

United States Senate

WASHINGTON, DC 20510-2101

September 21, 2004

The Honorable William H. Donaldson
Chairman
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Dear Mr. Chairman,

I'm writing about potential violations of federal securities law by the Nelnet Corporation. My concern involves questionable accounting practices, possible material misrepresentations in a recent SEC filing, potential manipulation of the financial market, possible insider trading, and possible fraud. I request that the Securities and Exchange Commission review this matter in connection with its responsibilities under federal securities laws.

As you may know, the Federal Family Education Loan (FFEL) program under the Higher Education Act subsidizes student loans by private and non-profit organizations, and the loans are guaranteed by the federal government against default. Students pay an interest rate established in accordance with the Higher Education Act of 1965, currently 3.37 percent for new loans, and lenders are guaranteed a rate that is normally slightly higher than the student rate. The government pays the additional amount to lenders in the form of a subsidy.

Currently, the normal guaranteed lender rate of return is 3.57 percent, which means that the federal government normally pays the lenders a subsidy of 0.20 percent of the loan. However, loans capitalized with tax-exempt securities are guaranteed a 9.5 percent rate of return; for these loans, the federal government provides a 6.13 percent subsidy.

In 1993, Congress amended the Higher Education Act with the intention of phasing out the 9.5 percent guarantee. In the last 18 months, however, the government subsidy on 9.5 percent loans has increased substantially, because of a novel and controversial financial transaction by a small group of lenders who have radically increased the number of loans they claim are guaranteed a 9.5 percent return.

I. Possible Misleading Statements Made in Nelnet's Form 8-K

Nelnet is the number one user of the controversial technique, which was first described by The Institute for College Access and Success in a report entitled *Money for Nothing*. Nelnet long has known that their method of using 9.5 percent loans is questionable, and that such payments are subject to recall. In May 2003, Nelnet asked the Department of Education to verify that its technique conforms with applicable law and regulatory guidance (see Appendix A). Nelnet's inquiry specifically cited 34 C.F.R. Section 682.302(c) and (e) and the Department of

Education's Dear Colleague Letter 96-L-186. In fact, until July of this year, Nelnet had told shareholders that it was not going to declare fully as corporate income the subsidy payments associated with these loans.

In June 2004, Nelnet received what *The Washington Post* called an "inconclusive" response from the Department of Education to Nelnet's request for approval of its method of issuing 9.5 percent loans (see Appendix B). The Department of Education sent a brief letter to Nelnet stating the following:

"34 C.F.R. Section 682.302(e) provides guidance with regard to special allowance payments for loans financed by proceeds of tax-exempt obligations. Additionally, the formulas for the calculations are provided in 34 C.F.R. Section 682.302(e). You can also refer to Dear Colleague Letter 96-L-186 for additional information.

Please let [us] know if you have any question or concerns." (see Appendix C)

Three days later, Nelnet stated to investors in an 8-K filing with the SEC that after consideration of "certain *clarifying information* received in connection with the guidance it had sought, and based on written and verbal communications with the Department of Education, [the corporation] has concluded that the earnings process has been completed [and that] the company is recognizing [9.5 percent self-designated loan] related income for the current period, and will recognize the related income for subsequent periods as earned." [emphasis added] Nelnet issued a press release to the same effect that day (see Appendix D).

But on September 19, 2004, the *Omaha World Herald* reported that a spokeswoman from the Department of Education said that the Department "did not inform Nelnet that its conduct was inside (or outside) the confines" of the law. The spokeswoman reportedly said that such a determination is typically made in follow-up reviews of programs. Nelnet has yet to issue a clarification of its original and now dubious 8-K averment.

II. Possible Insider Trading and Violations of SEC Rule 10b-5

In July, after Nelnet's questionable 8-K filing and press release, the corporation's stock climbed 24 percent. During that same month, the Standard and Poor's 500 Stock Index declined by 3.4 percent. In August, Nelnet directors reported personal sales of large amounts of personally-held Nelnet securities. Nelnet President, Don R. Bouc, for example, sold \$1.1 million in shares during August alone. One week later, he resigned from his position at the company.

According to the American Law Division of the Congressional Research Service, the propriety of Nelnet's actions and that of its Directors is in doubt under certain regulatory prohibitions developed pursuant to the Securities and Exchange Act of 1933 and 1934, including possible insider trading. Binding Rule 10b-5, promulgated pursuant to the 1934 Act, provides that:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

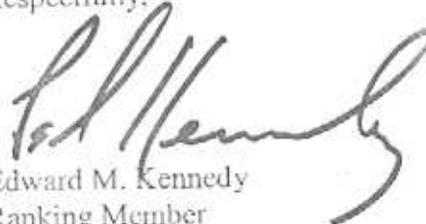
(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security." [emphasis added]

Based on the factual information summarized above, I urge the Commission to undertake an immediate review of Nelnet's practices to determine what action, if any, is appropriate pursuant to the Commission's responsibilities for enforcing federal securities laws. Nelnet's manipulation of the FFEL student loan program already may have illegally diverted hundreds of millions of dollars in federal support for college students, and it also may have defrauded investors worldwide. The entire matter therefore deserves prompt attention by the Department of Education, SEC, and Congress.

I'm hopeful that Congress and the Department of Education will act quickly to end this abuse, but I believe it is also essential for the Commission to consider appropriate action as well. Thank you for your consideration and I look forward to your reply.

Respectfully,



Edward M. Kennedy
Ranking Member
Senate Committee on Health, Education,
Labor and Pensions

cc: The Honorable Rod Paige, Secretary, Department of Education
The Honorable John P. Higgins, Jr., Inspector General, Department of Education
The Honorable David M. Walker, Comptroller General, Government Accountability
Office

20 45102

Nelnet Education Loan Funding, Inc.

121 South 13th Street, Suite 201

Lincoln, Nebraska 68508

402 458 2303

May 29, 2003

Angela Roca-Baker
 United States Department of Education
 Federal Student Aid
 Union Center Plaza
 830 First Street, NE
 Room 52E4
 Washington, DC 20207

Re: LaRS Billing Statement Confirmation

Dear Ms. Roca-Baker:

This letter is being written to confirm the proper way to submit Lender's Request for Payment of Interest and Special Allowance (LaRS) for the second quarter of 2003 by Nelnet Education Loan Funding, Inc. (NELF). Some background information may be helpful in your consideration of this issue. NELF is the successor in interest to a qualified scholarship funding corporation which converted to for-profit status in 1998 under § 150(d) of the tax Code. NELF is the issuer of tax exempt obligations pursuant to an Indenture of Trust dated November 15, 1985 (the 1985 Indenture) with Wells Fargo Bank Minnesota, National Association as trustee. NELF makes, purchases and finances student loans as part of its ordinary activities as a secondary market of student loans in the state of Nebraska. The trustee holds title to NELF's student loans and NELF holds 100% beneficial owner interest in its loans.

NELF is purchasing portfolios of FFEL loans with funds obtained from proceeds of the tax exempt 1985 Indenture in a series of acquisitions. Some of the portfolios will be purchased from third party non-affiliated sellers, and some will be purchased from affiliated sellers. Some of the portfolios will be transferred into the 1985 Indenture from the seller and some will be financed by a different NELF financing prior to being placed into the 1985 Indenture. As part of NELF's overall cash flow management plan, the purchased loans will be held within the 1985 Indenture and financed by the tax exempt obligations issued by NELF under that financing for a period of time depending upon cash management needs and other internal concerns, but in any event for at least one day or longer. Thereafter, loans will be refinanced and placed into financings which are taxable on a longer term basis; however, NELF will remain the 100% beneficial owner of the student loans that were previously funded in the tax exempt 1985 indenture. A flow chart is being sent with this letter to help illustrate.

We have reviewed applicable law, discussed with officials at the Department of Education the manner in which billing for special allowance should be handled in such circumstances and considered industry practices. During the time that the loans are held in the 1985 Indenture,

under 20 U.S.C. § 1087-1(b)(2)(B) and 34 C.F.R. § 682.302(c)(3), we intend to bill for special allowance at the quarterly rate of one-half the average of the bond equivalent rates of 91-day Treasury bill plus 3.5%, divided by 4, subject to a minimum of 9.5% minus the applicable interest rate on a loan, divided by 4. Since the loans thereafter will be refinanced under a taxable financing, NELF will maintain its 100% beneficial ownership interest in the loans previously purchased with proceeds of the 1985 Indenture, and the 1985 Indenture will not be retired or defeased, we intend to continue to bill for special allowance at such same quarterly rate (one-half of 91 day Treasury bill plus 3.5%, divided by 4, subject to the minimum of 9.5% minus the applicable rate on the loan, divided by 4) following such long term refinancing. We have based this upon 34 C.F.R. § 682.302(c)(2) as well as Dear Colleague Letter 96-L-186, 96-G-287 (Q&A No. 30), and our previous discussions with the Department on this matter. We intend to submit billings for special allowance at this same rate until such refinanced loans are either no longer beneficially owned by NELF (and are transferred to an unrelated or an affiliated purchaser), or until the 1985 Indenture is retired or defeased.

We would appreciate if you would consider our intended billing procedure summarized above and verify that it conforms to existing applicable laws and regulatory guidance at your earliest convenience, since we will be calculating the special allowance billings in the upcoming second quarter LARS within the next few weeks. Please indicate your confirmation that our intended billing procedure is compliant with the Higher Education Act of 1965, as amended, and regulations promulgated thereunder, by signing below. We intend to proceed under the analysis described above and assume its correctness, unless we are otherwise directed by you. Thank you for your consideration of this matter.

Sincerely,

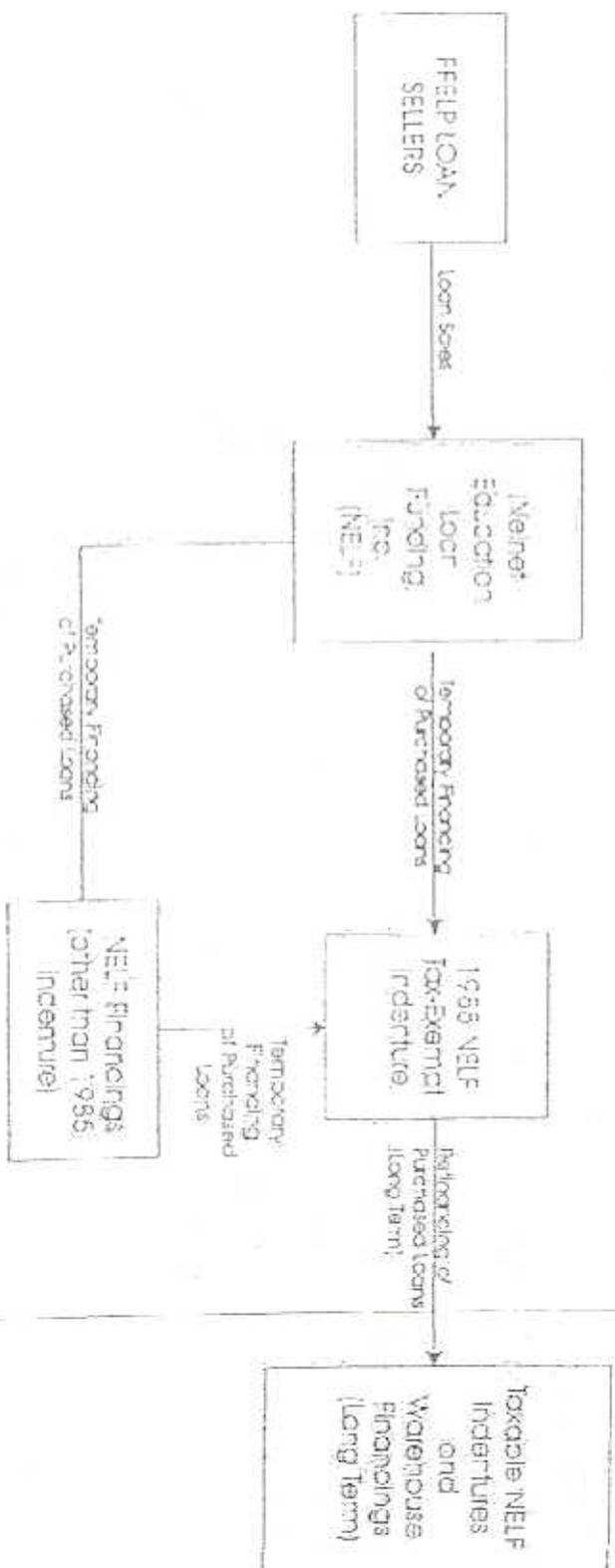


Terry J. Heimos
President of Nelnet Education Loan Funding, Inc.

I concur with the above.

Date

cc: Terri Shaw
Kristie Hansen
Frank Ramos
Sally Stroup



The Washington Post

AN INDEPENDENT NEWSPAPER

Student Loan Scandal

THERE ARE bureaucratic errors, there is congressional negligence—and then there are bureaucratic errors and congressional negligence on a scale so vast that it is hard to believe they can be accidental. The hundreds of millions of dollars in unnecessary government payments to the student loan industry in the past 18 months amount to such a scandal. The loans in question, established in 1980, are guaranteed by the government at 9.5 percent. Yet most students are paying interest rates of 3.5 percent or less. The difference—all taxpayers' money—is pure profit for the companies that have taken advantage of a loophole in the law.

According to a recent report by the Institute for College Access and Success, a nonprofit education think tank, Congress had actually intended to end in 1993 the 9.5 percent loan guarantee, one of many programs that provide incentives for institutions to lend to students. In May 2003, one company, Nelnet Inc., wrote to the Education Department to confirm its intention to expand its holdings of old loans with the 9.5 percent interest rate. Nelnet received no answer from the department for a year, during which time the department continued paying the company. In June of this year, the department replied inconclusively—at which point the company's stock price climbed 20 percent. Although Nelnet is the largest holder of loans guaranteed at 9.5 percent—and its holdings of such loans have increased by 818 percent since January 2003—it is only one of many such lenders. According to a preliminary Government Accountability Office report, commissioned by Reps. Chris Van Hollen (D-Md.) and Dale E. Kildee (D-Mich.), 37 lenders receive payments for loans with guaranteed interest rates of 9.5 percent, at a government cost of \$1 billion annually, and the volume of such loans is rising.

Why wasn't the loophole shut long ago? Education Department officials argue strenuously that only a two-year regulatory process could have done so, and they didn't initiate one, they say, because they thought Congress would deal with it. Congressional Republicans say they expected to deal with the problem in a comprehensive higher edu-

cation bill, but that has failed to pass (and in any case the proposed language would not have ended all the payments). Yet, other solutions could have been found. In the wake of revelations about the scale of the payments, the House yesterday passed an amendment to an appropriations bill, offered by Mr. Van Hollen and Mr. Kildee, that would close the loophole completely, albeit temporarily. (Of course, there is no guarantee it will become law.) And one former education Department general counsel has written to the secretary of education, Rodrick E. Paige, arguing that the loophole could have been closed immediately if officials had wished to do so.

There could be other explanations for their reluctance. One is that the president of Nelnet, Don R. Bouc—who has called for the loophole to be shut and the money to be better used—is well-connected enough to have been appointed to Mr. Paige's advisory committee on student financial assistance. Here is another. According to a report in the Chronicle of Higher Education, Nelnet is the second-largest contributor to congressional campaigns in the student loan industry, beaten only by industry giant Sallie Mae. Over the past 18 months, the student loan industry has contributed about \$750,000 to the 49 members of the House Committee on Education and the Workforce, of which \$136,000 has gone to the committee chairman, Rep. John A. Boehner (R-Ohio), and \$175,000 to Rep. Howard P. "Buck" McKeon (R-Calif.), chairman of the subcommittee on higher education. Mr. Boehner's spokesman vehemently denies any connection between the contributions and the issue and maintains that the committee's bill would have fixed the problem, which was mentioned in the president's latest budget. Still, it is difficult to understand, given the sums involved, why neither Mr. Paige nor Congress made this a higher priority.

For nearly a decade we have argued that Congress should reduce subsidies for banks that lend to students, and instead expand the direct-loan program, which provides about a quarter of student aid—or else reform the system to make it harder to manipulate. This scandal provides an excellent reason to look again at these questions.



JUN 30 2004

Mr. Paul Tone
 Government and Industry Relations
 Nelnet
 3015 South Parker Road, Suite 400
 Aurora, CO 80014

Dear Mr. Tone,

This letter is in response to Nelnet's May 29, 2003 correspondence with regard to confirmation of the proper way for a lender to submit the Lender's Request for Payment of Interest and Special Allowance (LARS) as it relates to portfolios funded from the proceeds of the tax-exempt 1985 Indenture.

34 C.F.R. Section 682.302(e) provides guidance with regard to special allowance payments for loans financed by proceeds of tax-exempt obligations. Additionally, the formulas for the calculations are provided in 34 C.F.R. Section 682.302(c). You can also refer to Dear Colleague Letter 96-1-186 for additional information.

Please let me know if you have any questions or concerns.

Sincerely,

A handwritten signature in black ink, appearing to read 'Victoria E. Bateman', written over a horizontal line.

Victoria E. Bateman, CPA, CGFM
 Chief Financial Officer and
 Acting General Manager, Financial Partner Services, FSA

Download: [PDF] [RTF] [XLS]

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 8-K**CURRENT REPORT****PURSUANT TO SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934**Date of Report (Date of earliest event reported)
JULY 2, 2004**NELNET, INC.**

(Exact name of registrant as specified in its charter)

NEBRASKA (State or other jurisdiction of incorporation)	001-31924 (Commission File Number)	84-0748901 (I.R.S. Employer Identification No.)
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121 SOUTH 13TH STREET SUITE 201 LINCOLN, NEBRASKA (Address of principal executive offices)	68508 (Zip Code)
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 Registrant's telephone number, including area code (402) 458-2370

Item 5. Other Events and Regulation FD Disclosure.

On July 2, 2004, Nelnet, Inc. issued a press release announcing that, effective June 30, 2004, it will begin to recognize income related to student loan portfolios funded from the proceeds of tax-exempt bonds, including amounts previously deferred through that date.

Based on provisions of the Higher Education Act of 1965 and related interpretations, education lenders may receive special allowance payments providing a 9.5% rate on loans previously financed with tax-exempt obligations issued prior to October 1, 1993. The company had previously sought confirmation regarding whether it was allowed to recognize special allowance income based on this minimum rate of return. For periods through March 31, 2004, as previously disclosed, the company had deferred recognition of this excess income generated by these loans pending satisfactory resolution of this issue.

After consideration of certain clarifying information received in connection with the guidance it had sought, and based on written and verbal communications with the Department of Education, Nelnet has concluded that the earnings process has been completed. The company is recognizing the related income for the current period, and will recognize the related income for subsequent periods as earned.

Earnings related to the deferred income at March 31, 2004, which deferred income was previously included in other liabilities on Nelnet's balance sheet, together with related income generated by these loans during the second quarter, will be included in the company's operating results for the quarter ended June 30, 2004, which are expected to be released at the end of July. Nelnet expects the recognition of this additional income will approximate \$60-70 million in the second quarter. The company does not expect the impact in future quarters to be as significant as in the second quarter and will be impacted by interest rates and other factors.

A copy of the press release is attached as Exhibit 99.1 to this Current Report

SIGNATURES

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 hereunto duly authorized.

Dated: July 2, 2004

NELNET, INC.

By: */s/ Michael S. Dunlap*
 Name: *Michael S. Dunlap*
 Title: *Chairman and Co-Chief Executive Officer (Co-Principal Executive Officer)*

EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
99.1	Press Release dated July 2, 2004

EXHIBIT 99.1

Media contact: Sheila Odom
402.458.2329
nelnetcommunications@nelnet.net

Investor contact: Cheryl Watson
317.469.2064
investorrelations@nelnet.net

For immediate release

Nelnet recognizes income

(Lincoln, NE) - Today, Nelnet announced that, effective June 30, 2004, it will begin to recognize income related to student loan portfolios funded from the proceeds of tax exempt bonds, including amounts previously deferred through that date.

Based on provisions of the Higher Education Act of 1965 and related interpretations, education lenders may receive special allowance payments providing a 9.5% rate on loans previously financed with tax-exempt obligations issued prior to October 1, 1993. The company had previously sought confirmation regarding whether it was allowed to recognize special allowance income based on this maximum rate of return. For periods through March 31, 2004, as previously disclosed, the company had deferred recognition of this excess income generated by these loans pending satisfactory resolution of this issue. After consideration of certain clarifying information received in connection with the guidance it had sought, Nelnet has concluded that the earnings process has been completed. The company is recognizing the related income for the current period, and will recognize the related income for subsequent periods as earned.

Earnings related to the deferred income at March 31, 2004, which deferred income was previously included in other liabilities on Nelnet's balance sheet, together with related income generated by these loans during the second quarter, will be included in the company's operating results for the quarter ended June 30, 2004, which are expected to be released at the end of July.

Recently named to the Russell 3000 index and awarded the Exceptional Performance designation by the U.S. Department of Education, Nelnet is one of the leading educational finance companies in the United States. With over \$12 billion in total assets, Nelnet originates in excess of \$2 billion for itself and its service partners annually, and its servicing software is used by 35 clients, including Nelnet, to service over \$49 billion in student loans. Nelnet ranks among the nation's leaders in terms of total student loan assets.

Additional information is available at www.nelnet.net.

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Nelnet offers a broad range of student loan and financial services and technology-based products, including student loan origination and lending, guarantee servicing, and a suite of software solutions. Our products are designed to simplify the student loan process by automating financial aid delivery, loan processing, and funds disbursement. Our services help to facilitate and streamline education finance for all involved in the industry, including student and parent borrowers, lenders, financial aid officers, guaranty agencies, governmental agencies, servicers, and the capital markets.

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