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Update on Litigation and Audit Risks Facing Student Lending Industry Participants

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Department of Education Review of Schools and Lenders re Prohibited Inducements and Borrower Choice

- As outgrowth of Cuomo investigation Department sent letters in fall 2007 to numerous colleges and lenders.
 - Letters request extensive information from July 1, 2005 on, among other things, financial transactions between lenders and schools.
- Department continuing program reviews of lenders practices in connection with prohibited inducements provisions of HEA.
 - Focus of reviews on compliance with rules that existed prior to July 1, 2008 changes in the regulations.
 - Lack of clarity pre-July 2008 on lenders' private loan practices as FFEL inducement issue.
 - Possible sanctions.

FFELP – Key Legal Proceedings

- Borrower Benefit Programs
 - Multidistrict litigation involving Northstar Education Finance
 - Multiple lawsuits against Northstar consolidated for pretrial purposes in District of Minnesota by Panel on Multidistrict litigation.
 - All of the lawsuits challenge Northstar's suspension of borrower benefit program in which 25 bp interest rate reduction offered for on time payments.

FFELP – Key Legal Proceedings (cont.)

■ Calculation of Interest Rate

■ Chae et al. v. Sallie Mae

- Putative class action filed in 2007 challenging use of simple daily interest method for calculating interest; and charging of late fees while charging simple daily interest.
- Complaint alleged violations of California common law and statutes.
- Summary judgment granted to Sallie Mae on June 16, 2008.
- Case on appeal before 9th Circuit.

Private Education Loan Market – Key Legal Proceedings

■ Discriminatory Impact Claims

- Putative class action against Sallie Mae in Federal Court in Connecticut. (*Rodriguez et. al v. Sallie Mae*, filed 12/18/2007.)
- Alleges that Sallie Mae's private loan pricing has discriminatory impact on minorities.
- Challenges use of school cohort default rates as factor in loan underwriting and pricing.
- Complaint alleges that Sallie Mae “steered” plaintiffs to substandard private loans on account of their race through relationships with colleges having high minority populations and discriminatory underwriting policies.

Key Legal Proceedings (cont.)

- Proposed class is broadly defined in complaint as all minority persons who have or have had a private loan underwritten by Sallie Mae or one of its agents.
- Complaint alleges violations of TILA, ECOA, and 42 U.S.C. §§ 1981-1982 (civil rights).
- Could lead to copycat suits against other lenders if successful.
- Case currently in discovery with motion for summary judgment pending.

Key Legal Proceedings (cont.)

■ FTC Holder Rule Claims

- Lenders who make private loans at for-profit schools have increased litigation risks under FTC Holder Rule.
- FTC Holder Rule allows student borrower to assert claims he has against for-profit school against lender as defense against repayment of loan.
 - FTC Holder claims against Keybank, Student Loan Express (“SLX”), AES, among others, arising from Silver States Helicopter school closing. (*Kilgore, et. al v. Keybank USA, et.al*, Superior Court, California, filed May 16, 2008.)

Key Legal Proceedings (cont.)

- Complaint alleges that lenders and servicers violated California Unfair Competition Law (B&P Section 7200) by, among other things, intentionally omitting FTC Holder Rule notice from promissory notes. Complaint also alleges that defendants' aided and abetted Ponzi scheme perpetrated by school officials.
- Losses on private loans made to Silver State students led to shareholder suit against CIT, parent of SLX, alleging CIT failed to disclose risk that it will have to write off \$179 million of private loans made to Silver State students.
- School in Chapter 7 and owners subject of criminal investigations.
- Highlights need for due diligence on schools and their management with respect to private loan business.

Shareholder Class Action Litigation Claiming Lender Misrepresentations on Private Loan Portfolios

- Class action against CIT Group (filed July 25, 2008 in federal court in NY)
 - Alleges that CIT's (owner of SLX) financial statements failed to disclose likely write off of \$129 million in private loans made to Silver States flight school that went bankrupt.

Shareholder Class Action Litigation (cont.)

- First Marblehead Corporation Securities Litigation (amended class action complaint filed November 28, 2008 in federal court in Mass.)
 - Complaint alleges FMD made host of material misstatements and omissions re quality of private loan portfolio, including:
 - Alleged misrepresentations re level of default rates.
 - Alleged misrepresentations re credit quality of private loans.
 - Failure to disclose that back-end residual interests in securitizations were materially impaired.
 - Failure to disclose that TERI (non-profit guarantor) was not positioned to adequately guarantee FMD's private loans.

Shareholder Class Action Litigation (cont.)

- Complaint also alleges sales of stock by insiders violated Section 10(b)(5).
- Motion to dismiss amended complaint pending.

■ Sallie Mae Shareholder Litigation

- Consolidated class actions in federal court in NY
- Complaint alleges Sallie Mae failed to engage in proper due diligence in originating loans to subprime borrowers, and further claims:
 - Sallie Mae's loan loss provisions for subprime borrowers were inadequate.
 - Sallie Mae had more extensive losses and defaults related to non-traditional portfolio than previously disclosed.

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Robert S. Lavet

Rob Lavet joined PPSV's Education Practice Group in 2008 as a Principal. Mr. Lavet counsels the firm's higher education clients on student loan matters and on transactional, corporate, securities, and litigation concerns, as well as the resolution of audits and government investigations. Prior to joining the firm, he was General Counsel to SLM Corporation (Sallie Mae). At Sallie Mae, Mr. Lavet managed legal affairs, corporate compliance and student loan servicing policy functions. He regularly advised board members and senior management on securities disclosures and corporate debt offerings, oversaw significant litigation and regulatory matters, led due diligence on numerous acquisitions and transactions, and integrated legal teams of acquired businesses in multiple locations. He and his team of attorneys took on leadership roles in postsecondary education as they developed strategies to address the emerging array of regulatory, legislative, corporate, and transactional challenges facing the nation's student loan programs. He successfully litigated the only federal court case involving the Department of Education's attempted application of the prohibited inducement section of the Higher Education Act to a lender.

Prior to joining Sallie Mae, Mr. Lavet served as a trial attorney at the U.S. Department of Justice, and as a partner with the law firm Cole, Corette & Abrutyn where he specialized in commercial litigation, and securities litigation. He is a member of the bar of the District of Columbia and served as a past president of the Washington Metropolitan Area Corporate Counsel Association.

Mr. Lavet graduated with honors from the University of Pennsylvania in 1976 and received his law degree with honors, from Georgetown University Law Center in 1979.