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THE BOND MARKET ASSOCIATION

October 12, 2006

Ms. Theresa Shaw
Chief Operating Officer
Federal Student Aid
United States Department of Education
Union Center Plaza
830 First Street NE
Washington, DC 20202

Dear Ms. Shaw:

On behalf of the members of the Bond Market Association (BMA), who underwrite 95 percent of the municipal bonds issued in the Unite States—I am writing to express my concern over the findings of the Department of Education's inspector general in its recent audit of the student loan lender Nelnet. By retroactively imposing new billing standards on lenders, the conclusions reached by the audit threaten far-ranging negative consequences for the issuers of, and investors in, tax-exempt municipal bonds backed by certain 9.5 percent special allowance payment (SAP) loans.

The audit's findings directly challenge the practice of recycling, a common transaction for issuers of tax-exempt student loan bonds for nearly three decades. Student loan lenders have routinely used the proceeds of 9.5 percent special allowance payment loans to purchase new loans, which then also qualify for the SAP payment. The audit states that newly purchased loans would not be eligible for the SAP payment unless they were funded either with the proceeds of an eligible tax-exempt bond or a loan funded by a tax-exempt bonds. Since the 1980s, it has been accepted practice for student loan lenders to use the proceeds of 9.5 percent SAP loans more than two generations removed from the original tax-exempt bond source of funding. This recycling activity underlies several billions of dollars of tax-exempt bonds. Congress recently acted to prohibit recycling of most 9.5 percent loans on a prospective basis. Retroactively changing the status of the securitized loans is not fair to investors or issuers who entered this market in good faith.

One of the foremost missions of the BMA is to promote efficient capital markets. The capital markets function best—that is, borrowing costs are the lowest—when investors, issuers and underwriters are certain of the prevailing legal framework. Legal uncertainty translates to increased risk for which investors must be compensated. This drives up borrowing costs, and underscores the importance that policy and legal decisions affecting the market should be prospective.

If accepted, the inspector general's conclusions in the Nelnet audit would disrupt the student loan finance market and unfairly penalize investors while eroding the important market fundamental of legal certainty. I urge the Department of Education not to concur with the inspector general's audit.

Sincerely,

John R. Vogt
Executive Vice President

cc: Margaret Spellings, Secretary of Education
cc: David L. Dunn, Chief of Staff
cc: Kent D. Talbert, General Council
cc: Sara Martinez Tucker, Under Secretary Designate