

Sallie Mae Bank



Dodd-Frank Act Stress Test  
2017 Results Disclosure

October, 2017

## I. Overview and Requirements

Sallie Mae Bank, more commonly known as Sallie Mae, with \$19.4 billion in assets is the nation's leading saving, planning and paying for education company. Our primary business is to originate and service Private Education Loans that we make to students and their families. We use the term "Private Education Loans" to mean education loans to students or their families that are not made, insured or guaranteed by any state or federal government. At June 30, 2017, we had a portfolio of \$15.7 billion Private Education Loans.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("DFAST") requires Banks with assets totaling \$10 billion - \$50 billion to conduct stress testing for three macroeconomic scenarios (base, adverse and severely adverse) on the consolidated balance sheet, income statement and the bank's capital across a range of macroeconomic and financial scenarios provided by the Federal Reserve Board. Banks are also required to provide qualitative supporting information on the methodologies and processes used to develop those internal projections. The stress test is based on December 31, 2016 actual results and covers a forecast of the next nine (9) quarters.

In accordance with the Dodd-Frank Act, Sallie Mae Bank has submitted the results of the stress testing and supporting information to its Board of Directors and to its primary financial regulatory agency, the Federal Deposit Insurance Corporation (the FDIC). Additionally, the Dodd-Frank Act instructs covered financial institutions to publish a summary of its severely adverse stress test results.

This document summarizes the results of the severely adverse scenario for Sallie Mae Bank and provides a forward-looking perspective on potential impacts to capital under this scenario. The severely adverse scenario describes a hypothetical set of conditions designed to assess the strength of banking organizations and their resilience to adverse economic environments. Sallie Mae's stress test results may not be comparable to the results of other institutions, as methodologies between institutions may vary.

## II. Severely Adverse Scenario Overview

The severely adverse scenario is characterized by a severe recession in the U.S. economy. Real GDP growth falls sharply for five straight quarters, falling 5.5% in the second quarter of 2017. The unemployment rate rises steadily from 4.7% at the end of 2016 to 10% in the third quarter of 2018. Unemployment only drops 0.2% by the first quarter of 2019 to 9.8%.

Against this economic backdrop, the three-month Treasury bill rate is 0.1% for the entire scenario. The capital markets are extremely volatile. The 10-year Treasury rate drops to 0.8% in the first quarter of 2017, rising gradually thereafter to 1.5% by the end of the scenario period while BBB corporate bond yields increase significantly throughout 2017 before gradually falling. The spread between the 10-year Treasury bond and the BBB corporate bond (Credit Spread) increases from 1.9% at the end of 2016 to 5.4% in the fourth quarter of 2017 and then gradually

declines reaching 3.2% by the scenarios end. The Severely Adverse Scenario is similar to the recent financial crisis.

### III. Risks

An important benefit of the stress test process is the identification and measurement of risks and vulnerabilities that most impact Sallie Mae Bank. This section describes the key risks considered in the stress test: credit risk, funding and liquidity risk, and Private Education Loan originations risk.

**Credit risk** is the risk of loss if Sallie Mae Bank cannot collect on contractual obligations of its Private Education Loan borrowers and co-signers. Gross defaults are the most important variable in the severely adverse scenario. Gross Defaults (and net charge-offs as a percentage of loans in repayment) are projected to be \$204 million (1.8%) in 2017, \$328 million (2.6%) in 2018 and \$249 million (1.9%) in 2019. This is an extremely stressful scenario from a credit perspective. To build the appropriate allowance for loan losses under the severely adverse scenario, the Bank would be required to book a total provision expense of \$467 million in 2017, \$359 million in 2018 and \$57 million in Q1 2019.

**Funding and liquidity risk** is the risk that Sallie Mae can't meet a demand for funds by increasing liabilities at reasonable costs. Despite the projected decline in origination volume under the severely adverse scenario, the Bank's asset base continues to grow significantly during the scenario period requiring similar growth in our funding base. During the severely adverse scenario period, the Bank raises funds through retail and brokered deposit markets as it was able to do during the recent financial crisis. These markets proved broad and deep and there was a movement from other investment alternatives to federally-insured deposits. The Bank assumes that funding from the term asset-backed securitization market is unavailable due to capital market volatility. Throughout the scenario period, we maintain a mix of 55% brokered deposits and 45% retail deposits. Further, the Bank maintains significant sources of contingency funding including its portfolio of loans which may be pledged as collateral for borrowings from the Federal Reserve.

**Private Education Loan origination risk** is the risk that Private Education Loan originations deviate substantially from historical performance. In the severely adverse scenario, which is characterized by massive economic weakness, we assume tuition prices increase 5% in 2017, 3% in 2018 and 1% in 2019, compared to an annual 5% increase throughout the baseline scenario. Also, in the severely adverse scenario we assume that Federal Stafford Loan limits are increased for the first time in eleven years by \$2,000 in response to the reduction of private capital available for higher education funding. Finally, in the severely adverse scenario we assume that we tighten underwriting standards significantly in response to rising default rates and volatility in the capital markets. Our assumptions were informed by actual experience during the 2007-2009 recession.

Other risks such as operational risk, regulatory risk and technology risk were considered and did not have a significant impact on earnings or capital.

## IV. Stress Test Methodologies

The stress testing process at Sallie Mae Bank incorporates macro-economic variables provided by the Federal Reserve and variables specific to our primary product, the Private Education Loan. All major business areas were involved in the stress testing process, including Credit, Marketing, Finance, Financial Planning and Analysis and Treasury. The Bank utilized a combination of statistical models and expert judgment logic and assumption models to derive the results. All models were subject to a model validation process coordinated by the Bank's Enterprise Risk Management Group. A robust governance framework exists within the Bank and was used to provide oversight and effective challenge to the stress testing activities. It is comprised of Management and Board level committees, charters and policies.

## V. Stress Test Results

### **Capital Ratios**

The table below summarizes Sallie Mae Bank's capital ratios after applying the DFAST severely adverse scenario over the nine-quarter planning horizon. Total risk based capital at December 31, 2016 was 13.8%. This provides a solid capital base for the growth anticipated over the next three years. Total Risk Based Capital at the Bank totals 12.5%, 12.7% and 12.8% at the end of 2017, 2018 and Q1 2019, the ninth period of the DFAST scenario. At December 31, 2016 SLM Corporation (the Corp) held \$292 million of cash available to be injected into the Bank as additional paid in capital.

Throughout the scenario period the Corp does not pay dividends to shareholders or repurchase outstanding common stock. Total equity at the Corp grows from \$2.3 billion at December 31, 2016 to \$2.9 billion at December 31, 2019. At the Bank, total equity grows from \$2.0 billion to \$2.8 billion over the same period.

Retained earnings at the Bank are positive throughout the scenario period and total \$923 million at December 31, 2019. No dividends have been paid from the Bank to the Corp between December 31, 2016 and December 31, 2019.

The Bank remains significantly above the regulatory capital levels of a well-capitalized bank in all periods despite the severely adverse economic environment.

## Sallie Mae Bank

	Sallie Mae Bank				Well Capitalized
	2016 (Actual)	2017	2018	1Q19	
<b>Severe:</b>					
Tier 1 Leverage Ratio	11.1%	10.4%	10.7%	10.9%	5.0%
Tier 1 Risk-Based Capital Ratio	12.6%	11.3%	11.5%	11.5%	8.0%
Total Risk Based Capital Ratio	13.8%	12.5%	12.7%	12.8%	10.0%

### Pre-Provision Net Revenue (PPNR)

PPNR for the Bank is presented in the table below. Operating expenses include a targeted approach to estimate operational risk. Meetings were held with key stakeholders across major departments to develop assumptions to determine what additional costs (services, staff, etc.) would be required under the severely adverse scenario and we assumed no reductions in headcount or marketing spend. Net interest income grows in line with the balance sheet, though at a lower relative rate due to the impact of the scenario on originations and margins.

## Sallie Mae Bank

### PPNR Summary

(\$ in millions)

		2017	2018	1Q-19
<b>Metrics</b>	Total Assets	\$ 21,157	\$ 23,409	\$ 23,589
	Private Education Loans	\$ 17,143	\$ 19,352	\$ 20,223
	Total Asset Growth	16%	11%	11%
	Net Interest Margin	\$ 1,050	\$ 1,188	\$ 320
<b>PPNR</b>	Pre-Provision Net Revenue	\$ 677	\$ 779	\$ 219
	Net Income	\$ 127	\$ 256	\$ 98

## Provision for Loan Losses

The below table summarizes Sallie Mae's provision for loan losses in the severely adverse case. Projected charge-off rates are consistent with charge-off rates experienced in 2009 and 2010 on similar assets. Results are influenced by several economic variables, but are most sensitive to the level of unemployment.

### Sallie Mae

PSL Reserve Roll-forward

DFAST Severely Adverse

(\$ in millions)	2017	2018	1Q19
Allowance for Loan Losses	\$ 448	\$ 488	\$ 497
Reserve % of Balance	2.63%	2.53%	2.47%

## VI. Significant Drivers of Stress Test Results

The most significant drivers of Sallie Mae's stress test results are Private Education Loan originations, costs of funds and defaults. Despite the decline in originations growth in the severely adverse scenario, the Bank's Private Education Loan portfolio and asset base continue to grow during the forecast period. Net interest income grows in line with the balance sheet, though at a lower, relative rate due to lower originations and slightly compressed margins. Our assumptions for these drivers were informed by our actual experience of the recent financial crisis.

### Conclusion

The Bank's capital levels exceed regulatory expectations for 'Well Capitalized' Institutions even in the severely adverse scenario. This is principally due to strong credit attributes, product design, and a conservative approach to funding that generates stable, attractive profitability.

## Forward-Looking Statements

This document contains “forward-looking” statements and information based on management’s current expectations as of the date of this document. Statements that are not historical facts, including statements about the Company’s beliefs, opinions or expectations and statements that assume or are dependent upon future events, are forward-looking statements. Forward-looking statements are subject to risks, uncertainties, assumptions and other factors that may cause actual results to be materially different from those reflected in such forward-looking statements. These factors include, among others, the risks and uncertainties set forth in Item 1A “Risk Factors” and elsewhere in the Company’s Annual Report on Form 10-K for the year ended Dec. 31, 2016 (filed with the SEC on Feb. 24, 2017) and subsequent filings with the SEC; increases in financing costs; limits on liquidity; increases in costs associated with compliance with laws and regulations; failure to comply with consumer protection, banking and other laws; changes in accounting standards and the impact of related changes in significant accounting estimates; any adverse outcomes in any significant litigation to which the Company or any subsidiary is a party; credit risk associated with the Company’s (or any subsidiary's) exposure to third parties, including counterparties to the Company’s (or any subsidiary's) derivative transactions; and changes in the terms of education loans and the educational credit marketplace (including changes resulting from new laws and the implementation of existing laws). The Company could also be affected by, among other things: changes in its funding costs and availability; reductions to its credit ratings; failures or breaches of its operating systems or infrastructure, including those of third-party vendors; damage to its reputation; risks associated with restructuring initiatives, including failures to successfully implement cost-cutting programs and the adverse effects of such initiatives on the Company’s business; changes in the demand for educational financing or in financing preferences of lenders, educational institutions, students and their families; changes in law and regulations with respect to the student lending business and financial institutions generally; changes in banking rules and regulations, including increased capital requirements; increased competition from banks and other consumer lenders; the creditworthiness of customers; changes in the general interest rate environment, including the rate relationships among relevant money-market instruments and those of earning assets versus funding arrangements; rates of prepayments on the loans made by the Company and its subsidiaries; changes in general economic conditions and the Company’s ability to successfully effectuate any acquisitions; and other strategic initiatives. The preparation of the Company’s consolidated financial statements also requires management to make certain estimates and assumptions, including estimates and assumptions about future events. These estimates or assumptions may prove to be incorrect. All forward-looking statements contained in this document are qualified by these cautionary statements and are made only as of the date of this document. The Company does not undertake any obligation to update or revise these forward-looking statements to conform such statements to actual results or changes in its expectations.