QVT Financial LP

1177 Avenue of the Americas, 9th Floor
New York, New York 10036
212-705-8888
www.qvt.com

October 2, 2007

Mr. Albert L. Lord
Chairman of the Board
SLM Corporation
12061 Bluemont Way
Reston, Virginia 20190

Dear Mr. Lord,

We are writing to you as shareholders to voice our strong support for Sallie Mae's decision to seek to compel the J.C. Flowers-led consortium to consummate the acquisition of the company at the agreed contractual price of $60 per share. We are a significant shareholder of Sallie Mae with accounts managed by QVT Financial LP holding over 1.4 million shares.

We have been involved as shareholders in numerous M&A transactions in which a buyer sought to renegotiate the acquisition price. Based on that experience, we believe that the J.C. Flowers-led consortium's attempt to renegotiate the acquisition of Sallie Mae represents a situation in which the buyer is extraordinarily poorly-placed to demand a reduction in the purchase price for the following reasons:

- It is abundantly clear in our view that (i) the enactment of the College Cost Reduction and Access Act ("CCRAA") does not constitute a "Material Adverse Effect" ("MAE") on Sallie Mae as such term is defined in the Merger Agreement and (ii) the recent turbulence in the credit markets is not a basis under the Merger Agreement for asserting an MAE.
- In the absence of an MAE, we believe that you will be able to hold the buyers liable for the full amount of the $900 million at which their liability under the Merger Agreement is capped, and that at least certain of the buyers will find it hard to take the risk of a damage award of that size.
- We also believe that Sallie Mae's position in the rapidly growing educational lending market makes it a unique asset that the buyers will be very reluctant to fail to acquire and that in any event is worth $60 per share or more to long-term investors such as ourselves.

While we are sure that you and the management and board of Sallie Mae have been through the issues raised by the buyers with the benefit of internal financial projections and counsel, we thought it might still be helpful to develop for you in detail an outsider's perspective as to why no reduction in price is warranted from either a contractual or negotiating leverage point of view. We also detail our views on the structure of the revised buyer consortium proposal and how big a reduction in value such a warrant structure would impose on shareholders.

<u>The Buyers' MAE arguments</u>

We have reviewed today's letter from J.C. Flowers detailing its MAE assertions. We find the buyer group's arguments that an MAE has occurred puzzling in the extreme and cannot imagine that they would survive even the most cursory judicial scrutiny.

The Flowers letter asserts that an MAE has occurred because of (i) "dramatic changes in the credit markets, changes that have a disproportionate impact on Sallie Mae" and (ii) the enactment of the CCRAA. We would make the following points in response.

<u>"Dramatic Changes in the Credit Markets"</u>

It is not clear to us how changes in the credit markets could lead to the failure of a condition to be satisfied under the Merger Agreement since the definition of MAE specifically carves out "changes in global, national or regional political conditions (including the outbreak of war or acts of terrorism) or in general economic, business, regulatory, political or market conditions or in national or global financial markets; *provided* that such changes do not disproportionately affect the Company relative to similarly-sized financial services companies."

With over $10 billion in assets under management, QVT Financial LP is actively-involved in the credit markets generally and in the asset-backed securities markets in particular. Without even entering into a debate about the actual current state of the credit markets and the outlook for improvement, we can say that we do not believe that changes in the credit markets have had any lasting impact on Sallie Mae's loan originations or ability to finance the loans it originates through securitization, and certainly not any that "disproportionately affect the Company relative to similarly-sized financial services companies". Indeed, quite unlike the market for residential mortgages, it is our understanding that the securitization market for student loans has continued to function throughout the difficult credit markets of the past several weeks. While we have noted that Sallie Mae has not done any securitization transactions since July in contrast to your historic pattern of doing significant transactions during the fall semester funding period of August and September, we know that other program sponsors have completed securitization transactions in August and September and our contacts indicate that student loans both in the FFELP and private space currently remain highly securitizable, albeit at somewhat wider levels.

In any event, we regard Flowers's argument that these changes in the credit markets "have a disproportionate impact on Sallie Mae" because it is "a company that has to raise tens of billions in the wholesale credit market every year to fund its operations" as absurd. It is self-evident that a large finance company has large funding needs and we do not see how the fact that Sallie Mae runs a large finance business means that a disruption in credit markets "disproportionately affect[s] the Company relative to similarly-sized financial service companies." Indeed, a general financial disruption, such as the recent turbulence in the credit markets, is precisely what the customary language of this exception to the MAE is intended to cover.

The CCRAA Cannot Be an MAE

We believe that the assertion in the Flowers letter that the enactment of the CCRAA constitutes an MAE as defined under the Merger Agreement rests on a fundamental misreading of the MAE clause that was actually negotiated. It may be the case that the buyer consortium believed it had negotiated a right not to close on the acquisition if legislation that was even one dollar worse for the Federally-guaranteed educational lending industry was enacted as the Flower letter asserts, but that is not what the contract says. The Merger Agreement instead carves out all "the legislative and budget proposals described under the heading 'Recent Developments' in the Company 10–K", not just the Bush budget proposals; many of the provisions that Flowers uses to claim that CCRA represents an MAE were already included in such legislative proposals.

More fundamentally, we doubt very much based on applicable Delaware precedent that a court will interpret the MAE clause actually negotiated to mean that if a change in applicable law is at all more adverse than what is set forth in your 10-K for the year ended December 31, 2006 (the "10-K") then an MAE is deemed to have occurred, regardless of whether such incremental change is itself material. We think a court would instead read the clause as requiring that an event or change have a material adverse effect on Sallie Mae, with materiality judged from the baseline established by what was specifically known to the buyer and carved out in the contract. Thus, we believe a court would only excuse the buyer consortium's non-performance if they could show that the incremental changes contained in the CCRAA and not set forth in the budget and legislative proposals described in the 10-K will themselves result in a material adverse effect on Sallie Mae, something the buyer consortium will, in our view, not be able to show.

Our conclusion is based on our analysis of the incremental impact of the provisions of the CCRAA relative to the pending budget and legislative proposals that are referenced in the 10-K. We know this is a conclusion that you share based on your September 26th statement that "Sallie Mae has measured the Act's adverse change versus the impact of similar legislation described in the company's SEC Form 10-K and concluded such changes would reduce "core earnings" net income, between 1.8 percent and 2.1 percent annually over the next 5 years, using business assumptions it has shared with the buyer group."

In addition to your internal financial forecast of net income "core earnings", we think that the following points that largely make use of the same CBO data on which the Flowers letter relies further serve to establish that whether one examines the more easily quantifiable incremental changes included in the CCRAA (e.g., increase in special allowance payment reductions, increase in lender origination fees, elimination of exceptional performer designation and reduction in default insurance) or its more subtle changes (e.g. loan forgiveness, PLUS loan auction, interest freeze) the Act cannot constitute an MAE:

- **Flowers Use of CBO Data.** The Flowers letter states that "according to the Congressional Budget Office, the College Cost Reduction and Access Act will cut subsidies to the student loan industry by $22.3 billion; the Bush Budget Proposal would have cut subsidies by $15.5 billion. The new legislation therefore is not only 'more adverse' to Sallie Mae than the Bush Budget Proposal, it is 45% 'more adverse.'" We believe this is a deceptive and superficial interpretation of the CBO estimate and the CCRAA as a whole. Flowers presumably obtained the $22.3 billion figure for "the student loan *industry*" by summing the $17.8 billion in reduced outlays listed by the CBO under the heading "Provisions Affecting Lenders" and the $4.5 billion in reduced outlays listed under "Provisions Affecting Guaranty Agencies." Sallie Mae is not a guaranty agency; thus 20% of Flowers' "$22.3 billion" figure is largely irrelevant.

- **Beneficial Provisions.** Furthermore, a portion of the $7.2 billion in new outlays that the CBO classified under "Provisions Affecting Borrowers" may accrue to lenders, partially offsetting the law's detrimental effects. These changes include:

  - **Income-Based Repayment.** We believe that the small incremental effect of the higher SAP-rate reduction on which public attention has largely focused may be offset by elements of the CCRAA that will likely prove favorable to education lenders. Income-based repayment will lengthen loan lives, and while borrowers will make reduced monthly payments, lenders will earn the same SAP, resulting in higher profits. We estimate that as many as 23% of Federally-guaranteed borrowers entering repayment could qualify for income-based repayment limitations.[1] The CBO scored the new program as a net government outlay of $1.035 billion over the next five years; if Sallie Mae captured 27% of that, roughly in line with its market share of new loan originations, it would earn an additional $279 million during the period, helping to offset the harm done by the incremental SAP cuts.

  - **Need-Analysis Methodology.** Likewise, changes in the government's need-analysis methodology could benefit lenders by effectively allowing subsidized Stafford borrowers to take out bigger loans, thanks to bigger "income-protection allowances" deducted from the expected family contribution. The CBO estimates that the need-analysis provisions in the CCRAA will cost the government an additional $48 million over the 2007-12 period; assuming that Sallie Mae captures

[1] Estimated from table 173 of the National Education Data Resource Center's Data Analysis System (http://nces.ed.gov/das/library/tables_listings/show_nedrc.asp?rt=p&tableID=539). We exclude the "<= $0 Income" column because, as the footnote indicates, it chiefly represents an artifact in the data. We compare the average annual loan payment to 15% of the excess of average income over 1.5 times the 2001 one-person poverty guideline of $8,590 (in accordance with the formula from H.R. 2669). Under this rough calculation, those with debt burdens above 10% turn out to qualify for income-based repayment – 23% of the population (and more than that if the spurious sub-zero income column is included).

only 20% of that (since some will go to increased Pell grants), it will earn an additional $9.6 million spread across the next five years – another modest offset.

- **PLUS Loan Auction.** We believe that the most likely effect of the proposed parent-PLUS loan-origination auction will be to increase Sallie Mae's market share in the segment—which was already quite high (38%, we calculate, in Federal fiscal year 2006)—while reducing the cost of originating these loans. The next largest parent-PLUS FFEL lender, according to the research firm Student Marketmeasure, is Citibank/Student Loan Corporation, with only 8% market share, followed by JPMorgan Chase and Bank of America, with shares of 7.5% and 6%, respectively.[2] If the auction creates a duopoly and, for example, Sallie Mae and Citibank retain their relative sizes, Sallie Mae stands to increase its 38% share to 83%.[3] Even if PLUS originations remained fixed at their 2006 levels, this additional 45 points of market share would generate an additional $3 billion of annual loan volume for Sallie Mae[4]—which, given that PLUS loans enter repayment immediately, and assuming what we believe to be a conservative 1% net spread for these loans, could yield $30 million in incremental annual profit.

- **Detrimental provisions covered by 10-K.** Though the Flowers letter and prior statements from J.C. Flowers intended for public dissemination focus almost exclusively on the differences between the CCRAA and the Bush budget proposal, the Merger Agreement stipulates that the impact of "changes in Applicable Law" must be measured against <u>all</u> of "the legislative and budget proposals described...in the Company 10-K"; it accords no special priority to the Bush budget. Since almost every detrimental provision in the CCRAA was foreshadowed by an extremely similar, often virtually identical, measure contained either in the Bush budget or in one of the legislative proposals discussed in the 10-K, the Merger Agreement renders much of the impact of the CCRAA irrelevant from the perspective of assessing an MAE.

    - **SAP Cuts.** The White House's 2008 budget proposed to cut the SAP spread by 50 bps and thereby "save an estimated $12.4 billion over 5 years" for the Federal government, at the expense of private lenders.[5] The CCRRA cuts the SAP spread by five additional basis points; however, the CBO estimated that this measure will cut outlays over the next five years by only $12.4 billion[6]—the same exact figure as the one provided by the Bush administration.

---

[2] Lender volume figures from <http://www.student-marketmeasure.com/_assets/facts/Top10PLUSLenders.html> are compared to total FFEL parent-PLUS originations of $6,938 million (see http://www.ed.gov/finaid/prof/resources/data/06q4ffelpga.xls).
[3] New share = 38/(38+8) = 0.83.
[4] 45% of $6.938 billion of parent-PLUS originations in fiscal 2006 = $3 billion.
[5] Department of Education, "Fiscal Year 2008 Budget Summary and Background Information," issued Feb. 5, 2007, p. 60 (http://www.ed.gov/about/overview/budget/budget08/summary/08summary.pdf).
[6] Congressional Budget Office, "Proposed Changes Affecting Mandatory Spending Relative to the CBO March 2007 Baseline," Sep. 4, 2007, p. 1 (http://www.newamerica.net/files/Conference%20Report%20 Score.pdf).

- **Increase in Origination Fees/Reduction in Guarantees.** We understand from a research report published by Thomas Weisel Partners on August 9th that a representative of J.C. Flowers singled out "increased origination fees ([from] 50 [to] 100bp and reduced government guarantees" as one of the primary reasons why the CCRAA would constitute an MAE. We believe that from the perspective of assessing an MAE, these changes are irrelevant, since the first was proposed by H.R. 5 (highlighted on p. 107 of the 10-K) and the second by the White House budget (also highlighted on p. 107 of the 10-K) and are thus carved out from the definition of MAE. Though the budget would not have eliminated the privileges of exceptional-performer status, H.R. 5 would have—public information that Sallie Mae had fully disclosed.

- **Loan Forgiveness.** According to the same Thomas Weisel research report, the J.C. Flowers representative also singled out the loan forgiveness provisions of the CCRAA as a reason why the Act would constitute an MAE, arguing that the "loan forgiveness option" created by the new legislation "may push borrowers to [the] Direct Lending Program." Even if we believed that this provision mattered for Sallie Mae's bottom line—which we do not—it would be irrelevant to the analysis of an MAE under the Merger Agreement: a substantially identical program was included in the Student Debt Relief Act (S. 359) and duly mentioned in Sallie Mae's 2006 10-K (on p. 107). Though the CCRAA modestly expands eligibility for loan forgiveness relative to S. 359, it also omits several of that bill's most egregious provisions, including one that would have paid schools for switching from FFELP to Direct Lending; we believe the net change is, if anything, positive for Sallie Mae.

The Buyer Consortium's Liability

While the buyer consortium's inclusion in the Merger Agreement of the typical private equity provision capping the consortium's liability at an amount equal to the "Parent Termination Fee" obviously sets an upper boundary on their liability that is small compared to the overall transaction value, the provision may also actually make it easier for a court to award damages in an amount close or equal to the Parent Termination Fee. We believe that this would be the case because a court should view the limitation as a liquidated damages provision allowing it to sidestep the issues of causation and quantification of damages with which courts have struggled in past instances of this type of merger-related litigation. We also think that while small compared to the transaction size and Sallie Mae's current market capitalization, the Parent Termination Fee is material to the J.C. Flowers and Friedman Fleischer & Lowe funds involved; from a negotiating perspective, the high degree of certainty that those funds will be compelled to pay their pro rata share of the termination fee should represent a strong disincentive to their ultimately electing to breach their obligations under the Merger Agreement.

Sallie Mae is a Unique Asset with Strong Prospects for Future Growth

In our view, the most important reason why no reduction from the contractually-negotiated price is warranted is that Sallie Mae represents a unique asset in a market with strong growth demographics. While we recognize that the company achieved a substantial premium to its pre-acquisition price through the auction it conducted, we do not regard $60 per share as an expensive price for a business with Sallie Mae's growth prospects.

There is no other company with a position even close to that occupied by Sallie Mae in the educational loan market, and in particular in the critical schools channel. While we believe that Sallie Mae will continue to operate a profitable FFELP business based on its legacy portfolio and the scale of its Federally-guaranteed lending, we think that your real prospects for growth lie in the private educational loan market. We believe that private educational lending can remain a particularly profitable consumer finance business for an extended period of time for at least those lenders that are able to generate the bulk of their loans through low-cost in school origination, something that Sallie Mae is uniquely positioned to continue to do. We also believe that the secular trends in education finance—growth in student numbers, tuition growing well above inflation and generally static levels of Federal support—mean that the overall US private student lending market will witness phenomenal growth despite the recent expansion of the GradPLUS lending program. In fact, we believe that even the collapse of the housing markets and subprime lending may result in a net benefit to educational lenders, with any general economic impact on borrowers being more than outweighed by increased lending volumes as parents and students find that they are no longer as readily able to access home equity to finance education.

We are familiar with many other types of consumer lending business and do not think that there is another US consumer lending business that has the prospects of educational finance. As shareholders, we would prefer to continue to own the prospects of that future growth rather than accept a reduction in the acquisition price you negotiated. We think that Sallie Mae is a unique asset that the buyer consortium will not be able to replicate or find elsewhere at a lower valuation and that the $60 per share price remains fair despite the change in the leveraged finance credit markets.

The Revised Acquisition Proposal.

We are strongly opposed to the revised proposal of $50 per share plus warrants. We believe it significantly undervalues Sallie Mae from a financial point of view and does not give fair value to the strength of your contractual and bargaining position. We would in addition point out a number of deficiencies in the warrants:

- **High Fixed Exercise Price.** Although the Flowers letter represents that "if the company performs consistent with Sallie Mae's projections, the warrants could result in a payout of over $7 per share", the actual proposed payout mechanism is not strictly linked to Sallie Mae's performance or even to an actual realized IRR, but instead to a fixed price that is twice the initial post-transaction equity value. While we are strong believers in your growth prospects and recognize the additional leverage the transaction will create for the equity, we find it hard to believe that this type of valuation can be achieved within five years without the assumption of a very high exit multiple. Also, the use of a fixed price rather than a price based on an actual IRR achieved by the buyer consortium means that even if the buyer consortium achieves a much higher IRR through an earlier disposition of the company none of the improved IRR benefit is passed through to the original shareholders.

- **Cap.** We think the inclusion of a cap on the warrant payout speaks volumes as to the buyer group's full views on Sallie Mae's valuation. Having obliged the old shareholders to share the equity risk of the leveraged buyout by taking 1/6th of the original consideration in a very out-of-the-money warrant, the buyers' structure would cap the old shareholders' potential gain at the original consideration.

- **Absence of Market; Settlement Mechanics.** We think the absence of any proposal to list the warrants means that the buyer consortium is asking Sallie Mae shareholders to hold for five years an illiquid private market security that cannot be readily traded or financed. We are also distrustful as to the settlement mechanism that will apply if the company's stock is not listed on the exercise date; the absence of detail suggests to us that holders will either be forced to exercise into illiquid physical stock in a private company or alternatively to accept some type of cash settlement at a valuation determined by the majority equity holders. The use of a European (exercisable only at maturity) as opposed to American (exercisable at any time) option structure further reduces the theoretical value of the warrant and lowers the likelihood that shareholders will be able to achieve much value by selling the warrants prior to maturity.

We strongly support your decision to hold firm to your contract and a $60 per share sale price and hope you will continue to reject any overtures to renegotiate the contract price or the structure of the consideration. Please feel free to contact Nick Brumm or Shane Wilson of QVT Financial LP should you wish to discuss any matter set forth in this letter.
Best regards—

QVT Financial LP
By its general partner
QVT Financial GP LLC

Nick Brumm
Managing Member