STUDENT LOAN CORP
Form 10-Q
November 05, 2010

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010

or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___ to ___

Commission File Number: 1-11616
THE STUDENT LOAN CORPORATION
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of incorporation or organization) | 16-1427135<br>(I.R.S. Employer Identification No.) |
| 750 Washington Blvd.<br>Stamford, Connecticut<br>(Address of principal executive offices) | 06901<br>(Zip Code) |

(203) 975-6320
(Registrant's telephone number, including area code)

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

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

| | | | |
|---|---|---|---|
| Large accelerated filer | o | Accelerated filer | x |
| Non-accelerated filer | o (Do not check if a smaller reporting company) | Smaller reporting company | 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 x

On November 1, 2010 there were 20,000,000 shares of The Student Loan Corporation’s common stock outstanding.

Form 10-Q

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PART I CONSOLIDATED FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

THE STUDENT LOAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except share and per share amounts)
(Unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| NET INTEREST INCOME | | | | |
| Interest income | $ 279,220 | $ 194,401 | $ 819,364 | $ 585,821 |
| Interest expense | (182,300 ) | (120,290 ) | (543,012 ) | (382,748 ) |
| Net interest income | 96,920 | 74,111 | 276,352 | 203,073 |
| Provision for loan losses | (72,886 ) | (38,690 ) | (158,173 ) | (104,658 ) |
| Net interest income after provision for loan losses | 24,034 | 35,421 | 118,179 | 98,415 |
| | | | | |
| OTHER (LOSS) INCOME | | | | |
| Gains on loans sold | 55,600 | 17,712 | 55,600 | 35,576 |
| Fair value write down of loans held for sale | (900,849 ) | (2,185 ) | (900,849 ) | (2,185 ) |
| Fee and other (loss) income | (3,373 ) | 70,720 | 6,023 | 108,529 |
| Total other (loss) income | (848,622 ) | 86,247 | (839,226 ) | 141,920 |
| | | | | |
| OPERATING EXPENSES | | | | |
| Salaries and employee benefits | 7,516 | 7,859 | 23,081 | 25,265 |
| Write-off of funding commitment fee paid to principal stockholder | 5,000 | – | 12,500 | – |
| Other expenses | 28,065 | 26,848 | 80,682 | 79,512 |
| Total operating expenses | 40,581 | 34,707 | 116,263 | 104,777 |
| | | | | |
| (Loss) income before income taxes | (865,169 ) | 86,961 | (837,310 ) | 135,558 |
| (Benefit) provision for income taxes | (325,522 ) | 32,154 | (318,943 ) | 47,967 |
| NET (LOSS) INCOME | $ (539,647 ) | $ 54,807 | $ (518,367 ) | $ 87,591 |
| | | | | |
| DIVIDENDS DECLARED AND PAID | $ 7,000 | $ 7,000 | $ 21,000 | $ 42,600 |
| | | | | |
| BASIC AND DILUTED (LOSS) EARNINGS PER COMMON SHARE | $ (26.98 ) | $ 2.74 | $ (25.92 ) | $ 4.38 |
| (based on 20,000,000 average shares outstanding) | | | | |
| | | | | |
| DIVIDENDS DECLARED AND PAID PER COMMON SHARE | $ 0.35 | $ 0.35 | $ 1.05 | $ 2.13 |

See accompanying Notes to the unaudited Consolidated Financial Statements.

THE STUDENT LOAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share and per share amounts)

| | September 30, 2010 (Unaudited) | December 31, 2009 |
|---|---|---|
| ASSETS | | |
| Federally insured student loans | $ – | $ 17,948,706 |
| Private education loans | 3,722,533 | 7,432,471 |
| Deferred origination and premium costs | 104,498 | 548,083 |
| Allowance for loan losses | (37,588) | (149,098) |
| Student loans, net | 3,789,443 | 25,780,162 |
| Loans held for sale | 33,486,095 | 2,409,267 |
| Cash | 588 | 17,998 |
| Deferred income tax asset | 214,743 | – |
| Residual interests in securitized loans | – | 820,291 |
| Other assets | 2,459,295 | 1,990,523 |
| Total Assets | $ 39,950,164 | $ 31,018,241 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities | | |
| Short-term borrowings, payable to principal stockholder | $ 4,346,400 | $ 5,131,000 |
| Short-term secured borrowings, payable to the Department of Education | – | 2,066,686 |
| Long-term borrowings, payable to principal stockholder | 2,800,000 | 4,391,000 |
| Long-term secured borrowings | 31,729,770 | 16,999,976 |
| Deferred income tax liability | – | 410,546 |
| Other liabilities | 305,732 | 348,612 |
| Total liabilities | 39,181,902 | 29,347,820 |
| Stockholders’ Equity | | |
| Common stock, $0.01 par value; authorized 50,000,000 shares; 20,000,000 shares issued and outstanding | 200 | 200 |
| Additional paid-in capital | 143,185 | 141,869 |
| Retained earnings | 624,877 | 1,528,352 |
| Total stockholders' equity | 768,262 | 1,670,421 |
| Total Liabilities and Stockholders' Equity | $ 39,950,164 | $ 31,018,241 |

The table below presents the carrying amounts of certain assets and liabilities of The Student Loan Corporation’s (the Company) consolidated variable interest entities (VIEs) which are included in the Consolidated Balance Sheet above. The assets in the table below include only those assets that can be used to settle obligations of the consolidated VIEs. The liabilities in the table below include third party liabilities of consolidated VIEs only, and exclude intercompany balances that eliminate in consolidation. The liabilities also exclude amounts for which creditors have recourse to the general credit of the Company.

| CONSOLIDATED VIEs | September 30, 2010 (Unaudited) |
|---|---|
| ASSETS | |
| Private education loans | $ 3,722,533 |

| | | |
|---|---|---|
| Deferred origination and premium costs | | 104,498 |
| Allowance for loan losses | | (37,588 ) |
| Loans held for sale | | 28,232,963 |
| Other assets(1) | | 2,137,687 |
| LIABILITIES | | |
| Long-term secured borrowings | $ | 31,729,770 |
| Other liabilities | | 168,726 |

(1) Amount primarily represents restricted cash and cash equivalents of $1.2 billion and accrued interest receivable of $0.9 billion

See accompanying Notes to the unaudited Consolidated Financial Statements.

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THE STUDENT LOAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollars in thousands, except per share amounts)
(Unaudited)

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| COMMON STOCK AND ADDITIONAL PAID-IN CAPITAL | | |
| Balance, beginning of period | $ 142,069 | $ 141,923 |
| Capital contributions and other changes | 1,316 | 107 |
| Balance, end of period | $ 143,385 | $ 142,030 |
| | | |
| RETAINED EARNINGS | | |
| Balance, beginning of period | $ 1,528,352 | $ 1,452,280 |
| Cumulative effect of adoption of accounting standards on January 1, 2010, net of taxes of $218.4 million | (364,108 ) | – |
| Net (loss) income | (518,367 ) | 87,591 |
| Common dividends declared, $1.05 and $2.13 per common share for the nine months ended September 30, 2010 and 2009, respectively | (21,000 ) | (42,600 ) |
| Balance, end of period | $ 624,877 | $ 1,497,271 |
| | | |
| TOTAL STOCKHOLDERS' EQUITY | $ 768,262 | $ 1,639,301 |

See accompanying Notes to the unaudited Consolidated Financial Statements.

THE STUDENT LOAN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

| | Nine Months Ended September 30, 2010 | Nine Months Ended September 30, 2009 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net (loss) income | $ (518,367) | $ 87,591 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization of equipment and computer software | 7,700 | 7,763 |
| Amortization of deferred loan origination and purchase costs | 95,402 | 65,451 |
| Provision for loan losses | 158,173 | 104,658 |
| Deferred tax provision | (406,176) | (43,893) |
| Other changes in loans held for sale including loan origination and purchase costs | (2,344,933) | (3,564,051) |
| Change in accrued interest receivable | (54,784) | (170,463) |
| Proceeds from loans sold | 4,741,949 | 1,843,065 |
| Gains on loans sold | (55,600) | (35,576) |
| Fair value write down of loans held for sale | 900,849 | 2,185 |
| Accreted interest on residual interests | – | (51,949) |
| Gain on residual interest valuation | – | (14,034) |
| Loss on servicing asset valuation | – | 21,804 |
| Cash received on residual interests in trading securitized assets | – | 149,998 |
| Change in other assets | 42,121 | 183,597 |
| Change in other liabilities | (40,627) | (39,110) |
| Other non-cash charges | 48,573 | 13,988 |
| Net cash provided by (used in) operating activities | $ 2,574,280 | $ (1,438,976) |
| | | |
| Cash flows from investing activities: | | |
| Change in loans | $ 1,536,413 | $ (1,703,364) |
| Change in loan origination and purchase costs | 18,397 | (1,929) |
| Proceeds from loans sold and securitized | – | 515,276 |
| Change in restricted cash and cash equivalents | (183,973) | (484,071) |
| Capital expenditures on equipment and computer software | (5,345) | (5,919) |
| Net cash provided by (used in) investing activities | $ 1,365,492 | $ (1,680,007) |
| | | |
| Cash flows from financing activities: | | |
| Net change in borrowings payable to principal stockholder with original maturities of three months or less | $ (514,600) | $ (5,105,200) |
| Proceeds from other short-term borrowings | 6,330,755 | 1,887,241 |
| Repayments of other short-term borrowings | (6,104,441) | (5,656,628) |
| Proceeds from long-term borrowings | 2,853,449 | 14,214,731 |
| Repayments of long-term borrowings | (6,501,345) | (2,178,501) |

| | | | | |
|---|---|---|---|---|
| Dividends paid to stockholders | | (21,000 ) | | (42,600 ) |
| Net cash (used in) provided by financing activities | $ | (3,957,182) | $ | 3,119,043 |
| | | | | |
| Net (decrease) increase in cash | $ | (17,410 ) | $ | 60 |
| Cash – beginning of period | | 17,998 | | 595 |
| Cash – end of period | $ | 588 | $ | 655 |
| | | | | |
| Supplemental disclosure: | | | | |
| Cash paid for: | | | | |
| Interest | $ | 511,845 | $ | 462,736 |
| Income taxes, net | $ | 54,780 | $ | 40,136 |

See accompanying Notes to the unaudited Consolidated Financial Statements.

THE STUDENT LOAN CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)
September 30, 2010

## 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

### New Developments

On September 17, 2010, The Student Loan Corporation (the Company) entered into an Agreement and Plan of Merger (Merger Agreement) between the Company and a wholly-owned subsidiary of Discover Bank (Discover) (a wholly-owned subsidiary of Discover Financial Services), for Discover to acquire the Company's private student loan business. Under the terms of the Merger Agreement, each share of the Company's common stock issued and outstanding immediately prior to the effective time of the merger will be converted into the right to receive $30.00 in cash. Separately, on that same day, the Company entered into Asset Purchase Agreements, under which the Company expects to sell certain of its residual interests in securitization trusts, ownership interest in its special purpose subsidiaries, and other related loan assets to SLM Corporation (Sallie Mae) and Citibank, N.A. (CBNA) (Asset Purchase Agreements).

Each of the Merger Agreement, and the Asset Purchase Agreements between the Company and Sallie Mae and CBNA is conditioned on the successful closing of the others. In addition, the closing of the transactions contemplated by these agreements is subject to the satisfaction or waiver of customary closing conditions (including, among others, shareholder approval for the Merger Agreement and the Asset Purchase Agreement with Sallie Mae). The merger is also conditioned upon repayment of the Company's borrowings with CBNA and termination of the Company's Amended and Restated Omnibus Credit Agreement, entered into on January 29, 2010 (Amended and Restated Omnibus Credit Agreement) with CBNA.

In connection with these transactions, a definitive proxy statement was filed with the U.S. Securities and Exchange Commission (SEC) on November 1, 2010. Refer to Note 2 for a further discussion of the Asset Purchase Agreements.

### Background

The accompanying unaudited Consolidated Financial Statements of the Company, a Delaware corporation, include the accounts of the Company and its wholly owned subsidiaries, SLC Student Loan Receivables I, Inc, SLC Conduit I LLC and its consolidated securitization trusts that are Variable Interest Entities (VIEs) and for which the Company is the primary beneficiary. SLC Student Loan Receivables I, Inc. is a special-purpose entity formed in 2001 for the purpose of acquiring student loans originated or acquired by the Company and transferring such loans to, and depositing such loans in, securitization trusts. SLC Conduit I LLC is a limited liability company formed in 2009 for the purpose of acquiring Federal Family Education Loan (FFEL) Program loans originated or acquired by the Company and issuing funding notes to the U.S. Department of Education (the Department) sponsored student loan-backed commercial paper conduit, Straight-A Funding, LLC (the Conduit). All intercompany balances and transactions have been eliminated.

The Company, which has a trust agreement to originate loans through CBNA, is an originator, manager and servicer of private education loans. In addition, the Company owns and services a portfolio of loans made in accordance with federally sponsored guaranteed student loan programs. CBNA owns 80% of the Company's outstanding common stock and is an indirect wholly owned subsidiary of Citigroup Inc. (Citigroup).

Interim Financial Information

In the opinion of management, all adjustments, consisting of normal, recurring accruals, necessary to state fairly the Company's financial position and results of operations in conformity with U.S. generally accepted accounting principles (GAAP) have been reflected. The results for the three and nine months ended September 30, 2010 may not be indicative of the results for the full year ending December 31, 2010. Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but is not required for interim reporting purposes, has been condensed or omitted. The accompanying unaudited Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and related Notes included in the Company's 2009 Annual Report on Form 10-K and the Company's Form 10-Q for the quarter ended June 30, 2010.

Basis of Presentation

The Company's accounting policies are in conformity with GAAP. The Company's operations are a single segment for financial reporting purposes, as the Company's operations consist only of originating, managing and servicing student loans.

Certain amounts in the prior period's financial statements have been reclassified to conform to the current period's presentation. Such reclassification had no effect on the Consolidated Balance Sheet and Consolidated Statements of Operations as previously reported.

Use of Estimates

The preparation of the Consolidated Financial Statements in conformity with GAAP requires the Company to make estimates based on assumptions about current and future economic and market conditions (including, but not limited to, credit risk, market liquidity and interest rates) which affect reported amounts and related disclosures in the Company's financial statements. Although current estimates reflect existing conditions and expected trends, as appropriate, it is reasonably possible that actual conditions in the future could differ from those estimates. Such differences could have a material adverse effect on the Company's results of operations and financial position. Among other effects, such changes could result in credit losses in excess of established reserves in the Allowance for loan losses and changes in the carrying value of the Company's loans held for sale to adjust the carrying value to the lower of cost or fair value.

Revenue Recognition

Revenues, which include net interest income, fees and gains on loans sold, if any, are recognized as they are earned. Interest income includes special allowance payments (SAP) from and excess interest payments to the federal government as prescribed under the Higher Education Act of 1965, as amended (the Higher Education Act), and is net of amortization of premiums and origination costs. The Company accounts for premiums and origination costs in accordance with Accounting Standards Codification (ASC) 310-20. Deferred premiums and origination costs on the Company's loan portfolio are amortized using the interest method and recognized as yield adjustments to net interest income.

Loans

The Company has a portfolio of student loans originated under the FFEL Program authorized by the Department under the Higher Education Act which are insured by guaranty agencies (guarantors). The Company recognizes student loan interest income as it is earned. SAP from and excess interest payments to the federal government, if any, are recognized as yield adjustments to interest income.

The Company also has a portfolio of private education loans primarily consisting of CitiAssist® loans. Some of those loans are insured against loss by private insurers or covered under other risk-sharing agreements with creditworthy schools. Other loans, including many higher risk loans, are neither insured nor covered under risk-sharing agreements. The Company is exposed to 100% of loss on such loans. Effective January 1, 2008, the Company elected to stop insuring new CitiAssist loan originations.

Pursuant to the Asset Purchase Agreement described above and in more detail in Note 2, the Company intends to sell certain of its FFEL Program and private education loans to Sallie Mae and CBNA. In accordance with this, at September 30, 2010 these loans are classified as Loans held for sale.

Allowance for Loan Losses

The Company's allowance for loan losses provides a reserve for estimated probable credit losses incurred in its FFEL Program and private education loan portfolios. Losses that are probable and estimable are expensed currently which increases the provision for loan losses. Actual losses are charged against the reserve as they occur, and subsequent recoveries are credited back to the reserve.

For FFEL Program loans, the Company divides the portfolio into pools with similar risk characteristics based on loan program type and loan status (in-school, grace, forbearance, repayment, and delinquency). For private education loans, the pools are divided based on loan program type, school type, loan status, underwriting criteria and insurance coverage. The allowance for each of these portfolios is based upon a migration analysis which utilizes historical delinquency and credit loss experience, generally developed using six months of historical data, applied to the current aging of the portfolio. Credit loss experience is based on net credit losses, after incorporating the impact of credit risk insurance coverage obtained from third parties on certain loans and any risk-sharing agreements with certain schools. The Company evaluates the output of the migration analysis and may make adjustments based on its consideration of current trends and conditions, including, among other things, lending and collection policy changes, regulatory changes and general economic conditions affecting borrowers, private insurers, risk sharers, and higher education institution clients. Counterparty exposures are assessed on a quarterly basis by evaluating payment performance trends, available financial performance, internal and external credit ratings, and news events. If the Company believes that it is probable that any one of the counterparties will be unable to meet its contractual obligations, additional reserves are recorded to reflect such event.

The Company ceases to accrue interest income on a student loan when one of the following events occurs: (1) a FFEL Program loan loses its guarantee, (2) an insured private education loan reaches 150 days of delinquency or (3) an uninsured private education loan reaches 90 days of delinquency. Accrual of interest is resumed if the loan guarantee is reinstated or when principal and interest become current again. Interest received on non-accruing loans is recorded directly into interest income. The Company immediately writes off the loan balance corresponding to the unguaranteed portion of FFEL Program loans at the end of the month in which the loan is at least 270 days delinquent and the uninsured portion of private education loans at the end of the month in which the loan is at least 120 days delinquent. The Company also writes off the loan balances for loans in which the guarantee claim is not received for FFEL Program and private education loans after 450 days and 240 days of delinquency, respectively. When loans or portions of loans are written off, the Company reduces interest income by the amounts of accrued, uncollected interest and unamortized deferred premiums and origination costs.

The Company's FFEL Program and private education loans contain terms that allow the borrower to postpone payments while in school or to postpone or reduce payments if they meet certain income or financial hardship criteria.  The Company continues to accrue interest income on such loans.  This accrued interest increases the borrowers' unpaid balance.

Transfer of Student Loans

Whole Loan Sales

The Company accounts for its whole loan sales in accordance with the provisions of ASC 860-10-40. In order for a transfer of financial assets to be considered a sale, the assets transferred by the Company must have been isolated from the seller, even in bankruptcy or other receivership, and the purchaser must have the right to pledge or exchange the assets transferred. In addition, the sale accounting rules of ASC 860-10-40-5 requires the Company to relinquish effective control over the loans sold as of the sale date.

Loans Securitized

Prior to January 1, 2010, the Company used two distinct methods of accounting for its securitizations. Certain of the Company's securitizations met the qualifications of ASC 860-10-40-5 to be accounted for as a sale. The qualifications were that the assets transferred were legally isolated from the Company, even in the event of a bankruptcy; that the holders of the beneficial interests were not constrained from pledging or exchanging their interests; and that the transferor did not maintain effective control over the transferred assets. The Company used a two-step structure with a qualifying special purpose entity (QSPE) to obtain legal isolation. For the Company's securitizations which were accounted for as a sale, referred to as off-balance sheet securitizations, the transferred assets were removed from the consolidated balance sheet and a gain or loss was recognized. The Company's securitizations that failed to meet the accounting requirements for a sale in accordance with ASC 860-10-40-5, referred to as on-balance sheet securitizations, were accounted for as secured borrowings and the transferred assets were consolidated in the Company's financial statements.

As a result of changes in accounting standards effective January 1, 2010, the Company consolidated all of its former QSPE's. In addition, all of the Company's future securitization transactions are likely to be accounted for as secured borrowings and consolidated in the Company's financial statements. For additional information, see Accounting Changes below.

The Company's on-balance sheet securitization transactions are collateralized by certain of its student loans, which are recorded in Federally insured student loans, Private education loans and Loans held for sale and by accrued interest on the student loans and restricted cash and cash equivalents, which are recorded in Other assets on the Consolidated Balance Sheets.

Historically, the Company retained interests in off-balance sheet securitization trusts in the form of residual interests, servicing assets, and retained notes. All of the Company's retained interests were recorded at fair value in accordance with GAAP. Unrealized gains and losses on retained interests were reported in Fee and other income. Accreted interest on residual interests was reported in Interest income. The Company estimated the fair value of the residual interests and servicing assets using an income approach which determined the present value of expected future cash flows using modeling techniques that incorporated management's best estimates of key assumptions, including prepayment speeds, credit losses, borrower benefits and discount rates.

The Company receives cash from the trusts for servicing fee revenues, residual interest distributions and payments of principal and interest on retained notes.

For additional information on the Company's securitization activities see Note 9.

Loans Financed through Department of Education Programs

The Company has funded certain of its FFEL Program loans through the Conduit. The funding received from the Conduit is accounted for as secured borrowings. These borrowings are recorded in long-term secured borrowings and the student loans pledged as collateral are recorded in Loans held for sale at September 30, 2010 and Federally insured student loans at December 31, 2009 on the Company's Consolidated Balance Sheets. See Note 6 for additional information regarding the Conduit.

The Company also obtains debt financing through the Department's Loan Participation Purchase Program (the Participation Program). The borrowings through the Participation Program are collateralized by FFEL Program Stafford and PLUS loans which are recorded in Loans held for sale on the Company's Consolidated Balance Sheets. Loans funded under the Participation Program are sold to the Department pursuant to the Department's Loan Purchase Commitment Program (the Purchase Program). Additional information pertaining to the Company's borrowings through the Participation Program can be found in Note 6.

Loans Held for Sale

Loans held for sale are loans that the Company intends to include in sale transactions, including loans that the Company intends to sell pursuant to the Asset Purchase Agreements described above as well as loans that the Company originates in anticipation of sale under the Purchase Program. Management continually assesses its future loan sale plans and may transfer loans or record loans directly into the held for sale portfolio to meet the Company's anticipated near term sale requirements. In accordance with the guidance in ASC 310-10-35-49, these loans are recorded at the lower of cost, consisting of principal and deferred costs, or fair value evaluated on an aggregate basis.

At September 30, 2010, loans held for sale were primarily composed of loans that the Company expects to sell to Sallie Mae and CBNA pursuant to the Asset Purchase Agreements, which provide for a purchase price that is lower than the carrying value of the loans.

During 2009, loans held for sale were primarily composed of loans to be sold to the Department under the Purchase Program, which provides for a purchase price that is higher than the carrying value of the loans. During the quarter ended September 30, 2009, the cost of certain loans held for sale, which could not be sold under the Purchase Program, exceeded fair value. Accordingly, the Company recorded lower of cost or fair value write downs on these loans held for sale of $2.2 million for both the three and nine months ended September 30, 2009 and the loans were transferred from loans held for sale back into the operating loan portfolio during the period.

Changes in the Company's loans held for sale are presented in the table below:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Balance at beginning of period | $ 4,713,030 | $ 1,574,653 | $ 2,409,267 | $ 1,072,316 |
| Originations and purchases | 94,742 | 1,897,265 | 2,604,227 | 3,752,164 |
| Transfers into loans held for sale | 34,344,446 | – | 34,344,446 | – |
| Transfers back into the operating loan portfolio | (21,649) | (51,429) | (25,352) | (55,241) |
| Loan sales | (4,686,350) | (1,128,016) | (4,686,350) | (2,322,765) |
| Fair value write down of loans held for sale | (900,849) | (2,185) | (900,849) | (2,185) |
| Other (1) | (57,275) | (34,112) | (259,294) | (188,113) |
| Balance at end of period | $ 33,486,095 | $ 2,256,176 | $ 33,486,095 | $ 2,256,176 |

(1) Amounts include, among other things, borrower principal payments and loan cancellations.

Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents represents amounts related to the Company's secured borrowings. This cash must be used to make payments related to the secured borrowings and is classified as a component of Other assets. Amounts on deposit in these accounts represent reserve accounts or are the result of timing differences between when principal and interest is collected on the trust assets and when principal and interest is paid on trust liabilities.

Derivatives

The Company currently has one cross-currency swap and one interest rate swap. The cross-currency swap is intended to manage the Company's exposure to foreign currency exchange rate fluctuations related to its Euro denominated secured borrowing. The Company's interest rate swap is intended to economically hedge the Company's exposure resulting from fluctuations between prime and London Interbank Offered Rate (LIBOR) related to certain of its secured borrowings collateralized by private education loans.

The Company historically had derivative financial instruments including interest rate swaps and floor options which were intended to economically hedge the interest rate risk inherent in its residual interests and servicing assets in off-balance sheet securitizations. The Company closed out of these positions during the fourth quarter of 2009 in anticipation of changes in accounting standards effective January 1, 2010, which resulted in the consolidation of the Company's previously unconsolidated securitizations and the elimination of the related retained interests. The Company's derivative instruments do not qualify for hedge accounting under ASC 815 and are carried at fair value in Other assets and Other liabilities with changes in fair value recorded currently in Fee and other income.

Internally Developed Software

Certain direct costs associated with the development of internal use software are capitalized. The Company capitalizes development costs for internal use software in accordance with the provisions of ASC 350-40. These costs are included in Other assets and are amortized by the straight-line method over the service period, not to exceed ten years. Capitalization of development costs starts after the preliminary project stage is completed and ends when the project is substantially complete and ready for its intended use. Capitalized internally developed software costs are periodically reviewed for impairment. Capitalized costs of projects deemed to be obsolete or abandoned are written off as operating expenses.

Accounting Changes

Subsequent Events: Amendments to Certain Recognition and Disclosure Requirements

In February 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-09, Subsequent Events: Amendments to Certain Recognition and Disclosure Requirements. This ASU clarifies that an entity that is an SEC filer is required to evaluate subsequent events through the date that the financial statements are issued. However, an entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. This ASU was effective beginning with the first quarter of 2010.

Additional Disclosures Regarding Fair Value Measurements

In January 2010, the FASB issued ASU 2010-06, Improving Disclosures about Fair Value Measurements. This ASU requires disclosing the amounts of significant transfers in and out of Level 1 and 2 of the fair value hierarchy and describing the reasons for the transfers. The disclosures are effective for reporting periods beginning after December 15, 2009. The Company adopted ASU 2010-06 as of January 1, 2010. Additionally, disclosures of the gross purchases, sales, issuances and settlements activity in Level 3 of the fair value measurement hierarchy will be required for fiscal years beginning after December 15, 2010.

Elimination of QSPEs and Changes in the Consolidation Model for Variable Interest Entities

In June 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 166, Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140 (SFAS 166, now incorporated into ASC Topic 860) and SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (SFAS 167, now incorporated into ASC Topic 810). The Company adopted both standards on January 1, 2010 and has elected to apply both standards prospectively. Accordingly, prior periods have not been restated.

SFAS 166 eliminated QSPEs. SFAS 167 details three key changes to the consolidation model. First, former QSPEs are now included in the scope of SFAS 167. In addition, the FASB has changed the method of analyzing which party to a VIE should consolidate the VIE (known as the primary beneficiary) to a qualitative determination of which party to the VIE has "power" combined with potentially significant benefits or losses, instead of the previous quantitative risks and rewards model. The party that has "power" has the ability to direct the activities of the VIE that most significantly impact the VIE's economic performance. Finally, the new standard requires that the primary beneficiary analysis be re-evaluated whenever circumstances change. The previous rules required reconsideration of the primary beneficiary only when specified reconsideration events occurred.

Based on the qualitative analysis performed, the Company determined that it is the primary beneficiary of all of its previously off-balance sheet securitizations because the Company was determined to be the variable interest holder with the power to most significantly influence the economic performance of the trusts.  In addition, through its residual interest, the Company was determined to have the obligation to absorb losses and the right to receive benefits of the VIE that could potentially be significant to the VIE.  This resulted in the consolidation of all of the Company's previously off-balance sheet securitizations on January 1, 2010.  The Company consolidated all of the former QSPEs by initially measuring the assets and liabilities of the former QSPEs at their carrying values (the amounts at which the assets and liabilities would have been carried in the Consolidated Financial Statements if the Company had always consolidated these former QSPEs).

The consolidation of the Company's previously unconsolidated securitization trusts on January 1, 2010 had the following impact on the Company's Consolidated Balance Sheet:

| (Dollars in thousands) | | January 1, 2010 |
|---|---|---|
| Assets: | | |
| Federally insured student loans | $ | 11,825,513 |
| Private education loans | | 2,064,716 |
| Deferred origination and premium costs | | 247,902 |
| Allowance for loan losses | | (6,987) |
| Student loans, net | | 14,131,144 |
| Residual interest in securitized loans | | (820,291) |
| Other assets | | 274,666 |
| Total Assets | $ | 13,585,519 |
| Liabilities and Stockholders' Equity: | | |
| Long-term secured borrowings | $ | 14,165,862 |
| Deferred income taxes | | (219,113) |
| Other liabilities | | 2,878 |
| Total Liabilities | | 13,949,627 |
| Retained earnings | | (364,108) |
| Total Liabilities and Stockholders' Equity | $ | 13,585,519 |

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## 2. SIGNIFICANT TRANSACTIONS

Pursuant to the Asset Purchase Agreements described above, the Company intends to sell certain of its residual interests in securitization trusts, ownership interest in its special purpose subsidiaries, and other related loan assets to Sallie Mae and CBNA. The Company has determined that the transactions constitute a sale of loans and extinguishment of debt and, accordingly, will account for these components of the transactions in accordance with the guidance in ASC 310-10-35-49 and ASC 405-20-40-1, respectively.

As a result of executing the Asset Purchase Agreements the Company transferred the loans it expects to sell to Sallie Mae and CBNA into Loans held for sale during the third quarter of 2010. ASC 310-10-35-49 requires that the loans transferred into held for sale be carried at the lower of cost, consisting of principal and deferred costs, or fair value. Based on the terms of the Asset Purchase Agreements, the loans were determined to have a fair value that was lower than their carrying value. Accordingly, the Company recorded lower of cost or fair value write downs on these loans of $900.8 million. The estimated fair values of these loans have been determined by the Company by allocating the net proceeds under each asset purchase agreement to the related assets and liabilities by first estimating the fair values of the assets and liabilities for which observable markets exist, such as those for the secured borrowings included in the transactions, and allocating the remaining proceeds to the loans. The fair values of the secured borrowings included in the transactions were determined by discounting cash flows using certain assumptions including, among other things, maturity and discount rates.

Upon closing of the transactions contemplated by the Asset Purchase Agreements, which is expected to occur during the fourth quarter of 2010, the Company expects to record a pre-tax gain of approximately $507 million primarily related to extinguishment of the secured borrowings transferred to Sallie Mae and CBNA. The pre-tax gain will be recognized in accordance with ASC 405-20-40-1, which specifies that a liability has been extinguished when i) the debtor pays the creditor and is relieved of its obligation for the liability or ii) the debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. The expected gain relates primarily to the difference between the fair value and the carrying value of the Company’s secured borrowings collateralized by FFEL Program loans. These borrowings generally have interest rates that are lower than prevailing interest rates and, as a result, the fair value of these borrowings is less than carrying value.

The actual impairment charge and gain to be recorded upon closing of the transactions could differ materially from these estimates based on various factors, including changes in economic conditions which affect the fair value of the assets and liabilities included in the transactions, failure to satisfy closing conditions, additional costs incurred in connection with these transactions, and changes in the composition, and amounts of the net assets sold.

## 3. FUTURE APPLICATIONS OF ACCOUNTING STANDARDS

Credit Quality and Allowance for Credit Losses Disclosures

In July 2010, the FASB issued ASU No. 2010-20, Disclosures about Credit Quality of Financing Receivables and Allowance for Credit Losses. The ASU requires a greater level of disaggregated information about the allowance for credit losses and the credit quality of financing receivables. The period-end balance disclosure requirements for loans and the allowance for loans losses will be effective for reporting periods ending on or after December 15, 2010, while disclosures for activity during a reporting period that occurs in the loan and allowance for loan losses accounts will be effective for reporting periods beginning on or after December 15, 2010.

Potential Amendments to Current Accounting Standards

The FASB is currently working on amendments to existing accounting standards governing financial instruments. Upon completion of the standards, the Company will need to reevaluate its accounting and disclosures. The FASB is proposing sweeping changes to the classification and measurement of financial instruments, hedging and impairment guidance. This project will have a significant impact to the Company. However, due to ongoing deliberations of the standard-setters, the Company is currently unable to determine the effect of future amendments or proposals at this time.

## 4. STUDENT LOANS

The Company’s portfolio of student loans consists primarily of loans originated under government guaranteed loan programs, principally the FFEL Program, and private education loans, primarily CitiAssist loans. Pursuant to the Asset Purchase Agreements described in Notes 1 and 2 above, at September 30, 2010 the majority of these loans are classified as Loans held for sale.

The Company’s loans are summarized by program type as follows:

| (Dollars in thousands) | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Federal Stafford Loans | $ – | $ 10,414,533 |
| Federal Consolidation Loans | – | 5,864,695 |
| Federal SLS/PLUS/HEAL Loans | – | 1,669,478 |
| Private education loans | 3,722,533 | 7,432,471 |
| Total student loans held, excluding deferred costs | 3,722,533 | 25,381,177 |
| Deferred origination and premium costs | 104,498 | 548,083 |
| Student loans held | 3,827,031 | 25,929,260 |
| Less: allowance for loan losses | (37,588 ) | (149,098 ) |
| Student loans held, net | 3,789,443 | 25,780,162 |
| Loans held for sale, excluding deferred costs | 33,808,484 | 2,381,026 |
| Deferred origination and premium costs | 578,460 | 28,241 |
| Allowance for fair value write down of loans held for sale | (900,849 ) | – |
| Loans held for sale | 33,486,095 | 2,409,267 |
| Other loans and lines of credit (1) | – | 5,616 |
| Total loan assets | $ 37,275,538 | $ 28,195,045 |

(1) Recorded in Other Assets and included in Other in Note 5.

## 5. OTHER ASSETS

Other assets are summarized as follows:

| (Dollars in thousands) | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Accrued interest receivable: | | |
| from student loan borrowers | $ 1,083,978 | $ 889,461 |
| from federal government | 6,207 | 1,607 |
| Restricted cash and cash equivalents | 1,163,168 | 690,536 |
| Income taxes receivable | 89,478 | 114,077 |
| Deferred financing fees | 73,876 | 39,667 |
| Equipment and computer software (1) | 22,154 | 24,745 |
| Servicing asset from securitization activity | – | 176,587 |
| Retained notes from securitization activities | – | 19,750 |
| Other | 20,434 | 34,093 |
| Total other assets | $ 2,459,295 | $ 1,990,523 |

(1) Amounts are reflected net of accumulated depreciation and software amortization of $70.4 million and $67.0 million at September 30, 2010 and December 31, 2009, respectively.

## 6. SHORT- AND LONG-TERM BORROWINGS

The following table summarizes the Company’s total borrowings:

| | September 30,2010 | | December 31, 2009 |
|---|---|---|---|
| (Dollars in thousands) | Interest Rates | Ending Balance | Ending Balance |
| Unsecured borrowings: | | | |
| Short-term borrowings, payable to principal stockholder under the Original Omnibus Credit Agreement | 2.43% to 2.99% | $ 1,591,000 | $ 5,131,000 |
| Long-term borrowings, payable to principal stockholder under the Original Omnibus Credit Agreement | 2.82% to 5.39% | 2,800,000 | 4,391,000 |
| Total unsecured borrowings | | $ 4,391,000 | $ 9,522,000 |
| | | | |
| Secured borrowings: | | | |
| Short-term borrowings payable to the Department | – | $ – | $ 2,066,686 |
| Short-term borrowings, payable to principal stockholder under the Amended and Restated Omnibus Credit Agreement | 0.25% to 4.76% | 2,755,400 | – |
| Senior notes on long-term secured borrowings from | 0.29% to% 4.75 | 21,104,965 | 6,812,894 |

| | | | | | |
|---|---|---|---|---|---|
| on-balance sheet securitizations(1) | | | | | |
| Subordinated notes on long-term secured borrowings from on-balance sheet securitizations(1) | 0.50% to 2.04% | | | 789,063 | – |
| Long-term secured borrowings from the Conduit(2) | 0.70 | % | | 9,835,742 | 10,187,082 |
| Total secured borrowings | | | $ | 34,485,170 | $ 19,066,662 |
| Total Borrowings: | | | $ | 38,876,170 | $ 28,588,662 |

(1) Interest due on secured borrowings from the Company's on-balance sheet securitizations is variable based on either 3-Month LIBOR, 1-Month LIBOR or prime, plus a fixed premium.

(2) Interest due on secured borrowings from the Conduit is variable based on the rates at which the Conduit is able to issue commercial paper, plus fixed costs associated with the Conduit.

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The Company's Amended and Restated Omnibus Credit Agreement as executed provided up to $6.6 billion in aggregate credit for new borrowings, including separate tranches (with their own sublimits and pricing) for overnight funding, FFEL Program loan funding, private education loan funding and illiquid asset funding. After completing two private education loan securitizations in the first quarter of 2010, the Company reduced the aggregate commitment amount by $1.0 billion to $5.6 billion. After completing another securitization in July 2010, the Company further reduced the aggregate commitment amount under the credit agreement by $1.0 billion to $4.6 billion. The initial term of the Amended and Restated Omnibus Credit Agreement expires on December 30, 2010 and all borrowings will be due and payable on or before this date.

During the third quarter, both the Company and CBNA agreed to negotiate an additional 364 day term (the Additional Term) in accordance with the provisions of the Amended and Restated Omnibus Credit Agreement. In addition, in light of the expected transactions with Discover, Sallie Mae and CBNA, the Company and CBNA are currently negotiating an extension of the Amended and Restated Omnibus Credit Agreement which would ensure the Company has access to funding subsequent to December 30, 2010 if the transactions have not closed by that date, until the earlier to occur of the closing of the transactions or the execution of the Additional Term. If no extension agreement is reached, the Company and CBNA expect to begin negotiating the Additional Term during the fourth quarter of 2010. The merger of the Company with Discover is conditioned upon repayment and termination of the Amended and Restated Omnibus Credit Agreement. If these transactions do not close by the end of the year, the Company expects an extension or agreement for the Additional Term will be executed before the expiration of the initial term of the Amended and Restated Omnibus Credit Agreement. However, there is no assurance that such extension or Additional Term agreement will be executed on a timely basis, and, if not, whether and when the Company could obtain sufficient alternate sources of financing on acceptable terms. If a suitable replacement or replacements, whether from CBNA or otherwise, are not put in place on a timely basis, the Company will no longer have a guaranteed funding source. This could have a material adverse effect on, among other things, the Company's ability to originate new loans, repay its debt obligations, fund business operations and maintain the current level of profitability.

The Amended and Restated Omnibus Credit Agreement also requires a comprehensive package of representations, warranties, conditions, covenants (including a borrowing base and various other financial covenants) and events of default. CBNA's consent is generally required for the release of pledged collateral for whole loan sales, securitizations, and participation in government funding programs. As a result of the impairment charge described in Note 2, the Company breached one of the financial covenants in the Amended and Restated Omnibus Credit Agreement during the third quarter of 2010. The Company requested, and CBNA granted, a waiver of this breach before it occurred.

At September 30, 2010, there were $4.4 billion of borrowings outstanding under the terms of the Omnibus Credit Agreement dated November 30, 2000, between the Company and CBNA (Original Omnibus Credit Agreement) and $2.8 billion outstanding under the Amended and Restated Omnibus Credit Agreement, which were collateralized by the remaining, otherwise unencumbered FFEL Program and private education loans with a carrying value of $5.3 billion. At September 30, 2010, the Company had sufficient collateral to borrow the remaining $1.8 billion available under the Amended and Restated Omnibus Agreement. These borrowings will continue to mature based on their originally contracted maturities, unless a change of control or an event of default, as defined by the Amended and Restated Omnibus Credit Agreement, occurs. A change of control is defined as any event that results in an entity other than CBNA or its affiliates owning more than 50% of the voting equity interest in the Company. If a change of control or an event of default (certain of which require explicit action by CBNA to effect an acceleration) under the Amended and Restated Omnibus Credit Agreement were to occur, all outstanding borrowings under the Original Omnibus Credit Agreement and the Amended and Restated Omnibus Credit Agreement would become due and payable immediately. The borrowings outstanding under the Original Omnibus Credit Agreement are also subject to the representations, warranties, conditions, covenants (including a borrowing base and various other financial covenants) and events of default contained in the Amended and Restated Omnibus Credit Agreement.

At September 30, 2010, $1.0 billion of the Company's outstanding unsecured borrowings under the Original Omnibus Credit Agreement and $2.1 billion of the Company's secured borrowings from certain of its private education loan securitizations included interest rate floor derivatives embedded in the respective debt instruments. These embedded options have been determined to be clearly and closely related to the debt instruments as these terms are defined in ASC 815 and, therefore, do not require bifurcation.

At September 30, 2010 and December 31, 2009, $0.2 billion of the Company's senior notes from securitizations is denominated in Euros and $0.1 billion of subordinated notes remains available for issuance. At September 30, 2010, the Company had total authorized long-term secured borrowings of $31.8 billion, which were collateralized by FFELP Program and private education loans with a carrying value of $26.5 billion and $5.6 billion, respectively. Principal payments on the long-term secured borrowings are made as principal amounts are collected on the collateralized loans. The secured borrowings from the Company's securitizations mature from September 2014 through February 2045. Secured borrowings related to the Conduit will mature before the expiration of the Conduit Program in January 2014.

See the Consolidated Balance Sheet for additional information regarding collateralized assets related to the Company's long-term secured borrowings.

The Conduit provides additional liquidity support to eligible student lenders by providing funding for FFEL Program Stafford and PLUS loans first disbursed on or after October 1, 2003 and before July 1, 2009, and fully disbursed by September 30, 2009. In addition to providing financing at a cost based on market rates, a significant benefit to lenders is that eligible loans are permitted to have borrower benefits, which are not permitted under the Participation and Purchase Programs. Funding from the Conduit is provided indirectly by the capital markets through the sale to private investors of government back-stopped asset-backed commercial paper (CP). The Company receives funding equal to 97% of the principal and interest to be capitalized of the pledged student loans. The CP issued by the Conduit has short-term maturities generally ranging up to 90 days. In the event the CP issued by the Conduit cannot be reissued at maturity and the Conduit does not have sufficient cash to repay investors, the Federal Financing Bank (FFB) has committed to provide short-term liquidity to the Conduit. If the Conduit is not able to issue sufficient CP to repay its investors or liquidity advances from the FFB, the Company can either secure alternative financing and repay its Conduit borrowings or sell the pledged student loans to the Department at a predetermined price equal to either 97% or 100% of the accrued interest and outstanding principal of pledged loans, based on first disbursement date and certain other loan criteria. If the Company were to sell the pledged loans to the Department, this would likely result in a significant loss to the Company.

## 7. FEE AND OTHER (LOSS) INCOME

Fee and other (loss) income is summarized as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Late fees | $ 3,434 | $ 1,309 | $ 11,235 | $ 3,785 |
| Net mark-to-market loss on interest rate derivative | (8,883 ) | – | (8,972 ) | – |
| (Loss) gain on foreign currency translation net of mark-to-market gain (loss) on foreign currency swap | 1,127 | 995 | 1,312 | 2,093 |
| | 614 | 1,178 | 1,402 | 5,343 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Other origination and servicing fees from CBNA | | | | | | | | | | |
| Net gains from securitization retained interests | | | | | | | | | | |
| and related derivatives | | – | | | 66,919 | | – | | 96,166 | |
| Other income | | 335 | | | 319 | | 1,046 | | 1,142 | |
| Total fee and other (loss) income | $ | (3,373 | ) | $ | 70,720 | $ | 6,023 | $ | 108,529 | |

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8. RELATED PARTY TRANSACTIONS

CBNA, an indirect wholly owned subsidiary of Citigroup, owns 80% of the outstanding common stock of the Company. Pursuant to various intercompany agreements, a number of significant transactions are carried out between the Company and Citigroup, CBNA and/or their affiliates. Related party agreements with CBNA include the Amended and Restated Omnibus Credit Agreement, a tax-sharing agreement and student loan originations and servicing agreements. In addition, the Company maintains a trust agreement with CBNA through which it originates FFEL Program loans. Also, the Company has an agreement for education loan servicing with Citibank (South Dakota), National Association. Management believes that the terms under which these transactions and services are provided are no less favorable to the Company than those that could be obtained from unaffiliated third parties.

The Company is part of a group of businesses within Citigroup, referred to as Citi Holdings. Citigroup intends to exit these businesses as quickly as practicable in an economically rational manner through business divestitures, portfolio run-off and asset sales. On September 17, 2010, the Company entered into a Merger Agreement with Discover and Asset Purchase Agreements with Sallie Mae and CBNA. See Notes 1 and 2 for further information about these agreements.

Detailed below is a summary of the Company's transactions with either CBNA or other Citigroup affiliates which are included in the accompanying Consolidated Statements of Operations:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Revenues: | | | | |
| Interest income | $ 2 | $ 111 | $ 135 | $ 378 |
| Interest expense | 70,158 | 69,287 | 244,809 | 275,910 |
| Fee and other (loss) income: | | | | |
| Derivative valuation (loss) gain | – | (56,153 ) | (267 ) | 40,311 |
| Other origination and servicing fees | 672 | 1,178 | 1,534 | 5,343 |
| | | | | |
| Operating Expenses: | | | | |
| Salaries and employee benefits | | | | |
| Employee benefits and administration | $ 1,490 | 1,616 | $ 4,571 | $ 4,982 |
| Stock-based compensation | 110 | 250 | 725 | 554 |
| Other expenses | | | | |
| Servicing, professional and other fees paid | 13,797 | 16,814 | 43,376 | 48,229 |
| Data processing and communications | 2,196 | 2,074 | 7,042 | 6,019 |
| Premises | 548 | 534 | 1,607 | 1,622 |
| Write-off of funding commitment fee | 5,000 | – | 12,500 | – |
| Other | 837 | 543 | 2,342 | 2,034 |

Asset Purchase Agreement

On September 17, 2010, the Company entered into an Asset Purchase Agreement by and among the Company, CBNA, Citibank (South Dakota) National Association, and SLC Student Loan Receivables I, Inc. (the CBNA Asset Purchase Agreement), whereby CBNA is expected to acquire from the Company (i) approximately $5 billion of unsecuritized FFEL Program and private education loans, (ii) residual interests in and servicing rights for one securitization trust holding approximately $2 billion of private education loans and a second securitization trust holding approximately $800 million of FFEL Program loans, and (iii) other assets and liabilities, including the shares of SLC Student Loan Receivables I, Inc., the depositor for the securitization trusts. The CBNA Asset Purchase Agreement provides that CBNA will pay to SLC an amount equal to the aggregate principal amount outstanding under SLC's Omnibus Credit Agreement together with all accrued and unpaid interest, excluding any termination fees related to early prepayment thereof (after taking into account the application of the proceeds to SLC under the Sallie Mae Asset Purchase Agreement), subject to certain adjustments as described in the CBNA Asset Purchase Agreement. See Notes 1 and 2 for additional information related to the CBNA and Sallie Mae Asset Purchase Agreements.

Funding Agreements

On January 29, 2010, the Company entered into the Amended and Restated Omnibus Credit Agreement with CBNA. The Amended and Restated Omnibus Credit Agreement supersedes and replaces in its entirety the Original Omnibus Credit Agreement and is effective as of January 1, 2010. The Company’s unsecured borrowings at December 31, 2009 represent borrowings outstanding under the terms of Original Omnibus Credit Agreement. The Amended and Restated Omnibus Credit Agreement, as executed, provided up to $6.6 billion in aggregate credit for new borrowings, including separate tranches (with their own sublimits and pricing) for overnight funding, FFEL Program loan funding, private education loan funding and illiquid asset funding. After completing two loan securitizations in the first quarter of 2010, the Company reduced the aggregate commitment amount under the credit agreement by a total of $1.0 billion to $5.6 billion. After completing another securitization in July 2010, the Company further reduced the aggregate commitment amount under the credit agreement by $1.0 billion to $4.6 billion. The initial term of the Amended and Restated Omnibus Credit Agreement expires on December 30, 2010 and all borrowings will be due and payable on or before this date.

At September 30, 2010 the Company had outstanding short- and long-term unsecured borrowings with CBNA under the Original Omnibus Credit Agreement of $1.6 billion and $2.8 billion, respectively, and $5.1 billion and $4.4 billion, respectively, at December 31, 2009. In addition, the Company had $2.8 billion of short-term secured borrowings under the Amended and Restated Omnibus Credit Agreement at September 30, 2010.

When the Amended and Restated Omnibus Credit Agreement was executed, the Company paid an upfront funding commitment fee of $57.0 million to secure the funding commitment. For the three and nine months ended September 30, 2010, the Company recognized amortization of the upfront funding commitment fee of $9.3 million and $35.3 million, respectively, which is included in Interest expense. The Company also recorded write downs of the upfront funding commitment fee of $5.0 million and $12.5 million in conjunction with the loan commitment reduction for the three and nine months ended September 30, 2010, respectively, which are included as a component of Operating expense. Under this agreement, CBNA also charges a monthly fee on the undrawn balance, for which the Company recognized $8.2 million and $40.5 million, respectively, for the three and nine months ended September 30, 2010 in Interest expense.

For further information on the Company’s borrowings with CBNA, see Note 6.

Interest Rate Swap and Option Agreements

Historically, the Company maintained interest rate derivative and option agreements with CBNA, an investment-grade counterparty. The interest rate derivative agreements were used in an effort to manage the interest rate risk inherent in the retained interests in the Company's off-balance sheet securitizations. The option agreements were designated as economic hedges to the floor income component of the residual interests. The Company closed out of these derivative positions during the fourth quarter of 2009 in anticipation of changes in accounting standards effective January 1, 2010, which resulted in the consolidation of the Company's previously unconsolidated securitizations and elimination of the related retained interests being hedged.

Student Loan Origination Agreement and Servicing Fees Earned

CitiAssist loans are originated and serviced under an intercompany agreement with CBNA. After final disbursement by CBNA, the Company purchases all qualified private education loans at CBNA's carrying value at the time of purchase, plus a contractual premium. Total principal balances of CitiAssist loans purchased by the Company were $0.1 billion and $0.8 billion for the three and nine months ended September 30, 2010, respectively, as compared to $1.6 billion and $1.7 billion for the three and nine months ended September 30, 2009, respectively. Total premiums paid by the Company related to CitiAssist loan purchases were $0.4 million and $5.1 million for the three and nine months ended September 30, 2010, respectively, as compared to $10.3 million and $11.4 million for the three and nine months ended September 30, 2009, respectively. At September 30, 2010, the Company was committed to purchase CitiAssist loans of $0.4 billion.

Servicing, Professional and Other Fees Paid

The majority of the loan originations and servicing work on the Company's FFEL Program and CitiAssist loan portfolios was performed under the provisions of intercompany agreements with affiliates of the Company, including Citibank (South Dakota), National Association.

Stock-based Compensation

The Company participates in various Citigroup stock-based compensation programs under which Citigroup stock or stock options are granted to certain of the Company's employees. The Company has no stock-based compensation programs in which its own stock is granted. The Company pays Citigroup directly for participation in certain of its stock-based compensation programs, but receives a capital contribution for those awards related to participation in the employee incentive stock option program.

CBNA Tax-sharing Agreement

The Company is included in the consolidated federal income tax return of Citigroup, as well as certain combined or unitary state/local income or franchise tax returns of Citigroup or its subsidiaries.  As such, the Company pays its income taxes through CBNA. The taxes paid by the Company are based on an effective tax rate that approximates the tax expense that would be recognized if the Company were to file such income tax returns on a stand-alone basis.

Other Intercompany Arrangements

Citigroup and its subsidiaries engage in other transactions and servicing activities with the Company, including cash management, data processing, telecommunications, payroll processing and administration, facilities procurement, underwriting, and others.

## 9. STUDENT LOAN SECURITIZATIONS AND VARIABLE INTEREST ENTITIES

The Company maintains programs to securitize certain portfolios of student loan assets.  Prior to January 1, 2010, the Company's securitization transactions qualifying as sales under ASC 860-10-40-5 were off-balance sheet transactions in which the loans were removed from the Consolidated Financial Statements of the Company and sold to an independent trust. In order to pay for the loan assets, the trust sold debt securities, collateralized primarily by the student loan assets, to outside investors.  For off-balance sheet securitizations, the Company generally retained interests in the form of subordinated residual interests (i.e., interest-only strips) and servicing rights.

The Company also entered into similar securitization transactions that did not qualify for sale treatment and, accordingly, were accounted for as secured borrowings.  These transactions do not give rise to a gain or loss on sale. Student loan assets sold to these securitization trusts, along with other assets and liabilities of the trusts, remain on-balance sheet.  The Company's FFEL Program loans that are funded through the Conduit are funded indirectly through the sale of asset-backed CP to private investors and are also accounted for as secured borrowings with the transferred assets remaining on-balance sheet.  See Notes 1 and 6 for additional details about the Company's secured borrowings.

As a result of changes in accounting standards effective January 1, 2010, the Company has consolidated all of its previously off-balance sheet securitization transactions.  In addition, all of the Company's future securitization transactions will likely be accounted for as secured borrowings and consolidated in the Company's financial statements.  For additional information about the changes in accounting standards and the impact of the consolidation on the Company's Consolidated Balance Sheet, see Accounting Changes in Note 1.

For an understanding of the carrying amount of assets pledged as collateral for secured borrowings through securitizations and the related liabilities at September 30, 2010, refer to the table included on the Consolidated Balance Sheet.  The assets of the Company's consolidated VIEs are restricted from being sold or pledged as collateral for other borrowings and the cash flows from these restricted assets may be used only to pay obligations of the trust.

Under terms of all the trust arrangements, the Company has the option, but not the obligation, to provide financial support, but has never provided such support.  A substantial portion of the credit risk associated with the securitized loans has been transferred to third party guarantors or insurers either under the FFEL Program or private credit insurance.

The following table summarizes the Company's securitization activity:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Student loans securitized (1) | $ 783,054 | $ 4,036,209 | $ 2,682,764 | $ 4,623,494 |
| Student loans funded through the Conduit (1) | – | 1,934,041 | 547,541 | 10,477,198 |
| Total student loans funded through securitization financings (1) | $ 783,054 | $ 5,970,250 | $ 3,230,305 | $ 15,100,692 |
| Net proceeds from student loans securitized (2) | $ 852,863 | $ 3,296,688 | $ 2,312,304 | $ 3,842,814 |
| Net proceeds from student loans funded through the Conduit during the current period (2) | – | 1,897,241 | 533,632 | $ 10,389,529 |
| Total net proceeds from securitization financings(2) | $ 852,863 | $ 5,193,929 | $ 2,845,936 | $ 14,232,343 |

(1) Amounts represent the principal amount of student loans securitized as of the securitization date.

(2) Amounts represent net proceeds from loans securitized or funded through the Conduit as of the securitization / funding date.

The difference between student loans funded through securitization financings and net proceeds received is largely a result of required overcollateralization, but also reflects issuance costs.

The following table summarizes the principal amounts and fair values of retained interests in the Company's off-balance sheet loan securitizations at December 31, 2009:

| | December 31, 2009 | |
|---|---|---|
| (Dollars in thousands) | FFEL Program Loans | Private Education Loans |
| Principal amounts | $ 11,830,320 | $ 2,066,492 |
| Retained interests | 868,529 | 148,099 |

The following table reflects amounts received from previously off-balance sheet securitization trusts:

| | Three Months Ended September 30, | Nine Months Ended September 30, |
|---|---|---|
| (Dollars in thousands) | 2009 | 2009 |
| Cash received for servicing | $ 19,249 | $ 58,937 |
| Cash received on residual interests | 47,428 | 149,998 |
| Cash received on retained notes | 502 | 1,893 |

During the three and nine months ended September 30, 2009, the Company earned $19.1 million and $58.6 million, respectively, of contractually specified servicing fees.  The company also earned $0.4 million and $1.7 million of interest on retained notes for the three and nine months ended September 30, 2009, respectively.

Changes in the Company's servicing assets are presented in the table below:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Balance at beginning of period | $ – | $ 185,998 | $ 176,587 | $ 208,133 |
| Changes in fair value due to changes in inputs and assumptions | – | 8,141 | – | 2,555 |
| Other changes (1) | – | (7,810) | (176,587) | (24,359) |
| Balance at end of period | $ – | $ 186,329 | $ – | $ 186,329 |

(1) Amount for the nine months ended September 30, 2010 represents the elimination of servicing assets as the Company consolidated previously off-balance sheet securitization trusts as a result of changes in accounting standards. Amounts for the three and nine months ended September 30, 2009 represent the effects of excess servicing income received and the passage of time.

The following table reflects net gains from securitization retained interests and related derivatives from off-balance sheet securitization trusts, which are recorded in Fee and other income:

| | Three Months Ended September 30, | Nine Months Ended September 30, |
|---|---|---|
| (Dollars in thousands) | 2009 | 2009 |
| Gains related to residual interests | $ 98,577 | $ 14,034 |
| Servicing revenue net of valuation gains and losses on servicing assets | 19,466 | 36,792 |
| Mark-to-market (losses) gains on derivatives | (56,153) | 40,311 |
| Realized and unrealized gains on retained notes | 5,029 | 5,029 |
| Net gains from securitization retained interests and related derivatives | $ 66,919 | $ 96,166 |

The Company utilized discounted cash flow models to measure the fair value of its residual interests and servicing assets. These models required management to make certain assumptions which, while based on relevant internal and external data, inherently involved significant judgment and uncertainty. Key assumptions utilized to measure the fair value of these retained interests include discount rates, basis spreads, anticipated net credit loss rates, anticipated prepayment rates and projected borrower benefit utilization rates. The Company's discount rate was the sum of a risk-free rate and a risk premium, which reflected the prevailing economic and market conditions at the balance sheet date.

The key assumptions used to value the residual interests of securitized trusts were as follows:

| | December 31,2009 | |
|---|---|---|
| Discount rates: | | |
| FFEL Program Consolidation Loans | 11.10 | % |
| FFEL Program Stafford and PLUS loan | 11.10 | % |
| Private education loans | 16.85 | % |
| Constant prepayment rates: | | |
| FFEL Program Consolidation Loans | 0.16% to 0.58% | |
| FFEL Program Stafford and PLUS loan | 4.44 | % |
| Private education loans | 3.45 | % |
| Anticipated credit losses, net of insurance and guarantees: | | |
| FFEL Program Consolidation Loans | 0.27 | % |
| FFEL Program Stafford and PLUS loan | 0.57 | % |
| Private education loans | 0.90 | % |
| Basis spread between LIBOR and Commercial Paper rates | 16 basis points | |
| Utilization rates of borrower benefits: | | |
| Automated clearing house | 2.6% to 38.1% | |
| On time payments | 0% to 34.5% | |

The key assumptions used to value the servicing assets of trusts related to securitization sales were as follows:

| | December 31, 2009 | |
|---|---|---|
| Discount rates: | | |
| FFEL Program Consolidation Loans | 5.39 | % |
| Private education loans | 5.89 | % |
| Constant prepayment rates: | | |
| FFEL Program Consolidation Loans | 0.16% to 0.58% | |
| Private education loans | 3.45 | % |
| Weighted average servicing margin | 20 basis points | |

Principal amounts of off-balance sheet securitized loans and the related loan delinquencies (loans which are 90 days or more past due) are presented in the following table:

| (Dollars in thousands) | | December 31, 2009 |
|---|---|---|
| Principal amounts | $ | 13,896,812 |
| Delinquencies | | 553,463 |

Credit losses, net of recoveries, for the Company’s off-balance sheet securitized loans are presented in the table below:

| | Three Months Ended | Nine Months Ended |
|---|---|---|

| (Dollars in thousands) | September 30, 2009 | September 30, 2009 |
|---|---|---|
| Credit losses, net of recoveries: | $ 3,448 | $ 9,273 |

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## 10. DERIVATIVE AGREEMENTS

The Company currently has one cross-currency swap and one interest rate swap. The cross-currency swap is intended to economically hedge the Company's exposure to foreign currency exchange rate fluctuations on its Euro denominated secured borrowing and matures at the earlier of the date at which the respective notes mature, the trust loan assets have been liquidated or 2032. The Company's interest rate swap relates to one of the Company's securitization trusts that was consolidated as a result of changes in accounting standards and was included within the Company's financial statements beginning in the first quarter of 2010. The interest rate swap is intended to economically hedge the trusts' risk resulting from fluctuations between prime and LIBOR and matures in 2017.

Historically, the Company maintained interest rate derivative and option agreements with CBNA, an investment-grade counterparty. The interest rate derivative agreements were used in an effort to manage the interest rate risk inherent in the retained interests in the Company's off-balance sheet securitizations. The option agreements were designated as economic hedges to the floor income component of the residual interests. The Company closed out of these derivative positions during the fourth quarter of 2009 in anticipation of changes in accounting standards effective January 1, 2010, which resulted in the consolidation of the Company's previously unconsolidated securitizations and elimination of the related retained interests being hedged.

The Company's derivative instruments do not qualify for hedge accounting under ASC 815.

The fair values of the Company's derivatives are included in Other assets and Other liabilities, respectively, and are provided in the table below:

| | September 30, 2010 | | | December 31, 2009 | | |
|---|---|---|---|---|---|---|
| | | Fair Value | | | Fair Value | |
| (Dollars in thousands) | Notional | Asset | Liability | Notional | Asset | Liability |
| Prime-LIBOR swap | $ 1,772,609 | $ 8,339 | $ – | $ – | $ – | $ – |
| Foreign currency swap | 232,050 | – | 26,374 | 232,050 | – | 17,381 |

Gains and losses on the Company's derivatives are recorded in Fee and other income and are provided in the table below:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Gains (losses) on foreign currency swap | $ 22,067 | $ 10,100 | $ (8,993) | $ 12,788 |
| Losses on prime-LIBOR swap | (8,883) | – | (8,972) | – |
| (Losses) gains on LIBOR-based swaps | – | (221) | – | 10,210 |
| (Losses) gains on interest rate floor options | – | (55,932) | – | 30,101 |
| Net gains (losses) on derivatives | $ 13,184 | $ (46,053) | $ (17,965) | $ 53,099 |

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11. FAIR VALUE OF FINANCIAL INSTRUMENTS (ASC 825-10)

The estimated fair value of the Company's financial instruments is presented in the following table:

| | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| (Dollars in thousands) | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Financial Assets: | | | | |
| Federally insured student loans | $ 27,551,884 | $ 27,552,405 | $ 20,719,055 | $ 20,368,741 |
| Private education loans | 9,723,654 | 8,920,603 | 7,475,990 | 5,014,558 |
| Cash and restricted cash and cash equivalents | 1,163,756 | 1,163,756 | 708,534 | 708,534 |
| Accrued interest receivable | 1,090,185 | 1,052,018 | 891,069 | 776,524 |
| Derivative assets | 8,339 | 8,339 | – | – |
| Residual interests in loans securitized | – | – | 820,291 | 820,291 |
| Servicing assets | – | – | 176,587 | 176,587 |
| Retained notes from securitization sales | – | – | 19,750 | 19,750 |
| Financial Liabilities: | | | | |
| Short-term borrowings | $ 4,346,400 | $ 4,364,998 | $ 7,197,686 | $ 7,219,301 |
| Long-term borrowings | 34,529,770 | 33,594,718 | 21,390,976 | 21,412,849 |
| Derivative liabilities | 26,374 | 26,374 | 17,381 | 17,381 |
| Interest payable | 55,516 | 55,516 | 63,898 | 63,898 |

In accordance with ASC 825-10, the estimated fair values have been determined by the Company using available market information and other valuation methodologies that are described below. The fair value approximates the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. These estimates are subjective in nature and involve uncertainties and matters of significant judgment. Accordingly, the estimates may not be indicative of the amounts that the Company could realize in a current market exchange. Changes in assumptions could materially affect the estimates.

The difference between fair value and carrying value may vary from period to period based on changes in a wide range of factors, including returns required by investors in financial instruments, LIBOR and CP interest rates, portfolio mix of variable and fixed rate loans, growth of the portfolio, timing of contractual repricing, portfolio age, default rates and maturity or contractual settlement dates.

Total Loan Assets

At September 30, 2010 the fair value of the Company's loans held for sale which it intends to sell to Sallie Mae and CBNA pursuant to the Asset Purchase Agreements was determined by the Company by allocating the net proceeds under each asset purchase agreement to the related assets and liabilities by first estimating the fair values of the assets and liabilities for which observable markets exist, such as those for the secured borrowings included in the transactions, and allocating the remaining proceeds to the loans. The fair values of the secured borrowings included in the transactions were determined by discounting cash flows using certain assumptions including, among other things, maturity and discount rates. The fair value of the Company's FFEL Program loans classified as held for sale which the Company has the ability and intent to sell to the Department under the Purchase Program was determined using contractual sales price. The fair value of all other loans was calculated by discounting cash flows through expected maturity using the estimated current relevant yield curve for the interest rates. The carrying value is presented net of the allowance for loan losses.

At December 31, 2009, the fair value of the Company’s FFEL Program loans classified as held for sale which the Company had the ability and intent to sell to the Department under the Purchase Program, was determined using contractual sales price. The fair value of all other loans was calculated by discounting cash flows through expected maturity using the estimated current relevant yield curve for the interest rates. The carrying value is presented net of the allowance for loan losses.

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Cash, Restricted Cash and Cash Equivalents and Accrued Interest Payable

Due to the short-term nature of these instruments, carrying value approximates fair value.

Accrued Interest Receivable

Most of the Company's accrued interest receivable relates to loans that are not currently in repayment. This accrued interest will be added to the borrowers' principal balances when the loans enter repayment. Accordingly, the fair value of accrued interest receivable that is expected to be capitalized was calculated using the same methodology used for the related loan assets. Accrued interest receivable on loans in repayment is considered short-term and, accordingly, carrying value approximates fair value.

Derivatives

The fair value of derivative instruments was based upon quotes received from counterparties. These quotes are based on the counterparties' proprietary models utilizing specific terms and conditions of the derivatives and other market observable inputs. Derivatives are recorded at fair value in the Company's Consolidated Financial Statements. For additional information about the Company's derivatives, see Note 10.

Residual Interests in Loans Securitized, Servicing Assets and Retained Notes

The fair value of the residual interests in the loans securitized, servicing assets, and retained notes (collectively, retained interests) at December 31, 2009 was determined using a discounted cash flow model. At December 31, 2009, retained interests from securitization were recorded at fair value in the Company's Consolidated Financial Statements. For more information on student loan securitizations, see Note 9.

Short-Term and Long-Term Borrowings

The Company pays interest on its short- and long-term borrowings based on CP, LIBOR or prime rates. These borrowings generally have variable interest rates with reset periods ranging from one day to every three months, depending on the specific terms of each borrowing. Many of the Company's borrowings are based on a base index plus a credit premium. These credit premiums are fixed over the life of the related borrowing. The fair value of the Company's borrowings from CBNA, the Conduit and from its on-balance sheet securitization trusts was calculated by discounting cash flows using, among other things, estimated assumptions including maturity and market discount rates.

## 12. FAIR VALUE (ASC 860-50-35 and 50, ASC 820-10 AND ASC 825-10)

The Company determines fair value using valuation techniques that are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 – Quoted prices for identical instruments in active markets.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations whose inputs are observable or whose primary value drivers are observable.

Level 3 – Instruments whose primary value drivers are unobservable.

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Items Measured at Fair Value on a Recurring Basis

The following table presents the Company's financial assets and liabilities that are measured at fair value on a recurring basis for each of these hierarchy levels:

| | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| (Dollars in thousands) | Level 2 | Level 3 (1) | Level 2 | Level 3 |
| Assets: | | | | |
| Other assets (2) | $ 8,339 | $ – | $ – | $ 196,337 |
| Residual interests in securitized loans | – | – | – | 820,291 |
| Total Assets | $ 8,339 | $ – | $ – | $ 1,016,628 |
| Liabilities: | | | | |
| Other liabilities | $ 26,374 | $ – | $ 17,381 | $ – |

(1) As a result of changes in accounting standards effective January 1, 2010, which resulted in the consolidation of the Company's previously unconsolidated securitizations trusts, the Company no longer has any retained interests in off-balance sheet securitizations, which were previously recorded in Level 3.

(2) Amount reported in Level 2 at September 30, 2010 represents an interest rate swap from one of the Company's securitization trusts that was consolidated as a result of changes in accounting standards, effective January 1, 2010.

Derivatives

The fair value of the derivatives instruments was based upon quotes received from counterparties. These quotes are based on the counterparties' proprietary models utilizing specific terms and conditions of the derivatives and other market observable inputs. Derivatives are recorded at fair value and are included in Other assets and Other liabilities in the table above and in the Company's Consolidated Financial Statements. For more information on derivatives, see Note 10.

Retained Interests in Securitized Loans

During 2009, the Company classified its residual interests, servicing assets and retained notes in its off balance-sheet securitizations as Level 3 instruments and utilized discounted cash flow models to measure the fair value. These models required management to make certain assumptions which, while based on relevant internal and external data, inherently involve significant judgment and uncertainty. At December 31, 2009, all of the Company's retained interests in off-balance sheet securitizations were recorded at fair value in the Company's Consolidated Financial Statements. For more information on loan securitizations, see Note 9.

The following table presents the changes in the Level 3 fair value category:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Residual interests in securitized loans: | | | | |
| Balance at beginning of period | $ – | $ 790,545 | $ 820,291 | $ 942,807 |
| Total gains and losses (realized/unrealized) included in earnings: | | | | |
| Interest income | – | 17,098 | – | 51,949 |
| Fee and other income | – | 98,577 | – | 14,034 |
| Purchases, issuances and settlements (1) | – | (47,428 ) | (820,291 ) | (149,998 ) |
| Balance at end of period | $ – | $ 858,792 | $ – | $ 858,792 |
| | | | | |
| Unrealized gains relating to assets still held at the reporting date (2) | $ – | $ 98,577 | $ – | $ 14,034 |
| | | | | |
| Servicing assets and retained notes included in Other assets: | | | | |
| Balance at beginning of period | $ – | $ 252,485 | $ 196,337 | $ 274,620 |
| Total losses (realized/unrealized) included in earnings: | | | | |
| Fee and other income | – | 15,476 | – | 14,419 |
| Purchases, issuances and settlements (1) | – | (62,029 ) | (196,337 ) | (83,107 ) |
| Balance at end of period | $ – | $ 205,932 | $ – | $ 205,932 |
| | | | | |
| Unrealized gains relating to assets still held at the reporting date (2) | $ – | $ 10,702 | $ – | $ 5,116 |

(1) Amount reported for the nine months ended September 30, 2010 represents the elimination of the Company's residual interests and servicing assets in its previously off-balance sheet securitization trusts as a result of changes in accounting standards which resulted in the consolidation of these trusts.

(2) The difference between total gains and losses (realized /unrealized) included in earnings and unrealized gains and losses relating to assets still held at the reporting date represents accreted yield.

Items Measured at Fair Value on a Non-recurring Basis

Certain assets and liabilities are measured at fair value on a non-recurring basis and therefore are not included in the table above. These include assets such as loans held for sale that are measured at the lower of cost or fair value. The Company's loans held for sale includes loans which it intends to sell to the Department under the Purchase Program and loans it intends to sell to Sallie Mae and CBNA pursuant to the Asset Purchase Agreements.

The fair value of the loans the Company intends to sell to the Department is determined using contractual sales price and therefore classified in Level 1 of the fair value hierarchy. For the three and nine months ended September 30, 2010, the fair value of these loans exceeded the carrying value and therefore, no write down was necessary.

The fair value of the Company's loans held for sale which it intends to sell to Sallie Mae and CBNA was determined by the Company by allocating the net proceeds under each asset purchase agreement to the related assets and liabilities by first estimating the fair values of the assets and liabilities for which observable markets exist, such as those for the secured borrowings included in the transactions, and allocating the remaining proceeds to the loans. The fair values of the secured borrowings included in the transactions were determined by discounting cash flows using certain assumptions including, among other things, maturity and discount rates. These loans are classified in Level 3 of the fair value hierarchy. Based on the terms of the Asset Purchase Agreements, the loans were determined to have a fair value that was lower than their carrying value. Accordingly, the Company recorded lower of cost or fair value write downs on these loans for the three and nine months ended September 30, 2010.

During the quarter ended September 30, 2009, the Company determined that certain loans held for sale under the Purchase Program could not Company calculated the fair value of these loans by discounting cash flows through expected maturity using the estimated current relevant yield curve for the interest rates and determined that the cost of these loans exceeded fair value. As a result, the Company recorded lower of cost or fair value write downs on these loans held for sale for both the three and nine months ended September 30, 2009 and the loans were transferred from loans held for sale back into the operating loan portfolio during the period. These loans are classified in Level 3 of the fair value hierarchy.

The following table presents the Company's financial assets and liabilities that are measured at fair value on a non-recurring basis for each of these hierarchy levels:

| | Fair Value Measurements Using | | |
|---|---|---|---|
| | September 30, 2010 | | December 31, 2009 |
| (Dollars in thousands) | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Unobservable Inputs (Level 3 ) | Quoted Prices in Active Markets for Identical Assets (Level 1) |
| Assets: | | | |
| Loans held for sale | $ 42,498 | $ 33,443,597 | $ 2,409,267 |

The following table presents the Company's lower of cost or fair value write downs on loans held for sale, which were classified as Level 3, recorded in Fee and other (loss) income:

| | Fair Value Measurements Using | | | |
|---|---|---|---|---|
| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Fair value write down of loans held for sale | $ (900,849 ) | $ (2,185 ) | $ (900,849 ) | $ (2,185 ) |

## 13. COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Company is involved in various litigation proceedings incidental to and typical of the business in which it is engaged. In addition, the Company has been named as a defendant in various litigation proceedings incidental to the Merger Agreement and Asset Purchase Agreements referred to in Notes 1 and 2. In the opinion of the Company's management, the ultimate resolution of these matters would not be likely to have a material adverse effect on the results of the Company's operations, financial condition or liquidity.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

Certain statements contained in this report that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are typically identified by the words or phrases “believe”, “expect”, “anticipate”, “intend”, “estimate”, “may increase”, “may result in”, “may fluctuate similar expressions or future or conditional verbs such as “will”, “should”, “would” and “could”. These forward-looking statements involve risks and uncertainties, which could cause The Student Loan Corporation’s (the Company) actual results to differ materially from those the Company expects, including, but not limited to:

- the success of the Company’s proposed merger with a wholly-owned subsidiary of Discover Bank (Discover) (a wholly-owned subsidiary of Discover Financial Services) and the sale of certain of the Company’s assets, including residual interests and servicing rights, to SLM Corporation (Sallie Mae) and Citibank, N.A. (CBNA);
- the amount, availability, and cost of future short- and long-term financing to the Company from CBNA, securitizations, whole loan sales, and other sources;
- the Company’s ability to acquire or originate a sufficient volume of private education loans in the amounts anticipated and with interest rates that generate sufficient yields and margins;
- the effects of legislative and regulatory changes that affect the demand for, collectability of and interest rates on student loans, especially the Health Care and Education Reconciliation Act of 2010 which eliminated the origination of new Federal Family Education Loan (FFEL) Program loans as of July 1, 2010;
- the success of the Company’s strategic repositioning efforts, including a more refined origination strategy and pricing changes on its private education loan originations;
- the success of the Company’s marketing and sales efforts to grow and improve the profitability of its private education loan business;
- actual credit losses, loan collection strategies and their impact on delinquency rates, including but not limited to those associated with changes to the Company’s loss mitigation programs, and the adequacy of loan loss reserves;
- fluctuations in interest rates and between various interest rate indices, particularly the manner in which short-term rates affect the Company’s funding costs, consolidation rates, the rates at which interest accrues on its loan portfolio and the effects of interest rate fluctuations on the demand for student loans;
- the amount of loan subsidies and any effect on the Company’s net interest margin;
- general economic conditions, including, without limitation, the performance of financial markets and unemployment rates;
- the availability of alternative financing options to students and their parents, including competitive products offered by other lenders;

- the amount of financial aid available to students and their parents and the cost of education;

- prepayment rates on student loans and the quality and profitability of those loans that move into repayment status, as well as actual experience with the repayment cycle of the loan portfolio;

- the performance of the Company's loan portfolio servicers, insurers, risk-sharers and higher education institution clients;

- the Company's and other servicers' ability to continue to service the loan portfolio in accordance with their contractual obligations;

- loan origination costs; and

- the adequacy of the Company's capital expenditures and of funds allocated for future capital expenditures.

The following discussion should be read in conjunction with the accompanying unaudited Consolidated Financial Statements and Notes, the Company's 2009 Annual Report on Form 10-K, and the Company's Form 10-Q for the quarter ended June 30, 2010.

Management's Discussion and Analysis provides the Company's perspective on its operations and business environment, including the following:

Business Overview – a general description of the Company's business as well as the impacts of market conditions on the business and business trends.

Business Highlights – a review of key events affecting the Company's historical and future operating results.

Critical Accounting Estimates – an overview of accounting policies that require critical judgments and estimates.

Financial Condition – a discussion and analysis of the Company's loan portfolio, disbursement and procurement activity and allowance for loan losses.

Results of Operations – a review of the Company's results of operations for the three and nine months ended September 30, 2010 and 2009 and discussion of the key factors impacting those results.

Liquidity and Capital Resources – an analysis of the Company's sources and uses of cash and capital obligations.

Legislation and Regulations – a discussion of legislative activities that affect the student loan industry.

Business Overview

The Company is one of the nation's leading originators and holders of student loans providing a full range of education financing products and services to meet the needs of students, parents, schools and lenders. The Company was incorporated in 1992 under the laws of the State of Delaware. CBNA owns 80% of the Company's outstanding common stock and is an indirect wholly owned subsidiary of Citigroup Inc. (Citigroup). The Company, which has a trust agreement to originate loans through CBNA, is an originator, manager and servicer of private education loans. In addition, the Company owns and services a portfolio of loans made in accordance with historical federally sponsored guaranteed student loan programs. The Company is committed to providing exceptional service to borrowers and schools, offering competitive and innovative products with solutions that allow students and their families to finance the education of their choice.

The majority of the Company's loans have been originated and guaranteed under the FFEL Program, authorized by the U.S. Department of Education (the Department) under the Higher Education Act of 1965, as amended (the Higher Education Act). Following the passage of H.R. 4872, the Health Care and Education Reconciliation Act of 2010, effective July 1, 2010, all new federally sponsored guaranteed student loans are being originated through the Federal Direct Loan Program. In compliance with this regulatory change, the Company is continuing to make disbursements on existing FFEL Program loans, however is no longer originating new loans under the FFEL Program.

While the elimination of the FFEL Program affects a portion of the Company’s strategy, since 2007, management has pro-actively repositioned the Company towards an increased focus on its private education loan business. Strategic repositioning activities include, among other things, changes in the private education loan underwriting process and modifications to the Company’s risk-based pricing. The Company has also taken initiatives to reduce its expense base and has continued to use the capital markets for long-term liquidity. These actions, in combination with the Company’s extensive experience in originating and managing private education loans, which it introduced in 1997, provide a strong foundation as the Company continues its mission to assist students with financing the education of their choice. With the benefit of its experience and reputation in student lending, the Company will continue to offer competitively priced private education loans for undergraduate, graduate, and professional students.

The earnings of the Company are primarily generated by the spread between the interest earned on its loan assets and the interest paid on its borrowings. Net interest income is impacted by, among other things: spread changes between the 90-day Commercial Paper rate as published by the Department (CP), the prime rate or the 91-day Treasury Bill rate and London Interbank Offered Rate (LIBOR); credit premiums on the Company’s debt; utilization rates of borrower benefits; private education loan pricing changes; and portfolio growth or contraction.

The Company utilizes funding from various sources for liquidity and to fund new loan originations including securitizations, government sponsored programs and borrowings from CBNA. The Department sponsored student loan-backed commercial paper conduit, Straight-A Funding, LLC (the Conduit) provides funding to the Company for certain of its FFEL Program Stafford and PLUS loans which were fully disbursed by September 30, 2009. In addition, since December 2008 the Company had been utilizing the Department’s Loan Participation Purchase Program (the Participation Program) and Loan Purchase Commitment Program (the Purchase Program) available through the Ensuring Continued Access to Student Loans Act (ECASLA) to fund new FFEL Program Stafford and PLUS loan originations.

Gains on sales of loans through the Purchase Program, whole loan sales and off-balance sheet securitizations have contributed significantly to the Company’s historical earnings. Future gains on sales of loans will depend on market conditions and the Company’s operational strategies. In addition, as a result of changes in accounting standards effective January 1, 2010, the Company does not expect to recognize gains or losses on future securitization transactions when they are executed. See Note 1 to the Consolidated Financial Statements for additional information related to these changes in accounting standards.

Business Highlights

On September 17, 2010, the Company entered into an Agreement and Plan of Merger (Merger Agreement) between the Company and Discover for Discover to acquire the Company’s private student loan business. Under the terms of the Merger Agreement, at the effective time of the merger, each share of the Company’s common stock issued and outstanding immediately prior to the effective time of the merger would be converted into the right to receive $30.00 in cash. Separately, on that same day, the Company entered into Asset Purchase Agreements, under which the Company expects to sell certain of its residual interests in securitization trusts, ownership interest in its special purpose subsidiaries, and other related loan assets to Sallie Mae and CBNA (Asset Purchase Agreements). Each of the Merger Agreement and the Asset Purchase Agreements between the Company and Sallie Mae and CBNA is conditioned on the successful closing of the others. In addition, the closing of the transactions contemplated by these agreements is subject to the satisfaction or waiver of customary closing conditions (including, among others, shareholder approval for the Merger Agreement and the Asset Purchase Agreement with Sallie Mae). The merger is also conditioned upon repayment and termination of the Company's Amended and Restated Omnibus Credit Agreement with CBNA.

The foregoing description of the contemplated transactions does not purport to be complete and is qualified in its entirety by reference to the definitive proxy statement filed with the U.S. Securities and Exchange Commission (SEC) on November 1, 2010.

As a result of executing the Asset Purchase Agreements, the Company transferred the loans it expects to sell to Sallie Mae and CBNA into loans held for sale and recorded an impairment charge of $900.8 million to adjust the carrying value to the lower of cost or fair value. Upon closing of the transactions contemplated by the agreements, which is expected to occur during the fourth quarter of 2010, the Company expects to record a pre-tax gain of approximately $507 million primarily related to the extinguishment of the debt transferred to Sallie Mae and CBNA. The actual gain recorded upon closing of the transactions could differ from this estimate based on various factors, including failure to satisfy closing conditions, additional costs incurred in connection with the transactions or changes in the composition, and amounts of the net assets sold.

During the third quarter of 2010, the Company sold $4.6 billion of loans to the Department under the Purchase Program, which resulted in a gain on sale of $55.6 million. The proceeds from this sale were used to pay back borrowings from the Participation Program, under which the majority of these loans were originally funded, as well as to pay down borrowings under the Amended and Restated Omnibus Credit Agreement. The Company also raised $0.9 billion in a FFEL Program loan securitization transaction during the third quarter. The Company used the proceeds from this securitization transaction as well as $2.8 billion of borrowings under the Amended and Restated Omnibus Credit Agreement to pay down $3.7 billion of grandfathered borrowings under the Omnibus Credit Agreement, dated November 30, 2000, between the Company and CBNA (Original Omnibus Credit Agreement) which matured during the quarter. The Company also reduced the aggregate commitment under the Amended and Restated Omnibus Credit Agreement by a total of $1.0 billion during the quarter.

In response to regulatory guidance, the Company is in the process of implementing changes to its private education loan loss mitigation programs. These changes are decreasing the balance of loans in forbearance status and increasing delinquencies and credit losses. In addition, the Company anticipates that a sub-portfolio of its higher risk insured private education loans will exceed the aggregate maximum insurer coverage and as a result, recoveries from the insurer on these loans are expected to cease during the fourth quarter. The Company has increased its allowance for loan losses for its estimate of inherent losses associated with these changes.

On October 13, 2010, the Company's Board of Directors elected not to declare a dividend in light of the expected merger with Discover and asset purchase transactions with Sallie Mae and CBNA.

Impacts of Changes in Accounting Standards on the Company's Financial Statements

Changes in accounting standards that were effective January 1, 2010 have significantly impacted the Company's balance sheet and results of operations as of and for the three and nine months ended September 30, 2010. These changes resulted in the consolidation of assets previously sold to unconsolidated securitization trusts and the debt issued by those trusts. This also resulted in the elimination of retained interests related to those securitizations along with the related mark-to-market gains and losses. The cumulative effect of adopting these new accounting standards on January 1, 2010 resulted in an aggregate after tax charge to retained earnings of $364.1 million. For additional information about the adoption on January 1, 2010, see Note 1 to the Consolidated Financial Statements.

Beginning January 1, 2010, the Company now recognizes in its financial statements the net interest income of these trusts along with loan loss provisions, mark-to-market gains and losses on derivatives held by the trusts and trust operating expenses. For a more comprehensive understanding of the impact of the consolidation of the Company's previously unconsolidated securitization trusts on the Company's results of operations, refer to the Results of Operations section beginning on page 43.

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Critical Accounting Estimates

Certain accounting estimates made by management are considered to be important to the portrayal of the Company's consolidated financial condition. Since management is required to make difficult, complex or subjective judgments and estimates, actual results could differ, possibly materially, from those estimates. The most significant of these critical estimates and judgments are those used to account for allowance for loan losses as well as loans held for sale, including those used to determine the write down on certain loans that the Company transferred into held for sale during the third quarter which it expects to sell to Sallie Mae and CBNA pursuant to the Asset Purchase Agreements.

Based on the terms of the Asset Purchase Agreements, the Company recorded a pre-tax impairment charge in the third quarter of 2010 of approximately $900.8 million to reduce the carrying value of the loans to the lower of cost or fair value. Upon closing of the transactions contemplated by these agreements, which is expected to occur during the fourth quarter of 2010, the Company expects to record a pre-tax gain of approximately $507 million. The expected gain relates primarily to the difference between the fair value and the carrying value of the Company's secured borrowings collateralized by FFEL Program loans. These borrowings generally have interest rates that are lower than prevailing interest rates and, as a result, the fair value of the borrowings is less than carrying value. Upon closing of the transactions, these borrowings will be extinguished and a gain will be recognized. The actual impairment charge and gain recorded upon closing of the transactions could differ materially from these estimates based on various factors, including changes in economic conditions which affect the fair value of the assets and liabilities included in the transactions, failure to satisfy closing conditions, additional costs incurred in connection with these transactions or changes in the composition, and amounts of the net assets sold. The most significant of these factors is the credit premium demanded by investors in student loan asset backed securities, which affects the fair value of the secured borrowings included in the transactions. A fifty basis point widening of the credit premiums demanded by the market would increase the impairment charge and increase the gain recorded upon closing by approximately $950 million. Alternatively, a fifty basis point narrowing of the credit premiums would decrease the impairment charge and decrease the gain recorded upon closing by approximately $875 million.

See the Notes to the Consolidated Financial Statements and the Company's 2009 Annual Report on Form 10-K for more information on the Company's accounting estimates including critical accounting estimates related to the Company's allowance for loan losses and loans held for sale.

Financial Condition

Loans

At September 30, 2010, the Company's student loan assets were composed of private education loans, related deferred costs and a portfolio of loans held for sale. The $3.7 billion of private education loans remaining in the Company's loan portfolio includes securitized loans from three of the Company's securitization trusts which the Company expects to remain with the business pursuant to the terms of the Merger Agreement. The Company's portfolio of loans held for sale includes $25.6 billion of securitized or pledged FFEL Program loans which the Company expects to sell to Sallie Mae as well as $7.9 billion of both securitized and unsecuritized FFEL Program and private education loans that the Company expects to sell to CBNA pursuant to the Asset Purchase Agreements. See Note 4 to the Consolidated Financial Statements for a presentation of the Company's loan portfolio.

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Balances related to the Company's managed, owned, and loans held for sale portfolios are summarized below:

| | Ending Balances | |
|---|---|---|
| (Dollars in millions) | September 30, 2010 | December 31, 2009 |
| Managed loans | $ 37,795 | $ 42,938 |
| Owned loans | 37,313 | 28,339 |
| Loans held for sale | 33,486 | 2,409 |

During the nine month period ended September 30, 2010, the Company's managed student loan portfolio decreased by 12% to $37.8 billion primarily due to the sale of $4.6 billion of FFEL Program loans to the Department of Education under the Purchase Program. During the same period, the Company's owned loan assets increased by $9.0 billion. This increase primarily reflects $12.2 billion of student loan assets from the Company's previously off-balance sheet securitization trusts that were consolidated as a result of changes in accounting standards effective January 1, 2010.

The Company makes loans through the retail and wholesale channels. The retail channel represents loan activity initiated through the Company's relationships with colleges and universities. The majority of the Company's school-certified private education loan originations are initiated through the efforts of the Company's retail sales force. The Company originates the remaining portion of such originations by marketing directly to students and their families, for example, through email and online advertising campaigns. The wholesale channel, which accounts for a small fraction of the Company's new loan originations, represents loan activity initiated outside of the retail channel, such as purchases of loans originated by other lenders under existing loan purchase commitments.

Details of the Company's origination activity are presented in the table below:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in millions) | 2010 | 2009 | 2010 | 2009 |
| Retail: | | | | |
| FFEL Program Stafford and PLUS Loan originations | $ 96 | $ 1,933 | $ 2,617 | $ 4,846 |
| CitiAssist® loans disbursed under commitments to purchase (1) | 191 | 346 | 593 | 1,112 |
| Total Retail | 287 | 2,279 | 3,210 | 5,958 |
| Wholesale: | | | | |
| Loan Consolidation and other secondary market volume | – | 16 | 20 | 58 |
| Total Originations | $ 287 | $ 2,295 | $ 3,230 | $ 6,016 |

(1) Represents CitiAssist loans disbursed by CBNA. These loans have been or will be purchased by the Company after final disbursement.

The Company's CitiAssist loan commitments are significantly lower than the same period in 2009, reflecting contraction in the private education loan market as well as changes to the Company's origination strategy. These changes, which included changes to the Company's underwriting standards and pricing structure, resulted in the discontinuation of Uninsured CitiAssist Custom Loan programs and significantly reduced the volume of originations at certain schools. Management believes that the contraction in the private education loan market reflects the current economic environment, which has led students and their families to make decisions that make college more affordable and allow them to borrow less. In addition changes to the government-sponsored student lending programs, including simplification of the application process and increases in loan limits, have decreased the demand for private education loans. The Company continuously enhances its private education loan product to optimize portfolio performance and ensure that it is competitive in the most attractive market segments. In addition, as the Company shifts its business model to position the Company as the private education lender of choice, direct marketing to students and their families will take on greater focus.

The Company's FFEL Program loan originations decreased by 46% for the nine months ended September 30, 2010 as compared to the same period in 2009. This decrease is largely due to H.R. 4872, the Health Care and Education Reconciliation Act of 2010, which eliminated new originations under the FFEL Program beginning on July 1, 2010. In compliance with this regulatory change, the Company is continuing to make disbursements on existing FFEL Program loans, however is no longer originating new loans under the FFEL Program.

In order to comply with certain legal and regulatory requirements, private education loans are originated by CBNA through an intercompany agreement. After final disbursement, the Company purchases all private education loans from CBNA. At September 30, 2010 and December 31, 2009, the private education loans disbursed and still held by CBNA were $0.2 billion and $0.4 billion, respectively.

Allowance for loan losses

The Company develops its allowance for loan losses using four segments: Insured CitiAssist, Uninsured CitiAssist Standard, Uninsured CitiAssist Custom, and as applicable, the FFEL Program. Uninsured CitiAssist Standard is primarily composed of CitiAssist loans that have been approved based on standard underwriting criteria similar to Insured CitiAssist and were originated on or after January 1, 2008. Uninsured CitiAssist Custom is primarily composed of loans made to non-traditional students or loans with less stringent underwriting standards. The Company stopped originating new Uninsured CitiAssist Custom loans in November 2008.

Although the Company evaluates the adequacy of its allowance for loan losses using four segments, the entire allowance for loan losses is available to absorb credit losses from any of the loans in the Company's student loan portfolio (excluding loans classified as held for sale). At September 30, 2010, the Company's student loan portfolio excluding loans classified as held for sale were primarily composed of loans from the Insured CitiAssist and Uninsured CitiAssist Standard segments. The allowance for loan losses includes all losses at each reporting period that are both probable and estimable. However, no assurance can be provided that the allowance for loan losses will be adequate to cover all losses that may in fact be realized in the future, or that a higher reserve for loan losses will not be required. For a full understanding of the methodology used to estimate the allowance for loan losses, see Note 1 to the Consolidated Financial Statements.

The Company's allowance for loan losses at September 30, 2010 was $37.6 million, a decrease of $111.5 million compared to $149.1 million at December 31, 2009. This decrease primarily reflects the $166.1 million reduction of allowance for loan losses related to loans transferred into held for sale at the end of the third quarter. This decrease was partially offset by an increase of $54.6 million associated with changes in expected recoveries on certain of the Company's higher risk insured private education loans, which the Company now expects will exceed the aggregate maximum insurer coverage; private education loan loss mitigation policy changes; additional reserves for newly consolidated student loan assets; and portfolio seasoning.

Charge-offs, net of recoveries, increased by $36.9 million, or 50%, during the nine months ended September 30, 2010 as compared to the same period in 2009 primarily due to changes to the Company's private education loan loss mitigation policies and seasoning of the Company's Uninsured CitiAssist Standard and Custom portfolios. Future charge-offs on the loans transferred into held for sale will not be reflected in the provision for loan losses. Instead, expected losses on these loans are included in the valuation allowance, and related impairment charge, which are recorded to adjust the carrying value to the lower of cost or fair value.

An analysis of the allowance for loan losses and its components is presented in the table below:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Balance at beginning of period(1) | | | | |
| FFEL Program | $ 22,113 | $ 21,622 | $ 26,080 | $ 14,445 |
| Insured CitiAssist | 25,298 | 12,771 | 17,554 | 8,512 |
| Uninsured CitiAssist Standard | 50,331 | 15,513 | 35,840 | 11,891 |
| Uninsured CitiAssist Custom | 75,823 | 78,831 | 76,611 | 75,481 |
| | $ 173,565 | $ 128,737 | $ 156,085 | $ 110,329 |
| Provision for loan losses | | | | |
| FFEL Program | $ 3,583 | $ 7,423 | $ 7,998 | $ 19,786 |
| Insured CitiAssist | 28,018 | 9,836 | 43,702 | 21,335 |
| Uninsured CitiAssist Standard | 19,188 | 6,095 | 46,329 | 12,232 |
| Uninsured CitiAssist Custom | 22,097 | 15,336 | 60,144 | 51,305 |
| | $ 72,886 | $ 38,690 | $ 158,173 | $ 104,658 |
| Charge offs | | | | |
| FFEL Program | $ (5,737 ) | $ (4,068 ) | $ (14,119 ) | $ (9,254 ) |
| Insured CitiAssist | (6,541 ) | (4,520 ) | (14,481 ) | (11,760 ) |
| Uninsured CitiAssist Standard | (10,384 ) | (2,654 ) | (23,693 ) | (5,169 ) |
| Uninsured CitiAssist Custom | (24,825 ) | (19,098 ) | (71,229 ) | (58,247 ) |
| | $ (47,487 ) | $ (30,340 ) | $ (123,522 ) | $ (84,430 ) |
| Recoveries | | | | |
| FFEL Program | $ – | $ – | $ – | $ – |
| Insured CitiAssist | – | – | – | – |
| Uninsured CitiAssist Standard | 335 | 99 | 994 | 99 |
| Uninsured CitiAssist Custom | 4,363 | 4,126 | 11,932 | 10,656 |
| | $ 4,698 | $ 4,225 | $ 12,926 | $ 10,755 |
| Reduction related to loans transferred into held for sale | | | | |
| FFEL Program | $ (19,959 ) | $ – | $ (19,959 ) | $ – |
| Insured CitiAssist | (25,186 ) | – | (25,186 ) | – |
| Uninsured CitiAssist Standard | (46,312 ) | – | (46,312 ) | – |
| Uninsured CitiAssist Custom | (74,617 ) | – | (74,617 ) | – |
| | $ (166,074 ) | $ – | $ (166,074 ) | $ – |
| Balance at end of period | | | | |
| FFEL Program | $ – | $ 24,977 | $ – | $ 24,977 |
| Insured CitiAssist | 21,589 | 18,087 | 21,589 | 18,087 |
| Uninsured CitiAssist Standard | 13,158 | 19,053 | 13,158 | 19,053 |
| Uninsured CitiAssist Custom | 2,841 | 79,195 | 2,841 | 79,195 |
| | $ 37,588 | $ 141,312 | $ 37,588 | $ 141,312 |

(1) Beginning balance for the nine months ended September 30, 2010 includes $7.0 million for the consolidation of loans from the Company’s previously off-balance sheet securitizations on January 1, 2010.

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Private Education Loan Insurance and Risk Sharing Programs

The Company's private education loan portfolio is not guaranteed by the federal government. Although private education loans do not carry a federal government guarantee, 52% of the outstanding balances of these loans, including those classified as held for sale, carry private insurance through United Guaranty Commercial Insurance Company of North Carolina and New Hampshire Insurance Company (UGCIC/NHIC), and 10% of the outstanding balances are insured through Arrowood Indemnity Company (Arrowood). UGCIC/NHIC are subsidiaries of American International Group (AIG). Arrowood is a wholly owned subsidiary of Arrowpoint Capital Corporation (Arrowpoint).

These insurance providers insure the Company against a portion of losses arising from borrower loan default, bankruptcy or death. Under the Arrowood program, private education loans submitted for default claim are generally subject to a risk-sharing deductible of 5% of the outstanding principal and accrued interest balances. Under the UGCIC/NHIC program, default claims are generally subject to risk-sharing deductibles between 10% and 20% of the outstanding principal and accrued interest balances. The Company ceased insuring new CitiAssist Standard loans in January 2008.

From 2003 through 2007, UGCIC/NHIC insured the Company for maximum portfolio losses ranging from 12.5% to 13.5% over the life of the loans. In addition, for loans insured from 2004 through 2007, the policies contain a stop loss provision whereby the gross loss rate on a sub-portfolio of higher risk loans is capped, ranging from 6.8% to 18% depending on the policy year. The Company is exposed to 100% of losses that exceed these maximum portfolio or sub-portfolio thresholds. While the maximum portfolio losses are not currently forecast to exceed these thresholds, the Company expects the aggregate losses on the sub-portfolio of higher risk private education loans that were insured in 2007 to exceed the maximum insurer coverage. The Company actively monitors these sub-portfolios and has increased its allowance for loan losses in an effort to reflect the anticipated losses on these loans. However, if market conditions deteriorate or the impact of the private education loan loss mitigation policy changes is higher than anticipated maximum portfolio and sub-portfolio losses could be higher than expected. For loans insured during 2005 and 2006, the insurance premium is calculated under an experience-rated plan, which may require additional premium payments of up to $58.2 million in order to maintain insurance coverage for these loans if the loss limits exceed the established parameters. If parameters are exceeded in 2010, payments would be required beginning in 2011. Currently, all insurers are generally making claim payments as agreed. However, the Company anticipates that UGCIC/NHIC will need to rely on experience-rated premium payments by the Company as well as support agreements, including reinsurance, from affiliates to meet their long-term claim obligations.

At September 30, 2010, NHIC was rated A+/ Negative by Standard & Poor's and Aa3/Negative by Moody's. UGCIC is no longer rated. On February 24, 2009, Moody's withdrew its rating of both UGCIC and its parent citing business reasons, which Moody's defines as reasons unrelated to bankruptcy, reorganization status or adequacy of information. Previously, UGCIC was rated a Baa2.

The Company stopped originating new Uninsured Custom loans in November 2008. At September 30, 2010, 76% of the total Uninsured Custom loans were in repayment compared to only 55% at September 30, 2009. The Uninsured Custom loans at September 30, 2010, including those classified as held for sale, include $179.1 million of higher risk loans made to students attending proprietary schools. Most of these Uninsured Custom loans did not follow the Company's standard underwriting process. Approximately 50% of the Uninsured Custom loans are covered by risk-sharing agreements with higher education institutions. Under these programs, the institution assumes a portion of the Company's credit exposure for the covered loans. The risk-sharing agreements generally take one of two forms: i) the school reimburses the Company for a specified percentage of losses of 50% to 100% when the losses exceed an agreed upon threshold ranging from 0% to 100%, or ii) the school pays 8% to 50% of the total disbursed amount to compensate for future expected losses. Although this reduces the Company's overall risk, these programs generally transfer less risk away from the Company than private insurance coverage. Uninsured CitiAssist Custom recoveries for the nine months ended September 30, 2010 include $7.2 million from the risk-sharing agreements compared to $7.7 million for the nine months ended September 30, 2009.

Private Education Loan Loss Mitigation Programs

The primary private education loan loss mitigation tool used by the Company has been forbearance. Forbearance allows borrowers experiencing temporary financial difficulties and willing to resume making payments the ability to temporarily suspend payments. Historically, eligible borrowers were generally permitted up to 12 months of forbearance over the life of their loan granted in six month increments.

Loss mitigation programs at banks and other financial institutions, including the Company, are subject to various regulatory requirements. In response to regulatory guidance, the Company has implemented the following changes to its private education loan loss mitigation programs:

- Borrowers must meet more rigorous eligibility criteria for forbearance. The eligibility assessment includes the borrower's willingness and ability to make payments after the forbearance period and, depending on the situation, may require the borrower to submit supporting documentation.

- Forbearance periods are generally limited to two months. However, one up-to-six month forbearance term is available immediately after the termination of the grace period and before any payments have been made. Previously, forbearance periods were generally granted in six month increments.

- All loan types have a cumulative lifetime cap on forbearance of 12 months. Previously, one loan type had a 24-month cap.

- Minimum periods of payment performance, during which borrowers are required to make full payments, are required between grants of forbearance. Previously, there were no payment performance requirements.

- The existing graduated repayment program, which allowed borrowers to make interest-only payments for a 24- or 48-month period is being phased out and new requests for this program are no longer granted.

These changes are decreasing private education loan forbearance and graduated repayment program usage and increasing delinquencies and credit losses. The Company's estimate of inherent losses associated with these policy changes as of September 30, 2010 is included in the allowance for loan losses.

With the policy changes implemented in mid-May, the amount of loans in forbearance at September 30, 2010, including those classified as held for sale, was $361.8 million lower than at September 30, 2009. The graduated repayment program usage of 19% at September 30, 2010 was virtually unchanged compared to prior quarter, but is expected to gradually decline beginning in the fourth quarter of the year. During the third quarter, the migration of loans through the delinquency buckets began to accelerate and credit losses are expected to increase in the fourth quarter of the year.

Information on private education loans, including delinquency and insurance coverage, is shown in the tables below:

| | September 30, 2010(1) | | | | December 31, 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| ars in sands) | Insured | Uninsured Standard | Uninsured Custom | Total | Insured | Uninsured Standard | Uninsured Custom | Total |
| private ation | $2,990,349 | $650,933 | $81,251 | $3,722,533 | $4,408,479 | $2,000,260 | $1,023,732 | $7,432,4 |
| te ation in yment | 2,273,203 | 73,529 | 70,914 | 2,417,646 | 2,752,005 | 501,365 | 694,630 | 3,948,0 |
| te ation in arance | 47,003 | 6,580 | 1,134 | 54,717 | 273,839 | 84,470 | 56,978 | 415,28 |
| te ation in arance entage vate ation in yment arance | 2.0 % | 8.2 % | 1.6 % | 2.2 % | 9.1 % | 14.4 % | 7.6 % | 9.5 |
| ent of te ation that quent 39 days | 2.4 % | 4.2 % | 3.1 % | 2.5 % | 2.3 % | 1.9 % | 4.1 % | 2.5 |
| ent of te ation that quent ys or | 1.3 % | 0.5 % | 0.9 % | 1.3 % | 1.9 % | 0.4 % | 1.2 % | 1.6 |
| wance oan s | $21,589 | $13,158 | $2,841 | $37,588 | $17,182 | $31,217 | $78,509 | $126,90 |
| te ation | – | – | – | – | – | – | 482,423 | 482,42 |

| | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| red by sharing ements schools | | | | | | | | | | | | | | | |
| -to-date ge of te ation in ment | 2,242,694 | | 42,385 | | 73,451 | | 2,358,530 | | 2,372,212 | | 273,478 | | 600,392 | | 3,246,0 |
| -to-date ge of te ation in yment arance | 2,365,072 | | 48,542 | | 76,170 | | 2,489,784 | | 2,655,263 | | 319,543 | | 656,031 | | 3,630,8 |
| alized to-date redit s as a ntage ge in yment | 0.3 | %(2) | 4.2 | %(3) | 4.8 | %(2) | 0.6 | % | 0.7 | %(2) | 3.4 | %(3) | 10.7 | %(2) | 2.8 |
| alized to-date redit s as a ntage erage in yment arance | 0.3 | %(2) | 3.6 | %(3) | 4.6 | %(2) | 0.5 | % | 0.6 | %(2) | 2.9 | %(3) | 9.8 | %(2) | 2.5 |
| vance ntage al loan ce | 0.7 | %(4) | 2.0 | %(3) | 3.5 | %(2) | 1.0 | % | 0.4 | %(4) | 1.6 | %(3) | 7.7 | %(2) | 1.7 |
| vance ntage al in yment | 1.0 | %(4) | 17.9 | %(3) | 4.0 | %(2) | 1.6 | % | 0.6 | %(4) | 6.2 | %(3) | 11.3 | %(2) | 3.2 |
| vance rage of | 2.8 | (5) | 7.4) | (6) | 0.8 | | 2.9 | | 1.1 | (5) | 3.3 | (6) | 1.2 | | 1.4 |

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s (in
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(1) Amounts presented above for September 30, 2010 represent the Company's private education loan portfolio (excluding loans classified as held for sale), which includes the Company's private education loans which are expected to remain with the Company and included as part of the expected merger with Discover.

(2) Decreases from December 31, 2009 primarily reflect the higher credit quality of the loans in portfolio (excluding loans held for sale) at September 30, 2009.

(3) Increases from December 31, 2009 primarily reflect the impact of changes in the Company's private education loan loss mitigation programs.

(4) Increases from December 31, 2009 primarily reflect the impact of changes in the Company's private education loan loss mitigation programs as well as changes in expected recoveries on a sub-portfolio of the Company's higher-risk insured private education loans, which the Company now expects will exceed the aggregate maximum insurer coverage.

(5) Increases from December 31, 2009 primarily reflect changes in expected recoveries on a sub-portfolio of the Company's higher-risk insured private education loans, which the Company now expects will exceed the aggregate maximum insurer coverage.

(6) The Company began originating loans in this portfolio in January 2008, so few loans have entered repayment. Accordingly, the amount of net credit losses is disproportionately low relative to the allowance for loan losses, which includes an allowance for loans not yet in repayment.

| | September 30, 2010(1) | | | | September 30, 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| ars in ands) | Insured | Uninsured Standard | Uninsured Custom | Total | Insured | Uninsured Standard | Uninsured Custom | Total |
| private ation | $2,990,349 | $650,933 | $81,251 | $3,722,533 | $4,419,082 | $1,899,819 | $1,043,523 | $7,362,4 |
| te ation in ment | 2,273,203 | 73,529 | 70,914 | 2,417,646 | 2,357,721 | 268,771 | 576,680 | 3,203,1 |
| te ation in arance | 47,003 | 6,580 | 1,134 | 54,717 | 301,629 | 51,504 | 59,959 | 413,09 |
| te ation in arance as centage vate ation loans payment arance | 2.0 % | 8.2 % | 1.6 % | 2.2 % | 11.3 % | 16.1 % | 9.4 % | 11.4 |
| nt of te ation that elinquent 39 days | 2.4 % | 4.2 % | 3.1 % | 2.5 % | 2.9 % | 3.0 % | 4.8 % | 3.2 |
| nt of te ation that elinquent ys or | 1.3 % | 0.5 % | 0.9 % | 1.3 % | 2.3 % | 0.6 % | 1.7 % | 2.0 |
| vance an s | $21,589 | $13,158 | $2,841 | $37,588 | $18,087 | $19,053 | $79,195 | $116,33 |
| te ation ed by haring agreements schools | – | – | – | – | – | – | 499,237 | 499,23 |
| | 2,242,694 | 42,385 | 73,451 | 2,358,530 | 2,302,636 | 228,018 | 585,137 | 3,115,7 |

| | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| to-date ge of te ation loans payment | | | | | | | | | | | | | | | | |
| to-date ge of te ation loans payment arance | 2,365,072 | | 48,542 | | 76,170 | | 2,489,784 | | 2,584,500 | | 267,087 | | 640,194 | | 3,491,7 | |
| alized to-date redit s as centage erage in ment | 0.3 | %(2) | 4.2 | %(3) | 4.8 | %(2) | 0.6 | % | 0.7 | %(2) | 3.0 | %(3) | 10.8 | %(2) | 2.8 | |
| alized to-date redit s as a ntage of ge in ment arance | 0.3 | %(2) | 3.6 | %(3) | 4.6 | %(2) | 0.5 | % | 0.6 | %(2) | 2.5 | %(3) | 9.9 | %(2) | 2.5 | |
| vance as centage al loan ce | 0.7 | %(4) | 2.0 | %(3) | 3.5 | %(2) | 1.0 | % | 0.4 | %(4) | 1.0 | %(3) | 7.6 | %(2) | 1.6 | |
| vance as centage al loans payment | 1.0 | %(4) | 17.9 | %(3) | 4.0 | %(2) | 1.6 | % | 0.8 | %(4) | 7.1 | %(3) | 13.7 | %(2) | 3.6 | |
| vance age of alized to-date net losses ears) | 2.8 | (5) | 7.4 | (6) | 0.8 | | 2.9 | | 1.2 | (5) | 2.8 | (6) | 1.2 | | 1.4 | |

(1) Amounts presented above for September 30, 2010 represent the Company’s private education loan portfolio (excluding loans classified as held for sale), which includes the Company’s private education loans which are expected to remain with the Company and included as part of the expected merger with Discover.

(2) Decreases from September 30, 2009 primarily reflect the higher credit quality of the loans in portfolio (excluding loans held for sale) at September 30, 2010.

(3) Increases from September 30, 2009 primarily reflect the impact of changes in the Company's private education loan loss mitigation programs.

(4) Increases from September 30, 2009 primarily reflect the impact of changes in the Company's private education loan loss mitigation programs as well as changes in expected recoveries on a sub-portfolio of the Company's higher-risk insured private education loans, which the Company now expects will exceed the aggregate maximum insurer coverage.

(5) Increases from September 30, 2009 primarily reflect changes in expected recoveries on a sub-portfolio of the Company's higher-risk insured private education loans, which the Company now expects will exceed the aggregate maximum insurer coverage.

(6) The Company began originating loans in this portfolio in January 2008, so few loans have entered repayment. Accordingly, the amount of net credit losses is disproportionately low relative to the allowance for loan losses, which includes an allowance for loans not yet in repayment.

Results of Operations

Factors Affecting Net Interest Income

Net Interest Margin Spread Analysis

The following table analyzes the components of net interest margin for the Company's student loan portfolio:

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2010 | | 2009 | |
| Student loan yield | 2.80 | % | 2.71 | % |
| Floor income | 0.40 | % | 0.34 | % |
| Consolidation loan rebate fees | (0.39 | )% | (0.23 | )% |
| Accreted interest on residual interests | – | | 0.24 | % |
| Amortization of deferred loan origination and purchase costs | (0.29 | )% | (0.31 | )% |
| Net yield | 2.52 | % | 2.75 | % |
| Cost of funds (1) | (1.67 | )% | (1.80 | )% |
| Net interest margin | 0.85 | % | 0.95 | % |

(1) Cost of funds was calculated by dividing interest expense by average interest bearing assets.

The Company's net interest margin is affected by a variety of factors, including the interest rate environment, regulatory actions and competition. The Company's student loan yield is either based on CP or Treasury rates (FFEL Program loans) or prime or LIBOR rates (private education loans) plus an incremental credit premium. The Company has the ability to set credit premiums on its private education loans to reflect current market conditions at origination. However, credit premiums earned on FFEL Program loans are prescribed under the Higher Education Act. The College Cost Reduction and Access Act (CCRA Act) reduced the yield on new loans originated on or after October 1, 2007. In addition, net interest margin is impacted by the relative profitability of the Company's FFEL Program and private education loan products, and by the weighting of these products within the Company's loan portfolio. For the nine months ended September 30, 2010, the Company earned $713.5 million and $325.5 million in student loan interest from its FFEL Program and private education loan portfolios, respectively.

In contrast, the Company's cost of funds is primarily based on three month LIBOR plus an incremental credit premium. Increasing or decreasing LIBOR rates combined with increasing or decreasing credit premiums affect the Company's overall interest expense. LIBOR rates on the Company's debt reset periodically while credit premiums are fixed based on market rates at the time of borrowing.

The Company's student loan yield is also impacted by floor income earned on its FFEL Program loans that were originated prior to April 1, 2006. Floor income is defined as the difference between the income earned at the borrower payment rate less the Department-stipulated asset spread and the funding cost of the asset. Floor income, as determined by the Company, is a financial measure that is not defined by U.S. generally accepted accounting principles (GAAP). The six basis point increase in net interest margin from floor income primarily reflects the consolidation of loans from the Company's previously off-balance sheet securitizations, a significant amount of which are loans that were originated prior to April 1, 2006 and generate floor income.

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The decrease in net interest margin of ten basis points is impacted by several factors. During the nine months ended September 30, 2010, the Company recognized in interest expense $75.8 million for amortization of the upfront commitment fee on the Amended and Restated Omnibus Credit Agreement, entered into on January 29, 2010 (Amended and Restated Omnibus Credit Agreement) and fees on the undrawn balance. This reduced net interest margin by 23 basis points. In addition, changes in accounting standards resulted in the consolidation of previously off-balance sheet securitization trusts which eliminated the related residual interests and associated accretion, which had contributed 24 basis points to net interest margin in the nine months ended September 30, 2009. If these factors were excluded, the adjusted net interest margin for the nine months ended September 30, 2010 would be 37 basis points higher than the same period of 2009. The consolidation of the previously off-balance sheet securitization trusts contributed to this overall increase in net interest margin largely because the cost of funds for these trusts is lower than that of other borrowings of the Company due to favorable market conditions existing at the time of securitization. At September 30, 2010 and 2009, the Company's outstanding borrowings had contractual weighted average interest rates of 1.5% and 1.7%, respectively.

Net interest margin also benefited from favorable changes in the spreads between the indices used to calculate a significant amount of the Company's interest revenue (CP and Prime) and LIBOR, the index used to determine most of the Company's interest expense. However, this was offset by higher credit premiums as the Company has refinanced a significant amount of its borrowings that matured with new long-term borrowings. Because pricing on the asset portfolio is fixed at origination, these term funding transactions, as well as any future funding transactions executed under current market conditions, will continue to have an adverse impact on net interest margin for the life of the borrowings.

In an effort to mitigate net interest margin compression, the Company continuously refines its product pricing to reflect current market conditions. In addition, the Company has accessed several sources of funding for FFEL Program loans including the Participation Program and the Conduit. These sources provide funding at more favorable credit premiums than alternative sources. See Legislation and Regulations on page 52 and Liquidity and Capital Resources on page 50, for further details.

Rate/Volume Analysis

The following table shows the factors contributing to changes in net interest income (interest income less interest expense) year-over-year, due to changes in both the weighted average balances and interest rates of loan assets and funding liabilities:

| | For the nine months ended September 30, 2010 vs. the nine months ended September 30, 2009<br>Increase (decrease) due to change in: | | |
|---|---|---|---|
| (Dollars in millions) | Volume | Rate | Net |
| Interest earning assets | $ 306.4 | $ (72.8) | $ 233.6 |
| Interest bearing liabilities | 228.1 | (67.8) | 160.3 |
| Net interest income | $ 78.3 | $ (5.0) | $ 73.3 |

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Three Months Ended September 30, 2010

The Company's comparisons of financial highlights are as follows:

| (Dollars in thousands) | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 | Favorable (Unfavorable) Change |
|---|---|---|---|
| Net interest income | $ 96,920 | $ 74,111 | $ 22,809 |
| Provision for loan losses | (72,886 ) | (38,690 ) | (34,196 ) |
| Gains on loans sold | 55,600 | 17,712 | 37,888 |
| Fair value write down of loans held for sale | (900,849 ) | (2,185 ) | (898,664 ) |
| Fee and other (loss) income | (3,373 ) | 70,720 | (74,093 ) |
| Operating expenses | (40,581 ) | (34,707 ) | (5,874 ) |
| Benefit (provision) for income taxes | 325,522 | (32,154 ) | 357,676 |
| Net (loss) income | $ (539,647 ) | $ 54,807 | $ (594,454 ) |
| Total operating expenses as a percentage of average managed student loans | 0.37 % | 0.32 % | (0.05 )% |
| Return on average equity | (182.2 )% | 13.6 % | (195.8 )% |
| Effective tax rate | 37.6 % | 37.0 % | (0.6 ) % |

Net interest income

Net interest income of $96.9 million for the three months ended September 30, 2010 was $22.8 million, or 31%, higher than the same period in 2009. This increase reflects a net increase of $38.2 million related to the adoption of new accounting standards which resulted in the consolidation of the Company's previously unconsolidated securitization trusts, $17.5 million for pricing changes on the Company's private education loans, $4.9 million for higher loan balances, and $2.2 million for the impact of favorable changes in the spreads between CP and LIBOR and prime and LIBOR. These increases were partially offset by higher funding costs which decreased net interest income by $21.9 million, amortization of the funding commitment fee on the Company's Amended and Restated Omnibus Credit Agreement of $9.3 million and fees on the undrawn balance of $8.2 million. Net interest margin of 0.90% was eleven basis points lower than the same period of 2009. Net interest margin excluding the amortization of the funding commitment fee and excluding fees on the undrawn balance was 1.06% for the three months ended September 30, 2010, five basis points higher than the same period in 2009 reflecting the consolidation of the Company's previously unconsolidated securitization trusts partially offset by higher funding costs.

Net interest income includes floor income of $43.2 million and $27.1 million for the three months ended September 30, 2010 and 2009, respectively. This increase primarily reflects the consolidation of loans from the Company's previously off-balance sheet securitizations, including a significant amount of loans that were originated prior to April 1, 2006 which generate floor income.

Provision for loan losses

The provision for loan losses increased by $34.2 million, or 88%, for the three months ended September 30, 2010 as compared to the same period in 2009. This increase primarily reflects changes in expected recoveries on certain of the Company's higher risk insured private education loans, which the Company now expects will exceed the aggregate maximum insurer coverage and changes in the Company's private education loan loss mitigation policies. For a full discussion of trends in the Company's loan losses, see Allowance for Loan Losses on page 37.

Gains on loans sold

Gains on loans sold of $55.6 million for the three months ended September 30, 2010 increased by $37.9 million compared to the same period in 2009 reflecting the sale of $4.6 billion of the Company's loans held for sale to the Department under the Purchase Program during the third quarter.

Fair value write down of loans held for sale

As a result of the executed Asset Purchase Agreements entered into on September 17, 2010, the Company transferred the loans it expects to sell to Sallie Mae and CBNA into loans held for sale and recorded a lower of cost or fair value write down of $900.8 million to adjust the carrying value to the lower of cost or fair value. The Company also recorded a lower of cost or fair value write down of its loans held for sale of $2.2 million during the three months September 30, 2009. See Notes 1 and 2 to the Consolidated Financial Statements for further information on the loans that were transferred into held for sale and the related write downs.

Fee and other (loss) income

For the three months ended September 30, 2010, the Company recorded fee and other loss of $3.4 million, which was primarily composed of mark-to-market losses on the Company's interest rate derivative. The decrease of $74.1 million compared to the same period in 2009 primarily reflects changes in the Company's fee and other income related to the Company's securitization activities largely as a result of changes in accounting standards which resulted in the consolidation of previously unconsolidated securitization trusts. See Note 1 to the Consolidated Financial Statements for further information regarding the change in accounting for securitizations.

The Company's derivative instruments are designed to minimize cash flow volatility for the securitization trusts in which they are embedded, but they are not designated as hedges under ASC 815 and, accordingly, the derivatives are marked to fair value each period. The fair value of the Company's derivative instruments is driven by market participants' expectations of future changes in the relevant interest and foreign exchange rates over the life of the instruments. In contrast, the assets and liabilities of the trusts are recorded at amortized cost. This dissimilar accounting treatment has and may continue to give rise to earnings volatility.

Changes in the fair value of the foreign currency swap within the Company's 2008-1 securitization trust have historically been largely offset by foreign currency translation adjustments on the Euro denominated debt. In the future, however, any significant fluctuations between the then current exchange rate and the market's expectation of future exchange rates could give rise to material gains or losses. In addition, changes in the fair value of the prime-LIBOR swap within the Company's 2006-A securitization trust, which was consolidated as of January 1, 2010, could be material and are not offset by any changes in the carrying value of the securitization trust's other assets or liabilities. For more information on the Company's derivative agreements, see Note 10 to the Consolidated Financial Statements.

Operating expenses

Total operating expenses of $40.6 million for the quarter ended September 30, 2010 were $5.9 million higher than the same period in 2009. Operating expenses during the third quarter of 2010 included a $5.0 million write-off of Omnibus Credit Agreement upfront commitment fees, which resulted from the Company's reduction in the aggregate commitment amount under the agreement and legal and financial advisory costs of $2.9 million associated with the transactions described above. While this reduction in the commitment amount resulted in a write-off in the current quarter, it reduces fees incurred on the undrawn balance. The Company's operating expense ratio (total operating expenses less the write-off of Omnibus Credit Agreement upfront commitment fees as a percentage of average managed student loans) for the third quarter of 2010 was 0.33%, one basis point higher than the same quarter of 2009 reflecting the legal and financial advisory costs noted above.

Benefit (provision) for income taxes

The Company’s benefit for income taxes for three months ended September 30, 2010 primarily reflects the tax benefit recorded on the impairment charge recorded by the Company during the third quarter of 2010.

Nine Months Ended September 30, 2010

The Company's comparisons of financial highlights are as follows:

| | Nine Months Ended September 30, | | Favorable (Unfavorable) |
|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | Change |
| Net interest income | $ 276,352 | $ 203,073 | $ 73,279 |
| Provision for loan losses | (158,173 ) | (104,658 ) | (53,515 ) |
| Gains on loans sold | 55,600 | 35,576 | 20,024 |
| Fair value write down of loans held for sale | (900,849 ) | (2,185 ) | (898,664 ) |
| Fee and other income | 6,023 | 108,529 | (102,506 ) |
| Operating expenses | (116,263 ) | (104,777 ) | (11,486 ) |
| Benefit (provision) for income taxes | 318,943 | (47,967 ) | 366,910 |
| Net income | $ (518,367 ) | $ 87,591 | $ (605,958 ) |
| Total operating expenses as a percentage of average managed student loans | 0.35 % | 0.32 % | (0.03 )% |
| Return on average equity | (55.4 )% | 7.4 % | (62.8 )% |
| Effective tax rate | 38.1 % | 35.4 % | (2.7 ) % |

Net interest income

Net interest income of $276.4 million for the nine months ended September 30, 2010 was $73.3 million, or 36%, higher than the same period in 2009. This increase reflects a net increase of $123.9 million related to the adoption of new accounting standards which resulted in the consolidation of the Company's previously unconsolidated securitization trusts, $54.3 million for the impact of favorable changes in the spreads between CP and LIBOR and prime and LIBOR, $38.3 million for pricing changes on the Company's private education loans, and $24.9 million for higher loan balances. These increases were partially offset by higher funding costs which decreased net interest income by $89.5 million, amortization of the funding commitment fee on the Company's Amended and Restated Omnibus Credit Agreement of $35.3 million and fees on the undrawn balance of $40.5 million. Net interest margin of 0.85% was 10 basis points lower than the same period of 2009. Net interest margin excluding the amortization of the funding commitment fee and excluding fees on the undrawn balance was 1.08% for the nine months ended September 30, 2010, 13 basis points higher than the same period in 2009 reflecting the consolidation of the Company's previously unconsolidated securitization trusts partially offset by higher funding costs.

Net interest income includes floor income of $130.2 million and $73.1 million for the nine months ended September 30, 2010 and 2009, respectively. This increase primarily reflects the consolidation of loans from the Company's previously off-balance sheet securitizations, including a significant amount of loans that were originated prior to April 1, 2006 which generate floor income.

Provision for loan losses

The provision for loan losses increased by $53.5 million for the nine months ended September 30, 2010 as compared to the same period in 2009. This increase primarily reflects changes in expected recoveries on certain of the Company's higher risk insured private education loans, which the Company now expects will exceed the aggregate maximum insurer coverage; private education loan loss mitigation policy changes; additional reserves for newly consolidated student loan assets; and portfolio seasoning. For a full discussion of trends in the Company's loan losses, see Allowance for Loan Losses on page 37.

Gains on loans sold

Gains on loans sold of $55.6 million for the nine months ended September 30, 2010 increased by $20.0 million compared to the same period in 2009 reflecting an increase in the amount of loans sold to the Department under the Purchase Program.

Fair value write down of loans held for sale

As a result of the executed Asset Purchase Agreements entered into on September 17, 2010, the Company transferred the loans it expects to sell to Sallie Mae and CBNA into loans held for sale and recorded a lower of cost or fair value write down of $900.8 to adjust the carrying value to the lower of cost or fair value.  The Company also recorded a lower of cost or fair value write down of its loans held for sale of $2.2 million during the nine months ended September 30, 2009.  See Notes 1 and 2 to the Consolidated Financial Statements for further information on the loans that were transferred into held for sale and the related write downs.

Fee and other (loss) income

The Company's fee and other income of $6.0 million for the nine months ended September 30, 2010 was $102.5 million lower than the same period in 2009.  This decrease primarily reflects changes in the Company's fee and other income related to the Company's securitization activities largely as a result of changes in accounting standards which resulted in the consolidation of previously unconsolidated securitization trusts.  See Note 1 to the Consolidated Financial Statements for further information regarding the change in accounting for securitizations.

Operating expenses

Total operating expenses of $116.3 million for the nine months ended September 30, 2010 were $11.5 million, or 11%, higher than the same period in 2009.  Operating expenses during the nine months ended September 30, 2010 included a $12.5 million write-off of Omnibus Credit Agreement upfront commitment fees, which resulted from the Company's reduction in the aggregate commitment amount under the agreement and legal and financial advisory costs of $4.0 million associated with the transactions described above. While this reduction in the commitment amount resulted in a write-off during 2010, it reduces fees incurred on the undrawn balance. The Company's operating expense ratio (total operating expenses less the write-off of Omnibus Credit Agreement upfront commitment fees as a percentage of average managed student loans) for the nine months ended September 30, 2010 was 0.32%, consistent with the same quarter of 2009.

Benefit (provision) for income taxes

The Company's provision for income taxes for nine months ended September 30, 2010 primarily reflects the tax benefit recorded on the impairment charge recorded by the Company during the third quarter of 2010.

Securitization Activity and Off-Balance Sheet Transactions

Securitization Activity

The Company securitizes student loans through the establishment of trusts, which purchase loans from the Company and sell notes backed by those loans.  The Company utilizes securitizations to assist in funding new loan origination activities.  The tables below provide information about the Company's securitization activities.  See Notes 1, 6 and 9 to the Consolidated Financial Statements for additional details about the Company's secured borrowings and securitization activities.

The Company completed three securitization financings during both the nine months ended September 30, 2010 and 2009. The Company's FFEL Program loans funded through the Conduit were also accounted for as secured borrowings.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (Dollars in thousands) | 2010 | 2009 | 2010 | 2009 |
| Student loans securitized (1) | $ 783,054 | $ 4,036,209 | $ 2,682,764 | $ 4,623,494 |
| Student loans funded through the Conduit (1) | – | 1,934,041 | 547,541 | 10,477,198 |
| Total student loans funded through securitization financings (1) | $ 783,054 | $ 5,970,250 | $ 3,230,305 | $ 15,100,692 |
| | | | | |
| Net proceeds from student loans securitized (2) | $ 852,863 | $ 3,296,688 | $ 2,312,304 | $ 3,842,814 |
| Net proceeds from student loans funded through the Conduit during the current period (2) | – | 1,897,241 | 533,632 | 10,389,529 |
| Total net proceeds from securitization financings(2) | $ 852,863 | 5,193,929 | $ 2,845,936 | $ 14,232,343 |

(1) Amounts represent the principal amount of student loans securitized as of the securitization date.

(2) Amounts represent net proceeds of loans securitized or funded through the Conduit as of the securitization / funding date.

The difference between student loans funded through securitization financings and the net proceeds received is largely a result of required overcollateralization, but also reflects issuance costs.

The following table reflects balances related to all of the Company's securitization transactions and other long-term secured borrowings:

| (Dollars in thousands) | September 30, 2010 | December 31, 2009 |
|---|---|---|
| Total on-balance sheet student loans securitized (1) | $ 22,339,389 | $ 7,649,159 |
| Total on-balance sheet student loans funded through the Conduit | 9,720,605 | 10,060,877 |
| Total off-balance sheet student loans securitized (2) | – | 13,896,812 |
| Total long-term secured borrowings(3) | 31,729,770 | 16,999,976 |
| Residual interests from off-balance sheet student loans securitized | – | 820,291 |
| Servicing assets from off-balance sheet student loans securitized | – | 176,587 |

(1) Amounts include securitized loan balances from eighteen on-balance sheet securitizations as of September 30, 2010 and five as of December 31, 2009.

(2) Amounts include securitized loan balances from ten off-balance sheet securitizations as of December 31, 2009.

(3) Amounts include secured borrowings from the Company's on-balance sheet securitizations and the Conduit.

Other Off-Balance Sheet Arrangements

The Company also has credit commitments with schools and institutions which are detailed in Sources and Uses of Cash below, as well one foreign currency swap and one interest rate swap which are described in Note 10 to the Consolidated Financial Statements.

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Liquidity and Capital Resources

Sources and Uses of Cash

In determining the appropriate mix of funding, the Company strives to balance the competing objectives of maximizing net interest income and minimizing risk. In an effort to manage risk, the Company seeks to match the terms of its funding with the terms of its revenue producing assets, particularly the interest rate characteristics (including the index on which the rate is based and the timing of rate resets) and weighted average lives. The Company largely relies on two primary sources of funding: borrowings from CBNA and securitizations.  However, during 2009 and 2010 the Company further diversified its sources of funding through various programs and facilities supported by the Department.

Funding Arrangements with CBNA

On January 29, 2010, the Company entered into the Amended and Restated Omnibus Credit Agreement with CBNA. The Amended and Restated Omnibus Credit Agreement, as executed, provided up to $6.6 billion in aggregate credit for new borrowings, including separate tranches (with their own sublimits and pricing) for overnight funding, FFEL Program loan funding, private education loan funding and illiquid asset funding. After completing three securitizations during the nine months ended September 30, 2010, the Company reduced the aggregate commitment amount under the credit agreement by $2.0 billion to $4.6 billion.  The initial term of the Amended and Restated Omnibus Credit Agreement expires on December 30, 2010 and all borrowings will be due and payable on or before this date.

During the third quarter, both the Company and CBNA agreed to negotiate an additional 364 day term (the Additional Term) in accordance with the provisions of the Amended and Restated Omnibus Credit Agreement. In addition, in light of the expected transactions with Discover, Sallie Mae and CBNA, the Company and CBNA are currently negotiating an extension of the Amended and Restated Omnibus Credit Agreement which would ensure the Company has access to funding subsequent to December 30, 2010 if the transactions have not closed by that date, until the earlier to occur of the closing of the transactions or the execution of the Additional Term.  If no extension agreement is reached, the Company and CBNA expect to begin negotiating the Additional Term during the fourth quarter of 2010. The merger of the Company with Discover is conditioned upon repayment and termination of the Amended and Restated Omnibus Credit Agreement. If these transactions do not close by the end of the year, the Company expects an extension or agreement for the Additional Term will be executed before the expiration of the initial term of the Amended and Restated Omnibus Credit Agreement. However, there is no assurance that such extension or Additional Term agreement will be executed on a timely basis, and, if not, whether and when the Company could obtain sufficient alternate sources of financing on acceptable terms.   If a suitable replacement or replacements, whether from CBNA or otherwise, are not put in place on a timely basis, the Company will no longer have a guaranteed funding source.  This could have a material adverse effect on, among other things, the Company's ability to originate new loans, repay its debt obligations, fund business operations and maintain the current level of profitability.

The Amended and Restated Omnibus Credit Agreement also requires a comprehensive package of representations, warranties, conditions, covenants (including a borrowing base and various other financial covenants) and events of default. CBNA’s consent is required for the release of pledged collateral for whole loan sales, securitizations, and participation in government funding programs.  As a result of the impairment charge described in Note 2, the Company breached one of the financial covenants in the Amended and Restated Omnibus Credit Agreement during the third quarter of 2010.  The Company requested, and CBNA granted, a waiver of this breach before it occurred.

At September 30, 2010, the Company had $4.4 billion and $2.8 billion of borrowings outstanding under the Original Omnibus Credit Agreement and the Amended and Restated Omnibus Credit Agreement, respectively.  In addition to proceeds from the Company's operations, to the extent needed, overnight borrowings available through the Amended and Restated Omnibus Credit Agreement may be utilized to fund the Company's business operations for the remainder of the year.

Securitizations

The Company continues to access funding directly with investors through the capital markets. During the nine months ended September 30, 2010, the Company completed two private education loan securitizations, including one executed under The Term Asset-Backed Securities Loan Facility (TALF). The Company also executed one FFEL Program securitization in July 2010.

Other Funding Programs

During 2009 and 2010 the Company utilized the following programs and facilities supported by the Department:

The Conduit: This program provides additional liquidity support to eligible student lenders by providing funding for FFEL Program Stafford and PLUS loans first disbursed on or after October 1, 2003 and before July 1, 2009, and fully disbursed by September 30, 2009. The Company receives funding equal to 97% of the principal and interest to be capitalized of the pledged student loans through the issuance of a funding note which is purchased by the Conduit. The funding notes mature no later than January 2014. As of September 30, 2010, the Conduit is not available for new funding.

The TALF: This facility provides additional liquidity support to the asset-backed securities market. The Company completed two private education loan securitizations under this facility during the period it was available. This facility expired on March 31, 2010. Prior to the expiration of this facility the Company also executed a private education loan securitization with investors directly through the capital markets. In addition, one of its TALF securitizations included investors that did not utilize funding from the facility.

The Participation Program and Purchase Programs: For eligible FFEL Program loans disbursed for the 2008 – 2009 and 2009 – 2010 academic years, the Participation Program provided lenders with short-term liquidity for new FFEL Program loan originations. Under the Purchase Program, the Department purchased eligible FFEL Program loans at a price that exceeded the outstanding principal, accrued interest and origination fees, resulting in gains on the sale of loans. These programs were only available until the October 15, 2010 final purchase date under the Purchase Program.

The Company has and will continue to shift its use of its available sources or augment funding with additional funding sources in response to changing market conditions.

The following table summarizes the Company's primary sources and uses of cash:

| | Nine Months Ended September 30, | | |
|---|---|---|---|
| (Dollars in billions) | 2010 | 2009 | |
| Sources of Cash: | | | |
| Proceeds related to the Participation and Purchase Programs, net of principal repayments | $ 2.7 | $ 1.1 | |
| Borrower repayments on student loans and other loan reductions | 2.7 | 1.4 | |
| Proceeds from student loans securitized | 2.3 | 3.8 | (1) |
| Proceeds from secured borrowings related to the Conduit | 0.5 | 10.4 | |
| Uses of Cash: | | | |
| Loan disbursements and other procurement activities | $ (3.4 ) | $ (6.6 ) | |
| Repayments of borrowings with CBNA, net of proceeds | (2.4 ) | (10.2 ) | |

| | | |
|---|---|---|
| Repayments of secured borrowings related to securitizations | (1.4) | (0.1) |
| Repayments of secured borrowings related to the Conduit | (0.9) | – |
| Payment of funding commitment fee and fee on undrawn balance to CBNA under the Amended and Restated Omnibus Credit Agreement | (0.1) | – |
| (Decrease) increase in cash during the period: | $ – | $ – |

(1) Includes proceeds from whole loan sales

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The Company had cash expenditures for equipment and computer software which were primarily composed of software developed for internal use. Cash expenditures for equipment and computer software totaled $5.3 million and $5.9 million for the nine months ended September 30, 2010 and 2009, respectively.

Future Funding Expectations

The Company’s future cash needs will depend primarily on the volume of new loan disbursements as well as the cash provided by, or used in, operating activities. Following the passage of H.R. 4872, the Health Care and Education Reconciliation Act of 2010, effective as of July 1, 2010, all new federally sponsored guaranteed student loans are being originated through the Federal Direct Loan Program. As a result, FFEL Program loan disbursement volumes will be significantly lower than historical levels. The Company expects new private education loan disbursements to be funded primarily via the capital markets and from the Amended and Restated Omnibus Credit Agreement. However, under the terms of the Amended and Restated Omnibus Credit Agreement, any future securitizations will require approval from Citigroup. In addition, the Company will continue to evaluate alternative funding sources. However, there can be no assurance that any such alternatives will provide terms that are comparable to or more favorable than those currently available to the Company. Management believes liquidity and capital will be sufficient to meet the Company's anticipated requirements until closing of the proposed Asset Purchase Agreements with Sallie Mae and CBNA and the Merger Agreement with Discover, which is expected to occur in the fourth quarter of 2010, utilizing funding from the Amended and Restated Omnibus Credit Agreement.

If these transactions do not close by the end of the year, the Company expects an extension or agreement for the Additional Term will be executed before the expiration of the initial term of the Amended and Restated Omnibus Credit Agreement. In such circumstances, management believes liquidity and capital will be sufficient to meet the Company's anticipated requirements until the expiration of the term of the Amended and Restated Omnibus Credit Agreement utilizing funding available from the Amended and Restated Omnibus Credit Agreement and via the securitization market. The adequacy of the Company’s liquidity and capital if the proposed transactions are not completed is dependent upon, among other things, the capital markets providing uninterrupted and cost effective funding. In addition, if the proposed transactions are not completed, the Company may enter into alternative sale or merger agreements. Any disposition of its ownership in the Company by Citigroup which results in a change of control whereby an entity other than CBNA or its affiliates owns more than 50% of the voting equity interest in the Company, or other event that results in the early termination of the Amended and Restated Omnibus Credit Agreement, could materially and adversely impact the Company’s liquidity and capital requirements.

Legislation and Regulations

Current Legislative and Regulatory Impacts

Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, President Obama signed into law H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act, which, among other things, establishes a new Bureau of Consumer Financial Protection (the Bureau) housed within the Federal Reserve. The Bureau will have regulatory authority over a broad range of entities engaged in the provision of consumer financial products and services, including banks and their affiliates as well as student lenders. This act consolidates into the Bureau all consumer protection responsibilities currently held by various regulatory agencies. Although the Bureau will coordinate with principal regulators, it will have exclusive federal authority to enforce the federal consumer financial laws against certain entities including large banks and their subsidiaries. The Act also creates a new framework for determining issues in connection with federal preemption of state consumer financial protection laws and enforcement powers of states in the field of consumer protection. This type of regulatory framework is materially different from that which currently exists for financial institutions such as the Company, whose principal regulator is the Office of the Comptroller of the Currency (OCC), with state enforcement and visitation deemed preempted by the authority of the OCC. This type of regulatory framework will have a material effect on the Company by substantially increasing the regulatory burden on the Company.

In addition to the creation of the Bureau, this act also requires securitizers to retain at least five percent of the credit risk associated with any securitized asset, unless the underlying loans meet standards that reduce risk. In addition, issuers of asset-backed securities will be required to provide additional disclosures about the underlying assets.

Other provisions included in the act include the creation of a Private Education Loan Ombudsman to provide timely assistance to borrowers of private education loans to resolve complaints, in collaboration with the Department of Education and with institutions of higher education, lenders, guaranty agencies, loan servicers, and other participants in private education loan programs.

In addition, not later than two years after the enactment, the Department of Education, Federal Trade Commission, and the Attorney General of the United States shall issue a report on the private education loan market including trends and behavioral characteristics of private educational lenders and borrowers.

This act also provides for an orderly liquidation authority which would allow federal authorities to place systemically important financial companies into liquidation.  Such companies may include financial companies that are non-banks, such as corporate groups that include insurance companies.  Insurance companies may be liquidated by state authorities as provided under state insurance insolvency law and if state regulators fail to act within certain timeframes, the FDIC may force such a proceeding.  Federal authorities may also liquidate non-insurance affiliates of insurance companies.  It is possible that these provisions, and the rules which may be promulgated pursuant to such provisions, may operate to place insurance companies, such as the ones with which a portion of the Company's private education loans are insured, into liquidation should the financial position of those entities be deemed to pose a systemic risk to the financial system, which could result in a lack of availability of funds to pay claims on the Company's insured loans.

FFEL Program

On March 30, 2010, President Obama signed into law H.R. 4872, the Health Care and Education Reconciliation Act of 2010, which included a provision to eliminate new FFEL Program loan originations effective July 1, 2010, and will have all schools use the Federal Direct Loan Program.  In compliance with this regulatory change, the Company is continuing to make disbursements on existing FFEL Program loans, however is no longer originating new loans under the FFEL Program.

Other Developments

H.R. 5055, the College Debt Swap Act of 2010 and S. 1541, the Private Student Loan Debt Swap Act of 2009 have been introduced into Congress, each of which would allow certain private education loan borrowers, who, at the time of taking out the private education loan, were eligible for loans through federally guaranteed student loan programs, to refinance their private education loans under the Federal Direct Loan Program.  The Company cannot predict whether this legislation will be enacted in this form, if at all, or the potential impact on the Company’s financial condition or results of operations.

H.R. 5043, the Private Student Loan Fairness Act of 2010 and S. 3219, the Fairness for Struggling Students have been introduced into Congress, each of which would eliminate the exemption of qualifying private student loans from being discharged in bankruptcy.  Current law provides that qualifying private student loans, such as most of the Company's CitiAssist loans, cannot be discharged unless the debtor can prove the payment of the debt will impose an undue hardship.  If such legislation were to be enacted into law, this could have a material effect on the Company by substantially increasing credit losses.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's principal measure of market risk due to interest rate changes is Interest Rate Exposure (IRE). IRE measures the change in expected net interest margin that results solely from unanticipated, instantaneous changes in market rates of interest. Other factors such as changes in volumes, premiums, margins and the impact of prior period pricing decisions can also change current period interest income, but are not captured by IRE. While IRE assumes that the Company makes no additional changes in pricing or balances in response to the unanticipated rate changes, in practice, the Company may alter its portfolio mix, customer pricing or hedge positions, which could significantly impact reported net interest margin. IRE does not measure the impact that market rate changes would have on the Company's earnings related to instruments classified as trading.

IRE is calculated by multiplying the gap between interest sensitive items, including loan assets as well as borrowings, certain of which contain interest rate floors, by a 100 basis point instantaneous change in the yield curve. The exposures in the table below represent the approximate change in net interest margin for the next 12 months based on current balances and pricing that would result from specific unanticipated changes in interest rates:

| | September 30, | | | |
|---|---|---|---|---|
| (Dollars in millions) | 2010 | | 2009 | |
| 100 basis points | Increase | Decrease | Increase | Decrease |
| Change in interest income | $ (22.2 ) | $ 59.5 | $ 0.2 | $ 10.0 |

In addition, the Company has exposure to uneven shifts in interest rate curves, primarily shifts in the spread between CP and LIBOR. The Company, through its Asset/Liability Management Committee, actively manages these risks by setting IRE limits and takes action in response to interest rate movements against the existing structure.

## Item 4. Controls and Procedures

### Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

### Internal Control Over Financial Reporting

There has not been any change in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

On September 20, 2010, the Company, its directors, CBNA and Citigroup were named as defendants in a putative class action lawsuit filed in the Delaware Court of Chancery, purportedly brought on behalf of the public common stockholders of the Company to enjoin the Sallie Mae transaction, the Discover merger and the CBNA transaction. This action is entitled Kahn v. The Student Loan Corporation, et al., C.A. No. 5832-VCL (Del. Ch.). The complaint alleges, among other things, that the individual defendants and CBNA breached their fiduciary duties by failing to maximize the value to be received by the company's stockholders and that Citigroup aided and abetted the other defendants' breaches of fiduciary duties. The complaint seeks, among other things, declaration of the action as a properly maintainable class action, preliminary and permanent injunctive relief against the consummation of the expected transactions by the defendants, compensatory damages and costs and disbursements.

On September 23, 2010, the Company, its directors, Discover Financial Services and Citigroup were named as defendants in a putative class action lawsuit filed in the Superior Court of the State of Connecticut, purportedly brought on behalf of the public common stockholders of the Company to enjoin the Sallie Mae transaction, the Discover merger and the CBNA transaction. This action is entitled Zengel v. The Student Loan Corporation, et al., Docket No.: FST-CV10-6006764-S (Conn. Sup. Ct.). The complaint alleges, among other things, that the individual defendants and the Company breached their fiduciary duties by failing to maximize the value to be received by the Company's stockholders and that Discover Financial Services and Citigroup aided and abetted the other defendants' breaches of fiduciary duties. The complaint seeks, among other things, preliminary and permanent injunctive relief against the consummation of the expected transactions and an order holding the defendants jointly and severally accountable for damages and costs and disbursements.

On September 24, 2010, the Company, its directors, CBNA and Citigroup were named as defendants in a putative class action lawsuit filed in the Delaware Court of Chancery, purportedly brought on behalf of the public common stockholders of the Company to enjoin the Sallie Mae transaction, the Discover merger and the CBNA transaction. This action is entitled Electrical Workers Pension Fund, Local 103, I.B.E.W. v. Atal, et al., C.A. No. 5849-VCL (Del. Ch.). The complaint alleges, among other things, that the individual defendants, CBNA and Citigroup breached their fiduciary duties by failing to maximize the value to be received by the Company's stockholders and by failing to make sufficient disclosures to the public regarding the transactions. The complaint seeks, among other things, declaration of the action as a properly maintainable class action, preliminary and permanent injunctive relief against the consummation of the expected transactions by the defendants, compensatory damages and costs and disbursements.

On October 6, 2010, the Company, its directors, CBNA, Citigroup, Discover Financial Services, Discover Bank and Academy Acquisition Corp. were named as defendants in a putative class action lawsuit filed in the Delaware Court of Chancery, purportedly brought on behalf of the public common stockholders of the Company to enjoin the Sallie Mae transaction, the Discover merger and the CBNA transaction. This action is entitled Electrical Workers Pension Fund, Local 103, I.B.E.W. v. The Student Loan Corporation, et al., C.A. 5875- (Del. Ch.). The complaint alleged, among other things, that the individual defendants, CBNA and Citigroup breached their fiduciary duties of good faith, loyalty and due care by seeking to effectuate a self-dealing transaction in which the Company's stockholders will be cashed out and will not receive fair consideration for their shares. The complaint further alleged that Discover Financial Services, Discover Bank and Academy Acquisition Corp. aided and abetted the individual defendants, CBNA and Citigroup in breaching their fiduciary duties by entering into the Discover Merger Agreement. The complaint seeks, among other things, declaration of the action as a properly maintainable class action, preliminary and permanent injunctive relief against the consummation of the expected transactions by the defendants, and reasonable attorneys' and experts' fees and costs. On October 7, 2010, the plaintiff in this case filed a Notice and Proposed Order of

Dismissal. This case is closed.

On October 15, 2010, the plaintiffs in the Connecticut action filed a first amended class action complaint in the Superior Court of the State of Connecticut against the same defendants named in their original complaint alleging, among other things, that the individual defendants and the Company breached their fiduciary duties by failing to maximize the value to be received by the Company’s stockholders and by failing to make sufficient disclosures to the public regarding the expected transactions announced in its preliminary proxy statement. The first amended class action complaint further alleges, among other things, that Discover Financial Services and Citigroup aided and abetted the other defendants’ breaches of fiduciary duties. The plaintiffs in this action seek the same relief as requested in their original complaint.

On October 18, 2010, the plaintiffs in the two pending Delaware actions filed a verified consolidated amended class action and derivative complaint against the Company’s directors, Citigroup and CBNA. The complaint alleges that the individual defendants breached their fiduciary duties by failing to maximize the value to be received by the Company’s stockholders and by failing to make sufficient disclosures to the public regarding the expected transactions announced in the preliminary proxy statement and that Citigroup and CBNA breached their fiduciary duties as purported controlling shareholders of the Company. This action is now entitled In re The Student Loan Corporation Litigation, Consol. C.A. No. 5832-VCL (Del. Ch.). The plaintiffs in the consolidated Delaware action seek the same relief as requested in the earlier filed Delaware complaints. On November 1, 2010, the Company, the Company's directors, Citigroup and CBNA filed an answer to the verified consolidated amended class action and derivative complaint.

In addition to the class action lawsuits described above, the Company is subject to various other claims, lawsuits and 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, the accuracy of the Company’s reports to credit bureaus, or actions taken with respect to collecting on delinquent or defaulted loans. Management believes that ultimate resolutions of these claims, lawsuits and other actions will not have a material adverse effect on the Company’s business, financial condition or results of operations.

## Item 1A. Risk Factors

Certain of the statements below are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. See Forward-Looking Statements on page 31.

The following discussion sets forth certain risks that the Company believes could cause its actual future results to differ materially from expected or historical results. However, the discussion below is not exhaustive, and other factors could have a material adverse impact on the Company's results. These factors include, natural disasters, acts of terrorism and epidemics and the factors listed under Forward-Looking Statements on page 31, among others.

The Company is exposed to several risks associated with the Merger Agreement with Discover and the Asset Purchase Agreements with Sallie Mae and CBNA.

On September 17, 2010, the Company entered into the Merger Agreement between the Company and Discover for Discover to acquire the Company's private student loan business. Under the terms of the Merger Agreement, each share of the Company's common stock issued and outstanding immediately prior to the effective time of the merger will be converted into the right to receive $30.00 in cash. Separately, on that same day, the Company entered into the Asset Purchase Agreements, under which the Company expects to sell certain of its residual interests in securitization trusts, ownership interest in its special purpose subsidiaries, and other related loan assets to Sallie Mae and CBNA. In this risk factor, the transactions contemplated by these three agreements are referred to as the transactions.

- Failure to complete the transactions or delays in completing the transactions could negatively affect the Company's stock price, financial condition and results of operations.

There is no assurance that the Company will be able to consummate the transactions. If the transactions are not completed for any reason, the Company may be subject to a number of risks, including the following:

- the Company will not realize the benefits expected from the transactions, including the conversion of all the shares of common stock into the right to receive $30.00 per share in cash from Discover;
- the current market price of the Company's common stock may reflect a market assumption that the transactions will occur and a failure to complete the transactions could result in a negative perception of the Company by the stock market and cause a decline in the market price of its common stock;
- certain costs relating to the transactions, including certain investment banking, financing, legal and accounting fees and expenses, must be paid even if the transactions are not completed, and the Company may be required to pay substantial fees to Discover and Sallie Mae if the agreements governing the transactions are terminated under specified circumstances;
- the actual impairment charge and gain recorded upon closing of the transactions could differ materially from these estimates based on various factors, including changes in economic conditions which affect the fair value of the assets and liabilities included in the transactions, failure to satisfy closing conditions, additional costs incurred in connection with these transactions or changes in the composition, and amounts of the net assets sold. The most significant of these factors is the credit premium demanded by investors in student loan asset backed securities, which affects the fair value of the secured borrowings included in the transactions; and
- the Company would continue to face the risks that it currently face as an independent company.

Delays in completing the transactions could exacerbate uncertainties concerning the effect of the transactions, which may have an adverse effect on the Company's business following the transactions and could defer or detract from the realization of the benefits expected to result from the transactions.

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There may be substantial disruption to the Company's business and distraction of management and employees as a result of the transactions.

There may be substantial disruption to the Company's business and distraction of management and employees from day-to-day operations because matters related to the transactions may require substantial commitments of time and resources, which could otherwise have been devoted to other opportunities that could have been beneficial to us.

- Business uncertainties and contractual restrictions while the transactions are pending may have an adverse effect on the Company.

Uncertainty about the effect of the transactions on employees, suppliers, service providers, partners, regulators, and customers may have an adverse effect on the Company. These uncertainties may impair the Company's ability to attract, retain, and motivate key personnel until the transactions are consummated and could cause suppliers, customers and others that deal with the Company to defer purchases or other decisions concerning the Company or seek to change existing business relationships. In addition, the agreements governing the transactions restrict the Company from making certain specified actions without the approval of Discover and Sallie Mae. These restrictions could prevent the Company from pursuing attractive business opportunities that may arise prior to the completion of the transactions.

- The agreements governing the transactions restrict the Company's ability to pursue alternatives to the transactions.

The agreements governing the transactions contain "no shop" provisions that, subject to limited fiduciary exceptions, restrict the Company's ability to initiate, solicit, encourage or facilitate, discuss, negotiate or accept a competing third party proposal to acquire all or a significant part of the Company. Further, there are only a limited number of exceptions that would allow the Company's board of directors to withdraw or change its recommendation to holders of common stock that they vote in favor of the adoption of the transactions.  If the Company's board of directors were to take such actions as permitted by the agreements governing the transactions, doing so in specified situations could entitle Sallie Mae or Discover to terminate the agreements to which they are a party, and to be paid substantial termination fees. In addition, CBNA, the holder of 80% of the Company's common stock has agreed, subject to limited exceptions, to vote its shares in favor of the approval of the transactions. These restrictions and CBNA's agreement to support the approval of the transactions could deter a potential acquirer from proposing an alternative transaction.

The Company's business operations are dependent upon Citigroup and any change that impacts Citigroup's involvement in the Company could have an adverse effect on the Company's financial condition and operations.

Citigroup indirectly owns 80% of the Company's common stock. Through various subsidiaries, Citigroup serves as the Company's:

- Lender –At September 30, 2010, the Company had outstanding borrowings of $4.4 billion under the Original Omnibus Credit Agreement and $2.8 billion under the Amended and Restated Omnibus Credit Agreement.  The Amended and Restated Omnibus Credit Agreement as executed provided up to $6.6 billion in aggregate credit for new borrowings, including separate tranches (with their own sublimits and pricing) for overnight funding, FFEL Program loan funding, private education loan funding and illiquid asset funding.  As a result of completing three loan securitizations during the nine months ended September 30, 2010, the Company was able to reduce the aggregate commitment amount under the credit agreement by a total of $2.0 billion to $4.6 billion.  The initial term of the Amended and Restated Omnibus Credit Agreement expires on December 30, 2010 and all borrowings will be due and payable on or before this date.

- Trustee – An affiliate of Citigroup acts as eligible lender trustee for the Company pursuant to a trust agreement since the Company does not meet the definition of an eligible lender in the Higher Education Act.

- Originating Lender – The Company originates its private education loans through an agreement with an affiliate of Citigroup, under its authority as a federally chartered bank, providing certain benefits to which the Company would not otherwise be entitled. The Company subsequently acquires such loans pursuant to the terms of a separate agreement with the affiliate.

- Service Provider – The majority of the work to originate and service the Company’s FFEL Program and private education loans is performed by an affiliate of Citigroup. Citigroup also provides many other services to the Company, including, but not limited to, cash management, tax return preparation, data processing, telecommunications, payroll processing and benefits administration. These arrangements provide economies of scale that significantly reduce the Company’s operating expenses.

The Company has outsourced a significant portion of its overall operations to certain affiliates and third parties. The Company's business operations could be adversely impacted if any of the existing agreements with these service providers was terminated or could not be renewed with substantially similar terms. The agreements governing Citigroup's role as originating lender and servicer for the Company contain provisions that would terminate the agreements if an event that results in a change in control were to take place. In addition, the Company is subject to the risk that these providers may not continue to provide the level of service that is needed to effectively operate the Company's business, including timely response to changes in the Company's demand for services. If any of these risks were to be realized, and assuming similar agreements with service providers could not be established, the Company could experience interruptions in operations that could negatively impact the Company's ability to meet customer demand for loan originations and disbursements, damage its relationships with customers, and reduce its market share, all of which could materially adversely affect the Company's results of operations and financial condition.

In January 2009, Citigroup announced that it was realigning its structure into two distinct businesses for management reporting purposes: Citicorp, which is composed of Citigroup's core businesses, and Citi Holdings, in which the Company is now included, which is composed of non-core businesses. Citigroup intends to exit the Citi Holdings' businesses as quickly as practicable, in an economically rational manner through business divestitures, portfolio run-offs, and asset sales. As a result, on September 17, 2010, the Company entered into the Merger Agreement for Discover to acquire the Company's private student loan business and the Asset Purchase Agreements with Sallie Mae and CBNA. If the proposed transactions are not completed, the Company may enter into alternative sale or merger agreements which could result in a change in ownership of the Company, including, among other possibilities, an eventual sale of all or part of Citigroup's ownership in the Company, or of all or part of the Company's assets, to an unaffiliated third party.

The Company does not know how a potential disposition or combination transaction, other than those described above, would affect the Company's business or its operations, although given the various relationships between Citigroup and the Company the effect could be material and adverse. Among other things, any disposition of its ownership in the Company by Citigroup that results in Citigroup or any of its subsidiaries owning less than 50% of the voting equity interest in the Company could result in the termination of certain agreements, including the Company's servicing and origination agreements. If a disposition or combination event results in an entity other than CBNA or its affiliates owning more than 50% of the voting equity interest in the Company, all outstanding borrowings under the Original Omnibus Credit Agreement and all borrowings under the Amended and Restated Omnibus Credit Agreement would become due and payable immediately. The Company's business operations could be materially and adversely impacted if any of these agreements cannot be replaced with agreements with substantially similar or more favorable terms.

Our business is subject to extensive regulation and recent market disruptions have led to proposals for new laws and regulations, or changes to existing laws and regulations.

As a participant in the financial services industry, the Company is subject to extensive regulation. In addition, as a result of the current economic and market downturn, there has been increased discussion of, and calls for, additional legislative changes and increased scrutiny from a variety of regulators. New laws or regulations, or changes in enforcement of existing laws or regulations, applicable to the Company's business may adversely affect the Company. Legislative or regulatory changes could lead to business disruptions, impact the value of assets that the Company holds or the scope or profitability of its business activities, require the Company to change certain of its business practices and expose the Company to additional costs (including compliance costs) and liabilities. For example, private student loan forbearance policies at banks and other financial institutions, including the Company, are subject to various regulatory requirements. In response to regulatory guidance, the Company is in the process of implementing changes to the Company's private education loan loss mitigation programs including, among other things, that participation by borrowers in private education loan forbearance and loss mitigation programs are subject to more rigorous requirements, that shorter forbearance periods be granted and that minimum periods of payment performance be required between grants of forbearance. The Company expects that these changes, when fully implemented, will materially increase net credit losses attributable to private education loans.

On July 21, 2010, President Obama signed into law H.R. 4173, the Dodd-Frank Wall Street Reform and Consumer Protection Act, which, among other things, establishes a new Bureau housed within the Federal Reserve. The Bureau will have regulatory authority over a broad range of entities engaged in the provision of consumer financial products and services, including banks and their affiliates as well as student lenders. This act consolidates into the Bureau all consumer protection responsibilities currently held by various regulatory agencies. Although the Bureau will coordinate with principal regulators, it will have exclusive federal authority to enforce the federal consumer financial laws. The Act also creates a new framework for determining issues in connection with federal preemption of state consumer protection laws and enforcement powers of states in the field of consumer protection. This type of regulatory framework is materially different from that which currently exists for financial institutions such as the Company, whose principal regulator is the OCC, with state enforcement and visitation deemed preempted by the authority of the OCC. This type of regulatory framework will have a material effect on the Company by substantially increasing the regulatory burden on the Company.

In July 2009, the Private Student Loan Debt Swap Act of 2009 was introduced into the Senate. As proposed, this act would allow certain private education loan borrowers who, at the time of taking out the private education loan, were eligible for loans through federally guaranteed student loan programs, to refinance their private education loans under the Federal Direct Loan Program. A House version of the bill was introduced in April 2010. The Company cannot predict whether this legislation will be enacted in this form, if at all, or the potential impact on the Company's financial condition or results of operations.

In addition, legislation that would allow private student loan borrowers to once again discharge their private student loans in bankruptcy has been introduced. For additional information on this proposed legislation, see the Other Developments section of Legislation and Regulations on page 52. Since 2005, private student loans have not been dischargeable in bankruptcy. If enacted into law, this would have a material effect on the Company's results of operations by significantly increasing its provision for loan losses.

The Company's business and earnings are affected by the fiscal policies adopted by regulatory authorities of the United States. For example, policies of the Federal Reserve Board directly influence the rate of interest paid by commercial banks, including CBNA, the Company's primary funding source, on its interest-bearing deposits. This may affect the Company's cost of borrowing from CBNA, and also may affect the value of financial instruments, including assets held for sale by the Company. In addition, such changes in fiscal policy may adversely affect the ability of the Company’s borrowers to repay their loans on a timely basis and the ability of prospective borrowers to qualify for loans.

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If any of these proposed regulatory changes were to be adopted, they could have an adverse effect on the Company's financial condition and results of operations. For further information on the impact of other recent legislative and regulatory activities, see Legislation and Regulations on page 52.

Recent legislative changes, which resulted in the elimination of the FFEL Program, could have a material adverse effect on the Company's business.

On March 30, 2010, President Obama signed into law H.R. 4872, the Health Care and Education Reconciliation Act of 2010, which eliminated new FFEL Program loan originations. Effective July 1, 2010, all new federally sponsored guaranteed student loans are being originated through the Federal Direct Loan Program. In compliance with this regulatory change, the Company is continuing to make disbursements on existing FFEL Program loans, however is no longer originating new loans under the FFEL Program. This legislative change has eliminated the primary sources of the Company's historical originations and interest income.

Since 2007, the Company has transitioned towards an increased focus on its private education loan business. This transition includes the Company's strategic repositioning activities, including, among other things, changes in the private education loan underwriting process and modifications to the Company's risk-based pricing. The Company has also taken initiatives to reduce its expense base and has continued to use the capital markets for long-term liquidity. These efforts are intended to create a business model that supports future earnings growth. However, there can be no assurance that the measures the Company has taken to transition its strategy to one more focused on the Company's private education loan business will be successful.

For further information on the impact of these recent legislative activities and other developments, see Legislation and Regulations on page 52.

Liquidity is essential to the Company's business, and the Company relies on external sources, including the Amended and Restated Omnibus Credit Agreement, capital markets, and government programs to fund its balance sheet. Failure to secure cost-effective funding would adversely impact the Company's ability to fund student loan originations and could materially increase the Company's cost of funds.

Uninterrupted access to liquidity is essential to the Company's business. The Company's liquidity and funding has been, and could continue to be, materially adversely affected by factors the Company cannot control, such as disruption of the financial markets or negative views about the financial services industry in general.

The Company's Amended and Restated Omnibus Credit Agreement provides funding through December 30, 2010. As executed, this agreement provided up to $6.6 billion in aggregate credit for new borrowings. As a result of completing three loan securitizations during the nine months ended September 30, 2010, the Company was able to reduce the aggregate commitment amount under the credit agreement by a total of $2.0 billion to $4.6 billion. However, the costs of funding, including the interest rates on any borrowings, the funding commitment fee and the fee on the undrawn balance, under this agreement are significantly higher than the borrowings that have matured during the year. This has further compressed the Company's net interest margin. Until the closing of the proposed transactions with Discover, Sallie Mae, and CBNA, unless the Company is able to identify and implement other funding alternatives, the Company will need to access the borrowings with high rates under this agreement to fund originations. Under the terms of this agreement, any future securitizations require CBNA's approval. In addition, if the proposed transactions are not completed, the Company will need to negotiate an extension to this agreement with CBNA or enter into one or more alternative funding arrangements in order to maintain adequate liquidity in 2011.

The Amended and Restated Omnibus Credit Agreement also requires a comprehensive package of representations, warranties, conditions, covenants (including a borrowing base and various other financial covenants) and events of default.

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The Amended and Restated Omnibus Credit Agreement supersedes and replaces in its entirety the Original Omnibus Credit Agreement. At September 30, 2010, the Company had $4.4 billion of outstanding borrowings made under the Original Omnibus Credit Agreement and $2.8 billion of outstanding borrowings made under the Amended and Restated Omnibus Credit Agreement. These borrowings continue to mature based on their originally contracted maturities, unless a change of control or an event of default, as defined by the Amended and Restated Omnibus Credit Agreement, occurs. A change of control is defined as any event that results in an entity other than CBNA or its affiliates owning more than 50% of the voting equity interest in the Company. The Company is part of a group of businesses within Citigroup, referred to as Citi Holdings. Citigroup intends to exit these businesses as quickly as practicable in an economically rational manner through business divestitures, portfolio run-off and asset sales. As a result, September 17, 2010, the Company entered into the Merger Agreement with Discover for Discover to acquire the Company's private student loan business and the Asset Purchase Agreements with Sallie Mae and CBNA. If the proposed transactions are not completed, the Company may enter into alternative sale or merger agreements which could result in a change in ownership of the Company, including, among other possibilities, an eventual sale of all or part of Citigroup's ownership in the Company, or of all or part of the Company's assets, to an unaffiliated third party. There can be no assurance as to when or if any disposition or combination transaction will occur. However, if a change of control or an event of default (certain of which require explicit action by CBNA to effect an acceleration) under the Amended and Restated Omnibus Credit Agreement were to occur, all outstanding borrowings under the Original Omnibus Credit Agreement and all borrowings under the Amended and Restated Omnibus Credit Agreement would become due and payable immediately. In either event, the Company would no longer have a guaranteed funding source, which would have a material adverse effect on, among other things, the Company's ability to originate new loans, repay its debt obligations, fund business operations and maintain the current level of profitability.

In addition to funding available to the Company under the Amended and Restated Omnibus Credit Agreement and through loan securitizations, the Company has further diversified its sources of funding, and continues to seek additional alternative sources of funding. Since December 2008, the Company had been utilizing the Participation Program and the Purchase Program available through the ECASLA to fund FFEL Program loans.

Since the second quarter of 2009, the Company also accessed additional funding through the Conduit. Funding for the Conduit is provided by the capital markets. In the event the CP issued by the Conduit cannot be reissued or "rolled" at maturity and the Conduit does not have sufficient cash to repay investors, the Department has committed to provide liquidity to the Conduit by entering into forward purchase agreements to purchase the eligible student loans backing the Conduit at a predetermined price. The predetermined price represents a discount to the principal balance of the loans. Accordingly, a sale of loans to the Department would result in a loss to the Company and negatively impact its results of operations.

The Company's financial condition is dependent upon and could be adversely affected by the extent to which management can successfully manage credit risks.

The Company's credit risk exposure has been partially mitigated through government guarantees, third-party insurers, and certain school risk-sharing agreements. The Company actively monitors the creditworthiness of its insurers, but in the event that a guarantor, third-party insurer or risk-share school is unable to meet its contractual obligations under the related arrangements, the Company's financial condition could be adversely affected.

At September 30, 2010, NHIC was rated A+/ Negative by Standard & Poor's and Aa3/Negative by Moody's. UGCIC is no longer rated. On February 24, 2009, Moody's withdrew its rating of both UGCIC and its parent citing business reasons, which Moody's defines as reasons unrelated to bankruptcy, reorganization status or adequacy of information. Previously UGCIC was rated Baa2. AIG, the parent company of UGCIC and NHIC, continues to receive financial support from the US Treasury and the Federal Reserve Bank in support of its financial difficulties.

AIG is in the process of restructuring the company. Any failure of AIG, or sale or restructuring of UGCIC/NHIC, could have an adverse impact on the Company's financial condition and results of operations as it relates to the Company's UGCIC/NHIC insured loan portfolio.

Currently, UGCIC and NHIC generally continue to make claim payments as agreed. However, the Company anticipates that UGCIC and NHIC will need to rely on experience rated premium payments by the Company as support agreements, including reinsurance, from affiliates to meet their long-term claim obligations. In addition, there are a variety of factors which could have adverse effect on UGCIC's and NHIC's long-term ability to continue making claim payments, including but not limited to, unfavorable market conditions, increases in the impact of the loss mitigation program policy changes that are significantly higher than forecasted amounts, regulatory or legislative changes and items affecting the financial condition of the insurers' affiliates.

In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act provides for an orderly liquidation authority which would allow federal authorities to place systemically important financial companies into liquidation. Such companies may include financial companies that are non-banks, such as corporate groups that include insurance companies. Insurance companies may be liquidated by state authorities as provided under state insurance insolvency law and if state regulators fail to act within certain timeframes, the FDIC may force such a proceeding. Federal authorities may also liquidate non-insurance affiliates of insurance companies. It is possible that these provisions, and the rules which may be promulgated pursuant to such provisions, may operate to place insurance companies, such as the ones with which a portion of the Company's private education loans are insured, into liquidation should the financial position of those entities be deemed to pose a systemic risk to the financial system, which could result in a lack of availability of funds to pay claims on the Company's insured loans. This could have a material adverse effect on the Company's financial condition and results of operations by increasing its net credit losses.

Due to recent regulatory changes and the current economic environment, several student lenders as well as the Company have tightened their underwriting. This decrease in the availability of student loans may adversely impact the financial condition of certain schools with which the Company does business. The current economic environment is also affecting the financial condition of certain schools with which the Company does business, particularly private non-profit schools. The Company's results could be adversely impacted to the extent that the schools for which it originates loans do not continue as going concerns. In addition, school closings could result in an increase in defaults for the borrowers attending these schools at the time they close and a significant increase in school closings could materially increase the Company's allowance for loan losses.

From April 1997 to 2002, the Company purchased private insurance from RSAUSA. RSAUSA decided to exit the U.S. market and sold RSAUSA in 2007 to Arrowpoint, a company owned and operated by their management and independent directors. Arrowpoint is being operated in a voluntary run-off mode with the objective of successfully meeting policy holder obligations and achieving a solvent run-off. As part of the purchase, Arrowpoint agreed to certain operating restrictions and the appointment of a claims monitor to protect policy holders. Arrowood, the Arrowpoint subsidiary which directly insures the Company's loans, is making claim payments on a regular basis. Neither Arrowpoint nor Arrowood is rated. Any failure of either could have an adverse impact on the Company's financial condition and results of operations as it relates to the Company's Arrowood insured loan portfolio.

The Company's credit risk exposure is also impacted by the size and performance of the Uninsured CitiAssist Standard and Uninsured CitiAssist Custom loan portfolios that are not originated under a risk-sharing relationship, which has grown over recent years. At September 30, 2010, the uninsured private education loan, including those classified as held for sale, include $179.1 million of higher risk loans made to students attending proprietary schools. Most of these higher risk loans did not follow the Company's traditional underwriting process. The Company no longer originates Uninsured CitiAssist Custom loans.

The Company's allowance for loan losses is dependent on estimates. These estimates are based on historical experience, adjusted for qualitative factors including changes in recent performance, general economic conditions or applicable laws and regulations. If actual experience varies significantly from historical experience or the Company's projections of the impact of changes in qualitative factors are inaccurate, the Company's estimated allowance for loan losses may be insufficient to cover losses inherent in the Company's portfolio.

Item 6. Exhibits

See Exhibit Index.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 5, 2010

The Student Loan Corporation

| | |
|---|---|
| By: | /s/ Joseph P. Guage<br>Joseph P. Guage<br>Chief Financial Officer and Duly Authorized Officer<br>(Principal Financial Officer) |

EXHIBIT INDEX

| Exhibit Number | Description of Exhibit |
|---|---|
| 3.1 | Restated Certificate of Incorporation of the Company, incorporated by reference to Exhibit 3.1 to the Company's 1992 Annual Report on Form 10-K (File No. 1-11616). |
| 3.2 | By-Laws of the Company, as amended, incorporated by reference to Exhibit 3.2 to the Company's 1994 Annual Report on Form 10-K (File No. 1-11616). |
| 10.1 | Agreement and Plan of Merger by and among The Student Loan Corporation, Discover Bank and Academy Acquisition Corp., incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed September 23, 2010 (File No. 1-11616). |
| 10.2 | Asset Purchase Agreement by and among The Student Loan Corporation, Citibank, N.A., Citibank (South Dakota) National Association, SLC Student Loan Receivables I, Inc., Bull Run 1 LLC, SLM Education Credit Finance Corporation and SLM Corporation, incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed September 23, 2010 (File No. 1-11616). |
| 10.3 | Asset Purchase Agreement by and among The Student Loan Corporation, Citibank, N.A., SLC Student Loan Receivables I, Inc. and Citibank (South Dakota) National Association, incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K filed September 23, 2010 (File No. 1-11616). |
| 10.4 | Purchase Price Adjustment Agreement by and among The Student Loan Corporation, Discover Bank and Citibank, N.A., incorporated by reference to Exhibit 10.4 to the Current Report on Form 8-K filed September 23, 2010 (File No. 1-11616). |
| 10.5 | Intra-Citi Service Agreement, dated August 1, 2010 between the Company and Citigroup Technology, Inc. , incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616). |
| 10.6 | Amendment No. 1, dated as of February 11, 2010, to the Amended and Restated Omnibus Credit Agreement between the Company and CBNA, incorporated by reference to Exhibit 10.10.1 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616) |
| 10.7 | Notice No. 2 dated as of July 7, 2010, amending the Amended and Restated Omnibus Credit Agreement between the Company and CBNA, incorporated by reference to Exhibit 10.10.2 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616) |
| 10.8 | Amendment No. 12, dated as of August 8, 2010, to the Non-Competition Agreement among the Company, Citibank, N.A. and Citigroup Inc., incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616) |
| 10.9 | Retention and Severance Program as agreed between the Company and Michael Reardon, dated July 30, 2010, incorporated by reference to Exhibit 10.3 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616) |

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| 10.10 | Retention and Severance Program as agreed between the Company and Joseph Guage, dated July 30, 2010, incorporated by reference to Exhibit 10.4 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616) |
| 10.11 | Retention and Severance Program as agreed between the Company and Christine Homer, dated July 30, 2010, incorporated by reference to Exhibit 10.5 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616) |

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| 10.12 | Retention and Severance Program as agreed between the Company and Patricia Morris, dated July 30, 2010, incorporated by reference to Exhibit 10.6 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616) |
| 10.13 | Retention and Severance Program as agreed between the Company and John Vidovich, dated July 30, 2010, incorporated by reference to Exhibit 10.7 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616) |
| 10.14 | Retention and Severance Program as agreed between the Company and Noelle Whitehead, dated July 30, 2010, incorporated by reference to Exhibit 10.8 to the Current Report on Form 8-K filed August 5, 2010 (File No. 1-11616) |
| 31.1 * | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 * | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 * | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Filed herewith.