder Rule as of June 15, 2006. The Higher Education Reconciliation Act of 2005 restricted reconsolidation, and as of July 1, 2006, borrowers with a FFELP Consolidation Loan may only reconsolidate with the FDLP if they are delinquent, referred to the guaranty agency for default aversion activity, and enter into the income contingent repayment program (ICR) in the FDLP.

Borrowers may also reconsolidate an existing FFELP Consolidation Loan with a new FFELP Stafford loan.

To meet the increasing cost of higher education, students and parents have turned to alternative sources of education financing outside of the FFELP. A large and growing source of this supplemental education financing is provided by Private Education Loans, for which we are the largest provider. These loans are still

Table of Contents

primarily originated through campus-based programs but during 2006, we aggressively grew our direct-to-consumer Private Education Loans channel and expect it to be an increasing source of Private Education Loans in the future. The Private Education Loan portfolio grew by 38 percent in 2006 to $22.6 billion and now represents 16 percent of our Managed student loan portfolio, up from 13 percent in 2005.

Private Education Loans consist of two general types: (1) those that are designed to bridge the gap between the cost of higher education and the amount financed through either capped federally insured loans or the borrowers resources, and (2) those that are used to meet the needs of students in alternative learning programs such as career training, distance learning and lifelong learning programs. Most higher education Private Education Loans are made in conjunction with a FFELP Stafford loan and as such are marketed through the same channel as FFELP loans by the same sales force. Unlike FFELP loans, Private Education Loans are subject to the full credit risk of the borrower. We manage this additional risk through clearly-defined loan underwriting standards and a combination of higher interest rates and loan origination fees that compensate us for the higher risk. As a result, we earn higher spreads on Private Education Loans than on FFELP loans. Private Education Loans will continue to be an important driver of future earnings growth as the demand for post-secondary education grows and costs increase much faster than increases in federal loan limits.

We originate lesser quantities of mortgage and consumer loans with the intent of immediately selling the majority of the mortgage loans. Mortgage and consumer loan originations and the mortgage loan portfolio we hold were 7 percent and less than one percent, respectively, of total loan originations and total loans outstanding as of and for the year ended December 31, 2006.

Table of Contents

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

	Years Ended December 31,			% Increase (Decrease)	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
Core Earnings interest income:					
FFELP Stafford and Other Student Loans	$ 2,771	$ 2,298	$ 1,715	21%	34%
FFELP Consolidation Loans	4,690	3,014	1,473	56	105
Private Education Loans	2,092	1,160	613	80	89
Other loans	98	85	74	15	15
Cash and investments	705	396	264	78	50
Total Core Earnings interest income	10,356	6,953	4,139	49	68
Total Core Earnings interest expense	7,877	4,798	2,301	64	109
Net Core Earnings interest income	2,479	2,155	1,838	15	17
Less: provisions for losses	303	138	114	120	21
Net Core Earnings interest income after provisions for losses	2,176	2,017	1,724	8	17
Other income	177	111	131	59	(15)
Loss on GSE debt extinguishment and defeasance			221		(100)
Operating expenses	645	547	487	18	12
Income before income taxes and minority interest in net earnings of subsidiaries	1,708	1,581	1,147	8	38
Income taxes	632	586	430	8	36
Income before minority interest in net earnings of subsidiaries	1,076	995	717	8	39
Minority interest in net earnings of subsidiaries		2		(100)	
Core Earnings net income	$ 1,076	$ 993	$ 717	8%	38%

Table of Contents

Summary of our Managed Student Loan Portfolio

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

Ending Balances (net of allowance for loan losses):

	December 31, 2006				
	FFELP Stafford and Other[1]	FFELP Consolidation Loans	Total FFELP	Private Education Loans	Total
On-balance sheet:					
In-school	$ 9,745	$	$ 9,745	$ 4,353	$ 14,098
Grace and repayment	14,530	60,348	74,878	6,075	80,953
Total on-balance sheet, gross	24,275	60,348	84,623	10,428	95,051
On-balance sheet unamortized premium/(discount)	575	988	1,563	(365)	1,198
On-balance sheet allowance for losses	(9)	(12)	(21)	(308)	(329)
Total on-balance sheet, net	24,841	61,324	86,165	9,755	95,920
Off-balance sheet:					
In-school	2,047		2,047	3,892	5,939
Grace and repayment	12,747	17,817	30,564	9,330	39,894
Total off-balance sheet, gross	14,794	17,817	32,611	13,222	45,833
Off-balance sheet unamortized premium/(discount)	244	497	741	(303)	438
Off-balance sheet allowance for losses	(10)	(3)	(13)	(86)	(99)
Total off-balance sheet, net	15,028	18,311	33,339	12,833	46,172
Total Managed	$ 39,869	$ 79,635	$ 119,504	$ 22,588	$ 142,092
% of on-balance sheet FFELP	29%	71%	100%		
% of Managed FFELP	33%	67%	100%		
% of total	28%	56%	84%	16%	100%

	December 31, 2005			
	FFELP Stafford and	FFELP Consolidation	Total	Private Education

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

[1] FFELP category is primarily Stafford loans and also includes federally insured PLUS and HEAL loans.

Table of Contents

Average Balances:

	Year Ended December 31, 2006				
	FFELP Stafford and Other[1]	FFELP Consolidation Loans	Total FFELP	Private Education Loans	Total
On-balance sheet	$ 21,152	$ 55,119	$ 76,271	$ 8,585	$ 84,856
Off-balance sheet	19,546	15,652	35,198	11,138	46,336
Total Managed	$ 40,698	$ 70,771	$ 111,469	$ 19,723	$ 131,192
% of on-balance sheet FFELP	28%	72%	100%		
% of Managed FFELP	37%	63%	100%		
% of total	31%	54%	85%	15%	100%

	Year Ended December 31, 2005				
	FFELP Stafford and Other[1]	FFELP Consolidation Loans	Total FFELP	Private Education Loans	Total
On-balance sheet	$ 20,720	$ 47,082	$ 67,802	$ 6,922	$ 74,724
Off-balance sheet	24,182	9,800	33,982	7,238	41,220
Total Managed	$ 44,902	$ 56,882	$ 101,784	$ 14,160	$ 115,944
% of on-balance sheet FFELP	31%	69%	100%		
% of Managed FFELP	44%	56%	100%		
% of total	39%	49%	88%	12%	100%

	Year Ended December 31, 2004				
	FFELP Stafford and Other[1]	FFELP Consolidation Loans	Total FFELP	Private Education Loans	Total
On-balance sheet	$ 19,317	$ 31,773	$ 51,090	$ 4,795	$ 55,885
Off-balance sheet	27,365	7,698	35,063	5,495	40,558
Total Managed	$ 46,682	$ 39,471	$ 86,153	$ 10,290	$ 96,443

% of on-balance sheet FFELP	38%	62%	100%		
% of Managed FFELP	54%	46%	100%		
% of total	48%	41%	89%	11%	100%

[1] FFELP category is primarily Stafford loans and also includes federally insured PLUS and HEAL loans.

Student Loan Spread

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

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

- the premiums paid, borrower fees charged and capitalized costs incurred to acquire student loans which impact the spread through subsequent amortization;

- the type and level of Borrower Benefits programs;

the level of Floor Income; and when considering the Core Earnings managed spread, the amount of Floor Income-eligible loans that have been hedged through Floor Income Contracts; and

funding and hedging costs.

The student loan spread is highly susceptible to liquidity, funding and interest rate risk. These risks are discussed separately at LIQUIDITY AND CAPITAL RESOURCES and in the RISK FACTORS discussion at the front of the document.

Student Loan Spread Analysis Core Earnings Basis

The following table analyzes the earnings from our portfolio of Managed student loans on a Core Earnings basis (see BUSINESS SEGMENTS *Pre-tax Differences between Core Earnings and GAAP by Business Segment*). The Core Earnings Basis Student Loan Spread Analysis presentation and certain components used in the calculation differ from the On-Balance Sheet Student Loan Spread Analysis presentation. The Core Earnings basis presentation, when compared to our on-balance sheet presentation, is different in that it:

includes the net interest margin related to our off-balance sheet student loan securitization trusts. This includes any related fees or costs such as the Consolidation Loan Rebate Fees, premium/discount amortization and Borrower Benefits yield adjustments;

includes the reclassification of certain derivative net settlement amounts. The net settlements on certain derivatives that do not qualify as SFAS No. 133 hedges are recorded as part of the gain (loss) on derivative and hedging activities, net line item on the income statement and are therefore not recognized in the student loan spread. Under this presentation, these gains and losses are reclassified to the income statement line item of the economically hedged item. For our Core Earnings basis student loan spread, this would primarily include: (a) reclassifying the net settlement amounts related to our written Floor Income Contracts to student loan interest income and (b) reclassifying the net settlement amounts related to certain of our basis swaps to debt interest expense;

excludes unhedged Floor Income earned on the Managed student loan portfolio; and

includes the amortization of upfront payments on Floor Income Contracts in student loan income that we believe are economically hedging the Floor Income.

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

limitation is that the

Core Earnings basis student loan spread includes the spread on loans that we have sold to securitization trusts.

	Years ended December 31,		
	2006	2005	2004
Core Earnings basis student loan yield	8.09%	6.32%	4.59%
Consolidation Loan Rebate Fees	(.55)	(.50)	(.42)
Offset Fees			(.02)
Borrower Benefits	(.09)	(.07)	(.08)
Premium and discount amortization	(.16)	(.17)	(.13)
Core Earnings basis student loan net yield	7.29	5.58	3.94
Core Earnings basis student loan cost of funds	(5.45)	(3.80)	(2.06)
Core Earnings basis student loan spread[1]	1.84%	1.78%	1.88%
Average Balances			
On-balance sheet student loans[1]	$ 84,173	$ 74,724	$ 55,885
Off-balance sheet student loans	46,336	41,220	40,558
Managed student loans	$ 130,509	$ 115,944	$ 96,443

[1] Excludes the impact of the Wholesale Consolidation Loan portfolio on the student loan spread and average balances for the year ended December 31, 2006.

Discussion of the Year-over-Year Effect of Changes in Accounting Estimates on the Core Earnings basis Loan Spread

As discussed in detail and summarized in a table at CRITICAL ACCOUNTING POLICIES AND ESTIMATES, we periodically update our estimates for changes in the student loan portfolio. Under SFAS No. 91, these changes in estimates must be reflected in the balance from inception of the student loan. We have also updated our estimates to reflect programmatic changes in our Borrower Benefits and Private Education Loan programs and have made modeling refinements to better reflect current and future conditions. The cumulative effects of the changes in estimates are summarized in the table below:

	Years Ended December 31,					
	2006		2005		2004	
	Dollar Value	Basis Points	Dollar Value	Basis Points	Dollar Value	Basis Points
Cumulative effect of changes in critical accounting estimates:						
Premium and discount amortization	$		$		$ 12	1
Borrower Benefits	15	1	34	3	22	2
Total cumulative effect of changes in estimates	$ 15	1	$ 34	3	$ 34	3

In 2006, we changed our policy related to Borrower Benefit qualification requirements and updated our assumptions to reflect this policy. In 2005 and 2004, we updated our estimates for the qualification for Borrower Benefits to account for programmatic changes as well as the effect of continued high levels of consolidations.

In 2004, we updated our estimates of the average life of our various loan programs to recognize the shifting mix of the portfolio. The net cumulative effect of these changes was a $12 million adjustment to increase the balance of the unamortized student loan premium. The difference between the effect for on-balance sheet and off-balance sheet was primarily due to a refinement in our estimates for off-balance sheet loans that did not have the same effect on-balance sheet and to the different mix of on-balance sheet loans versus the mix on a Managed Basis.

Table of Contents

Discussion of Core Earnings Basis Student Loan Spread Effects of Significant Events in 2006 and 2005

In addition to changes in estimates discussed above, FFELP Consolidation Loan activity has the greatest effect on fluctuations in our premium amortization and Borrower Benefits as we write-off the balance of unamortized premium and the Borrower Benefit reserve when loans are consolidated away, in accordance with SFAS No. 91. See below for a further discussion of the effects of FFELP Consolidation Loans on the student loan spread versus Stafford Loans. See also, CRITICAL ACCOUNTING POLICIES AND ESTIMATES Effects of Consolidation Activity on Estimates, above.

Also, there were high levels of FFELP Consolidation Loan activity in the second quarter of both 2006 and 2005 caused primarily by FFELP Stafford borrowers locking in lower interest rates by consolidating their loans prior to the July 1 interest rate reset for FFELP Stafford loans. In addition, there were two new methods of consolidation practiced by the industry in 2005 and the first half of 2006. First, borrowers were permitted for the first time to consolidate their loans while still in school. Second, a significant volume of our FFELP Consolidation Loans was reconsolidated with third party lenders through the FDLP, resulting in an increase in student loan premium write-offs. Also, the repeal of the Single Holder Rule increased the amount of loans that consolidated with third parties resulting in increased premium write-offs in the second half of the year. Consolidation of student loans does benefit the student loan spread to a lesser extent through the write-off of Borrower Benefits reserves associated with these loans. Both in-school consolidation and reconsolidation with third party through the FDLP were restricted as of July 1, 2006, through the Higher Education Act of 2005. While FFELP Consolidation Loan activity remained high in 2006, it was lower than 2005, which contributed to lower student loan premium amortization in 2006.

Discussion of Student Loan Spread Other Year-over-Year Fluctuations 2006 versus 2005

The decrease in the 2006 student loan spread versus 2005 is primarily due to the higher average balance of FFELP Consolidation Loans as a percentage of the on-balance sheet portfolio contributes to downward pressure on the spread. FFELP Consolidation Loans have lower spreads than other FFELP loans due to the 105 basis point Consolidation Loan Rebate Fee, higher Borrower Benefits, and funding costs due to their longer terms. These negative effects are partially offset by lower student loan premium amortization due to the extended term and a higher SAP yield. The average balance of FFELP Consolidation Loans grew as a percentage of the average Managed FFELP student loan portfolio from 56 percent in 2005 to 63 percent in 2006.

The 2006 student loan spread benefited from the increase in the average balance of Managed Private Education Loans as a percentage of the average Managed student loan portfolio from 12 percent in 2005 to 15 percent in 2006. Private Education Loans are subject to credit risk and therefore earn higher spreads than the Managed guaranteed student loan portfolio.

Discussion of Student Loan Spread Other Year-over-Year Fluctuations 2005 versus 2004

The decrease in the 2005 student loan spread versus 2004 is primarily due to the higher average balance of FFELP Consolidation Loans as a percentage of the on-balance sheet portfolio contributes to downward pressure on the spread. The average balance of FFELP Consolidation Loans grew as a percentage of the average Managed FFELP student loan portfolio from 46 percent in 2004 to 56 percent in 2005.

Other factors that impacted the student loan spread include higher spreads on our debt funding student loans as a result of the GSE Wind-Down, partially offset by lower Borrower Benefits costs, and the absence of Offset Fees on GSE financed loans. The increase in funding costs is due to the replacement of lower cost, primarily short-term GSE funding with longer term, higher cost funding. The negative effects on the spread were partially offset by the increase

in Private Education Loans.

Table of Contents

Wholesale Consolidation Loans

As discussed under Student Loans *Student Loan Spread Analysis Core Earnings Basis,* we have excluded the impact of Wholesale Consolidation Loans from our student loan spread analysis both on-balance sheet and on a Core Earnings basis. The average balance of Wholesale Consolidation Loans was $683 million for the year ended December 31, 2006. Had the Wholesale Consolidation Loan volume been included in the Core Earnings basis student loan spread, it would have had no impact to the spread for the year ended December 31, 2006. As of December 31, 2006, Wholesale Consolidation Loans totaled $3.6 billion, or 4.5 percent, of our total Managed Consolidation Loan portfolio.

Core Earnings Basis Student Loan Spreads by Loan Type

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

The following table reflects the Core Earnings basis student loan spreads by product, excluding the impact of the Wholesale Consolidation Loan portfolio as discussed above, for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,		
	2006	**2005**	**2004**
FFELP Loan Spreads (Core Earnings Basis):			
Stafford	1.40%	1.48%	1.73%
Consolidation	1.18	1.31	1.43
FFELP Loan Spread (Core Earnings Basis)	1.26	1.39	1.59
Private Education Loan Spreads (Core Earnings Basis):			
Before provision	5.13%	4.62%	4.22%
After provision	3.75	3.88	2.69

Table of Contents

Floor Income Managed Basis

The following table analyzes the ability of the FFELP student loans in our Managed student loan portfolio to earn Floor Income after December 31, 2006 and 2005

	December 31, 2006			December 31, 2005		
(Dollars in billions)	**Fixed Borrower Rate**	**Variable Borrower Rate**	**Total**	**Fixed Borrower Rate**	**Variable Borrower Rate**	**Total**
Student loans eligible to earn Floor Income:						
On-balance sheet student loans	$ 63.0	$ 18.3	$ 81.3	$ 53.4	$ 16.0	$ 69.4
Off-balance sheet student loans	17.8	14.5	32.3	10.3	18.4	28.7
Managed student loans eligible to earn Floor Income	80.8	32.8	113.6	63.7	34.4	98.1
Less: notional amount of Floor Income Contracts	(16.4)		(16.4)	(25.1)		(25.1)
Net Managed student loans eligible to earn Floor Income	$ 64.4	$ 32.8	$ 97.2	$ 38.6	$ 34.4	$ 73.0
Net Managed student loans earning Floor Income	$ 1.0	$	$ 1.0	$ .8	$	$ .8

The reconsolidation of FFELP Consolidation Loans described above has had an unanticipated impact on FFELP Consolidation Loans underlying the Floor Income Contracts that are economically hedging the fixed borrower interest rate earned on FFELP Consolidation Loans. We have sold Floor Income Contracts to hedge the potential Floor Income from specifically identified pools of FFELP Consolidation Loans that are eligible to earn Floor Income. Since reconsolidation of FFELP Consolidation Loans is limited by law, we did not anticipate that certain lenders would circumvent this law and reconsolidate loans through the FDLP. As a consequence, higher rate FFELP Consolidation Loans that underlie certain contracts were reconsolidated and no longer match the underlying Floor Income Contract, which resulted in the notional amount of Floor Income Contracts at December 31, 2006 being slightly higher than the outstanding balance of the underlying FFELP Consolidation Loans that the Floor Income Contracts were hedging. The Higher Education Act of 2005 has restricted the use of reconsolidation as of July 1, 2006, so we do not foresee any material impact on our Floor Income in the future.

The following table presents a projection of the average Managed balance of FFELP Consolidation Loans whose Fixed Rate Floor Income has already been economically hedged through Floor Income Contracts for the period January 1, 2007 to March 31, 2010. These loans are both on and off-balance sheet and the related hedges do not qualify under SFAS No. 133 accounting as effective hedges.

(Dollars in billions)	**2007**	**2008**	**2009**	**2010**

Average balance of FFELP Consolidation Loans whose Floor Income is economically hedged (Managed Basis)	$ 16	$ 15	$ 10	$ 2

Table of Contents

Private Education Loans

Allowance for Private Education Loan Losses

2005 Change in Accounting Estimate to the Allowance for Loan Losses and the Recognition of Accrued Interest Income for Private Education Loans

As discussed under CRITICAL ACCOUNTING POLICIES AND ESTIMATES Allowance for Loan Losses, in 2005 we changed our estimate of the allowance for loan losses and accrued interest for our Managed loan portfolio to a migration analysis of delinquent and current accounts. This change in reserving methodology was accounted for as a change in estimate in accordance with APB Opinion No. 20, Accounting Changes.

Activity in the Allowance for Private Education Loan Losses

As discussed in detail under CRITICAL ACCOUNTING POLICIES AND ESTIMATES, the provisions for student loan losses represent the periodic expense of maintaining an allowance sufficient to absorb losses, net of recoveries, inherent in the portfolio of Private Education Loans.

The following table summarizes changes in the allowance for Private Education Loan losses for the years ended December 31, 2006, 2005 and 2004.

	Activity in Allowance for Private Education Loans								
	On-Balance Sheet Years Ended December 31,			Off-Balance Sheet Years Ended December 31,			Managed Basis Years Ended December 31,		
	2006	2005	2004	2006	2005	2004	2006	2005	2004
lowance at ginning of riod	$ 204	$ 172	$ 166	$ 78	$ 143	$ 93	$ 282	$ 315	$ 259
ovision for ivate lucation Loan sses	258	186	130	15	3	28	273	189	158
ange in net ss estimates		(9)			(76)			(85)	
tal provision	258	177	130	15	(73)	28	273	104	158
arge-offs	(160)	(154)	(110)	(24)	(2)	(6)	(184)	(156)	(116)
ecoveries	23	19	14				23	19	14
t charge-offs	(137)	(135)	(96)	(24)	(2)	(6)	(161)	(137)	(102)
lance before curitization of ivate lucation Loans	325	214	200	69	68	115	394	282	315
eduction for curitization of	(17)	(10)	(28)	17	10	28			

ivate ducation Loans									
lowance at d of period	$ 308	$ 204	$ 172	$ 86	$ 78	$ 143	$ 394	$ 282	$ 315
et charge-offs a percentage average loans repayment	3.22%	4.14%	3.57%	.43%	.07%	.22%	1.62%	1.89%	1.92
lowance as a rcentage of e ending total an balance	3.06%	2.56%	3.07%	.66%	.89%	2.31%	1.71%	1.69%	2.67
lowance as a rcentage of ding loans in payment	6.36%	5.57%	6.05%	1.26%	1.68%	4.27%	3.38%	3.40%	5.08
verage verage of net arge-offs	2.25	1.52	1.79	3.46	29.75	24.81	2.44	2.06	3.09
verage total ans	$ 8,585	$ 6,922	$ 4,795	$ 11,138	$ 7,238	$ 5,495	$ 19,723	$ 14,160	$ 10,290
nding total ans	$ 10,063	$ 7,961	$ 5,592	$ 12,919	$ 8,758	$ 6,205	$ 22,982	$ 16,719	$ 11,797
verage loans repayment	$ 4,257	$ 3,252	$ 2,697	$ 5,721	$ 4,002	$ 2,611	$ 9,978	$ 7,254	$ 5,307
nding loans in payment	$ 4,851	$ 3,662	$ 2,842	$ 6,792	$ 4,653	$ 3,352	$ 11,643	$ 8,315	$ 6,194

Table of Contents

On-Balance Sheet versus Managed Presentation

All Private Education Loans are initially acquired on-balance sheet. When we securitize Private Education Loans, we no longer legally own the loans and they are accounted for off-balance sheet. For our Managed presentation in the table above, when loans are securitized, we reduce the on-balance sheet allowance for amounts previously provided and then provide for these loans off-balance sheet with the total of both on and off-balance sheet being the Managed allowance.

When Private Education Loans in our securitized trusts settling before September 30, 2005, become 180 days delinquent, we typically exercise our contingent call option to repurchase these loans at par value out of the trust and record a loss for the difference in the par value paid and the fair market value of the loan at the time of purchase. If these loans reach the 212-day delinquency, a charge-off for the remaining balance of the loan is triggered. On a Managed Basis, the losses recorded under GAAP for loans repurchased at day 180 are reversed and the full amount is charged-off at day 212. We do not hold the contingent call option for all trusts settled after September 30, 2005.

When measured as a percentage of ending loans in repayment, the off-balance sheet allowance is lower than the on-balance sheet percentage because of the different mix of loans on-balance sheet and off-balance sheet, as described above. Additionally, a larger percentage of the off-balance sheet loan borrowers are still in-school status and not required to make payments on their loans. Once repayment begins, the allowance requirements increase to reflect the increased risk of loss as loans enter repayment.

Managed Basis Private Education Loan Loss Allowance Discussion

The allowance for Private Education Loan losses at December 31, 2006 grew 40 percent versus 2005, which was in direct proportion to the 40 percent growth in the balance of loans in repayment, while net charge-offs increased 18 percent year-over-year. This resulted in an improvement in the ratio of net charge-offs to average loans in repayment from 1.89 percent at December 31, 2005 to 1.62 percent at December 31, 2006. The ending balance of the allowance for Private Education Loans at December 31, 2006 resulted in an average coverage of annual net charge-offs ratio of 2.44, which is an 18 percent increase over the December 31, 2005 ratio of 2.06.

The seasoning and the changing mix of loans in the portfolio, coupled with the higher repayment levels associated with the growth in our Private Education Loan portfolio have more recently resulted in higher levels of charge-offs and provision. We expect these levels to continue and likely to increase.

The year-over-year allowance on a Managed Basis increased by $52 million from 2004 to 2005, exclusive of the adjustments related to the changes in estimate and methodology discussed above. This increase was primarily driven by the 37 percent year-over-year increase in average loans in repayment. As a result of the change in the loan loss and recovery estimates discussed above, the allowance as a percentage of ending loans in repayment decreased from 5.08 percent to 3.40 percent, and consequently the year-over-year growth rate in the provision is less than the growth rate in the portfolio.

Table of Contents

Delinquencies

The table below presents our Private Education Loan delinquency trends as of December 31, 2006, 2005 and 2004. Delinquencies have the potential to adversely impact earnings as they are an initial indication of the borrower s potential to possibly default and as a result command a higher loan loss reserve than loans in current status. Delinquent loans also require increased servicing and collection efforts, resulting in higher operating costs.

	On-Balance Sheet Private Education Loan Delinquencies					
	December 31, 2006		December 31, 2005		December 31, 2004	
	Balance	%	Balance	%	Balance	%
Loans in-school/grace/deferment[1]	$ 5,218		$ 4,301		$ 2,787	
Loans in forbearance[2]	359		303		166	
Loans in repayment and percentage of each status:						
Loans current	4,214	86.9%	3,311	90.4%	2,555	89.9%
Loans delinquent 31-60 days[3]	250	5.1	166	4.5	124	4.4
Loans delinquent 61-90 days[3]	132	2.7	77	2.1	56	2.0
Loans delinquent greater than 90 days[3]	255	5.3	108	3.0	107	3.7
Total Private Education Loans in repayment	4,851	100%	3,662	100%	2,842	100%
Total Private Education Loans, gross	10,428		8,266		5,795	
Private Education Loan unamortized discount	(365)		(305)		(203)	
Total Private Education Loans	10,063		7,961		5,592	
Private Education Loan allowance for losses	(308)		(204)		(172)	
Private Education Loans, net	$ 9,755		$ 7,757		$ 5,420	
Percentage of Private Education Loans in repayment	46.5%		44.3%		49.0%	
Delinquencies as a percentage of Private Education Loans in repayment	13.1%		9.6%		10.1%	

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

[2] Loans for borrowers who have requested extension of grace period generally during employment transition or who have temporarily ceased making full payments due to hardship or other factors, consistent with the established loan program servicing policies and procedures.

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

Table of Contents

	Off-Balance Sheet Private Education Loan Delinquencies					
	December 31, 2006		December 31, 2005		December 31, 2004	
	Balance	%	Balance	%	Balance	%
Loans in-school/grace/deferment[1]	$ 5,608		$ 3,679		$ 2,622	
Loans in forbearance[2]	822		614		334	
Loans in repayment and percentage of each status:						
Loans current	6,419	94.5%	4,446	95.6%	3,191	95.2%
Loans delinquent 31-60 days[3]	222	3.3	136	2.9	84	2.5
Loans delinquent 61-90 days[3]	60	.9	35	.7	28	.8
Loans delinquent greater than 90 days[3]	91	1.3	36	.8	49	1.5
Total Private Education Loans in repayment	6,792	100%	4,653	100%	3,352	100%
Total Private Education Loans, gross	13,222		8,946		6,308	
Private Education Loan unamortized discount	(303)		(188)		(103)	
Total Private Education Loans	12,919		8,758		6,205	
Private Education Loan allowance for losses	(86)		(78)		(143)	
Private Education Loans, net	$ 12,833		$ 8,680		$ 6,062	
Percentage of Private Education Loans in repayment	51.4%		52.0%		53.1%	
Delinquencies as a percentage of Private Education Loans in repayment	5.5%		4.4%		4.8%	

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

(2) Loans for borrowers who have requested extension of grace period generally during employment transition or who have temporarily ceased making full payments due to hardship or other factors, consistent with the established loan program servicing policies and procedures.

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

	Managed Basis Private Education Loan Delinquencies					
	December 31, 2006		December 31, 2005		December 31, 2004	
	Balance	%	Balance	%	Balance	%
Loans in-school/grace/deferment[1]	$ 10,826		$ 7,980		$ 5,409	
Loans in forbearance[2]	1,181		917		500	
Loans in repayment and percentage of each status:						
Loans current	10,633	91.3%	7,757	93.3%	5,746	92.8%
Loans delinquent 31-60 days[3]	472	4.0	302	3.6	208	3.3
Loans delinquent 61-90 days[3]	192	1.7	112	1.4	84	1.4
Loans delinquent greater than 90 days[3]	346	3.0	144	1.7	156	2.5
Total Private Education Loans in repayment	11,643	100%	8,315	100%	6,194	100%
Total Private Education Loans, gross	23,650		17,212		12,103	
Private Education Loan unamortized discount	(668)		(493)		(306)	
Total Private Education Loans	22,982		16,719		11,797	
Private Education Loan allowance for losses	(394)		(282)		(315)	
Private Education Loans, net	$ 22,588		$ 16,437		$ 11,482	
Percentage of Private Education Loans in repayment	49.2%		48.3%		51.2%	
Delinquencies as a percentage of Private Education Loans in repayment	8.7%		6.7%		7.2%	

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

[2] Loans for borrowers who have requested extension of grace period generally during employment transition or who have temporarily ceased making full payments due to hardship or other factors, consistent with the established loan program servicing policies and procedures.

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

Toward the end of 2006 and in early 2007, we experienced lower collections resulting in increased levels of charge-off activity in our Private Education Loan portfolio. We believe that this is attributable in some degree to a

number of operational challenges at our DMO in performing pre-default and post-default collections on the Company s Private Education Loan portfolio. In August 2006, we announced that we intended to relocate responsibility for certain Private Education Loan collections from our Nevada call center to a new call center in Indiana. This transfer presented us with unexpected operational challenges that resulted in lower collections that have negatively impacted the Private Education Loan portfolio. Management has taken several remedial actions, including transferring experienced collection personnel to the new call center. In addition, the DMO also revised certain procedures, including its use of forbearance, to better optimize our long-term collection strategies. We expect that these developments will result in increased later stage delinquency levels and associated higher charge-offs in the first and perhaps the second quarters of 2007.

Forbearance Managed Basis Private Education Loans

Private Education Loans are made to parent and student borrowers in accordance with our underwriting policies. These loans generally supplement federally guaranteed student loans, which are subject to federal lending caps. Private Education Loans are not federally guaranteed or insured against any loss of principal or

Table of Contents

interest. Traditional student borrowers use the proceeds of these loans to obtain higher education, which increases the likelihood of obtaining employment at higher income levels than would be available without the additional education. As a result, the borrowers repayment capability improves between the time the loan is made and the time they enter the post-education work force. We generally allow the loan repayment period on traditional higher education Private Education Loans to begin six months after the borrower leaves school (consistent with our federally regulated FFELP loans). This provides the borrower time after graduation to obtain a job to service the debt. For borrowers that need more time or experience other hardships, we permit additional delays in payment or partial payments (both referred to as forbearances) when we believe additional time will improve the borrower s ability to repay the loan. Forbearance is also granted to borrowers who may experience temporary hardship after entering repayment, when we believe that it will increase the likelihood of ultimate collection of the loan. Forbearance can be requested by the borrower or initiated by the Company and is granted within established policies that include limits on the number of forbearance months granted consecutively and limits on the total number of forbearance months granted over the life of the loan. In some instances of forbearance, we require good-faith payments or continuing partial payments. Exceptions to forbearance policies are permitted in limited circumstances and only when such exceptions are judged to increase the likelihood of ultimate collection of the loan.

Forbearance does not grant any reduction in the total repayment obligation (principal or interest) but does allow for the temporary cessation of borrower payments (on a prospective and/or retroactive basis) or a reduction in monthly payments for an agreed period of time. The forbearance period extends the original term of the loan. While the loan is in forbearance, interest continues to accrue and is capitalized as principal upon the loan re-entering repayment status. Loans exiting forbearance into repayment status are considered current regardless of their previous delinquency status.

Forbearance is used most heavily immediately after the loan enters repayment. As indicated in the tables below that show the composition and status of the Managed Private Education Loan portfolio by number of months aged from the first date of repayment, the percentage of loans in forbearance decreases the longer the loans have been in repayment. At December 31, 2006, loans in forbearance as a percentage of loans in repayment and forbearance is 11.7 percent for loans that have been in repayment one to twenty-four months. The percentage drops to 3.4 percent for loans that have been in repayment more than 48 months. Approximately 76 percent of our Managed Private Education Loans in forbearance have been in repayment less than 24 months. These borrowers are essentially extending their grace period as they transition to the workforce. Forbearance continues to be a positive collection tool for Private Education Loans as we believe it can provide the borrower with sufficient time to obtain employment and income to support his or her obligation. We consider the potential impact of forbearance in the determination of the loan loss reserves.

Table of Contents

The tables below show the composition and status of the Private Education Loan portfolio by number of months aged from the first date of repayment:

	Months Since Entering Repayment				
	1 to 24 months	25 to 48 months	More than 48 months	After Dec. 31, 2006[(1)]	Total
December 31, 2006					
Loans in-school/grace/deferment	$	$	$	$ 10,826	$ 10,826
Loans in forbearance	898	209	74		1,181
Loans in repayment current	6,273	2,477	1,883		10,633
Loans in repayment delinquent 31-60 days	271	119	82		472
Loans in repayment delinquent 61-90 days	109	49	34		192
Loans in repayment delinquent greater than 90 days	157	117	72		346
Total	$ 7,708	$ 2,971	$ 2,145	$ 10,826	$ 23,650
Unamortized discount					(668)
Allowance for loan losses					(394)
Total Managed Private Education Loans, net					$ 22,588
Loans in forbearance as a percentage of loans in repayment and forbearance	11.7%	7.1%	3.4%	%	9.2%

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

	Months Since Entering Repayment				
	1 to 24 months	25 to 48 months	More than 48 months	After Dec. 31, 2005[(1)]	Total
December 31, 2005					
Loans in-school/grace/deferment	$	$	$	$ 7,980	$ 7,980
Loans in forbearance	667	173	77		917
Loans in repayment current	4,508	1,796	1,453		7,757
Loans in repayment delinquent 31-60 days	168	78	56		302
Loans in repayment delinquent 61-90 days	63	30	19		112
Loans in repayment delinquent greater than 90 days	72	44	28		144

Total	$ 5,478	$ 2,121	$ 1,633	$ 7,980	$ 17,212
Unamortized discount					(493)
Allowance for loan losses					(282)
Total Managed Private Education Loans, net					$ 16,437
Loans in forbearance as a percentage of loans in repayment and forbearance	12.2%	8.2%	4.7%	%	9.9%

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

	Months Since Entering Repayment				
	1 to 24 months	25 to 48 months	More than 48 months	After Dec. 31, 2004[(1)]	Total
December 31, 2004					
Loans in-school/grace/deferment	$	$	$	$ 5,409	$ 5,409
Loans in forbearance	350	103	47		500
Loans in repayment current	3,228	1,401	1,117		5,746
Loans in repayment delinquent 31-60 days	110	59	39		208
Loans in repayment delinquent 61-90 days	43	26	15		84
Loans in repayment delinquent greater than 90 days	67	56	33		156
Total	$ 3,798	$ 1,645	$ 1,251	$ 5,409	$ 12,103
Unamortized discount					(306)
Allowance for loan losses					(315)
Total Managed Private Education Loans, net					$ 11,482
Loans in forbearance as a percentage of loans in repayment and forbearance	9.2%	6.3%	3.8%	%	7.5%

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

The table below stratifies the portfolio of Managed Private Education Loans in forbearance by the cumulative number of months the borrower has used forbearance as of the dates indicated. As detailed in the table below, 4 percent of loans currently in forbearance have cumulative forbearance of more than 24 months, which is a decrease from the prior two years.

	December 31, 2006		December 31, 2005		December 31, 2004	
	Forbearance Balance	% of Total	Forbearance Balance	% of Total	Forbearance Balance	% of Total
Cumulative number of months borrower has used forbearance						
Up to 12 months	$ 870	74%	$ 686	75%	$ 334	66%
13 to 24 months	262	22	165	18	117	24
25 to 36 months	36	3	44	5	30	6
More than 36 months	13	1	22	2	19	4
Total	$ 1,181	100%	$ 917	100%	$ 500	100%

Allowance for FFELP Student Loan Losses

Since October 2005, we have operated under the EP designation in recognition of meeting certain servicing performance standards as set by the ED. On February 8, 2006, the Reconciliation Legislation reduced the level of default insurance for lenders with the EP designation to 99 percent from 100 percent on claims filed on or after July 1, 2006. As a result of the amended insurance levels, we established a Risk Sharing allowance as of December 31, 2005 for an estimate of losses on FFELP student loans based on the one percent reduction in default insurance for loans serviced with the EP designation. The reserve was established and has been maintained using a migration analysis similar to that described above for the Private Education Loans. As a result, for the year ended December 31, 2005, we provided for additional reserves of $10 million for on-balance sheet FFELP loans and $19 million for Managed FFELP loans. At December 31, 2006, the reserve was $20 million for on-balance sheet FFELP loans and $34 million for Managed FFELP loans.

Total Loan Net Charge-offs

The following tables summarize the net charge-offs for all loan types on-balance sheet and on a Managed Basis for the years ended December 31, 2006, 2005 and 2004.

Total on-balance sheet loan net charge-offs

	Years Ended December 31,		
	2006	2005	2004
Private Education Loans	$ 137	$ 135	$ 96
FFELP Stafford and Other Student Loans	5	4	7
Mortgage and consumer loans	5	5	6
Total on-balance sheet loan net charge-offs	$ 147	$ 144	$ 109

Total Managed loan net charge-offs

	Years Ended December 31,		
	2006	2005	2004
Private Education Loans	$ 161	$ 137	$ 102
FFELP Stafford and Other Student Loans	8	4	19
Mortgage and consumer loans	5	5	6
Total Managed loan net charge-offs	$ 174	$ 146	$ 127

The decrease in FFELP Stafford and Other Student Loans charge-offs in 2005 is due to the Company earning the EP designation in the fourth quarter of 2004.

Student Loan Premiums as a Percentage of Principal

The following table presents student loan premiums paid as a percentage of the principal balance of student loans acquired for the respective periods.

	Years Ended December 31,					
	2006		2005		2004	
	Volume	Rate	Volume	Rate	Volume	Rate
Student loan premiums paid:						
Sallie Mae brands	$ 12,271	.94%	$ 8,430	.38%	$ 6,197	.36%

Lender partners	11,738	1.97	12,463	1.77	10,541	1.60
Total Preferred Channel	24,009	1.44	20,893	1.21	16,738	1.14
Other purchases[1]	6,228	4.39	2,479	3.68	8,436	4.60
Subtotal base purchases	30,237	2.05	23,372	1.47	25,174	2.30
Consolidation originations	4,188	2.54	4,672	2.32	2,609	2.18
Total	$ 34,425	2.11%	$ 28,044	1.61%	$ 27,783	2.29%

(1) Primarily includes spot purchases (including Wholesale Consolidation Loans), other commitment clients, and subsidiary acquisitions.

The increase in premiums paid as a percentage of principal balance for Sallie Mae brands is primarily due to the increase in loans where we pay the origination fee and/or federal guaranty fee on behalf of borrowers, a practice we call zero-fee lending. Premiums paid on lender partners were similarly impacted by zero-fee lending. The borrower origination fee will be gradually phased out by the Reconciliation Legislation from 2007 to 2010.

The other purchases category includes the acquisition of Wholesale Consolidation Loans which totaled $3.5 billion at an average premium percentage of 5.07 percent for the year ended December 31, 2006. Wholesale Consolidation Loans are discussed in more detail at Student Loan Spread Wholesale Consolidation Loans. In 2004, other purchases included loans acquired in business combinations.

Included in consolidation originations is the 50 basis point FFELP Consolidation Loan origination fee paid on the total balance of new FFELP Consolidation Loans, including internally consolidated loans from our existing portfolio. The consolidation originations premium paid percentage is calculated on only consolidation volume that is incremental to our portfolio. This percentage is largely driven by the mix of internal consolidations.

Student Loan Acquisitions

In 2006, 76 percent of our Managed student loan acquisitions (exclusive of loans acquired through business combinations and capitalized interest, premiums and discounts) were originated through our Preferred Channel. The following tables summarize the components of our student loan acquisition activity for the years ended December 31, 2006, 2005 and 2004.

	Year Ended December 31, 2006		
	FFELP	Private	Total
Preferred Channel	$ 16,398	$ 7,611	$ 24,009
Other commitment clients	457	61	518
Spot purchases	5,710		5,710
Consolidations from third parties	4,092	96	4,188
Acquisitions from off-balance sheet securitized trusts, primarily consolidations	7,141	255	7,396
Capitalized interest, premiums and discounts	1,716	146	1,862
Total on-balance sheet student loan acquisitions	35,514	8,169	43,683
Consolidations to SLM Corporation from off-balance sheet securitized trusts	(7,141)	(255)	(7,396)
Capitalized interest, premiums and discounts off-balance sheet securitized trusts	658	472	1,130
Total Managed student loan acquisitions	$ 29,031	$ 8,386	$ 37,417

	Year Ended December 31, 2005		
	FFELP	Private	Total
Preferred Channel	$ 14,847	$ 6,046	$ 20,893
Other commitment clients	500	56	556
Spot purchases	1,880		1,880
Consolidations from third parties	4,671	1	4,672
Acquisitions from off-balance sheet securitized trusts, primarily consolidations	9,487		9,487
Acquisition of Idaho Transferee Corporation	43		43
Capitalized interest, premiums and discounts	1,364	(10)	1,354
Total on-balance sheet student loan acquisitions	32,792	6,093	38,885
Consolidations to SLM Corporation from off-balance sheet securitized trusts	(9,487)		(9,487)
Capitalized interest, premiums and discounts off-balance sheet securitized trusts	533	275	808
Total Managed student loan acquisitions	$ 23,838	$ 6,368	$ 30,206

	Year Ended December 31, 2004		
	FFELP	Private	Total
Preferred Channel	$ 12,756	$ 3,982	$ 16,738
Other commitment clients	368	45	413
Spot purchases	1,804	4	1,808
Consolidations from third parties	2,609		2,609
Acquisitions from off-balance sheet securitized trusts, primarily consolidations	5,554		5,554
Acquisition of Southwest	4,776	4	4,780
Acquisition of SLFA	1,435		1,435
Capitalized interest, premiums and discounts	1,398	(2)	1,396
Total on-balance sheet student loan acquisitions	30,700	4,033	34,733
Consolidations to SLM Corporation from off-balance sheet securitized trusts	(5,554)		(5,554)
Capitalized interest, premiums and discounts off-balance sheet securitized trusts	565	172	737
Total Managed student loan acquisitions	$ 25,711	$ 4,205	$ 29,916

As shown on the above table, off-balance sheet FFELP Stafford loans that consolidate with us become an on-balance sheet interest earning asset. This activity results in impairments of our Retained Interests in securitizations, but this is

offset by an increase in on-balance sheet interest earning assets, for which we do not record an offsetting gain.

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

	December 31,		
	2006	2005	2004
FFELP Stafford and Other Student Loans, net	$ 24,841	$ 19,988	$ 18,965
FFELP Consolidation Loans, net	61,324	54,859	41,596
Managed Private Education Loans, net	9,755	7,757	5,420
Other loans, net	1,309	1,138	1,048
Investments(1)	8,175	7,748	8,914
Residual Interest in off-balance sheet securitized loans	3,341	2,406	2,315
Other(2)	4,859	3,576	4,792
Total assets	$ 113,604	$ 97,472	$ 83,050

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

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

Preferred Channel Originations

In 2006, we originated $23.4 billion in student loan volume through our Preferred Channel, a 9 percent increase over the $21.4 billion originated in 2005. In 2006, we grew the internal lending brand Preferred Channel Originations by 43 percent and our own brands now constitute 56 percent of our Preferred Channel Originations, up from 43 percent in 2005. At the same time, the JPMorgan Chase volume decreased by 38 percent and was 16 percent of our Preferred Channel Originations, down from 28 percent in 2004. The pipeline of loans that we currently service and are committed to purchase was $5.4 billion and $6.8 billion at December 31, 2006 and 2005, respectively. The following tables further break down our Preferred Channel Originations by type of loan and source.

	Years Ended December 31,		
	2006	2005	2004
Preferred Channel Originations Type of Loan			
Stafford	$ 13,184	$ 12,547	$ 11,383
PLUS	2,540	2,570	2,303
GradPLUS	246		
Total FFELP	15,970	15,117	13,686
Private Education Loans	7,411	6,236	4,307
Total	$ 23,381	$ 21,353	$ 17,993

Table of Contents

	Years Ended December 31,			Increase (Decrease)			
	2006	2005	2004	2006 vs. 2005		2005 vs. 2004	
	FFELP	FFELP	FFELP	$	%	$	%
Preferred Channel Originations Source							
Internal lending brands	$ 6,939	$ 4,803	$ 3,562	$ 2,136	44%	$ 1,241	35%
Other lender partners	5,770	5,400	4,548	370	7	852	19
Total before JPMorgan Chase	12,709	10,203	8,110	2,506	25	2,093	26
JPMorgan Chase	3,261	4,914	5,576	(1,653)	(34)	(662)	(12)
Total	$ 15,970	$ 15,117	$ 13,686	$ 853	6%	$ 1,431	10%

	Private	Private	Private	$	%	$	%
Preferred Channel Originations Source							
Internal lending brands	$ 6,129	$ 4,306	$ 2,228	$ 1,823	42%	$ 2,078	93%
Other lender partners	861	942	742	(81)	(9)	200	27
Total before JPMorgan Chase	6,990	5,248	2,970	1,742	33	2,278	77
JPMorgan Chase	421	988	1,337	(567)	(57)	(349)	(26)
Total	$ 7,411	$ 6,236	$ 4,307	$ 1,175	19%	$ 1,929	45%

	Total	Total	Total	$	%	$	%
Preferred Channel Originations Source							
Internal lending brands	$ 13,068	$ 9,109	$ 5,790	$ 3,959	43%	$ 3,319	$ 57%
Other lender partners	6,631	6,342	5,290	289	5	1,052	20
Total before JPMorgan Chase	19,699	15,451	11,080	4,248	27	4,371	39
JPMorgan Chase	3,682	5,902	6,913	(2,220)	(38)	(1,011)	(15)
Total	$ 23,381	$ 21,353	$ 17,993	$ 2,028	9%	$ 3,360	$ 19%

Table of Contents

Student Loan Activity

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

	On-Balance Sheet Year Ended December 31, 2006				
	FFELP Stafford and Other[1]	FFELP Consolidation Loans	Total FFELP	Total Private Education Loans	Total On-Balance Sheet Portfolio
Beginning balance	$ 19,988	$ 54,859	$ 74,847	$ 7,757	$ 82,604
Net consolidations:					
Incremental consolidations from third parties		4,092	4,092	96	4,188
Consolidations to third parties	(2,201)	(2,078)	(4,279)	(14)	(4,293)
Net consolidations	(2,201)	2,014	(187)	82	(105)
Acquisitions	19,585	4,697	24,282	7,818	32,100
Net acquisitions	17,384	6,711	24,095	7,900	31,995
Internal consolidations	(5,973)	11,931	5,958	254	6,212
Off-balance sheet securitizations	(5,034)	(9,638)	(14,672)	(4,737)	(19,409)
Repayments/claims/resales/other	(1,524)	(2,539)	(4,063)	(1,419)	(5,482)
Ending balance	$ 24,841	$ 61,324	$ 86,165	$ 9,755	$ 95,920

	Off-Balance Sheet Year Ended December 31, 2006				
	FFELP Stafford and	FFELP Consolidation	Total	Total Private Education	Total Off-Balance Sheet

	Other[1]	Loans	FFELP	Loans	Portfolio
Beginning balance	$ 20,670	$ 10,575	$ 31,245	$ 8,680	$ 39,925
Net consolidations:					
Incremental consolidations from third parties					
Consolidations to third parties	(2,258)	(672)	(2,930)	(32)	(2,962)
Net consolidations	(2,258)	(672)	(2,930)	(32)	(2,962)
Acquisitions	424	233	657	472	1,129
Net acquisitions	(1,834)	(439)	(2,273)	440	(1,833)
Internal consolidations[2]	(5,366)	(592)	(5,958)	(254)	(6,212)
Off-balance sheet securitizations	5,034	9,638	14,672	4,737	19,409
Repayments/claims/resales/other	(3,476)	(871)	(4,347)	(770)	(5,117)
Ending balance	$ 15,028	$ 18,311	$ 33,339	$ 12,833	$ 46,172

	Managed Portfolio Year Ended December 31, 2006				
	FFELP Stafford and Other[1]	FFELP Consolidation Loans	Total FFELP	Total Private Education Loans	Total Managed Basis Portfolio
Beginning balance	$ 40,658	$ 65,434	$ 106,092	$ 16,437	$ 122,529
Net consolidations:					
Incremental consolidations from third parties		4,092	4,092	96	4,188
Consolidations to third parties	(4,459)	(2,750)	(7,209)	(46)	(7,255)
Net consolidations	(4,459)	1,342	(3,117)	50	(3,067)
Acquisitions	20,009	4,930	24,939	8,290	33,229

Net acquisitions	15,550	6,272	21,822	8,340	30,162
Internal consolidations[2]	(11,339)	11,339			
Off-balance sheet securitizations					
Repayments/claims/resales/other	(5,000)	(3,410)	(8,410)	(2,189)	(10,599)
Ending balance	$ 39,869	$ 79,635	$ 119,504	$ 22,588	$ 142,092
Total Managed Acquisitions[3]	$ 20,009	$ 9,022	$ 29,031	$ 8,386	$ 37,417

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

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

(3) The purchases line includes incremental consolidations from third parties and acquisitions.

Table of Contents

	On-Balance Sheet Year Ended December 31, 2005				
	FFELP Stafford and Other(1)	FFELP Consolidation Loans	Total FFELP	Total Private Education Loans	Total On-Balance Sheet Portfolio
Beginning balance	$ 18,965	$ 41,596	$ 60,561	$ 5,420	$ 65,981
Net consolidations:					
Incremental consolidations from third parties		4,671	4,671	1	4,672
Consolidations to third parties	(1,236)	(1,180)	(2,416)	(11)	(2,427)
Net consolidations	(1,236)	3,491	2,255	(10)	2,245
Acquisitions	16,837	1,795	18,632	6,091	24,723
Net acquisitions	15,601	5,286	20,887	6,081	26,968
Internal consolidations	(5,604)	14,020	8,416		8,416
Off-balance sheet securitizations	(6,561)	(4,044)	(10,605)	(2,791)	(13,396)
Repayments/claims/resales/other	(2,413)	(1,999)	(4,412)	(953)	(5,365)
Ending balance	$ 19,988	$ 54,859	$ 74,847	$ 7,757	$ 82,604

	Off-Balance Sheet Year Ended December 31, 2005				
	FFELP Stafford and Other(1)	FFELP Consolidation Loans	Total FFELP	Total Private Education Loans	Total Off-Balance Sheet Portfolio
Beginning balance	$ 27,825	$ 7,570	$ 35,395	$ 6,062	$ 41,457
Net consolidations:					

Incremental consolidations from third parties					
Consolidations to third parties	(1,853)	(400)	(2,253)	(18)	(2,271)
Net consolidations	(1,853)	(400)	(2,253)	(18)	(2,271)
Acquisitions	361	175	536	275	811
Net acquisitions	(1,492)	(225)	(1,717)	257	(1,460)
Internal consolidations[2]	(8,407)	(9)	(8,416)		(8,416)
Off-balance sheet securitizations	6,561	4,044	10,605	2,791	13,396
Repayments/claims/resales/other	(3,817)	(805)	(4,622)	(430)	(5,052)
Ending balance	$ 20,670	$ 10,575	$ 31,245	$ 8,680	$ 39,925

	Managed Portfolio Year Ended December 31, 2005				
	FFELP Stafford and Other[1]	**FFELP Consolidation Loans**	**Total FFELP**	**Total Private Education Loans**	**Total Managed Basis Portfolio**
Beginning balance	$ 46,790	$ 49,166	$ 95,956	$ 11,482	$ 107,438
Net consolidations:					
Incremental consolidations from third parties		4,671	4,671	1	4,672
Consolidations to third parties	(3,089)	(1,580)	(4,669)	(29)	(4,698)
Net consolidations	(3,089)	3,091	2	(28)	(26)
Acquisitions	17,198	1,970	19,168	6,366	25,534
Net acquisitions	14,109	5,061	19,170	6,338	25,508

Internal consolidations[2]	(14,011)	14,011			
Off-balance sheet securitizations					
Repayments/claims/resales/other	(6,230)	(2,804)	(9,034)	(1,383)	(10,417)
Ending balance	$ 40,658	$ 65,434	$ 106,092	$ 16,437	$ 122,529
Total Managed Acquisitions[3]	$ 17,198	$ 6,641	$ 23,839	$ 6,367	$ 30,206

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

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

(3) The purchases line includes incremental consolidations from third parties and acquisitions.

Table of Contents

	On-Balance Sheet Year Ended December 31, 2004				
	FFELP Stafford and Other(1)	FFELP Consolidation Loans	Total FFELP	Total Private Education Loans	Total On-Balance Sheet Portfolio
Beginning balance	$ 18,670	$ 26,907	$ 45,577	$ 4,470	$ 50,047
Net consolidations:					
Incremental consolidations from third parties		2,609	2,609		2,609
Consolidations to third parties	(666)	(225)	(891)	(4)	(895)
Net consolidations	(666)	2,384	1,718	(4)	1,714
Acquisitions	16,458	6,079	22,537	4,033	26,570
Net acquisitions	15,792	8,463	24,255	4,029	28,284
Internal consolidations	(2,201)	7,687	5,486		5,486
Off-balance sheet securitizations	(9,975)		(9,975)	(2,430)	(12,405)
Repayments/claims/resales/other	(3,321)	(1,461)	(4,782)	(649)	(5,431)
Ending balance	$ 18,965	$ 41,596	$ 60,561	$ 5,420	$ 65,981

	Off-Balance Sheet Year Ended December 31, 2004				
	FFELP Stafford and Other(1)	FFELP Consolidation Loans	Total FFELP	Total Private Education Loans	Total Off-Balance Sheet Portfolio
Beginning balance	$ 26,884	$ 8,023	$ 34,907	$ 3,835	$ 38,742
Net consolidations:					

Incremental consolidations from third parties					
Consolidations to third parties	(1,114)	(89)	(1,203)	(7)	(1,210)
Net consolidations	(1,114)	(89)	(1,203)	(7)	(1,210)
Acquisitions	378	187	565	172	737
Net acquisitions	(736)	98	(638)	165	(473)
Internal consolidations(2)	(5,486)		(5,486)		(5,486)
Off-balance sheet securitizations	9,975		9,975	2,430	12,405
Repayments/claims/resales/other	(2,812)	(551)	(3,363)	(368)	(3,731)
Ending balance	$ 27,825	$ 7,570	$ 35,395	$ 6,062	$ 41,457

	Managed Portfolio Year Ended December 31, 2004				
	FFELP Stafford and Other(1)	**FFELP Consolidation Loans**	**Total FFELP**	**Total Private Education Loans**	**Total Managed Basis Portfolio**
Beginning balance	$ 45,554	$ 34,930	$ 80,484	$ 8,305	$ 88,789
Net consolidations:					
Incremental consolidations from third parties		2,609	2,609		2,609
Consolidations to third parties	(1,780)	(314)	(2,094)	(11)	(2,105)
Net consolidations	(1,780)	2,295	515	(11)	504
Acquisitions	16,836	6,266	23,102	4,205	27,307
Net acquisitions	15,056	8,561	23,617	4,194	27,811
Internal consolidations(2)	(7,687)	7,687			

Off-balance sheet securitizations					
Repayments/claims/resales/other	(6,133)	(2,012)	(8,145)	(1,017)	(9,162)
Ending balance	$ 46,790	$ 49,166	$ 95,956	$ 11,482	$ 107,438
Total Managed Acquisitions[3]	$ 16,836	$ 8,875	$ 25,711	$ 4,205	$ 29,916

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

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

(3) The purchases line includes incremental consolidations from third parties and acquisitions.

The increase in consolidations to third parties in 2006 reflects FFELP lenders reconsolidating FFELP Consolidation Loans using the Direct Loan program as a pass-through entity, a practice which was severely restricted by The Higher Education Reconciliation Act of 2005 as of July 1, 2006. The increase also reflects the effect of the repeal of the single holder rule, which was effective for applications received on or after June 15, 2006. The single-holder rule had previously required that when a lender held all of the FFELP Stafford loans of a particular borrower whose loans were held by a single lender, in most cases that borrower could only obtain a FFELP Consolidation Loan from that lender.

During 2006, Private Education Loan consolidations were introduced as a separate product line and during the year we had $50 million of net incremental volume on a Managed Basis. We expect this product line to grow in the future and will aggressively protect our portfolio against third-party consolidation of Private Education Loans.

Other Income Lending Business Segment

The following table summarizes the components of other income, net, for our Lending business segment for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,		
	2006	2005	2004
Late fees	$ 107	$ 89	$ 92
Gains on sales of mortgages and other loan fees	15	18	22
Losses on securities, net	(4)	(36)	(23)
Other	59	40	40
Total other income, net	$ 177	$ 111	$ 131

Other income in 2006 includes a settlement received on the final disposition of leveraged leases for which we had previously reserved, plus an increase in forbearance fees.

The net losses on securities in 2005 and 2004 primarily relate to a $39 million leveraged lease impairment for an aircraft leased to Northwest Airlines and a $27 million impairment for aircraft leased to Delta Airlines, respectively. At December 31, 2006, we had investments in leveraged and direct financing leases, net of impairments, totaling $109 million that are the general obligations of American Airlines and Federal Express Corporation. Based on an analysis of the potential losses on certain leveraged leases plus the increase in current tax obligations related to the forgiveness of debt obligations and/or the taxable gain on the sale of the aircraft, our remaining after-tax accounting exposure from our investment in leveraged leases was $69 million at December 31, 2006, of which $52 million relates to American Airlines.

Operating Expense Lending Business Segment

The following table summarizes the components of operating expenses for our Lending business segment for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,

	2006	2005	2004
Sales and originations	$ 327	285	$ 259
Servicing and information technology	201	193	150
Corporate overhead	117	69	78
Total operating expenses	$ 645	$ 547	$ 487
Loss on GSE debt extinguishment and defeasance	$	$	$ 221

Operating expenses for our Lending operating segment include non-capitalizable costs incurred to acquire student loans and service our Managed student loan portfolio, as well as other selling, general and administrative expenses.

The $221 million loss in 2004 relates to the repurchase and defeasance of approximately $3.0 billion of GSE debt in connection with the Wind-Down of the GSE.

2006 versus 2005

Operating expenses for the year ended December 31, 2006, increased by 18 percent to $645 million versus $547 million for the year ended December 31, 2005. The increase is primarily due to sales and marketing expenses related to our direct to consumer initiatives and to higher sales expenses for higher education loan products. The increase was also due to an increase in origination and servicing costs, consistent with the increase in origination volume and the number of borrowers. In 2006, corporate overhead includes $34 million of stock option compensation expense, due to the implementation of SFAS No. 123(R).

2005 versus 2004

Operating expenses for the year ended December 31, 2005, increased by 12 percent to $547 million versus $487 million for the year ended December 31, 2004, exclusive of the loss on GSE debt extinguishment and defeasance. The increase is due to increased sales and marketing costs related to the FFELP Consolidation Loan program, new Private Education Loan initiatives and the launch of our direct to consumer initiative, Tuition Answer. Operating expenses were also higher due to a full year of expenses of sales and marketing personnel from Southwest and SLFA, acquired in the fourth quarter of 2004. The $43 million increase in servicing and information technology expenses is consistent with the growth in borrowers.

Table of Contents

DEBT MANAGEMENT OPERATIONS (DMO) BUSINESS SEGMENT

In our DMO operating segment, we provide a wide range of accounts receivable and collections services including student loan default aversion services, defaulted student loan portfolio management services, contingency collections services for student loans and other asset classes, and accounts receivable management and collection for purchased portfolios of receivables that are delinquent or have been charged off by their original creditors as well as sub-performing and non-performing mortgage loans. In the purchased receivables business, we focus on a variety of consumer debt types with emphasis on charged off credit card receivables and distressed mortgage receivables. We purchase these portfolios at a discount to their face value, and then use both our internal collection operations coupled with third party collection agencies to maximize the recovery on these receivables.

We account for our investments in charged off receivables in accordance with the AICPA s Statement of Position (SOP) 03-3, Accounting for Certain Loans or Debt Securities Acquired in a Transfer. Under this standard, we establish static pools of each quarter s purchases and aggregate them based on certain common risk characteristics and initially record them at fair value based on the pool s estimated future cash flow and internal rate of return. Under SOP 03-3, the yield that may be accreted as collections revenue on such loans is limited to the excess of our estimate of undiscounted expected principal, interest and other cash flows from the pool over our initial investment in the pool. We recognize income each month based on each static pool s effective interest rate. The static pools are tested quarterly for impairment by re-estimating the future cash flows to be received from the pools. Subsequent increases in estimated future cash flows are recognized prospectively through a yield adjustment over the remaining life of the static pool. When estimates of future cash flows to be collected are projected to be lower than projected, the carrying value of the pool is impaired and written down through a valuation allowance to maintain the effective interest rate. Cash collected on pools whose principal has fully amortized is recognized 100 percent in income.

The private sector collections industry is highly fragmented with few large public companies and a large number of small scale privately-held companies. The collections industry is highly competitive with credit card collections being the most competitive in both contingency collections and purchased paper activities. We are responding to these competitive challenges through enhanced servicing efficiencies and by continuing to build on customer relationships through value added services and financings.

The following table includes the results of operations for our DMO operating segment.

Condensed Statements of Income

	Years Ended December 31,			% Increase (Decrease)	
	2006	**2005**	**2004**	**2006 vs. 2005**	**2005 vs. 2004**
Fee income	397	360	300	10	20
Collections revenue	239	167	39	43	328
Total income	636	527	339	21	55
Operating expenses	358	288	161	24	79
Net interest expense	23	19	13	21	46

Income before income taxes and minority interest in net earnings of subsidiaries	255	220	165	16	33
Income taxes	94	81	65	15	25
Income before minority interest in net earnings of subsidiaries	161	139	100	16	39
Minority interest in net earnings of subsidiaries	4	4	1		300
Net income	$ 157	$ 135	$ 99	16%	36%

Revenues from USA Funds represented 32 percent, 34 percent and 56 percent, respectively, of total DMO revenue in 2006, 2005 and 2004. The percentage of revenue generated from services provided to USA Funds

Table of Contents

decreased due to the full year impact of recent acquisitions and the continued diversification into new asset classes in the purchased paper business.

DMO Revenue by Product

	Years Ended December 31,		
	2006	2005[2]	2004[3]
Purchased paper collections revenue	$ 239	$ 167	$ 39
Contingency:			
Student loans	305	258	253
Other	36	55	18
Total contingency	341	313	271
Other	56	47	29
Total	$ 636	$ 527	$ 339
USA Funds[1]	$ 204	$ 180	$ 190
% of total DMO revenue	32%	34%	56%

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

(2) Includes revenue attributed to GRP for the period from August 31 to December 31.

(3) Includes revenue attributed to AFS for the period from September 16 to December 31.

Contingency Fee Income

The $47 million increase in DMO contingency revenue from student loans for the year ended December 31, 2006 over 2005 can be primarily attributed to a change in the federal regulations governing the rehabilitation loan policy along with the growth in guaranty agency collections. Under this change, the number of payments to qualify for a rehabilitated loan was reduced to nine months from twelve months, so all loans that had made nine to eleven consecutive payments at thet time of change immediately qualified as a rehabilitated loan. The decrease in contingency fee revenues from non-student loan asset classes in 2006 versus the prior year was due to a non-recurring state tax collection contract in 2005 and to the Company not renewing certain low margin contingency fee contracts.

The rapid growth in Consolidation Loan activity has had a negative impact on our student loan contingency collection business. When a borrower consolidates a FFELP Stafford loan, the borrower is effectively refinancing his or her Stafford loan to a longer term at a fixed interest rate, which significantly reduces the borrower s monthly payment. The overall effect of the record Consolidation Loan activity is lower industry-wide student loan defaults and lower contingency collection inventory. The recently passed HEA reduces fees paid for collections via loan consolidation and also puts a cap on collections for loan consolidations. These fee reductions will also negatively impact student loan contingency fees going forward.

Contingency Inventory

The following table presents the outstanding inventory of receivables serviced through our DMO business.

	Years Ended December 31,		
	2006	**2005**	**2004**
Contingency:			
Student loans	$ 6,971	$ 7,205	$ 6,869
Other	1,667	2,178	1,756
Total	$ 8,638	$ 9,383	$ 8,625

Table of Contents

Purchased Paper

Our purchased paper collection business is comprised of the purchase of delinquent and charged off consumer receivables, primarily credit cards and the purchase of distressed mortgage receivables. Since these businesses operate in different segments of the marketplace with the primary distinguishing factor being the existence of collateral for the mortgage receivable, we have broken out their results separately in the presentations below.

Non-Mortgage

	Years Ended December 31,		
	2006	**2005**	**2004[1]**
Face value of purchases	$ 3,438	$ 2,826	$ 426
Purchase price	278	198	19
% of face value purchased	8.1%	7.0%	4.5%
Gross Cash Collections (GCC)	$ 348	$ 250	$ 59
Collections revenue	199	157	39
% of GCC	56%	63%	66%
Carrying value	$ 274	$ 158	$ 52

(1) AFS was purchased in September 2004, so the results for that year reflect only three months of activity.

The amount of face value of purchases in any quarter is a function of a combination of factors including the amount of receivables available for purchase in the marketplace, average age of each portfolio, the asset class of the receivables, and competition in the marketplace. As a result, the percentage of principal purchased will vary from quarter to quarter. The decrease in purchase paper revenue as a percentage of GCC can primarily be attributed to the increase in new portfolio purchases in the second half of 2005. Typically, revenue recognition based on a portfolio s effective yield rate is a lower percentage of cash collections in the early stages of servicing a portfolio. On both December 22, 2005, and December 29, 2006, we acquired an additional 12 percent ownership stake in AFS, increasing our ownership first to 76 percent and then to 88 percent.

Mortgage/Properties

On August 31, 2005, we acquired 100 percent of GRP, a debt management company that acquires and manages portfolios of sub-performing and non-performing mortgage loans, substantially all of which are secured by one-to-four family residential real estate. GRP was purchased in August 2005, so the results for that year ended reflect only four months of activity.

	Years Ended December 31,	
	2006	**2005**
Face value of purchases	$ 556	$ 165
Collections revenue	40	10
Collateral value of purchases	607	195

Purchase price	462	141
% of collateral value	76%	72%
Carrying value of purchases	$ 518	$ 298

The purchase price for sub-performing and non-performing mortgage loans is generally determined as a percentage of the underlying collateral. Fluctuations in the purchase price as a percentage of collateral value can be caused by a number of factors including cash flow characteristics, targeted yield, expected holding period, the percentage of second mortgages in the portfolio and the level of private mortgage insurance associated with particular assets.

Operating Expenses DMO Business Segment

Operating expenses for the DMO business segment for the years ended December 31, 2006, 2005 and 2004 totaled:

	Years Ended December 31,		
	2006	2005	2004
Total operating expenses	$ 358	$ 288	$ 161

Operating expenses increased by $70 million, or 24 percent, to $358 million for the year ended December 31, 2006. The increase in operating expenses versus the prior year was primarily due to the increase in accounts serviced and to higher expenses for outsourced collections and recovery costs. Also, 2006 includes a full year of GRP expenses and $12 million of stock option compensation expense, due to the implementation of SFAS No. 123(R).

A significant portion of the 2005 increase is attributable to the inclusion of a full year of AFS expenses and GRP expenses incurred since the acquisition on August 31, 2005. The increase is also attributable to the growth in contingency revenue and accounts serviced, as a high percentage of DMO expenses are variable which contributes to our stable margins.

At December 31, 2006, 2005 and 2004, the DMO operating segment had total assets of $1.5 billion, $1.1 billion and $519 million, respectively.

CORPORATE AND OTHER BUSINESS SEGMENT

Our Corporate and Other reportable segment reflects the aggregate activity of our smaller operating units including our Guarantor Servicing and Loan Servicing operating units, other products and services, as well as corporate expenses that do not pertain directly to our operating segments. Also, included in the Corporate and Other segment is Upromise, Inc. (Upromise), acquired in August of 2006.

In our Guarantor Servicing operating unit, we provide a full complement of administrative services to FFELP guarantors including guarantee issuance, processing, account maintenance, and guarantee fulfillment. In our Loan Servicing operating unit, we originate and service student loans on behalf of lenders who are unrelated to SLM Corporation.

Condensed Statements of Income

	Years Ended December 31,			% Increase (Decrease)	
	2006	2005	2004	2006 vs. 2005	2005 vs. 2004
Total interest income	$ 7	$ 5	$ 3	40%	67%
Total interest expense	12	6	6	100	
Net interest income	(5)	(1)	(3)	400	(67)

Less provisions for losses					
Net interest income after provisions for losses	(5)	(1)	(3)	400	(67)
Fee income	132	115	120	15	(4)
Other income	155	125	130	24	(4)
Total other income	287	240	250	20	(4)
Operating expenses	250	235	211	6	11
Income before income taxes	32	4	36	700	(89)
Income tax expense (benefit)	12	1	(15)	1100	(107)
Net income	$ 20	$ 3	$ 51	567%	(94)%

Fee and Other Income Corporate and Other Business Segment

The following table summarizes the components of fee and other income for our Corporate and Other business segment for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,		
	2006	2005	2004
Guarantor servicing fees	$ 132	$ 115	$ 120
Loan servicing fees	29	44	52
Upromise	42		
Other	84	81	78
Total fee and other income	$ 287	$ 240	$ 250

USA Funds, the nation s largest guarantee agency, accounted for 83 percent, 82 percent, and 85 percent, respectively, of guarantor servicing fees and 25 percent, 27 percent, and 16 percent, respectively, of revenues associated with other products and services for the years ended December 31, 2006, 2005 and 2004.

2006 versus 2005

The increase in guarantor servicing fees in 2006 versus 2005 is primarily due to a negotiated settlement with USA Funds such that USA Funds was able to pay account maintenance fees that were previously held up by the cap on payments from ED to guarantors in 2005. This cap was removed by legislation reauthorizing the student loan programs of the Higher Education Act on October 1, 2006.

2005 versus 2004

The decrease is guarantor servicing fees in 2005 versus 2004 is due to the full year effect of the lower issuance fee rate, the result of the reduction in the issuance fee from 65 basis points to 40 basis points, and to an $8 million reduction in account maintenance fees caused by a cap on payments from ED to guarantors, discussed above.

Operating Expenses Corporate and Other Business Segment

The following table summarizes the components of operating expenses for our Corporate and Other operating segment.

	Years Ended December 31,		
	2006	2005	2004
Operating expenses	$ 148	$ 149	$ 152
Upromise	33		
General and administrative expenses	69	86	59

Total operating expenses	$ 250	$ 235	$ 211

Operating expenses include direct costs incurred to perform guarantor servicing on behalf of guarantor agencies and to service loans for unrelated third parties, as well as information technology expenses related to these functions. General and administrative expenses include unallocated corporate overhead expenses for centralized headquarters functions such as executive management, accounting and finance, human resources and marketing.

2006 versus 2005

In 2006, operating expenses in the Corporate and Other segment include $17 million of stock option compensation expense, due to the implementation of SFAS No. 123(R) and the expenses of Upromise, acquired in August 2006. The decrease in general and administrative expenses is due to a $14 million net

settlement in the College Loan Corporation (CLC) lawsuit and to lower corporate information technology expenses.

At December 31, 2006, 2005 and 2004, the Corporate and Other operating segment had total assets of $999 million, $719 million and $524 million, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Except in the case of acquisitions, which are discussed separately, our DMO and Corporate and Other business segments are not capital intensive businesses and as such a minimal amount of debt and equity capital is allocated to these segments. Therefore, the following LIQUIDITY AND CAPITAL RESOURCES discussion is concentrated on our Lending business segment.

We have developed deep and diverse funding sources to ensure continued access to funding to support our business plan. Our biggest funding challenge continues to be our ability to maintain cost-effective liquidity to fund the growth in the Managed portfolio of student loans as well as to refinance previously securitized loans when borrowers choose to refinance their loans through a FFELP Consolidation Loan or a Private Education Consolidation Loan with us. At the same time, we maintain earnings spreads by controlling interest rate risk. Our main source of funding is student loan securitizations and we have built a highly liquid and deep market for such financings as evidenced by the $32.1 billion in student loans securitized in thirteen transactions in 2006, and $26.1 billion in twelve transactions in 2005. We are the largest issuer in the student loan asset-backed sector. FFELP securitizations are unique securities in the asset-backed market as they are backed by student loans with an explicit U.S. government guarantee on 99 percent of principal and interest (prior to July 1, the guarantee was 100 percent). The investor base for our student loan-backed securities is worldwide and we believe that the market for these securities will be available to meet our long-term funding needs for the foreseeable future. Securitizations comprised 69 percent of our Managed debt outstanding at December 31, 2006, unchanged from December 31, 2005.

In addition to securitizations, we also continued to diversify our sources of funding and issued $11.7 billion in SLM Corporation long-term, unsecured debt in 2006. Over the years we have strategically introduced several SLM Corporation long-term debt structures that further diversified our funding sources and substantially increased our fixed income investor base. In total, at December 31, 2006, on-balance sheet debt, exclusive of on-balance sheet securitizations and secured indentured trusts, totaled $48.9 billion versus $41.7 billion at December 31, 2005.

Liquidity at SLM Corporation is important to enable us to effectively fund our student loan acquisitions, to meet maturing debt obligations, and to fund operations. The following table details our sources of liquidity and the available capacity at December 31, 2006 and 2005.

	December 31, 2006 Available Capacity	December 31, 2005 Available Capacity
Sources of primary liquidity:		
Unrestricted cash and liquid investments	$ 4,720	$ 3,928
Unused commercial paper and bank lines of credit	6,500	5,500
ABCP borrowing capacity	1,047	41
Total sources of primary liquidity	12,267	9,469

Sources of stand-by liquidity:				
Unencumbered FFELP student loans		28,070		24,530
Total sources of primary and stand-by liquidity	$	40,337	$	33,999

We believe our unencumbered FFELP student loan portfolio provides an additional source of potential or stand-by liquidity because the maturation of government guaranteed student loan securitizations has created a wide and deep marketplace for such transactions. In addition to the securitization markets, we believe that the wholesale market for FFELP student loans provides an additional potential source of stand-by liquidity. At

Table of Contents

December 31, 2006, we had $365 million of investments on our balance sheet that were pledged as collateral related to certain derivative positions and $99 million of other non-liquid investments, neither of which were included in the above table.

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

The following tables present the ending and average balances and average interest rates of our Managed borrowings for the years ended December 31, 2006, 2005 and 2004. The average interest rates include derivatives that are economically hedging the underlying debt but do not qualify for hedge accounting treatment under SFAS No. 133. (See BUSINESS SEGMENTS Limitations of Core Earnings Derivative Accounting *Reclassification of Realized Gains (Losses) on Derivative and Hedging Activities.*)

	Years Ended December 31,								
	2006 Ending Balance			2005 Ending Balance			2004 Ending Balance		
	Short Term	Long Term	Total Managed Basis	Short Term	Long Term	Total Managed Basis	Short Term	Long Term	Total Manage Basis
ecured borrowings	$ 3,435	$ 45,501	$ 48,936	$ 3,787	$ 37,944	$ 41,731	$ 1,830	$ 31,465	$ 33,29
entured trusts -balance sheet)	93	2,852	2,945	23	3,372	3,395	377	6,873	7,2
uritizations -balance sheet)		55,100	55,100		47,235	47,235		35,769	35,76
uritizations f-balance sheet)		49,865	49,865		43,138	43,138		43,814	43,8
al	$ 3,528	$ 153,318	$ 156,846	$ 3,810	$ 131,689	$ 135,499	$ 2,207	$ 117,921	$ 120,1

	Years Ended December 31,					
	2006		2005		2004	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
GSE borrowings (unsecured)	$	%	$	%	$ 9,967	2.21%
Unsecured borrowings	43,927	5.50	37,980	3.98	28,241	2.29
Indentured trusts (on-balance sheet)	3,252	4.57	4,782	3.27	2,168	2.47
Securitizations (on-balance sheet)	48,184	5.39	39,713	3.72	28,354	1.79
Securitizations (off-balance sheet)	50,112	5.49	44,545	3.77	42,606	2.09
Total	$ 145,475	5.44%	$ 127,020	3.80%	$ 111,336	2.08%

Unsecured On-Balance Sheet Financing Activities

The following table presents the senior unsecured credit ratings on our debt from major rating agencies as of December 31, 2006.

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

The table below presents our unsecured on-balance sheet funding by funding source for the years ended December 31, 2006 and 2005.

	Debt Issued for the Years Ended December 31,		Outstanding at December 31,	
	2006	2005	2006	2005
Convertible debentures	$	$	$ 1,997	$ 1,992
Retail notes	535	790	4,137	3,618
Foreign currency denominated notes[(1)]	3,862	3,997	12,635	8,782
Extendible notes	1,499	998	5,746	5,246
Global notes (Institutional)	5,843	4,465	22,375	20,287
Medium-term notes (Institutional)			1,797	1,802
Other			249	4
Total	$ 11,739	$ 10,250	$ 48,936	$ 41,731

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

In addition to the term issuances reflected in the table above, we also use our commercial paper program for short-term liquidity purposes. The average balance of commercial paper outstanding during the years ended December 31, 2006 and 2005 was $82 million and $345 million, respectively. The maximum daily amount outstanding for the years ended December 31, 2006 and 2005 was $2.2 billion and $2.8 billion, respectively.

Preferred Stock Issuance

At December 31, 2006, we had 3.3 million shares of 6.97 percent Cumulative Redeemable Preferred Stock, Series A (the Series A Preferred Stock) and 4.0 million shares of Floating-Rate Non-Cumulative Preferred Stock, Series B (the Series B Preferred Stock) outstanding. Neither series has a maturity date but can be redeemed at the Company s option beginning November 16, 2009 for Series A, and on any dividend payment date on or after June 15, 2010 for Series B. Redemption would include any accrued and unpaid dividends up to the redemption date. The shares have no preemptive or conversion rights and are not convertible into or exchangeable for any of the Company s other securities or property. Dividends on both series are not mandatory and are paid quarterly, when, as, and if declared by the Board of Directors.

Upon liquidation or dissolution of the Company, holders of our Series A and Series B Preferred Stock are entitled to receive $50 and $100 per share, respectively, plus an amount equal to accrued and unpaid dividends for the then current quarterly dividend period, if any, pro rata, and before any distribution of assets are made to holders of our common stock.

Contingently Convertible Debentures

We had approximately $2 billion Contingently Convertible Debentures (Co-Cos) outstanding at December 31, 2006. The Co-Cos are convertible, under certain conditions, into shares of SLM common stock at an initial conversion price

of $65.98. The investors generally can only convert the debentures if the Company s common stock has appreciated for a prescribed period to 130 percent of the conversion price, which would amount to $85.77. The convertible debentures bear interest at a floating rate equal to three-month LIBOR minus .05 percent, until July 25, 2007, after which, the debentures can pay additional contingent interest under certain circumstances. Beginning on July 25, 2007, we may call the debentures and the investors may put the debentures, subject to certain conditions.

In calculating diluted earnings per share (diluted EPS) we follow the guidance of EITF Issue No. 04-8, The Effect of Contingently Convertible Debt on Diluted Earnings per Share, which requires the shares underlying the Co-Cos to be included in diluted EPS computations regardless of whether the market price trigger or the conversion price has been met, using the if-converted accounting method, while the after-tax interest expense of the Co-Cos is added back to earnings. Diluted EPS amounts disclosed prior to December

Table of Contents

2004 have been retroactively restated to give effect to the application of EITF No. 04-8 as it relates to the Company s $2 billion in Co-Cos issued in May 2003.

The following table provides the historical effect of our Co-Cos on our common stock equivalents (CSEs) and after-tax interest expense in connection with the retroactive implementation of EITF No. 04-8 for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,		
	2006	2005	2004
(In thousands)			
CSE impact of Co-Cos (shares)	30,312	30,312	30,312
Co-Cos after-tax interest expense	$ 67,274	$ 44,572	$ 21,405

The table below outlines the effect of the Co-Cos on the numerators and denominators for the diluted EPS calculations for the years ended December 31, 2006, 2005 and 2004. The net effect of the Co-Cos on diluted EPS will vary with the period to period changes in net income of the Company.

	Years Ended December 31,		
	2006	2005	2004
Numerator:			
Net income attributable to common stock	$ 1,121,389	$ 1,360,381	$ 1,901,769
Adjusted for debt expense of convertible debentures (Co-Cos), net of taxes[1]	67,274	44,572	21,405
Adjusted for non-taxable unrealized gains on equity forwards[2]	(3,528)		
Net income attributable to common stock, adjusted	$ 1,185,135	$ 1,404,953	$ 1,923,174
Denominator ***(shares in thousands):***			
Weighted average shares used to compute basic EPS	410,805	418,374	436,133
Effect of dilutive securities:			
Dilutive effect of Co-Cos	30,312	30,312	30,312
Dilutive effect of stock options, nonvested restricted stock, restricted stock units, Employee Stock Purchase Plan (ESPP) and equity forwards[2][3][4]	10,053	11,574	9,342
Dilutive potential common shares[5]	40,365	41,886	39,654
Weighted average shares used to compute diluted EPS	451,170	460,260	475,787
Net earnings per share:			
Basic EPS	$ 2.73	$ 3.25	$ 4.36
Dilutive effect of Co-Cos[1]	(.03)	(.11)	(.23)
Dilutive effect of equity forwards[2][4]	(.01)		
Dilutive effect of stock options, nonvested restricted stock, restricted stock units, and ESPP[3]	(.06)	(.09)	(.09)

Diluted EPS	$	2.63	$	3.05	$	4.04

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

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

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

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

(5) For the years ended December 31, 2006, 2005 and 2004, stock options and equity forwards of approximately 57 million shares, 30 million shares and 4 million shares, respectively, were outstanding but not included in the computation of diluted earnings per share because they were antidilutive.

Securitization Activities

Securitization Program

Our FFELP Stafford, Private Education Loan and FFELP Consolidation Loan securitizations are structured such that they are legal sales of assets using a two-step transaction with a special purpose entity that legally isolates the transferred assets from the Company and its creditors, even in the event of bankruptcy. The holders of the beneficial interests issued by the special purpose entity are not constrained from pledging or exchanging their interests. In all of our securitizations, we retain the right to receive cash flows from the student loans and reserve accounts in excess of the amounts needed to pay servicing costs, derivative costs (if any), administration and other fees, and the principal and interest on the bonds backed by the student loans. The investors of the securitization trusts have no recourse to the Company s other assets should there be a failure of the securities backed by student loans to pay when due. Some of our securitizations meet the requirements for sale treatment under GAAP, according to the criteria of SFAS No. 140. In these transactions we use a two-step sale to a qualifying special purpose entity (QSPE), such that we do not maintain effective control over the transferred assets. Accordingly, these transactions are accounted for off-balance sheet.

In certain securitization structures, there are terms within the deal structure that result in such securitizations not qualifying for sale treatment and accordingly, they are accounted for on-balance sheet as variable interest entities (VIEs). Terms that prevent sale treatment include: (1) allowing us to hold certain rights that can affect the remarketing of certain bonds, (2) allowing the trust to enter into interest rate cap agreements after the initial settlement of the securitization, which do not relate to the reissuance of third party beneficial interests or (3) allowing us to hold an unconditional call option related to a certain percentage of the securitized assets. The securitization structure where we can affect the remarketing of the bonds was developed to broaden and diversify the investor base for FFELP Consolidation Loan securitizations by allowing us to issue bonds with shorter expected maturities and with non-amortizing, fixed rate and foreign currency denominated tranches. As of December 31, 2006, we had $48.6 billion of securitized student loans in on-balance sheet FFELP Consolidation Loan securitization trusts. These securitizations are included as financings in the table below.

We recognize a gain on sales related to securitizations that qualify as off-balance sheet transactions. The gain is calculated as the difference between the allocated cost basis of the assets sold and the relative fair value of the assets received. The carrying value of the student loan portfolio being securitized includes the applicable accrued interest, unamortized student loan premiums or discounts, loan loss reserves and Borrower Benefits reserves. The fair value of the Residual Interest is determined using a discounted cash flow methodology using assumptions discussed in more detail below. The ongoing earnings from our off-balance sheet securitizations are recognized in servicing and securitization revenue.

The following table summarizes our securitization activity for the years ended December 31, 2006, 2005 and 2004. Those securitizations listed as sales are off-balance sheet transactions and those listed as financings remain on-balance sheet.

	Years Ended December 31,										
	2006				2005				2004		
s in millions)	No. of Transactions	Amount Securitized	Pre-Tax Gain	Gain %	No. of Transactions	Amount Securitized	Pre-Tax Gain	Gain %	No. of Transactions	Amount Securitized	Pre-Tax Gain
zations sales:											
Stafford and Other loans	2	$ 5,004	$ 17	.3%	3	$ 6,533	$ 68	1.1%	4	$ 10,002	$ 134
Consolidation	4	9,503	55	.6	2	4,011	31	.8			
Education Loans	3	5,088	830	16.3	2	3,005	453	15.1	2	2,535	241
curitizations sales	9	19,595	$ 902	4.6%	7	13,549	$ 552	4.1%	6	12,537	$ 375
zations financings:											
acked commercial									1	4,186	
Consolidation	4	12,506			5	12,503			6	17,124	
curitizations gs	4	12,506			5	12,503			7	21,310	
curitizations	13	$ 32,101			12	$ 26,052			13	$ 33,847	

[1] The ABCP is a revolving multi-seller conduit that allows the Company to borrow up to $6 billion. The Company may purchase loans out of this trust at its discretion and as a result, the trust does not qualify as a QSPE and is accounted for on balance sheet as a variable interest entity (VIE).

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

The decrease in the FFELP Stafford/PLUS loans gain as a percentage of loans securitized from 1.1 percent for the year ended December 31, 2005 to .3 percent for the year ended December 31, 2006 is primarily due to: 1) an increase in the CPR assumption to account for continued high levels of FFELP Consolidation Loan activity; 2) an increase in the discount rate to reflect higher long-term interest rates; 3) the re-introduction of Risk Sharing with the Reconciliation Legislation during 2005 reauthorizing the student loan programs of the Higher Education Act; and 4) an increase in the amount of student loan premiums included in the carrying value of the loans sold. The higher premiums also affected FFELP Consolidation Loan securitizations and were primarily due to the securitization of loans previously acquired through business combinations. These loans carried higher premiums based on the allocation of the purchase price through purchase accounting. Higher premiums were also due to loans acquired through zero-fee lending and the school-as-lender channels.

The increase in the Private Education Loans gain as a percentage of loans securitized from 15.1 percent for the year ended December 31, 2005 to 16.3 percent for the year ended December 31, 2006 is primarily due to a higher spread earned on the assets securitized.

Table of Contents

Residual Interest in Securitized Receivables

The following tables summarize the fair value of our Residual Interests and the assumptions used to value such Residual Interests, along with the underlying off-balance sheet student loans that relate to those securitizations in securitization transactions that were treated as sales as of December 31, 2006 and 2005.

	As of December 31, 2006			
	FFELP Stafford and PLUS	FFELP Consolidation Loan Trusts[1]	Private Education Loan Trusts	Total
Fair value of Residual Interests[2]	$ 701	$ 676	$ 1,965	$ 3,342
Underlying securitized loan balance[3]	14,794	17,817	13,222	45,833
Weighted average life	2.9 yrs.	7.3 yrs.	7.2 yrs	
Prepayment speed (annual rate)[4]				
Interim status[5]	0%	n/a	0%	
Repayment status[5]	0-43%	3-9%	4-7%	
Life of loan repayment status[5]	24%	6%	6%[7]	
Expected credit losses (% of student loan principal)	.06%	.07%	4.36%	
Residual cash flows discount rate	12.6%	10.5%	12.6%	

	As of December 31, 2005			
	FFELP Stafford and PLUS	FFELP Consolidation Loan Trusts[1]	Private Education Loan Trusts	Total
Fair value of Residual Interests[2]	$ 774	$ 483	$ 1,149	$ 2,406
Underlying securitized loan balance[3]	20,372	10,272	8,946	39,590
Weighted average life	2.7 yrs.	8.0 yrs.	7.8 yrs.	
Prepayment speed (annual rate)[4]	10%-20%[6]	6%	4%	
Expected credit losses (% of student loan principal)	.14%	.23%	4.74%	
Residual cash flows discount rate	12.3%	10.3%	12.4%	

(1) Includes $151 million and $235 million related to the fair value of the Embedded Floor Income as of December 31, 2006 and 2005, respectively. Changes in the fair value of the Embedded Floor Income are primarily due to changes in the interest rates and the paydown of the underlying loans.

(2) At December 31, 2006 and 2005, we had unrealized gains (pre-tax) in accumulated other comprehensive income of $389 million and $370 million, respectively, that primarily related to the Residual Interests.

(3) In addition to student loans in off-balance sheet trusts, we had $48.6 billion and $40.9 billion of securitized student loans outstanding (face amount) as of December 31, 2006 and 2005, respectively, in on-balance sheet FFELP Consolidation Loan securitization trusts.

(4) Effective December 31, 2006, we implemented CPR curves for Residual Interest valuations that are based on the number of months since entering repayment that better reflect the CPR as the loan seasons. Under this methodology, a different CPR is applied to each year of a loan s seasoning. Previously, we applied a CPR that was based on a static life of loan assumption, irrespective of seasoning, or, in the case of FFELP Stafford and PLUS loans, we used a vector approach in applying the CPR. The change in CPR methodology resulted in an immaterial change in the fair value of the Residual Interest. The CPR assumption used for all periods includes the impact of projected defaults.

(5) The repayment status CPR depends on the number of months since first entering repayment or as the loan seasons through the portfolio. Life of loan CPR is related to repayment status only and does not include the impact of the loan while in interim status.

(6) The CPRs used for December 31, 2005 FFELP Stafford and PLUS valuations were 20 percent for 2006, 15 percent for 2007 and 10 percent thereafter.

(7) During 2006, the Company and others in the industry began consolidating Private Education Loans. As a result we experienced an increase in actual prepayment speeds primarily related to this new consolidation activity. We expect such consolidation activity to continue going forward and, as a result, the life of loan CPR assumption was increased from 4 percent to 6 percent as of December 31, 2006. As of December 31, 2006, $304 million of the $389 million in accumulated other comprehensive income relates to the Private Education Loan trusts.

Off-Balance Sheet Net Assets

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

	December 31, 2006	December 31, 2005
Off-Balance Sheet Assets:		
Total student loans, net	$ 46,172	$ 39,925
Restricted cash and investments	4,269	3,761
Accrued interest receivable	1,467	937
Total off-balance sheet assets	51,908	44,623
Off-Balance Sheet Liabilities:		
Debt, par value	50,058	43,331
Debt unamortized discount and deferred issuance costs	(193)	(193)
Total debt	49,865	43,138
Accrued interest payable	405	250
Total off-balance sheet liabilities	50,270	43,388
Off-Balance Sheet Net Assets	$ 1,638	$ 1,235

Liquidity Risk and Funding Long-Term

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

including a table of our sources of liquidity at the beginning of this LIQUIDITY AND CAPITAL RESOURCES section.

During 2006, we, along with others in the industry, began consolidating Private Education Loans. This will increase the prepayment spreads in Private Education Loan trusts, which will have a similar effect on Retained Interests in Private Education Loan securitizations as discussed above in Private Education Loan securitizations (see the Retained Interest in Securitized Receivables table included in Note 9 to our consolidated financial statements, Student Loan Securitization, for further discussion and the Company s response to this activity).

Table of Contents

Servicing and Securitization Revenue

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

The following table summarizes the components of servicing and securitization revenue for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,		
	2006	**2005**	**2004**
Servicing revenue	$ 336	$ 323	$ 326
Securitization revenue, before Embedded Floor Income and impairment	368	270	230
Servicing and securitization revenue, before Embedded Floor Income and impairment	704	593	556
Embedded Floor Income	14	81	241
Less: Floor Income previously recognized in gain calculation	(8)	(57)	(156)
Net Embedded Floor Income	6	24	85
Servicing and securitization revenue, before impairment	710	617	641
Retained Interest impairment	(157)	(260)	(80)
Total servicing and securitization revenue	$ 553	$ 357	$ 561
Average off-balance sheet student loans	$ 46,336	$ 41,220	$ 40,558
Average balance of Retained Interest	$ 3,101	$ 2,476	$ 2,434
Servicing and securitization revenue as a percentage of the average balance of off-balance sheet student loans (annualized)	1.19%	.87%	1.38%

Servicing and securitization revenue is primarily driven by the average balance of off-balance sheet student loans, the amount of and the difference in the timing of Embedded Floor Income recognition on off-balance sheet student loans and Retained Interest impairments. The increase in securitization revenue, before net Embedded Floor Income and impairment, from 2004 to 2006, is primarily due to (1) the continued increase in the amount of Private Education Loan Residual Interests as a percentage of the total Residual Interest. Private Education Loan Residual Interests generate a higher yield than FFELP loan Residual Interests, and (2) an increase in the amount of off-balance sheet loans.

Servicing and securitization revenue can be negatively impacted by impairments of the value of our Retained Interest, caused primarily by the effect of higher than expected FFELP Consolidation Loan activity on FFELP Stafford/PLUS student loan securitizations and the effect of market interest rates on the Embedded Floor Income included in the Retained Interest. The majority of the consolidations bring the loans back on-balance sheet, so for those loans, we

retain the value of the asset on-balance sheet versus in the trust. For the years ended December 31, 2006, 2005 and 2004, we recorded impairments of $157 million, $260 million and $80 million, respectively. These impairment charges were primarily the result of FFELP Stafford loans prepaying faster than projected through loan consolidation ($104 million, $256 million and $47 million for the years ended December 31, 2006, 2005 and 2004, respectively), and the effect of market interest rates on the Embedded Floor Income which is part of the Retained Interest ($53 million, $4 million and $33 million for the years ended December 31, 2006, 2005 and 2004 respectively). The level and timing of FFELP Consolidation Loan activity is highly volatile, and in response we continue to revise our estimates of the effects of FFELP Consolidation Loan activity on our Retained Interests and it may result in additional impairment recorded in future periods if FFELP Consolidation Loan activity remains higher than projected. These impairment charges are recorded as a loss and are included as a reduction to securitization revenue.

Table of Contents

We receive annual servicing fees of 90 basis points, 50 basis points and 70 basis points of the outstanding securitized loan balance related to our FFELP Stafford/PLUS, FFELP Consolidation Loan and Private Education Loan securitizations, respectively.

CONTRACTUAL CASH OBLIGATIONS

The following table provides a summary of our obligations associated with long-term notes and equity forward contracts at December 31, 2006. For further discussion of these obligations, see Note 8, Long-Term Debt, Note 10, Derivative Financial Instruments, and Note 14, Stockholders Equity, to the consolidated financial statements.

	1 Year or Less	2 to 3 Years	4 to 5 Years	Over 5 Years	Total
Long-term notes[1][2]	$ 4,156	$ 29,684	$ 21,860	$ 47,753	$ 103,453
Equity forward contracts[3]		1,205	1,298	97	2,600
Total contractual cash obligations	$ 4,156	$ 30,889	$ 23,158	$ 47,850	$ 106,053

(1) Only includes principal obligations and specifically excludes SFAS No. 133 derivative market value adjustments.

(2) Includes Financial Interpretation (FIN) No. 46 long-term beneficial interests of $55.1 billion of notes issued by consolidated variable interest entities in conjunction with our on-balance sheet securitization transactions and included in long-term notes in the consolidated balance sheet.

(3) Our obligation to repurchase shares under equity forward contracts is calculated using the average purchase prices for outstanding contracts in the year the contracts expire. At or prior to the maturity date of the agreements, we can purchase shares at the contracted amount plus or minus an early break fee, or we can settle the contract on a net basis with either cash or shares. The equity forward contracts permit the counterparty to terminate a portion of the contracts prior to their maturity date and to force the Company to settle the contracts if the price of the Company s common stock falls below pre-determined levels as defined by the contract as the initial trigger price. The counterparty can continue to terminate portions of the contract if the stock price continues to reach lower pre-determined levels, until the price hits the final trigger price and the entire contract is terminated. Counterparties have a maximum of two triggers each.

OFF-BALANCE SHEET LENDING ARRANGEMENTS

The following table summarizes the commitments associated with student loan purchases and contractual amounts related to off-balance sheet lending related financial instruments at December 31, 2006.

	1 Year or Less	2 to 3 Years	4 to 5 Years	Over 5 Years	Total
Student loan purchases[1]	$ 19,163	$ 23,364	$ 9,796	$ 9,270	$ 61,593

Lines of credit	559	657	930		2,146
	$ 19,722	$ 24,021	$ 10,726	$ 9,270	$ 63,739

(1) Includes amounts committed at specified dates under forward contracts to purchase student loans and anticipated future requirements to acquire student loans from lending partners (discussed below) estimated based on future volumes at contractually committed rates. These commitments are not accounted for as derivatives under SFAS No. 133 as they do not meet the definition of a derivative due to the lack of a fixed and determinable purchase amount.

We have issued lending-related financial instruments including lines of credit to meet the financing needs of our customers. The contractual amount of these financial instruments represents the maximum possible credit risk should the counterparty draw down the commitment and the counterparty subsequently fails to perform according to the terms of our contract. The remaining total contractual amount available to be borrowed under these commitments is $2.1 billion. We do not believe that these instruments are representative of our actual future credit exposure or funding requirements. To the extent that the lines of credit are drawn upon, the balance outstanding is collateralized by student loans. At December 31, 2006, draws on lines of credit were approximately $418 million, and are reflected in other loans in the consolidated balance sheet. For additional information, see Note 13, Commitments, Contingencies and Guarantees, to the consolidated financial statements.

RISKS

Overview

Managing risks is an essential part of successfully operating a financial services company. Our most prominent risk exposures are operational, market and interest rate, political and regulatory, liquidity, credit, and Consolidation Loan refinancing risk. We discuss these and other risks in the Risk Factors section (Item 1A) of this document. The discussion that follows enhances that disclosure by discussing the risk management strategies that we employ to mitigate these risks.

Operational Risk

Operational risk can result from regulatory compliance errors, servicing errors (see further discussion below), technology failures, breaches of the internal control system, and the risk of fraud or unauthorized transactions by employees or persons outside the Company. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards and contractual commitments, adverse business decisions or their implementation, and customer attrition due to potential negative publicity.

The federal guarantee on our student loans and our designation as an Exceptional Performer by ED is conditioned on compliance with origination and servicing standards set by ED and guarantor agencies. A mitigating factor is our ability to cure servicing deficiencies and historically our losses have been small. Should we experience a high rate of servicing deficiencies, the cost of remedial servicing or the eventual losses on the student loans that are not cured could be material. Our servicing and operating processes are highly dependent on our information system infrastructure, and we face the risk of business disruption should there be extended failures of our information systems, any number of which could have a material impact on our business. To mitigate these risks we have a number of back-up and recovery plans in the event of systems failures, which are regularly tested and monitored.

We manage operational risk through our risk management and internal control processes, which involve each business line including independent cost centers, such as servicing, as well as executive management. The business lines have direct and primary responsibility and accountability for identifying, controlling, and monitoring operational risk, and each business line manager maintains a system of controls with the objective of providing proper transaction authorization and execution, proper system operations, safeguarding of assets from misuse or theft, and ensuring the reliability of financial and other data. We have centralized certain staff functions such as accounting, human resources and legal to further strengthen our operational controls. While we believe that we have designed effective methods to minimize operational risks, our operations remain vulnerable to natural disasters, human error, technology and communication system breakdowns and fraud.

Market and Interest Rate Risk

Market and interest rate risk is the risk of loss from adverse changes in market prices, interest rates, and/or foreign currency exchange rates of our financial instruments. Our primary market risk is from changes in interest rates and interest spreads. We have an active interest rate risk management program that is designed to reduce our exposure to changes in interest rates and maintain consistent earning spreads in all interest rate environments. We use derivative instruments extensively to hedge our interest rate exposure, but there still is a risk that we are not hedging all potential interest rate exposures or that the hedges do not perform as designed. We measure interest rate risk by calculating the variability of net interest income in future periods under various interest rate scenarios using projected balances for interest earning assets, interest-bearing liabilities and derivatives used to hedge interest rate risk. Many assumptions

are utilized by management to calculate the impact that changes in interest rates may have on net interest income, the more significant of which are related to student loan volumes and pricing, the timing of cash flows from our student loan portfolio, particularly the impact of Floor Income and the rate of student loan consolidations, basis risk, credit spreads and the maturity of our debt and derivatives. (See also Interest Rate Risk Management.)

As discussed in more detail under BUSINESS SEGMENTS Limitations of Core Earnings, even though we believe our derivatives are economic hedges, some of them do not qualify for hedge accounting treatment under SFAS No. 133. Therefore, changes in interest rates can cause volatility in those earnings for the market value of our derivatives. Under SFAS No. 133, these changes in derivative market values are recorded through earnings with no consideration for the corresponding change in the fair value of the hedged item. Changes in interest rates can also have a material effect on the amount of Floor Income earned in our student loan portfolio and the valuation of our Retained Interest asset. Our earnings can also be materially affected by changes in our estimate of the rate at which loans may prepay in our portfolios as measured by the CPR. The value of the Retained Interests on FFELP Stafford securitizations is particularly affected by the level of Consolidation Loan activity. We face a number of other challenges and risks that can materially affect our future results such as changes in:

- applicable laws and regulations, which may change the volume, average term, effective yields and refinancing options of student loans under the FFELP or provide advantages to competing FFELP and non-FFELP loan providers;
- demand and competition for education financing;
- financing preferences of students and their families;
- borrower default rates on Private Education Loans;
- continued access to the capital markets for funding at favorable spreads particularly for our non-federally insured Private Education Loan portfolio; and
- our operating execution and efficiencies, including errors, omissions, and effectiveness of internal control.

Our foreign currency exchange rate exposure is primarily the result of foreign denominated liabilities issued by the Company. Cross-currency interest rate swaps are used to lock-in the exchange rate for the term of the liability. In addition, the Company has foreign exchange rate exposure as a result of international operations; however, the exposure is minimal at this time.

We are also subject to market risk relative to our equity forward contracts that allow us to repurchase our common stock in the future from a third party at the market price at the time of entering the contract. Should the market value of our stock fall below certain predetermined levels, the counterparty to the contract has a right to terminate the contract and settle all or a portion at the original contract price. We are required to mark our equity forwards to market, so decreases in our stock price could result in material losses. See COMMON STOCK for more detail on equity forward contracts.

Political/Regulatory Risk

Because we operate in a federally sponsored loan program, we are subject to political and regulatory risk. As part of the HEA, the student loan program is periodically amended and must be reauthorized every six years. Past changes included reduced loan yields paid to lenders in 1993 and 1998, increased fees paid by lenders in 1993, decreased level of the government guaranty in 1993 and reduced fees to guarantors and collectors, among others. On February 8, 2006, the Reconciliation Legislation was signed into law. There are a number of changes that could have a material impact on the Company.

Recently, a number of bills have been introduced in both houses of Congress that, if enacted in their current form, over time could have a material adverse impact on our results of operations. See RECENT DEVELOPMENTS.

The Secretary of Education oversees and implements the HEA and periodically issues regulations and interpretations that may impact our business.

Liquidity Risk (See also LIQUIDITY AND CAPITAL RESOURCES Securitization Activities Liquidity Risk and Funding Long-Term)

Credit Risk

We bear the full risk of borrower and closed school losses experienced in our Private Education Loan portfolio. These loans are underwritten and priced according to risk, generally determined by a commercially available consumer credit scoring system, FICO. Because of the nature of our lending, after an initial decrease, borrower FICO scores will generally improve over time. Additionally, for borrowers who do not meet our lending requirements or who desire more favorable terms, we generally require credit-worthy co-borrowers. Our higher education Private Education Loans are not dischargeable in bankruptcy, except in certain limited circumstances.

We have defined underwriting and collection policies, and ongoing risk monitoring and review processes for all Private Education Loans. Potential credit losses are considered in our risk-based pricing model. The performance of the Private Education Loan portfolio may be affected by the economy, and a prolonged economic downturn may have an adverse effect on its credit performance. Management believes that it has provided sufficient allowances to cover the losses that may be experienced in both the federally guaranteed and Private Education Loan portfolios over the next two years depending on the portfolio. In addition, when a school closes, losses may be incurred for student borrowers who have not completed their education and who may have deferred against repayment or on part of their loans. We have provided for these potential losses in our allowance for loan losses. There is, however, no guarantee that such allowances are sufficient enough to account for actual losses. (See LENDING BUSINESS SEGMENT Private Education Loans *Activity in the Allowance for Private Education Loan Losses.*)

We have credit risk exposure to the various counterparties with whom we have entered into derivative contracts. We review the credit standing of these companies. Our credit policies place limits on the amount of exposure we may take with any one party and in most cases, require collateral to secure the position. The credit risk associated with derivatives is measured based on the replacement cost should the counterparties with contracts in a gain position to the Company fail to perform under the terms of the contract. We also have credit risk with one commercial airline and Federal Express Corporation related to our portfolio of leveraged leases. (See LENDING BUSINESS SEGMENT Other Income Lending Business Segment.)

Consolidation Loan Refinancing Risk

The process of consolidating FFELP Stafford loans into FFELP Consolidation loans can have detrimental effects. First, we lose student loans in our portfolio that are consolidated with other lenders. In 2006, we experienced a net decrease of $3.1 billion of student loans from Consolidation Loan activity as more of our FFELP student loans were consolidated with other lenders than were consolidated by us. This was primarily caused by the run-off of FFELP Consolidation Loans through the reconsolidation through the Direct Loan Program, as discussed in LENDING BUSINESS SEGMENT Student Loan Activity and to the effects of the repeal of the Single Holder Rule. FFELP Consolidation Loans have lower net yields than the FFELP Stafford loans they replace, which is somewhat offset by the longer average lives of FFELP Consolidation Loans.

When FFELP Stafford loans in our securitization trusts consolidate, they are a prepayment for the trust. In periods of high consolidation activity, the prepayments can be greater than we have anticipated which can result in an impairment of our on-balance sheet Retained Interest in those trusts due to its shorter life. See CRITICAL ACCOUNTING POLICIES AND ESTIMATES Effects of Consolidation Activity on Estimates. Also, we must maintain sufficient, short-term liquidity to enable us to cost-effectively refinance previously securitized FFELP loans as they are consolidated back on to our balance sheet.

See also the discussion of the effects of reconsolidation on the FFELP Consolidation Loan portfolio at LENDING BUSINESS SEGMENT Consolidation Activity and its effect on our Floor Income Contracts economically hedging FFELP Consolidation Loans at LENDING BUSINESS SEGMENT Summary of our Managed Student Loan Portfolio *Student Loan Floor Income Contracts.*

Table of Contents

Interest Rate Risk Management

Asset and Liability Funding Gap

The tables below present our assets and liabilities (funding) arranged by underlying indices as of December 31, 2006. In the following GAAP presentation, the funding gap only includes derivatives that qualify as effective SFAS No. 133 hedges (those derivatives which are reflected in net interest margin, as opposed to those reflected in the gains/(losses) on derivatives and hedging activities, net line on the income statement). The difference between the asset and the funding is the funding gap for the specified index. This represents our exposure to interest rate risk in the form of basis risk and repricing risk, which is the risk that the different indices may reset at different frequencies or may not move in the same direction or at the same magnitude.

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

GAAP Basis

Index (Dollars in billions)	**Frequency of Variable Resets**	**Assets**	**Funding[1]**	**Funding Gap**
3 month Commercial paper	daily	$ 75.2	$	$ 75.2
3 month Treasury bill	weekly	7.8	.2	7.6
Prime	annual	.6		.6
Prime	quarterly	1.3		1.3
Prime	monthly	8.0		8.0
PLUS Index	annual	2.0	.3	1.7
3-month LIBOR	daily			
3-month LIBOR	quarterly	1.5	89.0	(87.5)
1-month LIBOR	monthly	.1	3.0	(2.9)
CMT/CPI index	monthly/quarterly		3.8	(3.8)
Non Discrete reset[2]	monthly		7.6	(7.6)
Non Discrete reset[3]	daily/weekly	6.9	.3	6.6
Fixed Rate[4]		12.7	11.9	.8
Total		$ 116.1	$ 116.1	$

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

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

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

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

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

Table of Contents

Managed Basis

Index (Dollars in billions)	Frequency of Variable Resets	Assets	Funding[1]	Funding Gap
3 month Commercial paper	daily	$ 101.1	$ 10.4	$ 90.7
3 month Treasury bill	weekly	13.9	12.5	1.4
Prime	annual	1.0		1.0
Prime	quarterly	7.4	5.5	1.9
Prime	monthly	13.9	12.8	1.1
PLUS Index	annual	3.5	5.5	(2.0)
3-month LIBOR	daily		84.7	(84.7)
3-month LIBOR	quarterly	1.5	10.5	(9.0)
1-month LIBOR	monthly	.1	2.0	(1.9)
Non Discrete reset[2]	monthly		9.9	(9.9)
Non Discrete reset[3]	daily/weekly	11.1	.2	10.9
Fixed Rate[4]		10.2	9.7	.5
Total		$ 163.7	$ 163.7	$

(1) Includes all derivatives that management considers economic hedges of interest rate risk and reflects how we internally manage our interest rate exposure.

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

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

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

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

over a long period of time. We use interest rate swaps and other derivatives to achieve our risk management objectives.

When compared with the GAAP presentation, the Managed basis presentation includes all of our off-balance sheet assets and funding, and also includes basis swaps that primarily convert quarterly 3-month LIBOR to other indices that are more correlated to our asset indices.

Table of Contents

Weighted Average Life

The following table reflects the weighted average life for our Managed earning assets and liabilities at December 31, 2006.

(Averages in Years)	On-Balance Sheet	Off-Balance Sheet	Managed
Earning assets			
Student loans	9.7	5.7	9.5
Other loans	5.9		5.9
Cash and investments	.6	.1	.4
Total earning assets	9.0	5.2	8.8
Borrowings			
Short-term borrowings	.3		.3
Long-term borrowings	6.8	5.7	6.5
Total borrowings	6.6	5.7	6.3

Long-term debt issuances likely to be called by us or putable by the investor have been categorized according to their call or put dates rather than their maturity dates. In recent years the shift in the composition of our FFELP student loan portfolio from Stafford loans to FFELP Consolidation Loans has lengthened the Managed weighted average life of the student loan portfolio from 9.0 years at December 31, 2005, to 9.5 years at December 31, 2006.

COMMON STOCK

The following table summarizes the Company s common share repurchase, issuance and equity forward activity for the years ended December 31, 2006, 2005 and 2004.

	Years Ended December 31,		
(Shares in millions)	2006	2005	2004
Common shares repurchased:			
Open market	2.2		.5
Equity forward contracts	5.4	17.3	32.7
Benefit plans[1]	1.6	1.5	1.5
Total shares repurchased	9.2	18.8	34.7
Average purchase price per share[2]	$ 52.41	$ 49.94	$ 38.03

Common shares issued	6.7	8.3	10.7
Equity forward contracts:			
Outstanding at beginning of period	42.7	42.8	43.5
New contracts	10.9	17.2	32.0
Settlements	(5.4)	(17.3)	(32.7)
Outstanding at end of period	48.2	42.7	42.8
Authority remaining at end of period to repurchase or enter into equity forwards	15.7	18.7	35.8

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

(2) For equity forward contracts, the average purchase price per share for 2005 and 2004 is calculated based on the average strike price of all equity forward contracts including those whose strike prices were amended and were net settled in the cashless transactions discussed above. There were no such cashless transactions in 2006.

During December 2005, September 2004 and November 2004, we amended substantially all of our outstanding equity forward purchase contracts. The strike prices on these contracts were adjusted to the then

current market share prices of the common stock and the total number of shares under contract was reduced from 46.5 million, 53.4 million and 49.0 million shares to 42.4 million, 46.7 million and 42.2 million shares, respectively. As a result of these amendments, we received a total of 4.1 million and 13.4 million shares that settled in 2005 and 2004, respectively, free and clear in cashless transactions. This reduction of shares covered by the equity forward contracts is shown on a net basis in the settlements row of the table above.

As of December 31, 2006, the expiration dates and range of and weighted average purchase prices for outstanding equity forward contracts were as follows:

Year of Maturity (Contracts in millions of shares)	Outstanding Contracts	Range of Purchase Prices	Weighted Average Purchase Price
2008	7.3	$54.74	$ 54.74
2009	14.7	54.74	54.74
2010	15.0	54.74	54.74
2011	9.1	50.30-53.76	52.72
2012	2.1	46.30-46.70	46.40
	48.2		$ 54.00

The closing price of the Company s common stock on December 29, 2006 was $48.77. Should the market value of our stock fall below certain initial trigger prices, the counterparty to the contract has a right to terminate the contract and settle all or a portion at the original contract price. For equity forward contracts outstanding at December 31, 2006, these initial trigger prices range from $25.93 per share to $35.58 per share.

In February 2007, the Company made payments to certain counterparties to lower the strike prices and trigger prices on their outstanding equity forward contracts. Also in February 2007, the Company agreed with certain counterparties to amend the trigger prices on their outstanding equity forward contracts. In total, the Company amended the terms of the contracts covering 18.5 million shares. As a result of these transactions, the Company s aggregate position on equity forward contracts is 48.2 million shares at an average strike price of $51.86. The highest trigger price on all outstanding equity forward contracts is now $30.11, down from $35.58.

As of February 28, 2007, the expiration dates and range of and weighted average purchase prices for outstanding equity forward contracts were as follows:

Year of maturity (Contracts in millions of shares)	Outstanding Contracts	Range of Purchase Prices	Weighted Average Purchase Price
2008	7.3	$43.50-$44.00	$ 43.80
2009	14.7	46.00-54.74	53.66
2010	15.0	54.74	54.74
2011	9.1	49.75-53.76	51.91
2012	2.1	46.30-46.70	46.40

48.2	$ 51.86

In December 2005, the Company retired 65 million shares of common stock held in treasury at an average price of $37.35 per share. This retirement decreased the balance in treasury stock by $2.4 billion, with corresponding decreases of $13 million in common stock and $2.4 billion in retained earnings.

RECENT DEVELOPMENTS

Student Aid Reward Act of 2007

On February 13, 2007, Senator Kennedy introduced the Student Aid Reward Act of 2007, which offers financial incentives to schools to participate in the Direct Loan Program. Under the bill, schools would receive payments from the government not to exceed 50 percent of the budget scored savings to the government as

a result of the school using the FDLP rather than the FFELP. The bill provides that schools could use such payments to supplement the amount awarded to Pell Grant recipients or could use such payment for grants to low- or middle-income graduate students. Schools would be required to join the Direct Loan Program for five years from the date the first payment is made to qualify for the payments. Because payments would be contingent on available funding, schools switching from the FFELP to the FDLP would be paid first and, then, other FDLP schools, if funds remained, would be paid on a pro-rata basis.

President s 2008 Budget Proposals

On February 5, 2007, President Bush transmitted his fiscal 2008 budget proposals to Congress. The budget included several proposals that would reduce or alter payments to both lenders and guarantors in the FFELP. The specific proposals include: (1) reducing special allowance payments on new loans by 0.50 percentage points; (2) reducing the default guaranty from 97 percent to 95 percent; (3) reducing payments to Exceptional Performers by two percentage points; (4) doubling lender origination fee for FFELP Consolidation Loans, from 0.5 percent to 1.0 percent; (5) reducing collections retention to 16 percent beginning in fiscal 2008; (6) reducing administrative cost allowance payments to guaranty agencies, changing the formula from a percent of original principal to a unit cost basis; and (7) eliminating the Perkins loan program.

If enacted in their current form, and the Company takes no remedial action, the FFELP programs cuts proposed in the President s budget proposal detailed above, which are to be implemented prospectively, could over time have a materially adverse affect on our financial condition and results of operations, as new loans originated under the new proposal become a higher percentage of the portfolio.

Student Loan Sunshine Act

In February 2007, the Student Loan Sunshine Act was introduced in both the House and Senate with the stated purpose of protecting student loan borrowers by providing them with more information and disclosures about private student loans. The bill applies to all lenders that make private educational loans through colleges and universities, as well as to lenders of direct-to-consumer educational loans. The bill s provisions also apply to post-secondary educational institutions that receive federal funds. The legislation would impose significant new disclosure and reporting requirements on schools and lenders and would prohibit gifts with a value greater than $10 from lenders to financial aid professionals. The legislation would require schools to include at least three unaffiliated lenders on any preferred lender list. The legislation would amend the Truth in Lending Act to require lenders to notify the school if their student, or parent of their student, applies for a private education loan, regardless of whether the lender has an education loan arrangement with the school, and to require the school to notify the prospective borrower whether and to what extent the private education loan exceeds the cost of attendance, after consideration of all federal, state and institutional aid that the borrower has or is eligible to receive.

If the Student Loan Sunshine Act is enacted in its current form, it could negatively impact the financial aid process and the timely disbursement of private education loans, including the efficiency of direct-toconsumer loans, for borrowers at post-secondary education institutions, all of which could adversely affect our results of operations. In addition, the bill could adversely affect the strategy under which our primary marketing point of contact is the school s financial aid internal brand originations.

Student Debt Relief Act of 2007

On January 22, 2007, Senator Edward Kennedy (D-MA) introduced the Student Debt Relief Act of 2007 (S. 359) along with Senators Durbin (D-IL), Lieberman (D-CT), Mikulski (D-MD), Obama (D-IL), and Schumer (D-NY) as co-sponsors. The proposed legislation would, in addition to increasing Pell grants and providing other benefits to

student loan borrowers,

once again allow in-school loan consolidation and allow reconsolidation of FFELP Consolidation Loans;

make charging Direct Loan origination fees subject to the discretion of the Secretary of Education; and,

for borrowers with Direct Loans only, provide borrowers employed in public service with loan forgiveness after 120 payments under the income contingent repayment plan.

The Student Debt Relief Act also contains the provisions of the Student Aid Reward Act of 2007 (see discussion below). If the Student Debt Relief Act becomes law in its current form, it could negatively impact the Company s future earnings.

College Student Relief Act of 2007

On January 17, 2007, the U.S. House of Representatives passed H.R. 5, the College Student Relief Act of 2007. The bill was principally designed to lower student loan interest rates paid by borrowers of subsidized undergraduate FFELP and FDLP loans over a five year period beginning July 1, 2007, from 6.8 percent to 3.4 percent in 2011. Because the lender rate is separate from the borrower rate, the interest rate cut does not affect lenders. The interest rate cut, however, does have a sizable budget effect because the federal government pays to the lender any positive difference between the lender rate and the borrower rate. To offset the additional budget cost, the legislation makes several changes to increase costs to lenders and guaranty agencies. The legislation would reduce default insurance from 97 percent to 95 percent, eliminate Exceptional Performer, double the lender origination fee on all new loans from 0.5 percent to 1 percent, reduce special allowance formula on all new Stafford, PLUS, and FFELP Consolidation Loans by 0.1 percent (exempting the smallest lenders) and increase the offset fee that consolidation lenders pay, to 1.3 percent for consolidation loan holders whose portfolio contains more than 90 percent FFELP Consolidation Loans. The legislation would reduce the amount that guaranty agencies may retain upon collecting on defaulted claim-paid loans.

The legislation will be transmitted in the Senate, where it will be referred to the Senate Health, Education, Labor, and Pensions Committee and is unlikely to be considered as a stand-alone bill. The Senate HELP committee is expected to begin consideration of the Reconciliation of the Higher Education Act prior to its expiration in June and sections of H.R. 5 could be considered as part of that legislation.

The Company has several loan pricing mechanisms, such as the level of Borrower Benefits, that would mitigate some of the negative impact of this proposal. Also, reduced profitability in the student loans could result in a number of our competitors leaving the industry which would benefit us. In addition, this legislation would be implemented prospectively, so its effect would gradually impact us over a number of years. Accordingly, we cannot predict the effect of this proposed legislation on the Company s financial condition and results of operation.

SEC and House Committee Requests

On February 13, 2007, the Company received a copy of a letter addressed to Albert L. Lord, the Company s Chairman of the Board of Directors, from the U.S. House of Representatives Committee on Education and Labor. The letter requested that Mr. Lord and the Company provide the House Committee on Education and Labor and the House Financial Services Committee with information on communications with the White House and the U.S. Department of Education about the President s budget proposals and recent legislative initiatives for the period from November 1, 2006 through the date of the request. We are cooperating with committee counsel in order to provide the requested information.

On February 15, 2007, the Securities and Exchange Commission contacted the Company about Mr. Lord s sales of SLM Corporation common stock and requested information and documents relating to sales of SLM Corporation common stock by the Company s Board of Directors, officers or employees. We are cooperating with the Securities and Exchange Commission in order to provide the requested information and documents.

OTHER RELATED EVENTS AND INFORMATION

ED Dear Colleague Letter Restating Requirements of 9.5 Percent Loan Special Allowance Payments Eligibility

On January, 23, 2007, ED issued a Dear Colleague Letter to the industry. The letter restated the requirements of the Higher Education Act of 1965, as amended, and ED s regulations that control whether

FFELP loans made or acquired with funds derived from tax-exempt obligations are eligible for 9.5 percent SAP. The letter s restatement is consistent with claims asserted by the ED s Office of Inspector General (OIG) in their Final Audit Report on Special Allowance Payments to Nelnet for Loans Funded by Tax-Exempt Obligations issued on September 29, 2006. On January 24, 2007, ED sent a letter to the Company which sets forth the same restatement and also imposes audit and certification requirements for any 9.5 percent SAP billings after September 30, 2006. On February 15, 2007, the Company delivered a letter to ED, which, subject to certain conditions, including no successful challenge by an industry participant of ED s restated eligibility requirements for 9.5 percent SAP, stated that the Company would make no further claims for 9.5 percent SAP retroactive to October 1, 2006, and for those loans affected, would bill at the standard SAP rate. In the fourth quarter of 2006, the Company accrued $2.4 million in interest income in excess of income based upon the standard special allowance rate on its portfolio of loans that is entitled to receive 9.5 percent SAP. After adjusting for the fourth quarter accrual, we earned a total of $13.1 million in interest income in excess of standard special allowance payments during 2006. Regardless of the issuance of the Dear Colleague Letter, the Company s portfolio of 9.5 percent loans and associated SAP billings have been in a constant state of decline. As a result, our voluntary forgoing of future claims of 9.5 percent SAP will not have a material impact on future earnings. In addition, we will record an impairment of $9 million related to the intangible asset associated with the 9.5 percent loans acquired in business combinations.

Extension of the Higher Education Act

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 2 to the consolidated financial statements, Significant Accounting Policies Recently Issued Accounting Pronouncements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity Analysis

The effect of short-term movements in interest rates on our results of operations and financial position has been limited through our interest rate risk management. The following tables summarize the effect on earnings for the years ended December 31, 2006 and 2005 and the effect on fair values at December 31, 2006 and 2005, based upon a sensitivity analysis performed by management assuming a hypothetical increase in market interest rates of 100 basis points and 300 basis points while funding spreads remain constant. This analysis does not consider any potential impairment to our Residual Interests that may result from a higher discount rate that would be used to compute the present value of the cash flows if long-term interest rates increased. See Note 9 to the consolidated financial statements, Student Loan Securitization, which details the potential decrease to fair value that could occur.

	Year Ended December 31, 2006 Interest Rates:				Year Ended December 31, 2005 Interest Rates:			
	Change from Increase of 100 Basis Points		Change from Increase of 300 Basis Points		Change from Increase of 100 Basis Points		Change from Increase of 300 Basis Points	
(Dollars in millions, except per share amounts)	$	%	$	%	$	%	$	%
Effect on Earnings								
Increase/(decrease) in pre-tax net income before unrealized gains (losses) on derivative and hedging activities	$ (4)	%	$ (20)	(1)%	$ 12	1%	$ 14	1%
Unrealized gains (losses) on derivative and hedging activities	136	59	215	93	202	32	347	55
Increase in net income before taxes	$ 132	7%	$ 195	10%	$ 214	10%	$ 361	17%
Increase in diluted earnings per share	$ .213	8%	$ .352	13%	$ .323	11%	$ .580	19%

		At December 31, 2006 Interest Rates:			
		Change from Increase of 100 Basis Points		Change from Increase of 300 Basis Points	
(Dollars in millions)	Fair Value	$	%	$	%
Effect on Fair Values					
Assets					

Total FFELP student loans	$ 87,797	$ (182)	%	$ (313)	%
Private Education Loans	12,063				
Other earning assets	9,950	(38)		(109)	(1)
Other assets	10,299	(436)	(4)	(750)	(7)
Total assets	$ 120,109	$ (656)	(1)%	$ (1,172)	(1)%
Liabilities					
Interest bearing liabilities	$ 108,142	$ (1,427)	(1)%	$ (3,610)	(3)%
Other liabilities	3,680	877	24	2,613	71
Total liabilities	$ 111,822	$ (550)	%	$ (997)	(1)%

Table of Contents

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

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

During the year ended December 31, 2006 and 2005, certain FFELP student loans were earning Floor Income and we locked in a portion of that Floor Income through the use of futures and Floor Income Contracts. The result of these hedging transactions was to convert a portion of the fixed rate nature of student loans to variable rate, and to fix the relative spread between the student loan asset rate and the variable rate liability.

In the above table, under the scenario where interest rates increase 100 and 300 basis points, the changes in pre-tax net income before the unrealized gains (losses) on derivative and hedging activities is primarily due to the impact of (i) our off-balance sheet hedged FFELP Consolidation Loan securitizations and the related Embedded Floor Income recognized as part of the gain on sale, which results in a decrease in payments on the written Floor contracts that more than offset impairment losses on the Embedded Floor Income in the Residual Interest; (ii) our unhedged on-balance sheet loans not currently having significant Floor Income due to the recent increase in interest rates, which results in these loans being more variable rate; and (iii) a portion of our fixed rate assets being funded with variable debt. The first item will generally cause income to increase when interest rates increase from a low interest rate environment, whereas, the second and third items will generally offset this increase. In the 100 and 300 basis point scenario for the year ended December 31, 2006, item (iii) had a greater impact than item (i) resulting in a net loss. Item (i) had a bigger impact in both scenarios for the year ended December 31, 2005 due to the lower interest rate environment that

existed relative to 2006.

In addition to interest rate risk addressed in the preceding tables, the Company is also exposed to risks related to foreign currency exchange rates and the equity price of its own stock. Foreign currency exchange risk is primarily the result of foreign denominated debt issued by the Company. As it relates to the Company s corporate unsecured and securitization debt programs used to fund the Company s business, the Company s policy is to use cross currency interest rate swaps to swap all foreign denominated debt payments (fixed and floating) to U.S. dollar LIBOR using a fixed exchange rate. In the tables above, there would be an immaterial impact on earnings if exchange rates were to decrease or increase, due to the terms of the hedging instrument

and hedged items matching. The balance sheet interest bearing liabilities would be affected by a change in exchange rates, however, the change would be materially offset by the cross currency interest rate swaps in other assets or other liabilities. In addition, the Company has foreign exchange risk as a result of international operations, however, the exposure is minimal at this time.

Equity price risk of the Company s own stock is due to equity forward contracts used in the Company s share repurchase program. A hypothetical decrease in the Company s stock price per share of $5.00 and $10.00 would result in a $241 million and $482 million unrealized loss on derivative and hedging, respectively. In addition to the net income impact, other liabilities would increase by the aforementioned amounts. Stock price decreases can also result in the counterparty exercising its right to demand early settlement on a portion of or the total contract depending on trigger prices set in each contract. The initial trigger prices as of December 31, 2006 range from approximately $25.93 to $35.58. At December 29, 2006, the closing price of the Company s stock was $48.77. With the $5.00 and $10.00 decrease in unit stock price above, none of these triggers would be met and no counterparty would have the right to early settlement.

Item 8. Financial Statements and Supplementary Data

Reference is made to the financial statements listed under the heading (a) 1.A. Financial Statements of Item 15 hereof, which financial statements are incorporated by reference in response to this Item 8.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Nothing to report.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of December 31, 2006. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2006, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (a) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (b) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure.

As reported in a Current Report on Form 8-K filed by the Company on March 1, 2007, the Company has included within this Annual Report on Form 10-K for the year ended December 31, 2006 restated consolidated statements of cash flows for the annual periods of 2005 and 2004 and each of the quarterly periods of 2006 and 2005. The restatements do not affect the Company s consolidated statements of income, consolidated balance sheets or consolidated statements of changes in stockholders equity for any of the affected periods. Accordingly, the Company s historical revenues, net income, earnings per share, total assets and total stockholders equity remain unchanged.

The restatements result from several incorrect classifications on the consolidated statements of cash flows, primarily related to restricted cash accounts involving on-balance sheet securitizations. The cash flows from these accounts had been classified as operating activities. However, in accordance with Statement of Financial Accounting Standards (SFAS) No. 95, Statement of Cash Flows, cash flows from these accounts should have been, and in the future will be,

classified as investing activities, rather than operating activities. Accordingly, the restatements will affect solely the classification and subtotals of cash flow activities, but they will have no impact on the net increase (decrease) in total cash set forth in the consolidated statements of cash flows for any of the previously reported periods. During the fourth quarter of 2006, management remediated the control deficiency that resulted in the restatements by initiating a comprehensive evaluation of the

classifications of cash flows within the Company s consolidated statements of cash flows. Consequently, this matter did not constitute a control deficiency as of December 31, 2006.

Changes in Internal Control Over Financial Reporting

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) occurred during the fiscal quarter ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

Nothing to report.

PART III.

Item 10. Directors, Executive Officers and Corporate Guidance

The information regarding directors and executive officers set forth under the headings Proposal 1: Election of Directors and Executive Officers in the Proxy Statement to be filed on schedule 14A relating to the Company s Annual Meeting of Stockholders scheduled to be held on May 17, 2007 (the 2007 Proxy Statement) is incorporated by reference in this section.

The information regarding reports filed under Section 16 of the Securities and Exchange Act of 1934 set forth under the heading Section 16(a) Beneficial Ownership Reporting Compliance of our 2007 Proxy Statement is incorporated by reference in this section.

The information regarding the Company s Code of Business Conduct set forth under the heading Code of Business Conduct of our 2007 Proxy Statement is incorporated by reference in this section.

The information regarding the Company process regarding nominees to the board of directors and the identification of the audit committee financial experts set forth under the heading Corporate Governance of our 2007 Proxy Statement is incorporated by reference in this section.

Item 11. Executive Compensation

The information set forth under the caption Executive Compensation in the Proxy Statement is incorporated into this Annual Report by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information set forth in Note 16 to the consolidated financial statements, Stock-Based Compensation Plans, listed under the heading (a) 1.A. Financial Statements of Item 15 hereof and the information set forth under the captions Stock Ownership and General Information Principal Shareholders in the Proxy Statement is incorporated by reference in this section. There are no arrangements known to the Company, the operation of which may at a subsequent date result in a change in control of the Company.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information set forth under the caption Related-Party Transactions and, regarding director independence, Corporate Governance in the Proxy Statement is incorporated by reference.

Item 14. Principal Accounting Fees and Services

The information set forth under the caption Proposal 2 Ratification of the Appointment of Independent Registered Public Accounting Firm in the Proxy Statement is incorporated by reference in this section.

PART IV.

Item 15. Exhibits, Financial Statement Schedules

(a) 1. Financial Statements

A. The following consolidated financial statements of SLM Corporation and the Report of the Independent Registered Public Accounting Firm thereon are included in Item 8 above:

Management s Annual Report on Internal Control over Financial Reporting	F-2
Report of Independent Registered Public Accounting Firm	F-3
Consolidated Balance Sheets as of December 31, 2006 and 2005	F-5
Consolidated Statements of Income for the years ended December 31, 2006, 2005 and 2004	F-6
Consolidated Statements of Changes in Stockholders Equity for the years ended December 31, 2006, 2005 and 2004	F-7
Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005 and 2004	F-9
Notes to Consolidated Financial Statements	F10

2. Financial Statement Schedules

All schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

3. Exhibits

The exhibits listed in the accompanying index to exhibits are filed or incorporated by reference as part of this Annual Report.

The Company will furnish at cost a copy of any exhibit filed with or incorporated by reference into this Annual Report. Oral or written requests for copies of any exhibits should be directed to the Corporate Secretary.

4. Appendices

Appendix A Federal Family Education Loan Program

(b) Exhibits

*2	Agreement and Plan of Reorganization by and among the Student Loan Marketing Association, SLM Holding Corporation, and Sallie Mae Merger Company
**3.1	Amended and Restated Certificate of Incorporation of the Registrant
**3.2	Amended By-Laws of the Registrant
**4	Warrant Certificate No. W-2, dated as of August 7, 1997
*10.1	Board of Directors Restricted Stock Plan
*10.2	Board of Directors Stock Option Plan
*10.3	Deferred Compensation Plan for Directors
*10.4	Incentive Performance Plan

*10.5	Stock Compensation Plan
*10.6	1993-1998 Stock Option Plan
*10.7	Supplemental Pension Plan
*10.8	Supplemental Employees Thrift & Savings Plan (Sallie Mae 401(K) Supplemental Savings Plan)
***10.9	Directors Stock Plan

114

***10.10	Management Incentive Plan
10.11	Employee Stock Option Plan
10.12	Amended and Restated Employees Stock Purchase Plan
10.13	Employment Agreement between the Registrant and Albert L. Lord, Vice Chairman of the Board of Directors and Chief Executive Officer, dated as of January 1, 2003
10.14	Employment Agreement between the Registrant and Thomas J. Fitzpatrick, President and Chief Operating Officer, dated as of January 1, 2003
10.15(*)	Employment Agreement between the Registrant and C.E. Andrews, Executive Vice President, Accounting and Risk Management, dated as of February 24, 2004.
10.16	Named Executive Officer Compensation
10.17	Summary of Non-Employee Director Compensation
10.18	Limited Liability Company Agreement of Education First Marketing LLC
10.19	Limited Liability Company Agreement of Education First Finance LLC
10.20	Settlement Agreement and Release(1)
10.21	First Amendment to Settlement Agreement and Release(1)
10.22	Second Amendment to Settlement Agreement and Release(1)
10.23	Employment Agreement between Registrant and Thomas J. Fitzpatrick, President and Chief Executive Officer, effective as of June 1, 2005
++10.24	Sallie Mae Deferred Compensation Plan for Key Employees Restatement Effective January 1, 2005
++10.25	SLM Corporation Incentive Plan Performance Stock Term Sheet Core Net Income Target
++10.26	Stock Option Agreement SLM Corporation Incentive Plan Net-Settled, Price-Vested Options 1 year minimum 2006
++10.27	SLM Corporation Change in Control Severance Plan for Senior Officers
14	Code of Business Conduct
*21	Subsidiaries of the Registrant
+23	Consent of PricewaterhouseCoopers LLP
+31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
+31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
+32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2003
+32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2003

* Incorporated by reference to the correspondingly numbered exhibits to the Registrant s Registration Statement on Form S-4, as amended (File No. 333-21217)

** Incorporated by reference to the correspondingly numbered exhibits to the Registrant s Registration on Form S-1 (File No. 333-38391)

*** Incorporated by reference to the Registrant s Definitive Proxy Statement on Schedule 14A, as filed with the Securities and Exchange Commission on April 10, 1998 (File No. 001-13251)

Filed with the Securities and Exchange Commission with the Registrant s Annual Report on Form 10-K for the year ended December 31, 2003

Management Contract or Compensatory Plan or Arrangement

Filed with the Securities and Exchange Commission with the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2003

(*) Filed with the Securities and Exchange Commission with the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2004

Filed with the Securities and Exchange Commission with the Registrant s Annual Report on Form 10-K for the year ended December 31, 2004

Filed with the Securities and Exchange Commission with the Registrant s Quarterly Report on Form 10-Q for the quarter ended March 31, 2005

Table of Contents

Filed with the Securities and Exchange Commission with the Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005

++ Filed with the Securities and Exchange Commission with the Registrant s Annual Report on Form 10-K for the year ended December 31, 2005.

+ Filed with the Securities and Exchange Commission with this Form 10-K

(1) Confidential Treatment has been requested as to certain portions of these exhibits. Such portions have been omitted. We separately filed with the Securities and Exchange Commission a complete set of these exhibits, including the portions omitted in our filing.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Dated: March 1, 2007

SLM CORPORATION

By: /s/ Thomas J. Fitzpatrick
Thomas J. Fitzpatrick
Vice Chairman and Chief Executive Officer

Pursuant to the requirement of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Thomas J. Fitzpatrick Thomas J. Fitzpatrick	Vice Chairman and Chief Executive Officer (Principal Executive Officer)	March 1, 2007
/s/ C.E. Andrews C.E. Andrews	Executive Vice President and Chief Financial Officer (Principal Accounting Officer and Duly Authorized Officer)	March 1, 2007
/s/ Albert L. Lord Albert L. Lord	Chairman of the Board of Directors	March 1, 2007
/s/ Ann Torre Bates Ann Torre Bates	Director	March 1, 2007
/s/ Charles L. Daley Charles L. Daley	Director	March 1, 2007
/s/ William M. Diefenderfer, III William M. Diefenderfer, III	Director	March 1, 2007
/s/ Diane Suitt Gilleland Diane Suitt Gilleland	Director	March 1, 2007
/s/ Earl A. Goode	Director	March 1, 2007

Earl A. Goode		
/s/ Ronald F. Hunt	Director	March 1, 2007
Ronald F. Hunt		
/s/ Benjamin J. Lambert, III	Director	March 1, 2007
Benjamin J. Lambert, III		

Table of Contents

Signature	Title	Date
/s/ Barry A. Munitz	Director	March 1, 2007
Barry A. Munitz		
/s/ A. Alexander Porter, Jr.	Director	March 1, 2007
A. Alexander Porter, Jr.		
/s/ Wolfgang Schoellkopf	Director	March 1, 2007
Wolfgang Schoellkopf		
/s/ Steven L. Shapiro	Director	March 1, 2007
Steven L. Shapiro		
/s/ Barry L. Williams	Director	March 1, 2007
Barry L. Williams		

Table of Contents

CONSOLIDATED FINANCIAL STATEMENTS
INDEX

	Page
Management s Annual Report on Internal Control over Financial Reporting	F-2
Report of Independent Registered Public Accounting Firm	F-3
Consolidated Balance Sheets	F-5
Consolidated Statements of Income	F-6
Consolidated Statements of Changes in Stockholders Equity	F-7
Consolidated Statements of Cash Flows	F-9
Notes to Consolidated Financial Statements	F-10

MANAGEMENT S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we assessed the effectiveness of our internal control over financial reporting as of December 31, 2006. In making this assessment, our management used the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management also used an IT governance framework that is based on the COSO framework, *Control Objectives for Information and related Technology*, which was issued by the Information Systems Audit and Control Association and the IT Governance Institute. Based on our assessment and those criteria, management concluded that, as of December 31, 2006, our internal control over financial reporting is effective.

Our management s assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears below.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of SLM Corporation:

We have completed integrated audits of SLM Corporation s consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1), present fairly, in all material respects, the financial position of SLM Corporation and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the Company adopted SFAS No. 123(R), Share Based Payment, and as a result changed its method of accounting for stock based compensation.

As discussed in the section entitled Restatement of the Consolidated Statements of Cash Flows included in Note 2 to the consolidated financial statements, the accompanying 2005 and 2004 consolidated statements of cash flows have been restated.

Internal control over financial reporting

Also, in our opinion, management s assessment, included in the accompanying Management s Annual Report on Internal Control over Financial Reporting appearing on page F-2, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinions.

Table of Contents

A company s internal control over financial reporting is a process designed 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. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP
McLean, Virginia
March 1, 2007

Table of Contents

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

	December 31, 2006	December 31, 2005
Assets		
FFELP Stafford and Other Student Loans (net of allowance for losses of $8,701 and $6,311, respectively)	$ 24,840,464	$ 19,988,116
FFELP Consolidation Loans (net of allowance for losses of $11,614 and $8,639 respectively)	61,324,008	54,858,676
Private Education Loans (net of allowance for losses of $308,346 and $204,112, respectively)	9,755,289	7,756,770
Other loans (net of allowance for losses of $20,394 and $16,180, respectively)	1,308,832	1,137,987
Investments		
Available-for-sale	2,464,121	2,095,191
Other	99,330	273,808
Total investments	2,563,451	2,368,999
Cash and cash equivalents	2,621,222	2,498,655
Restricted cash and investments	3,423,326	3,300,102
Retained Interest in off-balance sheet securitized loans	3,341,591	2,406,222
Goodwill and acquired intangible assets, net	1,371,606	1,105,104
Other assets	5,585,943	3,918,053
Total assets	$ 116,135,732	$ 99,338,684
Liabilities		
Short-term borrowings	$ 3,528,263	$ 3,809,655
Long-term borrowings	104,558,531	88,119,090
Other liabilities	3,679,781	3,609,332
Total liabilities	111,766,575	95,538,077
Commitments and contingencies		
Minority interest in subsidiaries	9,115	9,182
Stockholders equity		
Preferred stock, par value $.20 per share, 20,000 shares authorized; Series A: 3,300 and 3,300 shares issued, respectively, at stated value of $50 per share; Series B: 4,000 and 4,000 shares issued, respectively, at stated value of $100 per share	565,000	565,000
Common stock, par value $.20 per share, 1,125,000 shares authorized: 433,113 and 426,484 shares issued, respectively	86,623	85,297
Additional paid-in capital	2,565,211	2,233,647

Accumulated other comprehensive income (net of tax of $183,684 and $197,834, respectively)	349,111	367,910
Retained earnings	1,834,718	1,111,743
Stockholders equity before treasury stock	5,400,663	4,363,597
Common stock held in treasury: 22,496 and 13,347 shares, respectively	1,040,621	572,172
Total stockholders equity	4,360,042	3,791,425
Total liabilities and stockholders equity	$ 116,135,732	$ 99,338,684

See accompanying notes to consolidated financial statements.

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

	Years Ended December 31,		
	2006	**2005**	**2004**
Interest income:			
FFELP Stafford and Other Student Loans	$ 1,408,938	$ 1,014,851	$ 725,619
FFELP Consolidation Loans	3,545,857	2,500,008	1,364,777
Private Education Loans	1,021,221	633,884	335,451
Other loans	97,954	84,664	74,289
Cash and investments	503,002	276,756	232,859
Total interest income	6,576,972	4,510,163	2,732,995
Total interest expense	5,122,855	3,058,718	1,433,696
Net interest income	1,454,117	1,451,445	1,299,299
Less: provisions for losses	286,962	203,006	111,066
Net interest income after provisions for losses	1,167,155	1,248,439	1,188,233
Other income:			
Gains on student loan securitizations	902,417	552,546	375,384
Servicing and securitization revenue	553,541	356,730	560,971
Losses on securities, net	(49,357)	(63,955)	(49,358)
Gains (losses) on derivative and hedging activities, net	(339,396)	246,548	849,041
Guarantor servicing fees	132,100	115,477	119,934
Debt management fees	396,830	359,907	300,071
Collections revenue	239,829	166,840	38,687
Other	338,307	273,259	289,802
Total other income	2,174,271	2,007,352	2,484,532
Operating expenses:			
Salaries and benefits	703,210	625,024	497,170
Loss on GSE debt extinguishment and defeasance			220,848
Other	642,942	513,304	397,762
Total operating expenses	1,346,152	1,138,328	1,115,780
Income before income taxes and minority interest in net earnings of subsidiaries	1,995,274	2,117,463	2,556,985
Income taxes	834,311	728,767	642,689
Income before minority interest in net earnings of subsidiaries	1,160,963	1,388,696	1,914,296
Minority interest in net earnings of subsidiaries	4,007	6,412	1,026
Net income	1,156,956	1,382,284	1,913,270

Preferred stock dividends	35,567	21,903	11,501
Net income attributable to common stock	$ 1,121,389	$ 1,360,381	$ 1,901,769
Basic earnings per common share	$ 2.73	$ 3.25	$ 4.36
Average common shares outstanding	410,805	418,374	436,133
Diluted earnings per common share	$ 2.63	$ 3.05	$ 4.04
Average common and common equivalent shares outstanding	451,170	460,260	475,787
Dividends per common share	$ .97	$ .85	$ .74

See accompanying notes to consolidated financial statements.

Table of Contents

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

ferred ock	Common Stock Shares			Preferred	Common	Additional Paid-In	Accumulated Other Comprehensive Income	Retained
ares	Issued	Treasury	Outstanding	Stock	Stock	Capital	(Loss)	Earnings
00,000	472,642,996	(24,964,753)	447,678,243	$ 165,000	$ 94,529	$ 1,553,240	$ 425,621	$ 941,284
								1,913,270
							(42,849)	
							57,644	
							256	
								(321,313)
								(11,501)
	10,623,412	61,810	10,685,222		2,125	280,890		
						58,606		
						12,724		
		(563,500)	(563,500)					
		(19,323,760)	(19,323,760)					
		(13,393,350)	(13,393,350)					
		(1,450,466)	(1,450,466)					

00,000	483,266,408	(59,634,019)	423,632,389	$ 165,000	$ 96,654	$ 1,905,460	$ 440,672	$ 2,521,740