MICROFINANCIAL INC
Form 10-Q
August 15, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

or

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

Commission File No. 1-14771

MICROFINANCIAL INCORPORATED

(Exact name of registrant as specified in its charter)

Massachusetts	04-2962824
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

16 New England Executive Park, Suite 200, Burlington, MA 01803
(Address of principal executive offices)
(781) 994-4800
(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(b) of the Securities and 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.
þ Yes o No

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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). þ Yes o No

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (check one).

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
o Yes þ No

As of July 31, 2011, 14,257,324 shares of the registrant s common stock were outstanding.

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MICROFINANCIAL INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

	June 30, 2011	December 31, 2010
ASSETS		
Cash and cash equivalents	$ 434	$ 1,528
Restricted cash	979	753
Net investment in leases:		
Receivables due in installments	193,345	191,067
Estimated residual value	22,629	21,832
Initial direct costs	1,420	1,490
Less:		
Advance lease payments and deposits	(3,603)	(3,479)
Unearned income	(58,993)	(59,245)
Allowance for credit losses	(12,895)	(13,132)
Net investment in leases	141,903	138,533
Investment in rental contracts, net	732	461
Property and equipment, net	2,083	800
Other assets	1,219	1,530
Total assets	$ 147,350	$ 143,605
LIABILITIES AND STOCKHOLDERS EQUITY		
Revolving line of credit	$ 59,574	$ 62,650
Accounts payable	2,512	2,435
Capital lease obligation	6	26
Dividends payable	12	5
Other liabilities	3,222	1,375
Deferred income taxes	9,618	7,627
Total liabilities	74,944	74,118
Stockholders equity:		
Preferred stock, $.01 par value; 5,000,000 shares authorized; no shares issued at June 30, 2011 and December 31, 2010		
Common stock, $.01 par value; 25,000,000 shares authorized; 14,231,692 and 14,231,933 shares issued at June 30, 2011 and December 31, 2010, respectively	142	142
Additional paid-in capital	46,515	46,475
Retained earnings	25,749	22,870
Total stockholders equity	72,406	69,487
Total liabilities and stockholders equity	$ 147,350	$ 143,605

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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MICROFINANCIAL INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except share and per share data)
(Unaudited)

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Revenues:				
Income on financing leases	$ 9,136	$ 8,509	$ 18,237	$ 16,631
Rental income	2,073	1,920	4,079	3,878
Income on service contracts	103	132	211	273
Loss and damage waiver fees	1,220	1,119	2,421	2,223
Service fees and other	931	941	1,863	1,934
Total revenues	13,463	12,621	26,811	24,939
Expenses:				
Selling, general and administrative	4,037	3,581	7,990	6,811
Provision for credit losses	4,251	5,562	9,003	12,493
Depreciation and amortization	783	474	1,464	902
Interest	680	885	1,343	1,696
Total expenses	9,751	10,502	19,800	21,902
Income before provision for income taxes	3,712	2,119	7,011	3,037
Provision for income taxes	1,429	818	2,699	1,171
Net income	$ 2,283	$ 1,301	$ 4,312	$ 1,866
Net income per common share basic	$ 0.16	$ 0.09	$ 0.30	$ 0.13
Net income per common share diluted	$ 0.16	$ 0.09	$ 0.30	$ 0.13
Weighted-average shares:				
Basic	14,231,692	14,230,670	14,239,180	14,220,529
Diluted	14,503,702	14,452,575	14,495,745	14,432,535

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements

MICROFINANCIAL INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(In thousands, except share and per share data)
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Total Stockholders Equity
Balance at December 31, 2009	14,174,326	$ 142	$ 46,197	$ 20,426	$ 66,765
Stock issued for deferred compensation	88,269		295		295
Stock-based compensation			112		112
Amortization of unearned compensation	3,750		10		10
Stock repurchase program	(34,412)		(139)		(139)
Common stock dividends ($0.20 per share)				(2,852)	(2,852)
Net income				5,296	5,296
Balance at December 31, 2010	14,231,933	142	46,475	22,870	69,487
Stock issued for deferred compensation	51,642		212		212
Stock-based compensation			68		68
Stock repurchase program	(51,883)		(240)		(240)
Common stock dividends ($0.10 per share)				(1,433)	(1,433)
Net income				4,312	4.312
Balance at June 30, 2011	14,231,692	$ 142	$ 46,515	$ 25,749	$ 72,406

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements

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MICROFINANCIAL INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW
(In thousands)
(Unaudited)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Cash flows from operating activities:		
Cash received from customers	$ 52,469	$ 44,928
Cash paid to suppliers and employees	(9,240)	(7,824)
Cash paid for income taxes	(238)	(951)
Interest paid	(1,229)	(1,173)
Interest received	1	1
Net cash provided by operating activities	41,763	34,981
Cash flows from investing activities:		
Investment in lease and rental contracts	(36,635)	(38,857)
Investment in direct costs	(498)	(575)
Investment in property and equipment	(734)	(62)
Net cash used in investing activities	(37,867)	(39,494)
Cash flows from financing activities:		
Proceeds from secured debt	48,729	50,933
Repayment of secured debt	(51,805)	(43,823)
Payment of debt closing costs	(2)	
Increase in restricted cash	(226)	(24)
Repayment of capital lease obligation	(20)	(33)
Repurchase of common stock	(240)	
Payment of dividends	(1,426)	(1,421)
Net cash (used in) provided by financing activities	(4,990)	5,632
Net change in cash and cash equivalents	(1,094)	1,119
Cash and cash equivalents, beginning of period	1,528	391
Cash and cash equivalents, end of period	$ 434	$ 1,510
Reconciliation of net income to net cash provided by operating activities:		
Net income	$ 4,312	$ 1,866
Adjustments to reconcile net income to net cash provided by operating activities:		

Amortization of unearned income, net of initial direct costs	(18,237)	(16,631)
Depreciation and amortization	1,464	902
Provision for credit losses	9,003	12,493
Recovery of equipment cost and residual value	40,715	34,862
Stock-based compensation expense	68	62
Changes in assets and liabilities:		
Current taxes payable	137	(74)
Deferred income taxes	1,991	293
Other assets	311	111
Accounts payable	289	328
Other liabilities	1,710	769
Net cash provided by operating activities	$ 41,763	$ 34,981
Supplemental disclosure of non-cash activities:		
Acquisition of property and equipment through lease incentives	$ 791	$
Fair market value of stock issued for compensation	$ 212	$ 169

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements

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MICROFINANCIAL INCORPORATED
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tables in thousands, except share and per share data)

A. Nature of Business

MicroFinancial Incorporated (referred to as MicroFinancial, we, us or our) operates primarily through its wholly-owned subsidiaries, TimePayment Corp. and LeaseComm Corporation. TimePayment is a specialized commercial finance company that leases and rents microticket equipment and provides other financing services. LeaseComm started originating leases in January 1986 and in October 2002 suspended virtually all originations due to an interruption in financing. TimePayment commenced originating leases in July 2004. The average amount financed by TimePayment during 2010 was approximately $5,800 compared to the 2011 year to date average of $6,100. LeaseComm historically financed contracts of approximately $1,900. We primarily source our originations through a nationwide network of independent equipment vendors, sales organizations and other dealer-based origination networks. We fund our operations through cash provided by operating activities and borrowings under our revolving line of credit.

B. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission for interim financial statements. Accordingly, our interim statements do not include all of the information and disclosures required for our annual financial statements. In the opinion of our management, the condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation of these interim results. These financial statements should be read in conjunction with our consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2010. The results for the six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2011.

The balance sheet at December 31, 2010 has been derived from the audited financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010.

Allowance for Loan Losses and Credit Quality

We maintain an allowance for credit losses on our investment in leases, service contracts and rental contracts at an amount that we believe is sufficient to provide adequate protection against losses in our portfolio. Given the nature of the microticket market and the individual size of each transaction, we do not have a formal credit review committee to review individual transactions. Rather, we developed a sophisticated, multi-tiered pricing model and have automated the credit scoring, approval and collection processes. We believe that with the proper pricing model, we can grant credit to a wide range of applicants provided we have priced appropriately for the associated risk. As a result of approving a wide range of credits, we experience a relatively high level of delinquency and write-offs in our portfolio. We periodically review the credit scoring and approval process to ensure that the automated system is making appropriate credit decisions. Contracts in our portfolio are not re-graded subsequent to the initial extension of credit and the allowance is not allocated to specific contracts. Rather, we view the contracts as having common characteristics and maintain a general allowance against our entire portfolio utilizing historical collection statistics and an assessment of current credit risk in the portfolio as the basis for the amount.

We have adopted a consistent, systematic procedure for establishing and maintaining an appropriate allowance for credit losses for our microticket transactions. We estimate the likelihood of credit losses net of recoveries in the portfolio at each reporting period based upon a combination of the lessee s bureau reported credit score at lease inception and the current delinquency status of the account. In addition to these elements, we also consider other relevant factors including general economic trends, trends in delinquencies and credit losses, static pool analysis of our portfolio, trends in recoveries made on charged off accounts, and other relevant factors which might affect the performance of our portfolio. This combination of historical experience, credit scores, delinquency levels, trends in credit losses, and the review of current factors provide the basis for our analysis of the adequacy of the allowance for credit losses. We take charge-offs against our receivables when such receivables are deemed uncollectible. In general a receivable is uncollectable when it is 360 days past due or earlier, if other adverse events occur with

MICROFINANCIAL INCORPORATED
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(Tables in thousands, except share and per share data)

respect to an account. Historically, the typical monthly payment under our microticket leases has been small and as a result, our experience is that lessees will pay past due amounts later in the process because of the relatively small amount necessary to bring an account current.

In 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses requiring us to provide detailed disclosures about the nature of credit risk inherent in our financing receivables, how we analyze that risk in estimating our allowance for credit losses, and the changes in the allowance for credit losses.

We segregate our lease portfolio between TimePayment Corp. and LeaseComm Corp. to perform the calculation and analysis of the allowance for credit losses. Each subsidiary consists of a single portfolio segment which we refer to as microticket equipment. We take charge-offs against our receivables when such receivables are deemed uncollectible. None of our receivables are placed on nonaccrual status as they are charged off when deemed uncollectible.

Activity in the allowance for credit losses for the six months ended June 30, 2011 and 2010 was as follows:

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Allowance for credit losses, beginning	$ 13,132	$ 13,856
Provision for credit losses	9,003	12,493
Charge-offs	(11,733)	(14,946)
Recoveries	2,493	2,028
Allowance for credit losses, ending	$ 12,895	$ 13,431

The following table reconciles the activity in the allowance for credit losses by portfolio segment at June 30, 2011:

	LeaseComm Microticket equipment	TimePayment Microticket equipment	Total
Allowance for Credit Losses:			
Beginning balance	$ 231	$ 12,901	$ 13,132
Charge-offs	(394)	(11,339)	(11,733)
Recoveries	641	1,852	2,493
Provisions (credits)	(290)	9,293	9,003
Ending balance	$ 188	$ 12,707	$ 12,895
Ending balance: Individually evaluated for impairment			
Ending balance: Collectively evaluated for impairment	188	12,707	12,895
Ending balance: Contracts acquired with deteriorated credit quality			
Financing Receivables:			
Ending balance	415	154,383	154,798(1)

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	LeaseComm Microticket equipment	TimePayment Microticket equipment	Total
Ending balance: Individually evaluated for impairment			
Ending balance: Collectively evaluated for impairment	415	154,383	154,798(1)
Ending balance: Contracts acquired with deteriorated credit quality			

(1) Total financing receivables include net investment in leases. For purposes of asset quality and allowance calculations, the allowance for credit losses is excluded.

Each period the provision for credit losses in the income statement results from the combination of an estimate by management of credit losses that occurred during the current period and the ongoing adjustment of prior estimates of losses occurring in prior periods.

To serve as a basis for making this provision, we maintain an internally developed proprietary scoring model that considers several factors including the lessee s bureau reported credit score at lease inception. We also consider other relevant factors including general economic trends, trends in delinquencies and credit losses, static pool analysis of our portfolio, trends in recoveries made on charged off accounts, and other relevant factors which might affect the performance of our portfolio. The combination of historical experience, credit scores, delinquency levels, trends in credit losses, and the review of current factors provide the basis for our analysis of the adequacy of the allowance for credit losses.

We assign internal risk ratings for all lessees and determine the credit worthiness of each lease based upon this internally developed proprietary scoring model. The LeaseComm portfolio is evaluated in total with a reserve of 50% of the outstanding amount greater than 90 days plus 25% of the amount outstanding from 1 to 89 days as that portfolio is decreasing. For the TimePayment portfolio, the scoring model generates one of nine acceptable risk ratings based upon the credit worthiness of each lease or it rejects the lease application. The scores are assigned at lease inception and these scores are maintained over the lease term regardless of payment performance. To facilitate review and reporting, management aggregates these nine scores into one of three categories with similar risk profiles and delinquency characteristics identified as Gold, Silver or Bronze.

Leases assigned a gold rating represent those transactions which exhibit the highest risk rating based on our internal credit scores. They are considered of sufficient quality to preclude an otherwise adverse rating. Gold rated leases are typically represented by lessees with high bureau reported credit scores at lease inception or are supported by established businesses for those transactions which are not personally guaranteed by the lessee.

Leases assigned a silver rating fall in the middle range of the nine acceptable scores generated by the scoring model. These transactions possess a reasonable amount of risk based on their profile and may exhibit vulnerability to deterioration if adverse factors are encountered. These accounts typically demonstrate adequate coverage but warrant a higher level of monitoring by management to ensure that weaknesses do not advance.

A bronze rating applies to leases at the lower end of the nine acceptable scores generated by the scoring model whereby the lessee may have difficulty meeting the lease obligation if adverse factors are encountered. Bronze rated transactions typically have lower reported credit scores at lease inception and will typically have other less desirable credit attributes.

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The following table presents the aging of the recorded investment in leases as of June 30, 2011, by our internally graded score:

	Current	Past Due	Total
TimePayment Corp.			
Grade			
Gold	$ 45,456	$ 3,625	$ 49,081
Silver	79,753	18,601	98,354
Bronze	4,485	2,463	6,948
Total	129,694	24,689	154,383
LeaseComm	183	232	415
Total	$129,877	$24,921	$154,798

The following table presents the aged analysis of past due financing receivables by our internally developed proprietary scoring model in leases as of June 30, 2011:

	Current	31 to 60 days Past Due	61 to 90 days Past Due	Over 90 Days Past Due	Total	Over 90 Days Accruing
LeaseComm:	$ 183	$ 11	$ 8	$ 213	$ 415	$ 213
TimePayment Corp.						
Gold	45,456	1,372	540	1,713	49,081	1,713
Silver	79,753	2,762	2,488	13,351	98,354	13,351
Bronze	4,485	261	294	1,908	6,948	1,908
TimePayment Corp. subtotal	129,694	4,395	3,322	16,972	154,383	16,972
Total	$129,877	$4,406	$3,330	$17,185	$154,798	$17,185
Percent of Total Financing Receivables	83.9%	2.8%	2.2%	11.1%	100%	

Fair Value of Financial Instruments

For financial instruments including cash and cash equivalents, restricted cash, accounts payable, and other liabilities, we believe that the carrying amount approximates fair value due to their short-term nature. The fair value of the revolving line of credit is calculated based on the incremental borrowing rates currently available on loans with similar terms and maturities. The fair value of our revolving line of credit at June 30, 2011 approximates its carrying value.

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Net Income Per Share

Basic net income per common share is computed based on the weighted-average number of common shares outstanding during the period. Diluted net income per common share gives effect to all potentially dilutive common shares outstanding during the period. The computation of diluted net income per share does not assume the issuance of common shares that have an antidilutive effect on net income per common share. At June 30, 2011 and 2010, 409,305 and 499,305 options, respectively, were excluded from the computation of diluted net income per share because their effect would have been antidilutive.

Net income per share for the three and six months ended June 30, 2011 and 2010 is as follows:

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Net income	$ 2,283	$ 1,301	$ 4,312	$ 1,866
Weighted average common shares outstanding	14,231,692	14,230,670	14,239,180	14,220,529
Dilutive effect of common stock options, warrants and restricted stock	272,010	221,905	256,565	212,006
Shares used in computation of net income per common share diluted	14,503,702	14,452,575	14,495,745	14,432,535
Net income per common share basic	$ 0.16	$ 0.09	$ 0.30	$ 0.13
Net income per common share diluted	$ 0.16	$ 0.09	$ 0.30	$ 0.13

Stock-Based Employee Compensation

Under our 2008 Equity Incentive Plan, we reserved 1,000,000 shares of common stock for issuance. In February 2011, under our 2008 Equity Incentive Plan the Compensation and Benefits Committee of our Board of Directors granted 33,044 restricted stock units to our executive officers. The restricted stock units vest over five years at 25% annually beginning on the second anniversary of the grant date. The restricted stock units were valued on the date of grant and the fair value of these awards was $4.11 per share. For the six months ended June 30, 2011 the expense related to these units is $11,000.

The following summarizes stock option activity for the six months ended June 30, 2011:

	Shares	Price Per Share	Weighted-Average Exercise Price
Outstanding at December 31, 2010	908,028	$ 1.585 to $13.10	$ 5.07
Granted			
Expired	(90,000)	$ 13.10	$ 13.10

Forfeited			
Outstanding at June 30, 2011	818,028	$ 1.585 to $6.70	$ 4.19

In February 2011, we granted our non-employee directors a total of 51,642 shares of stock with immediate vesting and a fair value of $4.11 per share, for a total grant date fair value of $212,249, in accordance with our director compensation policy. In February 2010, we granted our non-employee directors a total of 53,844 shares of stock with immediate vesting and a fair value of $3.15 per share, for a total grant date value of $169,609, in accordance with our director compensation policy.

During the six months ended June 30, 2011, 90,000 options originally granted to members of the Board of Directors in February 2001 expired. During the six months ended June 30, 2010, 350,000 options originally granted to members of the Board of Directors in February of 2000 expired. There were no options granted or exercised during the six months ended June 30, 2011.

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(Tables in thousands, except share and per share data)

The following table summarizes unvested restricted stock activity:

	Restricted Stock Number of Shares	Restricted Stock Units Number of Shares
Non-vested at December 31, 2010		$ 33,518
Granted	51,642	33,044
Vested	(51,642)	
Non-vested at June 30, 2011		66,562

During the three months ended June 30, 2011, amortized compensation expense related to the restricted stock units was $12,000. During the six months ended June 30, 2011, amortized compensation expense related to the restricted stock units was $22,000.

Information relating to our outstanding stock options at June 30, 2011 is as follows:

	Outstanding				Exercisable	
Exercise Price	Shares	Weighted-Average Life (Years)	Intrinsic Value	Weighted-Average Exercise Price	Shares	Intrinsic Value
$ 6.70	235,000	0.66		6.70	235,000	
1.59	150,000	1.41	$ 592	1.59	150,000	$ 592
5.77	31,923	5.67		5.77		
5.85	142,382	6.58		5.85	71,191	
2.30	258,723	7.67	836	2.30	64,681	209
	818,028	4.24	$ 1,428	4.56	520,872	$ 801

During the three months ended June 30, 2011 and 2010, the total share based employee compensation cost recognized was $33,000 and $35,000, respectively. During the six months ended June 30, 2011 and 2010, the total share based compensation cost recognized was $68,000 and $62,000, respectively.

Dividends

On January 21, 2011, we declared a dividend of $0.05 payable on February 15, 2011 to stockholders of record on February 1, 2011.

On April 21, 2011, we declared a dividend of $0.05 payable on May 13, 2011 to stockholders of record on May 2, 2011.

Cash and Cash Equivalents

We consider all highly liquid instruments purchased with original maturities of less than three months to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.

Concentration of Credit Risk

We deposit our cash and invest in short-term investments primarily through national commercial banks. Deposits in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC) are exposed to loss in the event of nonperformance by the institution. The Company maintains cash deposits in excess of the FDIC insurance coverage.

C. Revolving line of credit

On August 2, 2007, we entered into a three-year revolving line of credit with a bank syndicate led by Sovereign Bank (Sovereign) based on qualified TimePayment lease receivables. The total commitment under the facility was originally $30 million, and was subsequently increased to $60 million in July 2008, to $85 million in February 2009, and most recently to $100 million in connection with a July 2010 amendment. Outstanding borrowings are collateralized by eligible lease contracts and a security interest in all of our other assets. Prior to the July 2010 amendment, outstanding borrowings bore interest at Prime plus 1.75% or at a London Interbank Offered Rate

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(LIBOR) plus 3.75%, in each case subject to a minimum rate of 5.00%. Following the July 2010 amendment, outstanding borrowings bear interest at Prime plus 1.25% or LIBOR plus 3.25%, without being subject to any minimum rate. Under the terms of the facility, loans are Prime Rate Loans, unless we elect LIBOR Loans. If a LIBOR Loan is not renewed at maturity it automatically converts to a Prime Rate Loan.

As a part of the July 2010 amendment, the maturity date of the facility was extended to August 2, 2013. At our option upon maturity, the unpaid principal balance may be converted to a six-month term loan.

At June 30, 2011, $57.0 million of our loans were LIBOR loans and $2.6 million of our loans were Prime Rate Loans. The interest rate on our loans at June 30, 2011 was between 3.49% and 4.50%. The amount available on our revolving line of credit at June 30, 2011 was $40.4 million. The revolving line of credit has financial covenants that we must comply with to obtain funding and avoid an event of default. As of June 30, 2011, we were in compliance with all covenants under the revolving line of credit.

D. Commitments and Contingencies

Legal Matters

We are involved from time to time in litigation incidental to the conduct of our business. Although we do not expect that the outcome of any of these matters, individually or collectively, will have a material adverse effect on our financial condition or results of operations, litigation is inherently unpredictable. Therefore, judgments could be rendered, or settlements entered, that could adversely affect our operating results or cash flows in a particular period. We routinely assess all of our litigation and threatened litigation as to the probability of ultimately incurring a liability, and record our best estimate of the ultimate loss in situations where we access the likelihood of loss as probable.

Lease Commitments

We accept lease applications on a daily basis and, as a result, we have a pipeline of applications that have been approved, where a lease has not been originated. Our commitment to lend does not become binding until all of the steps in the lease origination process have been completed, including the receipt of the lease, supporting documentation and verification with the lessee. Since we fund on the same day a lease is verified, we do not have any outstanding commitments to lend.

Stock Repurchase

On August 10, 2010, our Board of Directors approved a common stock repurchase program under which we are authorized to purchase up to 250,000 of our outstanding shares from time to time. The repurchases may take place in either the open market or through block trades. The repurchase program will be funded by our working capital and may be suspended or discontinued at anytime.

During the first quarter of fiscal year 2011 we repurchased and retired 51,883 shares of our common stock under our stock buyback program. We did not repurchase any shares of our common stock during the second quarter of fiscal year 2011.

E. Subsequent Events

We have evaluated all events or transactions that occurred through the date on which we issued these financial statements. Other than the declaration of dividends we did not have any material subsequent events that impacted our consolidated financial statements.

On July 20, 2011, we declared a dividend of $0.05 payable on August 15, 2011 to shareholders of record on August 1, 2011.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tables in thousands, except share and per share data)

F. Recent Accounting Pronouncements

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures. This update provides amendments to FASB 820-10 Fair Value Measurements and Disclosures that require new disclosures as follows:

Transfers in and out of Levels 1 and 2. A reporting entry should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers.

Activity in level 3 fair value measurements.

A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities.

In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the rollforward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We adopted the provisions of ASU 2010-6 which are required for the current year and the adoption did not have a material effect on our consolidated financial position or results of operations.

In July 2010, the FASB issued ASU 2010-20 Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. This guidance expands the disclosures pertaining to the credit quality of loans and should provide users of the financial statements with a better overall understanding of the credit risk in the loan portfolio. This guidance is effective for interim and annual periods ending after December 15, 2010. We adopted the provisions of ASU 2010-20 during the year ended December 31, 2010. In connection with the adoption of ASU 2010-20 certain additional disclosure are required for reporting periods ending after December 31, 2010, related to the activity within the Company s portfolio segments. These disclosures have been included in these notes to unaudited condensed consolidated financial statements.

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

Introduction

The following information should be read in conjunction with our condensed consolidated financial statements and notes thereto in Part I, Item 1 of this Quarterly Report and with Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2010.

Forward-Looking Information

Statements in this document that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. In addition, words such as believes anticipates expects, intends and similar expressions are intended to identify forward-looking statements. We caution that a number of important factors could cause actual results to differ materially from those expressed in any forward-looking statements made by us or on our behalf. Such statements contain a number of risks and uncertainties, including but not limited to those associated with: the demand for the equipment types we finance; our significant capital requirements; our inability to obtain the financing we need, or to use internally generated funds, in order to continue originating contracts; the risks of defaults on our leases; our provision for credit losses; our residual interests in underlying equipment; possible adverse consequences associated with our collection policy; the effect of higher interest rates on our portfolio; increasing competition; increased governmental regulation of the rates and methods we use in financing and collecting on our leases and contracts; acquiring other portfolios or companies; dependence on key personnel; changes to accounting standards for equipment leases; adverse results in litigation and regulatory matters, or promulgation of new or enhanced legislation or regulations; and general economic and business conditions. Readers should not place undue reliance on forward-looking statements, which reflect our view only as of the date hereof. We undertake no obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances. We cannot assure that we will be able to anticipate or respond timely to changes which could adversely affect our operating results. Results of operations in any past period should not be considered indicative of results to be expected in future periods. Fluctuations in operating results may result in fluctuations in the price of our common stock. Statements relating to past dividend payments or our current dividend policy should not be construed as a guarantee that any future dividends will be paid. For a more complete description of the prominent risks and uncertainties inherent in our business, see the risk factors included in our most recent Annual Report on Form 10-K and other documents we file from time to time with the Securities and Exchange Commission.

Overview

We are a specialized commercial finance company that provides microticket equipment leasing and other financing services. The average amount financed by TimePayment during 2010 was approximately $5,800 compared to the 2011 year to date average of $6,100. LeaseComm historically financed contracts of approximately $1,900. Our existing portfolio consists of business equipment leased or rented primarily to small commercial enterprises.

We finance the funding of our leases and contracts primarily through cash provided by operating activities and borrowings on our revolving line of credit. On August 2, 2007, we entered into a three-year revolving line of credit with a bank syndicate led by Sovereign Bank (Sovereign) based on qualified TimePayment lease receivables. The total commitment under the facility was originally $30 million, and was subsequently increased to $60 million in July 2008, to $85 million in February 2009, and most recently to $100 million in connection with a July 2010 amendment. Outstanding borrowings are collateralized by eligible lease contracts and a security interest in all of our other assets. Prior to the July 2010 amendment, outstanding borrowings bore interest at Prime plus 1.75% or at a London Interbank Offered Rate (LIBOR) plus 3.75%, in each case subject to a minimum rate of 5.00%. Following the July 2010 amendment, outstanding borrowings bear interest at Prime plus 1.25% or LIBOR plus 3.25%, without being subject to any minimum rate. Under the terms of the facility, loans are Prime Rate Loans, unless we elect LIBOR Loans. If a LIBOR Loan is not renewed at maturity it automatically converts to a Prime

Rate Loan. As a part of the July 2010 amendment, the maturity date of the facility was extended to August 2, 2013. At our option upon maturity, the unpaid principal balance may be converted to a six-month term loan.

In a typical lease transaction, we originate a lease through our nationwide network of equipment vendors, independent sales organizations and brokers. Upon our approval of a lease application and verification that the lessee has received the equipment and signed the lease, we pay the dealer for the cost of the equipment, plus the dealer s profit margin.

Substantially all leases originated or acquired by us are non-cancelable. During the term of the lease, we are scheduled to receive payments sufficient to cover our borrowing costs and the cost of the underlying equipment and provide us with an appropriate profit. We pass along some of the costs of our leases and contracts by charging late fees, prepayment penalties, loss and damage waiver fees and other service fees, when applicable. Collection fees are imposed based on our estimate of the costs of collection. The loss and damage waiver fees are charged if a customer fails to provide proof of insurance and are reasonably related to the cost of replacing the lost or damaged equipment or product. The initial non-cancelable term of the lease is equal to or less than the equipment s estimated economic life and often provides us with additional revenues based on the residual value of the equipment at the end of the lease. Initial terms of the leases in our portfolio generally range from 12 to 60 months, with an average initial term of 45 months as of December 31, 2010.

Critical Accounting Policies

Our significant accounting policies are more fully described in Note B to the condensed consolidated financial statements included in this Quarterly Report and in Note B to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the Securities and Exchange Commission. Certain accounting policies are particularly important to the portrayal of our consolidated financial position and results of operations. These policies require the application of significant judgment by us and as a result, are subject to an inherent degree of uncertainty. In applying these policies, we make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosures. We base our estimates and judgments on historical experience, terms of existing contracts, observance of trends in the industry, information obtained from dealers and other sources, and on various other assumptions that we believe to be reasonable and appropriate under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Our critical accounting policies, including revenue recognition, the allowance for credit losses, determining for income taxes, and accounting for share-based compensation are each discussed in more detail in our Annual Report on Form 10-K. We have reviewed those policies and determined that they remain our critical accounting policies and that we did not make any changes in those policies during the six months ended June 30, 2011.

Results of Operations Three months ended June 30, 2011 compared to the three months ended June 30, 2010

Revenue

	Three Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Income on financing leases	$ 9,136	7.4%	$ 8,509
Rental income	2,073	8.0	1,920
Income on service contracts	103	(22.0)	132
Loss and damage waiver fees	1,220	9.0	1,119
Service fees and other income	931	(1.1)	941
Total revenues	$ 13,463	6.7%	$ 12,621

Our lease contracts are accounted for as financing leases. At origination, we record the gross lease receivable, the estimated residual value of the leased equipment, initial direct costs incurred and the unearned lease income. Unearned lease income is the amount by which the gross lease receivable plus the estimated residual value exceeds the cost of the equipment. Unearned lease income and initial direct costs incurred are amortized over the related lease term using the interest method. Other revenues such as loss and damage waiver fees, service fees relating to the leases and contracts, and rental revenues are recognized as they are earned.

Total revenues for the three months ended June 30, 2011 were $13.5 million, an increase of $800,000, or 6.7%, from the three months ended June 30, 2010. The overall increase was due to an increase of $600,000 in income on financing leases, an increase of $200,000 in rental income, an increase of $91,000 in fees and other income, partially offset by a decrease of $29,000 in income on service contracts. The increase in income on financing leases is a result of the continued growth in new lease originations. The increase in rental income is the result of TimePayment lease contracts coming to term and converting to rentals. Service contact revenue continues to decline since we have not funded any new service contracts since 2004.

Selling, General and Administrative Expenses

	Three Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Selling, general and administrative	$4,037	12.7%	$3,581
As a percent of revenue	30.0%		28.3%

Our selling, general and administrative (SG&A) expenses include costs of maintaining corporate functions including accounting, finance, collections, legal, human resources, sales and underwriting, and information systems. SG&A expenses also include service fees and other marketing costs associated with our portfolio of leases and rental contracts. SG&A expenses increased by $456,000 for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010. The increase was primarily driven by increases in compensation expense of $147,000, increases of employee benefits of $145,000, and a $70,000 increase in rent expense associated with the opening of our California office location. The number of employees as of June 30, 2011 was 129 compared to 113 as of June 30, 2010.

Provision for Credit Losses

	Three Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Provision for credit losses	$4,251	(23.6)%	$5,562
As a percent of revenue	31.6%		44.1%

We maintain an allowance for credit losses on our investment in leases, service contracts and rental contracts at an amount that we believe is sufficient to provide adequate protection against losses in our portfolio. Our provision for credit losses decreased by $1.3 million for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010, while net charge-offs decreased by 28.3% to $4.3 million. The provision was based on providing a general allowance on leases funded during the period and our analysis of actual and expected losses in our portfolio. The decrease in the allowance reflects improvements in delinquency levels of the lease portfolio.

Depreciation and Amortization

	Three Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Depreciation fixed assets	$ 121	9.0%	$ 111
Depreciation rental equipment	662	82.4	363
Total depreciation and amortization	$ 783	65.2	$ 474
As a percent of revenue	5.8%		3.8%

Depreciation and amortization expense consists of depreciation on fixed assets and rental equipment. Fixed assets are recorded at cost and depreciated over their expected useful lives. Certain rental contracts are originated as a result of the renewal provisions of our lease agreements where at the end of lease term, the customer may elect to continue to rent the leased equipment on a month-to-month basis. The rental equipment is recorded at its residual value and depreciated over a term of 12 months. This term represents the estimated life of a previously leased piece of equipment and is based upon our historical experience. In the event the contract terminates prior to the end of the 12 month period, the remaining net book value is expensed.

Depreciation expense on rental contracts increased by $299,000 as compared to the three months ended June 30, 2011, as compared to the three months ended June 30, 2010. The increase in depreciation is due to the increase in the overall size of our portfolio of rental equipment. Depreciation and amortization of property and equipment increased by $10,000 for the three months ended June 30, 2011, due to additions acquired during 2011, as compared to the three months ended June 30, 2010.

Interest Expense

	Three Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Interest	$680	(23.2)%	$885
As a percent of revenue	5.1%		7.0%

We pay interest on borrowings under our senior credit facility. Interest expense decreased by $200,000 for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010. This decrease resulted primarily from our decreased level of borrowings as well as lower interest costs on our revolving line of credit. At June 30, 2011, the balance on our revolving line of credit was $59.6 million compared to $59.0 million at June 30, 2010. However, until the July 2010 amendment to the line of credit, a minimum 5% interest rate applied to outstanding borrowings. No such limit exists under the amended current line of credit. At June 30, 2011, $57.0 million of our loans were LIBOR loans and $2.6 million of our loans were Prime Rate Loans. The interest rate on our loans at June 30, 2011 was between 3.49% and 4.50%.

Provision for Income Taxes

	Three Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Provision for income taxes	$1,429	74.7%	$ 818
As a percent of revenue	10.6%		6.5%
As a percent of income before taxes	38.5%		38.6%

The provision for income taxes, deferred tax assets and liabilities and any necessary valuation allowance recorded against net deferred tax assets, involves summarizing temporary differences resulting from the different treatment of items, such as leases, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet. We then assess the likelihood that deferred tax assets will be recovered from future taxable income or tax carry-back availability and to the extent we believe recovery is more likely than not, a valuation allowance is unnecessary. The provision for income taxes increased by $611,000 for the three months ended June 30, 2011, as compared to the three months ended June 30, 2010. This increase resulted primarily from the $1.6 million increase in pre-tax income for the three months ended June 30, 2010 to the three months ended June 30, 2011.

As of December 31, 2010, we had a liability of $15,000 for unrecognized tax benefits and a liability of $6,000 for accrued interest and penalties related to various state income tax matters. As of June 30, 2011 we had a liability of $17,000 for unrecognized tax benefits and a liability of $4,000 for accrued interest and penalties related to various state income tax matters. The change in the unrecognized tax benefit relates to the closing of an audit and the notification of a new audit. It is reasonably possible that the total amount of unrecognized tax benefits may change significantly within the next 12 months; however, at this time we are unable to estimate the change.

Our federal income tax returns are subject to examination for tax years ended on or after December 31, 2007 and our state income tax returns are subject to examination for tax years ended on or after December 31, 2006.

Other Operating Data

Dealer funding was $18.7 million for the three months ended June 30, 2011, a decrease of $2.2 million or 10.6%, compared to the three months ended June 30, 2010. We continue to concentrate on our business development efforts, which include increasing the size of our vendor base and sourcing a larger number of applications from those vendors. Receivables due in installments, estimated residual values, net investment in service contracts and investment in rental contracts increased from $216.9 million at March 31, 2011 to $218.9 million at June 30, 2011. Net cash provided by operating activities increased by $3.3 million, or 18.4%, to $21.2 million during the three months ended June 30, 2011 as compared to the three months ended June 30, 2010.

Results of Operations Six months ended June 30, 2011 compared to the six months ended June 30, 2010

Revenue

	Six Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Income on financing leases	$ 18,237	9.7%	$ 16,631
Rental income	4,079	5.2	3,878
Income on service contracts	211	(22.7)	273
Loss and damage waiver fees	2,421	8.9	2,223
Service fees and other income	1,863	(3.7)	1,934
Total revenues	$ 26,811	7.5%	$ 24,939

Our lease contracts are accounted for as financing leases. At origination, we record the gross lease receivable, the estimated residual value of the leased equipment, initial direct costs incurred and the unearned lease income. Unearned lease income is the amount by which the gross lease receivable plus the estimated residual value exceeds the cost of the equipment. Unearned lease income and initial direct costs incurred are amortized over the related lease term using the interest method. Other revenues such as loss and damage waiver fees, service fees relating to the leases and contracts, and rental revenues are recognized as they are earned.

Total revenues for the six months ended June 30, 2011 were $26.8 million, an increase of $1.9 million, or 7.5%, from the six months ended June 30, 2010. The overall increase was due to an increase of $1.6 million in income on financing leases, an increase of $200,000 in rental income, and a $100,000 increase in fees and other income, partially offset by a decrease of $62,000 in service contracts. The increase in income on financing leases is a result of the continued growth in new lease originations. The increase in rental income is the result of TimePayment lease contracts coming to term and converting to rentals. Service contact revenue continues to decline since we have not funded any new service contracts since 2004.

Selling, General and Administrative Expenses

	Six Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Selling, general and administrative	$7,990	17.3%	$6,811
As a percent of revenue	29.8%		27.3%

Our selling, general and administrative (SG&A) expenses include costs of maintaining corporate functions including accounting, finance, collections, legal, human resources, sales and underwriting, and information systems. SG&A expenses also include service fees and other marketing costs associated with our portfolio of leases and rental contracts. SG&A expenses increased by $1.2 million for the six months ended June 30, 2011, as compared to the six months ended June 30, 2010. The increase was primarily driven by increases in payroll and payroll taxes of $600,000, an increase in employee benefits of $200,000 and an increase of $100,000 in rent expense associated with the opening of our California office.

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Provision for Credit Losses

	Six Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Provision for credit losses	$9,003	(27.9)%	$12,493
As a percent of revenue	33.6%		50.1%

We maintain an allowance for credit losses on our investment in leases, service contracts and rental contracts at an amount that we believe is sufficient to provide adequate protection against losses in our portfolio. Our provision for credit losses decreased by $3.5 million for the six months ended June 30, 2011, as compared to the six months ended June 30, 2010, while net charge-offs decreased by 28.5% to $9.2 million. The provision is based on providing a general allowance on leases funded during the period and our analysis of actual and expected losses in our portfolio. The decrease in the allowance reflects improvements in delinquency levels of the lease portfolio and a reduction in charge-off levels.

Depreciation and Amortization

	Six Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Depreciation fixed assets	$ 241	6.2%	$ 227
Depreciation rental equipment	1,223	81.2	675
Total depreciation and amortization	$ 1,464	62.3%	$ 902
As a percent of revenue	5.5%		3.6%

Depreciation and amortization expense consists of depreciation on fixed assets and rental equipment, and the amortization of service contracts. Fixed assets are recorded at cost and depreciated over their expected useful lives. Certain rental contracts are originated as a result of the renewal provisions of our lease agreements where at the end of lease term, the customer may elect to continue to rent the leased equipment on a month-to-month basis. The rental equipment is recorded at its residual value and depreciated over a term of 12 months. This term represents the estimated life of a previously leased piece of equipment and is based upon our historical experience. In the event the contract terminates prior to the end of the 12 month period, the remaining net book value is expensed.

Depreciation expense on rental contracts increased by $600,000 for the six months ended June 30, 2011, as compared to the six months ended June 30, 2010. The increase in depreciation is due to the increase in the overall size of our portfolio of rental equipment. Depreciation and amortization of property and equipment increased by $14,000 for the six months ended June 30, 2011, due to additions acquired during 2011 as compared to the six months ended June 30, 2010.

Interest Expense

	Six Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Interest	$1,343	(20.8)%	$1,696
As a percent of revenue	5.0%		6.8%

We pay interest on borrowings under our senior credit facility. Interest expense decreased by $400,000 for the six months ended June 30, 2011, as compared to the six months ended June 30, 2010. This decrease resulted primarily from our decreased level of borrowings as well as lower interest costs on our revolving line of credit. At June 30, 2011, the balance on our revolving line of credit was $59.6 million compared to $59.0 million at June 30, 2010. However, until the July 2010 amendment to the line of credit, a minimum 5% interest rate applied to outstanding borrowings. No such limit exists under the amended current line of credit. At June 30, 2011, $57.0 million of our loans were LIBOR loans and $2.6 million of our loans were Prime Rate Loans. The interest rate on our loans at June 30, 2011 was between 3.49% and 4.50%.

Provision for Income Taxes

	Six Months Ended June 30,		
	2011	Change	2010
	(Dollars in thousands)		
Provision for income taxes	$2,699	130.5%	$1,171
As a percent of revenue	10.1%		4.7%
As a percent of income before taxes	38.5%		38.6%

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The provision for income taxes, deferred tax assets and liabilities and any necessary valuation allowance recorded against net deferred tax assets, involves summarizing temporary differences resulting from the different treatment of items, such as leases, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded on the balance sheet. We then assess the likelihood that deferred tax assets will be recovered from future taxable income or tax carry-back availability and to the extent we believe recovery is more likely than not, a valuation allowance is unnecessary. The provision for income taxes increased by $1.5 million for the six months ended June 30, 2011, as compared to the six months ended June 30, 2010. This increase resulted primarily from the $4.0 increase in pre-tax income.

As of December 31, 2010, we had a liability of $15,000 for unrecognized tax benefits and a liability of $6,000 for accrued interest and penalties related to various state income tax matters. As of June 30, 2011 we had a liability of $17,000 for unrecognized tax benefits and a liability of $4,000 for accrued interest and penalties related to various state income tax matters. The change in the unrecognized tax benefit relates to the closing of an audit and the opening of a new one. It is reasonably possible that the total amount of unrecognized tax benefits may change significantly within the next 12 months; however, at this time we are unable to estimate the change.

Our federal income tax returns are subject to examination for tax years ended on or after December 31, 2007 and our state income tax returns are subject to examination for tax years ended on or after December 31, 2006.

Other Operating Data

Dealer funding was $37.1 million for the six months ended June 30, 2011, a decrease of $2.0 million or 5.1%, compared to the six months ended June 30, 2010. We continue to concentrate on our business development efforts, which include increasing the size of our vendor base and sourcing a larger number of applications from those vendors. Receivables due in installments, estimated residual values, net investment in service contracts and investment in rental contracts increased from $215.7 million at December 31, 2010 to $218.9 million at June 30, 2011. Net cash provided by operating activities increased by $6.8 million, or 19.4%, to $41.8 million during the six months ended June 30, 2011 as compared to the six months ended June 30, 2010.

Exposure to Credit Losses

The amounts in the table below represent the balance of delinquent receivables on an exposure basis for all leases, rental contracts, and service contracts in our portfolio. An exposure basis aging classifies the entire receivable based on the invoice that is the most delinquent. For example, in the case of a rental or service contract, if a receivable is 90 days past due, all amounts billed and unpaid are placed in the over 90 days past due category. In the case of lease receivables, where the minimum contractual obligation of the lessee is booked as a receivable at the inception of the lease, if a receivable is 90 days past due, the entire receivable, including all amounts billed and unpaid as well as the minimum contractual obligation yet to be billed, will be placed in the over 90 days past due category.

(dollars in thousands)	June 30, 2011		December 31, 2010	
Current	$164,584	85.1%	$160,674	84.1%
31-60 days past due	5,535	2.9	6,142	3.2
61-90 days past due	4,026	2.1	4,369	2.3
Over 90 days past due	19,200	9.9	19,882	10.4
Gross receivables due in installments	$193,345	100.0%	$191,067	100.0%

Liquidity and Capital Resources

General

Our lease and finance business is capital-intensive and requires access to substantial short-term and long-term credit to fund lease originations. Since inception, we have funded our operations primarily through borrowings under our credit facilities, on-balance sheet securitizations, the issuance of subordinated debt, free cash flow and our initial public offering completed in February 1999. We will continue to require significant additional capital to maintain and expand our funding of leases and contracts, as well as to fund any future acquisitions of leasing companies or portfolios. In the near term, we expect to finance our business utilizing the cash on hand, free cash flow, and our line of credit which matures in August 2013. Additionally, our uses of cash include the payment of interest and principal on borrowings, selling, general and administrative expenses, income taxes and capital expenditures.

For the six months ended June 30, 2011 and 2010, our primary sources of liquidity were cash provided by operating activities and borrowings on our revolving line of credit. We generated cash flow from operations of $41.8 million for the six months ended June 30, 2011 compared to $35.0 million for the six months ended June 30, 2010. At June 30, 2011, we had approximately $59.6 million outstanding under our revolving line of credit facility and had available borrowing capacity of approximately $40.4 million as described below.

We used net cash in investing activities of $37.9 million during the six months ended June 30, 2011 and $39.5 million for the six months ended June 30, 2010. Investing activities primarily relate to the origination of leases.

Net used in financing activities was $5.0 million for the six months ended June 30, 2011 and net cash provided by financing activities was $5.6 million for the six months ended June 30, 2010. Financing activities primarily consist of the borrowings and repayments under our revolving line of credit facility and dividend payments.

The maturity date of our revolving line of credit is August 2013, at which time the outstanding loan balance plus interest becomes due and payable. At our option upon maturity, the unpaid principal balance may be converted to a six-month term loan.

Borrowings

We utilize our revolving line of credit to fund the origination and acquisition of leases that satisfy the eligibility requirements established pursuant to the facility. Borrowings outstanding consist of the following:

	June 30, 2011				December 31, 2010			
(dollars in 000)	Amounts Outstanding	Interest Rate	Unused Capacity	Maximum Facility Amount	Amounts Outstanding	Interest Rate	Unused Capacity	Maximum Facility Amount
Revolving line of credit facility [(1)]	$59,574	3.49-4.50%	$40,426	$100,000	$62,650	3.52-4.50%	$37,350	$100,000

(1) The unused capacity is subject to the borrowing base formula.

On August 2, 2007, we entered into a three-year revolving line of credit with a bank syndicate led by Sovereign Bank (Sovereign) based on qualified TimePayment lease receivables. The total commitment under the facility was originally $30 million, and was subsequently increased to $60 million in July 2008, to $85 million in February 2009, and most recently to $100 million in connection with a July 2010 amendment. Outstanding borrowings are collateralized by eligible lease contracts and a security interest in all of our other assets. Prior to the July 2010 amendment, outstanding borrowings bore interest at Prime plus 1.75% or at a London Interbank Offered Rate (LIBOR) plus 3.75%, in each case subject to a minimum rate of 5.00%. Following the July 2010 amendment, outstanding borrowings bear interest at Prime plus 1.25% or LIBOR plus 3.25%, without being subject to any minimum rate. Under the terms of the facility, loans are Prime Rate Loans, unless we elect LIBOR Loans. If a LIBOR Loan is not renewed at maturity it automatically converts to a Prime Rate Loan. As a part of the July 2010 amendment, the maturity date of the facility was extended to August 2, 2013. At our option upon maturity, the unpaid principal balance may be converted to a six-month term loan. At June 30, 2011, $57.0 million of our loans were LIBOR Loans and $2.6 million of our loans were Prime Rate Loans. The interest rate on the revolving line of credit was between 3.49% and 4.50% at June 30, 2011. As of June 30, 2011, the qualified lease receivables eligible under the borrowing base exceeded the $100 million revolving line of credit.

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Dividends

On July 20, 2011, we declared a dividend of $0.05 payable on August 15, 2011 to shareholders of record on August 1, 2011. On April 21, 2011, we declared a dividend of $0.05 payable on May 13, 2011 to stockholders of record on May 2, 2011. On January 21, 2011 we declared a dividend of $0.05 payable on February 15, 2011 to stockholders of record on February 1, 2011.

On January 22, 2010 we declared a dividend of $0.05 payable on February 15, 2010 to shareholders of record on February 1, 2010. On April 20, 2010, we declared a dividend of $0.05 payable on May 14, 2010 to shareholders of record on May 3, 2010.

Future dividend payments are subject to ongoing review and evaluation by our Board of Directors. The decision as to the amount and timing of future dividends, if any, will be made in light of our financial condition, capital requirements and growth plans, as well as our external financing arrangements and any other factors our Board of Directors may deem relevant. We can give no assurance as to the amount and timing of future dividends.

Share repurchases

On August 10, 2010, our Board of Directors approved a common stock repurchase program under which we are authorized to purchase up to 250,000 of our outstanding shares from time to time. The repurchases may take place in either the open market or through block trades. The repurchase program will be funded by our working capital and may be suspended or discontinued at anytime. During the quarter ended March 31, 2011 we repurchased and retired 51,883 shares of our common stock under our stock buyback program, at a total cost of $241,000. During the quarter ended June 30, 2011 we did not repurchase any shares.

Contractual Obligations and Lease Commitments

Contractual Obligations

We have entered into various agreements, such as debt and operating lease agreements that require future payments. For the six months ended June 30, 2011 we had borrowed $48.7 million against our revolving line of credit and had repaid $51.8 million. The $59.6 million of outstanding borrowings as of June 30, 2011 will be repaid by the daily application of TimePayment receipts to our outstanding balance.

Our future minimum cash lease payments under non-cancelable operating leases are as follows:

	2011	2012	2013	2014	2015	Thereafter
Operating lease obligations	$153	$622	$644	$638	$595	$1,587

Lease Commitments

We accept lease applications on a daily basis and have a pipeline of applications that have been approved, where a lease has not been originated. Our commitment to lend does not become binding until all of the steps in the lease origination process have been completed, including but not limited to the receipt of a complete and accurate lease document, all required supporting information and successful verification with the lessee. Since we fund on the same day a lease is successfully verified, we have no firm outstanding commitments to lend.

Recent Accounting Pronouncements

See Note F of the notes to the unaudited condensed consolidated financial statements for a discussion of the impact of recent accounting pronouncements.

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ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

The following discussion about our risk management activities includes forward-looking statements that involve risk and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. In the normal course of operations, we also face risks that are either non-financial or non-quantifiable. Such risks principally include credit risk and legal risk, and are not represented in the analysis that follows.

The implicit yield on all of our leases and contracts is on a fixed interest rate basis due to the leases and contracts having scheduled payments that are fixed at the time of origination. When we originate or acquire leases or contracts, we base our pricing in part on the spread we expect to achieve between the implicit yield on each lease or contract and the effective interest rate we expect to incur in financing such lease or contract through our credit facility. Increases in interest rates during the term of each lease or contract could narrow or eliminate the spread, or result in a negative spread.

Given the relatively short average life of our leases and contracts, our goal is to maintain a blend of fixed and variable interest rate obligations which limits our interest rate risk. As of June 30, 2011, we have repaid all of our fixed-rate debt and have $59.6 million of outstanding variable interest rate obligations under our revolving line of credit.

Our revolving line of credit bears interest at rates which fluctuate with changes in the Prime Rate or LIBOR; therefore, our interest expense is sensitive to changes in market interest rates. The effect of a 10% adverse change in market interest rates, sustained for one year, on our interest expense would be immaterial.

We maintain an investment portfolio in accordance with our investment policy guidelines. The primary objectives of the investment guidelines are to preserve capital, maintain sufficient liquidity to meet our operating needs, and to maximize return. We minimize investment risk by limiting the amount invested in any single security and by focusing on conservative investment choices with short terms and high credit quality standards. We do not use derivative financial instruments or invest for speculative trading purposes.

ITEM 4. Controls and Procedures

Disclosure controls and procedures: As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b). Based upon the evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

Internal control over financial reporting: During the fiscal quarter ended June 30, 2011, no changes were made in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II Other Information

ITEM 1. Legal Proceedings

We are involved from time to time in litigation incidental to the conduct of our business. Although we do not expect that the outcome of any of these matters, individually or collectively, will have a material adverse effect on our financial condition or results of operations, litigation is inherently unpredictable. Therefore, judgments could be rendered, or settlements entered, that could adversely affect our operating results or cash flows in a particular period. We routinely assess all of our litigation and threatened litigation as to the probability of ultimately incurring a liability, and record our best estimate of the ultimate loss in situations where we assess the likelihood of loss as probable.

ITEM 1A. Risk Factors

For a discussion of the material risks that we face relating to our business, financial performance and industry, as well as other risks that an investor in our common stock may face, see the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010. The risks described in our Annual Report on Form 10-K and elsewhere in this report are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business, financial condition or operating results.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the quarter ended June 30, 2011 we did not repurchase any shares of our common stock under our stock buyback program.

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ITEM 6. Exhibits
(a) Exhibits index

3.1	Restated Articles of Organization, as amended (incorporated by reference to Exhibit 3.1 in the Registrant s Registration Statement on Form S-1, No. 333-56639, filed with the Securities and Exchange Commission on June 9, 1998).
3.2	Restated Bylaws, as amended (incorporated by reference to Exhibit 3.2 in the Registrant s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2007).
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101**	The following materials from the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Balance Sheets as of June 30, 2011 and December 31, 2010, (ii) Condensed Consolidated Statements of Income for the three and six months ended June 30, 2011 and 2010, (iii) Consolidated Statements of Stockholders Equity as of June 30, 2011 and December 31, 2010, (iv) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2011 and 2010, (iv) Condensed Consolidated Statements of Stockholders Equity as of June 30, 2011 and December 31, 2010 and 2009 and (v) Notes to Consolidated Financial Statements, tagged as blocks of text.

* Filed herewith

** Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections

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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, thereunto duly authorized.

MicroFinancial Incorporated

By: /s/ Richard F. Latour
President and Chief Executive Officer

By: /s/ James R. Jackson Jr.
Vice President and Chief Financial Officer

Date: August 15, 2011

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Issued

Treasury

Outstanding

Preferred Stock

Common Stock

Additional Paid-In Capital

Navient's Subsidiary Investment

Accumulated
Other
Comprehensive
Income (Loss)

Retained Earnings

Treasury Stock

Total SLM Corporation Equity

Non-controlling interest

Total Equity
Balance at June 30, 2014

7,300,000

423,295,249

(358,771
)

422,936,478

$
565,000

$
84,659

$
1,071,916

$
—

$
(365
)

$
20,167

$
(3,113
)

$
1,738,264

$
—

$
1,738,264

Net income

—

—

—

—

—

—

—

—

—

82,926

—

82,926

—

82,926

Other comprehen-sive loss, net of tax

—

—

—

—

—

—

—

—

(1,487
)

—

—

(1,487
)

—

(1,487
)
Total comprehensive income

—

—

—

—

—

—

—

—

—

—

—

81,439

—

81,439

Cash dividends:

Preferred Stock, series A ($.87 per share)

—

—

—

—

—

—

—

—

—

(2,875
)

—

(2,875
)

—

(2,875
)
Preferred Stock, series B ($.49 per share)

—

—

—

—

—

—

—

—

—

(1,975
)

—

(1,975
)

—

(1,975
)
Dividend equivalent units related to employee stock-based compensation plans

—

—

—

—

—

—

33

—

—

(33
)

—

—

—

—

Issuance of common shares

—

584,787

—

584,787

—

118

2,047

—

—

—

—

2,165

—

2,165

Stock-based compensation expense

—

—

—

—

—

—

4,505

—

—

—

—

4,505

—

4,505

Shares repurchased related to employee stock-based compensation plans

—

—

(356,622
)

(356,622
)

—

—

—

—

—

—

(3,095
)

(3,095

)

—

(3,095
)
Balance at September 30, 2014

7,300,000

423,880,036

(715,393
)

423,164,643

$
565,000

$
84,777

$
1,078,501

$
—

$
(1,852
)

$
98,210

$
(6,208
)

$
1,818,428

$
—

$
1,818,428

See accompanying notes to consolidated financial statements.

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SLM CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(In thousands, except share and per share amounts)
(Unaudited)

	Navient's Subsidiary Investment	Accumulated Other Comprehensive Income (Loss)	Total SLM Corporation Equity	Non-controlling interest	Total Equity
Balance at December 31, 2012	$1,068,928	$ 14,348	$1,083,276	$ 6,025	$1,089,301
Net income (loss)	198,743		198,743	(1,020)	197,723
Other comprehensive income, net of tax	—	25,687	25,687	—	25,687
Total comprehensive (loss)	—	—	224,430	(1,020)	223,410
Net transfers to affiliate	(139,539)	—	(139,539)	—	(139,539)
Balance at September 30, 2013	$1,128,132	$ 40,035	$1,168,167	$ 5,005	$1,173,172

See accompanying notes to consolidated financial statements.

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SLM CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(In thousands, except share and per share amounts)(Unaudited)

		Common Stock Shares								
	Preferred Stock Shares	Issued	Treasury	Outstanding	Preferred Stock	Common Stock	Additional Paid-In Capital	Navient's Subsidiary Investment	Accumulated Other Comprehensi Income (Loss)	Re Ear
Balance at December 31, 2013	—	—	—	—	$—	$—	$—	$1,164,495	$(3,024)	$—
Net income (loss)	—	—	—	—	—	—	—	68,173	—	106
Other comprehensive income, net of tax	—	—	—	—	—	—	—	—	1,172	—
Total comprehensive income (loss)	—	—	—	—	—	—	—	—	—	—
Net transfers from affiliate	—	—	—	—	—	—	—	479,409	—	—
Separation adjustments related to Spin-Off of Navient Corporation	7,300,000	422,790,320	—	422,790,320	565,000	84,558	1,062,519	(1,712,077)	—	—
Sale of non-controlling interest	—	—	—	—	—	—	—	—	—	—
Cash dividends:										
Preferred Stock, series A ($.87 per share)	—	—	—	—	—	—	—	—	—	(4,
Preferred Stock, series B ($.49 per share)	—	—	—	—	—	—	—	—	—	(3,
Dividend equivalent units related to employee stock-based compensation plans	—	—	—	—	—	—	41	—	—	(41
Issuance of common shares	—	1,089,716	—	1,089,716	—	219	4,391	—	—	—

Stock-based compensation expense	—	—	—	—	—	—	11,550	—	—	—
Shares repurchased related to employee stock-based compensation plans	—	—	(715,393)	(715,393)	—	—	—	—	—	—
Balance at September 30, 2014	7,300,000	423,880,036	(715,393)	423,164,643	$565,000	$84,777	$1,078,501	$—	$(1,852)	$9

See accompanying notes to consolidated financial statements.

SLM CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2014	2013
Operating activities		
Net income	$174,068	$197,723
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	55,071	40,081
Tax provision	115,502	122,011
Amortization of FDIC fees	—	1,046
Amortization of brokered deposit placement fee	7,548	7,128
Amortization of deferred loan origination costs and fees, net	1,446	753
Net amortization (accretion) of discount on investments	433	(6,442)
Depreciation of premises and equipment	2,326	2,977
Amortization and impairment of acquired intangibles	4,145	3,085
Stock-based compensation expense	20,127	12,420
Interest rate swap	1,307	(641)
Gains on sale of loans, net	(120,963)	(192,097)
Changes in operating assets and liabilities:		
Net decrease in loans held for sale	6,448	2,674
Origination of loans held for sale	(6,448)	(2,674)
Increase in accrued interest receivable	(220,273)	(184,590)
(Increase) decrease in other interest-earning assets	(47,836)	87
(Increase) decrease in other assets	11,499	8,148
Decrease in income tax payable	(294,116)	(209,362)
Increase (decrease) in accrued interest payable	2,639	(130)
Increase in payable due to Navient	18,114	228,243
Increase (decrease) in other liabilities	30,741	(23,584)
Total adjustments	(412,290)	(190,867)
Total net cash (used in) provided by operating activities	(238,222)	6,856
Investing activities		
Loans acquired and originated	(38,165)	(274,975)
Net proceeds from sales of loans held for investment	1,994,017	2,428,404
Net increase in loans held for investment	(2,932,369)	(2,809,567)
Purchases of available-for-sale securities	(55,928)	(33,037)
Proceeds from sales and maturities of available-for-sale securities	7,337	14,313
Total net cash used in investing activities	(1,025,108)	(674,862)
Financing activities		
Brokered deposit placement fee	(5,533)	—
Net decrease in brokered certificates of deposit	(601,685)	(552,908)
Net (decrease) increase in NOW account deposits	(18,214)	6,558
Net (decrease) increase in High Yield Savings Deposits	(39,359)	22,083
Net (decrease) increase in Retail Certificates of Deposit	(13,268)	27,759
Net increase in MMDA deposits	862,447	927,997

Net decrease in deposits with entity that is a subsidiary of Navient	(5,633)	(122,870)
Special cash contribution from Navient	472,718	—
Net capital contributions from entity that is a subsidiary of Navient	7,448	28,164
Preferred stock dividends paid	(8,078)	—
Dividend paid to entity that is a subsidiary of Navient	—	(120,000)
Net cash provided by financing activities	650,843	216,783
Net decrease in cash and cash equivalents	(612,487)	(451,223)

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Cash and cash equivalents at beginning of period	2,182,865	1,599,082
Cash and cash equivalents at end of period	$1,570,378	$1,147,859
Cash disbursements made for:		
Interest	$64,987	$58,573
Income taxes paid	$294,116	$209,362

See accompanying notes to consolidated financial statements.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, unless otherwise noted)

1. Significant Accounting Policies

Basis of Presentation

The financial reporting and accounting policies of SLM Corporation (“Sallie Mae,” “SLM,” the “Company,” “we” or “us”) conform to generally accepted accounting principles in the United States of America (“GAAP”). In conjunction with the Spin-Off (as herein after defined), our consolidated financial statements are comprised of financial information relating to Sallie Mae Bank (the “Bank”), Upromise, Inc. ("Upromise") and the Private Education Loan origination functions. We use “Private Education Loans” to mean education loans to students or their families that are non-federal loans and loans not insured or guaranteed under the previously existing Federal Family Education Loan Program (“FFELP”). Also included in our financial statements, for periods before the Spin-Off, are certain general corporate overhead expenses allocated to the Company.

On April 30, 2014, we completed our plan to legally separate into two distinct publicly traded entities - an education loan management, servicing and asset recovery business, Navient Corporation (“Navient”), and a consumer banking business, SLM Corporation. The separation of Navient from SLM Corporation (the “Spin-Off”) was preceded by an internal corporate reorganization, which was the first step to separate the education loan management, servicing and asset recovery business from the consumer banking business. As a result of a holding company merger under Section 251(g) of the Delaware General Corporation Law (“DGCL”), which is referred to herein as the “SLM Merger,” all of the shares of then existing SLM Corporation’s common stock were converted, on a 1-to-1 basis, into shares of common stock of New BLC Corporation, a newly formed company that was a subsidiary of pre-Spin-Off SLM Corporation (“pre-Spin-Off SLM”), and, pursuant to the SLM Merger, New BLC Corporation replaced then existing SLM Corporation as the publicly-traded registrant and changed its name to SLM Corporation. As part of the internal corporate reorganization, the assets and liabilities associated with the education loan management, servicing and asset recovery business were transferred to Navient, and those assets and liabilities associated with the consumer banking business remained with or were transferred to the newly constituted SLM Corporation. The separation and distribution were accounted for on a substantially tax-free basis.

The timing and steps necessary to complete the Spin-Off and comply with the Securities and Exchange Commission ("SEC") reporting requirements, including the replacement of pre-Spin-Off SLM Corporation with our current publicly-traded registrant, have resulted in our Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC on February 19, 2014, and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, filed with the SEC on May 12, 2014, providing business results and financial information for the periods reported therein on the basis of the consolidated businesses of pre-Spin-Off SLM. While information contained in those prior reports may provide meaningful historical context for the Company’s business, the Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 was our first periodic report made on the basis of the post-Spin-Off business of the Company.

At the time of the Spin-Off transaction, we had a targeted starting equity balance of $1,710 million. To achieve the targeted equity balance we retained $565 million of preferred stock and approximately $473 million of cash to offset the obligation attributable to the principal of Series A Preferred Stock and the Series B Preferred Stock, substantially similar to pre-Spin-Off SLM's respective series of preferred stock.

For periods before the Spin-Off, these financial statements are presented on a basis of accounting that reflects a change in reporting entity and have been adjusted for the effects of the Spin-Off. These carve-out financial statements and selected financial information represent only those operations, assets, liabilities and equity that form Sallie Mae on a stand-alone basis. Because the Spin-Off occurred on April 30, 2014, these financial statements include the carved out financial results for the first four months of 2014. All prior period amounts represent carved-out amounts.

Consolidation

The consolidated financial statements include the accounts of the Company and its majority-owned and controlled subsidiaries after eliminating the effects of intercompany accounts and transactions.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
1. Significant Accounting Policies (Continued)

Allowance for Private Education Loan Losses
We maintain an allowance for loan losses at an amount sufficient to absorb probable losses incurred in our portfolios at the reporting date based on a projection of estimated probable credit losses incurred in the portfolio.
We analyze our portfolio to determine the effects various stages of delinquency have on borrower default behavior and ultimate charge-off activity. We estimate the allowance for loan losses for our loan portfolio using a migration analysis of delinquent and current accounts. A migration analysis is a technique used to estimate the likelihood a loan receivable may progress through the various delinquency stages and ultimately charge off. We may also take into account the current and future economic environment and other qualitative factors when calculating the allowance for loan losses.
The evaluation of the allowance for loan losses is inherently subjective, as it requires material estimates that may be susceptible to significant changes. Our default estimates are based on a loss confirmation period (loss confirmation period represents the expected period between a loss event and when management considers the debt to be uncollectible), taking into consideration account management practices that affect the timing of a loss, such as the usage of forbearance.
Prior to the Spin-Off, the Bank exercised its right and sold substantially all of the Private Education Loans it originated that became delinquent or were granted forbearance to one or more of its then affiliates at its fair value. Because of this arrangement, the Bank did not hold many loans in forbearance. As a result, the Bank had very little historical forbearance activity and very few delinquencies.
In connection with the Spin-Off, the agreement under which the Bank previously made these sales was amended so that the Bank now only has the right to require Navient to purchase (at fair value) loans only where (a) the borrower has a lending relationship with both the Bank and Navient (“Split Loans”) and (b) the Split Loans either (1) are more than 90 days past due; (2) have been restructured; (3) have been granted a hardship forbearance or more than six months of administrative forbearance; or (4) have a borrower or cosigner who has filed for bankruptcy. At September 30, 2014, we held approximately $126 million of Split Loans.
Pre-Spin-Off SLM charged off loans when they were 212 days delinquent. As such, default aversion strategies were focused on the final stages of delinquency, from 150 days to 212 days. In connection with the Spin-Off, we changed our charge-off policy for Private Education Loans to charging off loans when they reach 120 days delinquent. As a result of changing our corporate charge-off policy and greatly reducing the number of potentially delinquent loans we sell to Navient, our default aversion strategies must now focus on loans 30 to 120 days delinquent. This change has the effect of accelerating the recognition of losses due to the shorter charge-off period (120 days). In addition, at the time of the Spin-Off, we changed our loss confirmation period from two years to one year to reflect the shorter charge-off policy and our revised servicing practices. These two changes resulted in recognizing a $14 million net reduction in our allowance for loan losses in second quarter 2014 because we are now only reserving for one year of losses as compared with two years under the prior policy, which more than offset the impact of the shorter charge-off period.
The one-year estimate underlying the allowance for loan losses is subject to a number of assumptions. If actual future performance in delinquency, charge-offs and recoveries are significantly different than estimated, or account management assumptions or practices were to change, this could materially affect the estimate of the allowance for loan losses, the timing of when losses are recognized, and the related provision for loan losses on our consolidated statements of income.

Separately, for our troubled debt restructurings ("TDR") portfolio, we estimate an allowance amount sufficient to cover life-of-loan expected losses through an impairment calculation based on the difference between the loan’s basis and the present value of expected future cash flows (which would include life-of-loan default and recovery assumptions) discounted at the loan’s original effective interest rate. Our TDR portfolio is comprised mostly of loans with interest rate reductions and forbearance usage greater than three months.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
1. Significant Accounting Policies (Continued)

Securitization Accounting

In the third quarter 2014, we entered into our first securitization transaction. We accounted for this as a sale of loans and we do not consolidate the securitization trust. This securitization used a two-step structure with a special purpose entity that legally isolated the transferred assets from us, even in the event of bankruptcy. The transaction was also structured to ensure the holders of the beneficial interests issued are not constrained from pledging or exchanging their interests, and we do not maintain effective control over the transferred assets. If these criteria had not been met, then the transaction would be accounted for as an on-balance sheet secured borrowing. Our securitization transaction was legally structured to be a sale of assets that isolated the transferred assets from us. If a securitization qualifies as a sale, we then assess whether we are the primary beneficiary of the securitization trust and are required to consolidate such trust. If we are the primary beneficiary then no gain or loss is recognized.

The investors in the securitization trust have no recourse to our assets should there be a failure of the trust to pay when due. Generally, the only recourse the trust has to us is in the event we breach a seller representation or warranty or our duties as master servicer, in which event we agree to repurchase the related loans from the trust. As master servicer, our primary responsibility will be to monitor the performance of the subservicer and find a substitute subservicer in the event the subservicer of the trust defaults.

We did not record a servicing asset or servicing liability related to the securitization transaction we entered into in third quarter 2014 because we determined the master servicing fee we receive is at market rate.

Gains on Sale of Loans, net

We participate and sell loans to third parties and affiliates (including entities that were related parties prior to the Spin-off Transaction). These sales may be through whole loan sales or securitization transactions that qualify for sales treatment. These loans were initially recorded as held for investment, and were transferred to held-for-sale immediately prior to sale or securitization. Beginning in April 2012, loans were sold at fair value. Details of these transactions are further discussed in Note 12, "Arrangements with Navient Corporation."

In the third quarter 2014, we sold $1.2 billion of loans through loan sales and a securitization transaction with third parties. As a result of these loan sales we recorded net gains of $85 million. In the third quarter 2013, we recorded $43 million in net gains from the sale of $0.6 billion of loan sales.

For the nine months ended September 30, 2014, we sold $1.9 billion of loans through loan sales and a securitization transaction. As a result of these loan sales we recorded net gains of $121 million. In the nine months ended September 30, 2013, we recorded $192 million in net gains from the sale of $2.3 billion of loans.

Income Taxes

In connection with the Spin-Off, the Company has become the taxpayer legally responsible for $283 million of deferred taxes payable (installment payments due quarterly through 2018) in connection with gains recognized by pre-Spin-Off SLM on debt repurchases in prior years. As part of the tax sharing agreement between the Company and Navient, Navient has agreed to fully pay us for these deferred taxes due. An indemnification receivable of $264 million was recorded, which represents the fair value of the future payments under the agreement based on a discounted cash flow model. We will accrue interest income on the indemnification receivable using the interest method.

The Company also recorded a liability related to uncertain tax positions of $27 million for which we are indemnified by Navient. If there is an adjustment to the indemnified uncertain tax liability, an offsetting adjustment to the indemnification receivable will be recorded as pre-tax adjustment to the income statement.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
1. Significant Accounting Policies (Continued)

As of the date of the Spin-Off on April 30, 2014, we recorded a liability of $310 million ($283 million related to deferred taxes and $27 million related to uncertain tax positions) and an indemnification receivable of $291 million ($310 million less the $19 million discount). As of September 30, 2014, the liability balance is $299 million ($283 million related to deferred taxes and $16 million related to uncertain tax positions) and the indemnification receivable balance is $254 million ($238 million related to deferred taxes and $16 million related to uncertain tax positions).
Recently Issued Accounting Pronouncements
On May 28, 2014, the Financial Accounting Standards Board issued ASU No. 2014-09, "Revenue from Contracts with Customers," which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance when it becomes effective. The new standard is effective on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We have determined that this new guidance will have an immaterial impact on the financial results of the Company.

2. Investments

The amortized cost and fair value of securities available for sale are as follows:

	As of September 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:				
Mortgage-backed securities	$155,136	$1,332	$(2,575)	$153,893

	As of December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available for sale:				
Mortgage-backed securities	$106,977	$706	$(5,578)	$102,105

Our investment portfolio is comprised of mortgage-backed securities issued by Ginnie Mae, Fannie Mae and Freddie Mac with amortized costs of $76,274, $67,163 and $11,699, respectively, at September 30, 2014. We own these securities to meet our requirements under the Community Reinvestment Act. As of September 30, 2014, there were 22 of 51 separate mortgage-backed securities with unrealized losses in our investment portfolio. As of December 31, 2013, there were 20 of 33 separate mortgage-backed securities with unrealized losses in our investment portfolio. As of September 30, 2014, 11 of the 22 securities in a net loss position were issued under Ginnie Mae programs that carry a full faith and credit guarantee from the U.S. Government. The remaining securities in a net loss position carry a principal and interest guarantee by Fannie Mae and Freddie Mac. We have the ability and the intent to hold these securities for a period of time sufficient for the market price to recover to at least the adjusted amortized cost of the security.

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SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
2. Investments (Continued)

The mortgage-backed securities have been pledged to the Federal Reserve Bank ("FRB") as collateral against any advances and accrued interest under the Primary Credit program or any other program sponsored by the FRB. We had $149,057 and $103,049 par value of mortgage-backed securities pledged to this borrowing facility at September 30, 2014 and December 31, 2013, respectively, as discussed further in Note 6, "Borrowed Funds."

As of September 30, 2014, the amortized cost and fair value of securities, by contractual maturities, were as follows:

Year of Maturity	Amortized Cost	Estimated Fair Value
2038	$611	$662
2039	12,079	12,888
2042	28,317	26,719
2043	74,701	74,307
2044	39,428	39,317
Total	$155,136	$153,893

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)

3. Loans Held for Investment

Loans Held for Investment consist of Private Education Loans and FFELP Loans.

Our Private Education Loans are made largely to bridge the gap between the cost of higher education and the amount funded through financial aid, federal loans or customers' resources. Private Education Loans bear the full credit risk of the customer. We manage this risk through historical risk-performance underwriting strategies and the addition of qualified cosigners. Private Education Loans generally carry a variable rate indexed to LIBOR; as of September 30, 2014, 83 percent of all Private Education Loans were indexed to LIBOR. We provide incentives for customers to include a cosigner on the loan, and the vast majority of loans in our portfolio are cosigned. We also encourage customers to make payments while in school.

FFELP Loans are insured as to their principal and accrued interest in the event of default subject to a Risk Sharing level based on the date of loan disbursement. When a FFELP Loan first disbursed on and after July 1, 2006 defaults, the federal government guarantees 97 percent of the principal balance plus accrued interest (98 percent on loans disbursed before July 1, 2006) and the holder of the loan is at risk for the remaining amount not guaranteed as a Risk Sharing loss on the loan. FFELP Loans originated after October 1, 1993 are subject to Risk Sharing on loan default claim payments unless the default results from the borrower's death, disability or bankruptcy, in which case the loan is 100 percent guaranteed.

Loans held for investment are summarized as follows:

	September 30, 2014	December 31, 2013
Private Education Loans	$7,829,420	$6,563,342
Deferred origination costs	9,975	5,063
Allowance for loan losses	(59,973)	(61,763)
Total Private Education Loans, net	7,779,422	6,506,642
FFELP Loans	1,317,963	1,426,972
Unamortized acquisition costs, net	3,730	4,081
Allowance for loan losses	(5,742)	(6,318)
Total FFELP Loans, net	1,315,951	1,424,735
Loans held for investment, net	$9,095,373	$7,931,377

The estimated weighted average life of Private Education Loans in our portfolio was approximately 6.7 years and 7.0 years at September 30, 2014 and December 31, 2013, respectively.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
3. Loans Held for Investment (Continued)

The average balance and the respective weighted average interest rates are summarized as follows:

	Three Months Ended September 30, 2014			Three Months Ended September 30, 2013		
	Average Balance	Weighted Average Interest Rate		Average Balance	Weighted Average Interest Rate	
Private Education Loans	$7,407,774	8.20	%	$5,846,241	8.22	%
FFELP Loans	1,339,748	3.23		1,167,174	3.38	
Total portfolio	$8,747,522			$7,013,415		

	Nine Months Ended September 30, 2014			Nine Months Ended September 30, 2013		
	Average Balance	Weighted Average Interest Rate		Average Balance	Weighted Average Interest Rate	
Private Education Loans	$7,394,985	8.19	%	$5,860,864	8.15	%
FFELP Loans	1,373,945	3.25		1,099,436	3.33	
Total portfolio	$8,768,930			$6,960,300		

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)

4. Allowance for Loan Losses

Our provision for Private Education Loan losses represent the periodic expense of maintaining an allowance sufficient to absorb incurred probable losses, in the held-for-investment loan portfolios. The evaluation of the allowance for loan losses is inherently subjective, as it requires material estimates that may be susceptible to significant changes. We believe the allowance for loan losses is appropriate to cover probable losses incurred in the loan portfolios. See Note 1, "Significant Accounting Policies - Allowance for Private Education Loan Losses" for a more detailed discussion.

Allowance for Loan Losses Metrics

	Allowance for Loan Losses Three Months Ended September 30, 2014					
	FFELP Loans		Private Education Loans		Total	
Allowance for Loan Losses						
Beginning balance	$6,212		$ 54,315		$60,527	
Total provision	291		14,607		14,898	
Charge-offs[1]	(761	)	(4,378	)	(5,139	)
Student loan sales[2]	—		(4,571	)	(4,571	)
Ending Balance	$5,742		$ 59,973		$65,715	
Allowance:						
Ending balance: individually evaluated for impairment	$—		$ 2,966		$2,966	
Ending balance: collectively evaluated for impairment	$5,742		$ 57,007		$62,749	
Loans:						
Ending balance: individually evaluated for impairment	$—		$ 13,115		$13,115	
Ending balance: collectively evaluated for impairment	$1,317,963		$ 7,816,305		$9,134,268	
Charge-offs as a percentage of average loans in repayment (annualized)	0.32	%	0.39	%		
Allowance as a percentage of the ending total loan balance	0.44	%	0.77	%		
Allowance as a percentage of the ending loans in repayment	0.61	%	1.31	%		
Allowance coverage of charge-offs (annualized)	1.89		3.42			
Ending total loans, gross	$1,317,963		$ 7,829,420			
Average loans in repayment	$953,620		$ 4,453,775			
Ending loans in repayment	$945,230		$ 4,575,143			

(1) Prior to the Spin-Off, Private Education Loans were sold to an entity that is now a subsidiary of Navient prior to being charged-off.
(2) Represents fair value write-downs on loans sold.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
4. Allowance for Loan Losses (Continued)

	Allowance for Loan Losses Three Months Ended September 30, 2013		
	FFELP Loans	Private Education Loans	Total
Allowance for Loan Losses			
Beginning balance	$4,616	$ 50,868	$55,484
Total provision	1,403	19,001	20,404
Charge-offs[1]	(671)	—	(671)
Student loan sales[2]	—	(15,632)	(15,632)
Ending Balance	$5,348	$ 54,237	$59,585
Allowance:			
Ending balance: individually evaluated for impairment	$—	$ —	$—
Ending balance: collectively evaluated for impairment	$5,348	$ 54,237	$59,585
Loans:			
Ending balance: individually evaluated for impairment	$—	$ —	$—
Ending balance: collectively evaluated for impairment	$1,217,404	$ 6,214,840	$7,432,244
Charge-offs as a percentage of average loans in repayment (annualized)	0.30 %	— %	
Allowance as a percentage of the ending total loan balance	0.44 %	0.87 %	
Allowance as a percentage of the ending loans in repayment	0.59 %	1.54 %	
Allowance coverage of charge-offs (annualized)	1.99	—	
Ending total loans, gross	$1,217,404	$ 6,214,840	
Average loans in repayment	$896,801	$ 3,400,620	
Ending loans in repayment	$902,766	$ 3,518,997	

(1) Prior to the Spin-Off, Private Education Loans were sold to an entity that is now a subsidiary of Navient prior to being charged-off.
(2) Represents fair value write-downs on delinquent loans sold prior to the Spin-Off to an entity that is now a subsidiary of Navient, recorded at the time of sale.

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SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
4. Allowance for Loan Losses (Continued)

	Allowance for Loan Losses Nine Months Ended September 30, 2014		
	FFELP Loans	Private Education Loans	Total
Allowance for Loan Losses			
Beginning balance	$6,318	$ 61,763	$68,081
Total provision	1,482	53,589	55,071
Charge-offs[1]	(2,058)	(4,378)	(6,436)
Student loan sales[2]	—	(51,001)	(51,001)
Ending Balance	$5,742	$ 59,973	$65,715
Allowance:			
Ending balance: individually evaluated for impairment	$—	$ 2,966	$2,966
Ending balance: collectively evaluated for impairment	$5,742	$ 57,007	$62,749
Loans:			
Ending balance: individually evaluated for impairment	$—	$ 13,115	$13,115
Ending balance: collectively evaluated for impairment	$1,317,963	$ 7,816,305	$9,134,268
Charge-offs as a percentage of average loans in repayment (annualized)	0.28 %	0.13 %	
Allowance as a percentage of the ending total loan balance	0.44 %	0.77 %	
Allowance as a percentage of the ending loans in repayment	0.61 %	1.31 %	
Allowance coverage of charge-offs (annualized)	2.09	10.27	
Ending total loans, gross	$1,317,963	$ 7,829,420	
Average loans in repayment	$980,733	$ 4,408,852	
Ending loans in repayment	$945,230	$ 4,575,143	

(1) Prior to the Spin-Off, Private Education Loans were sold to an entity that is now a subsidiary of Navient prior to being charged-off.
(2) Post-Spin-Off represents fair value write-downs on loans sold. Pre-Spin-Off represents fair value write-downs on delinquent loans sold to an entity that is now a subsidiary of Navient, recorded at the time of sale.

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SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
4. Allowance for Loan Losses (Continued)

	Allowance for Loan Losses Nine Months Ended September 30, 2013		
	FFELP Loans	Private Education Loans	Total
Allowance for Loan Losses			
Beginning balance	$3,971	$ 65,218	$69,189
Total provision	2,802	37,279	40,081
Charge-offs[1]	(1,425)	—	(1,425)
Student loan sales[2]	—	(48,260)	(48,260)
Ending Balance	$5,348	$ 54,237	$59,585
Allowance:			
Ending balance: individually evaluated for impairment	$—	$ —	$—
Ending balance: collectively evaluated for impairment	$5,348	$ 54,237	$59,585
Loans:			
Ending balance: individually evaluated for impairment	$—	$ —	$—
Ending balance: collectively evaluated for impairment	$1,217,404	$ 6,214,840	$7,432,244
Charge-offs as a percentage of average loans in repayment (annualized)	0.23 %	— %	
Allowance as a percentage of the ending total loan balance	0.44 %	0.87 %	
Allowance as a percentage of the ending loans in repayment	0.59 %	1.54 %	
Allowance coverage of charge-offs (annualized)	2.81	—	
Ending total loans, gross	$1,217,404	$ 6,214,840	
Average loans in repayment	$839,085	$ 3,580,401	
Ending loans in repayment	$902,766	$ 3,518,997	

(1) Prior to the Spin-Off, Private Education Loans were sold to an entity that is now a subsidiary of Navient prior to being charged-off.
(2) Represents fair value write-downs on delinquent loans sold prior to the Spin-Off to an entity that is now a subsidiary of Navient, recorded at the time of sale.

All of our loans are collectively assessed for impairment except for loans classified as TDRs. Prior to the Spin-Off, we did not have TDR loans because the loans were generally sold in the same month that the terms were restructured. Subsequent to May 1, 2014, we have individually assessed $13.1 million of Private Education Loans as TDRs. When these loans are determined to be impaired, we provide for an allowance for losses sufficient to cover life-of-loan expected losses through an impairment calculation based on the difference between the loan's basis and the present value of expected future cash flows discounted at the loan's original effective interest rate.
Within the Private Education Loan portfolio, loans greater than 90 days past due are considered to be nonperforming. FFELP Loans are at least 97 percent guaranteed as to their principal and accrued interest by the federal government in the event of default, and therefore, we do not deem FFELP Loans as nonperforming from a credit risk standpoint at any point in their life cycle prior to claim payment, and continue to accrue interest through the date of claim.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
4. Allowance for Loan Losses (Continued)

Key Credit Quality Indicators
FFELP Loans are at least 97 percent insured and guaranteed as to their principal and accrued interest in the event of default; therefore, there are no key credit quality indicators associated with FFELP Loans. Included within our FFELP portfolio as of September 30, 2014 are $832 million of FFELP rehabilitation loans. These loans have previously defaulted but have subsequently been brought current according to a loan rehabilitation agreement. The credit performance on rehabilitation loans is worse than the remainder of our FFELP portfolio. At September 30, 2014 and December 31, 2013, 62.5 percent and 62.9 percent of our FFELP portfolio consisted of rehabilitation loans.
For Private Education Loans, the key credit quality indicators are FICO scores, the existence of a cosigner, the loan status and loan seasoning. The FICO scores are assessed at origination and maintained through the loan's term. The following table highlights the gross principal balance of our Private Education Loan portfolio stratified by key credit quality indicators.

	Private Education Loans Credit Quality Indicators					
	September 30, 2014			December 31, 2013		
Credit Quality Indicators:	Balance[1]	% of Balance		Balance[1]	% of Balance	
Cosigners:						
With cosigner	$7,032,973	90	%	$5,898,751	90	%
Without cosigner	796,447	10		664,591	10	
Total	$7,829,420	100	%	$6,563,342	100	%
FICO at Origination:						
Less than 670	$529,649	7	%	$461,412	7	%
670-699	1,154,088	15		1,364,286	21	
700-749	2,465,490	31		1,649,192	25	
Greater than or equal to 750	3,680,193	47		3,088,452	47	
Total	$7,829,420	100	%	$6,563,342	100	%
Seasoning[2]:						
1-12 payments	$2,683,899	34	%	$1,840,538	28	%
13-24 payments	1,084,549	14		1,085,393	17	
25-36 payments	515,960	6		669,685	10	
37-48 payments	308,387	4		362,124	6	
More than 48 payments	58,130	—		30,891	—	
Not yet in repayment	3,178,495	42		2,574,711	39	
Total	$7,829,420	100	%	$6,563,342	100	%

(1) Balance represents gross Private Education Loans.
(2) Number of months in active repayment for which a scheduled payment was due.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
4. Allowance for Loan Losses (Continued)

The following tables provide information regarding the loan status and aging of past due loans.

	Private Education Loan Delinquencies					
	September 30, 2014			December 31, 2013		
	Balance	%		Balance	%	
Loans in-school/grace/deferment[1]	$3,178,495			$2,574,711		
Loans in forbearance[2]	75,782			16,314		
Loans in repayment and percentage of each status:						
Loans current	4,515,313	98.7	%	3,933,143	99.0	%
Loans delinquent 31-60 days[3]	44,082	1.0		28,854	0.7	
Loans delinquent 61-90 days[3]	12,415	0.3		10,280	0.3	
Loans delinquent greater than 90 days[3]	3,333	—		40	—	
Total private education loans in repayment	4,575,143	100.0	%	3,972,317	100.0	%
Total private education loans, gross	7,829,420			6,563,342		
Private education loans deferred origination costs	9,975			5,063		
Total private education loans	7,839,395			6,568,405		
Private education loans allowance for losses	(59,973)			(61,763)		
Private education loans, net	$7,779,422			$6,506,642		
Percentage of private education loans in repayment		58.4	%		60.5	%
Delinquencies as a percentage of private education loans in repayment		1.3	%		1.0	%
Loans in forbearance as a percentage of loans in repayment and forbearance		1.6	%		0.4	%

(1) Deferment includes customers who have returned to school or are engaged in other permitted educational activities and are not yet required to make payments on the loans (e.g., residency periods for medical students or a grace period for bar exam preparation).

(2) Loans for customers who have requested extension of grace period generally during employment transition or who have temporarily ceased making full payments due to hardship or other factors, consistent with established loan program servicing policies and procedures.

(3) The period of delinquency is based on the number of days scheduled payments are contractually past due.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
4. Allowance for Loan Losses (Continued)

Accrued Interest Receivable

The following table provides information regarding accrued interest receivable on our Private Education Loans. The table also discloses the amount of accrued interest on loans greater than 90 days past due as compared to our allowance for uncollectible interest. The allowance for uncollectible interest exceeds the amount of accrued interest on our 90 days past due portfolio for all periods presented.

	Private Education Loan Accrued Interest Receivable		
	Total Interest Receivable	Greater than 90 days Past Due	Allowance for Uncollectible Interest
September 30, 2014	$430,299	$142	$3,250
December 31, 2013	$333,857	$1	$4,076

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)

5. Deposits

The following table summarizes total deposits at September 30, 2014 and December 31, 2013.

	September 30, 2014	December 31, 2013
Deposits - interest bearing	$9,101,491	$8,946,514
Deposits - non-interest bearing	71,531	55,036
Total deposits	$9,173,022	$9,001,550

Interest Bearing

Interest bearing deposits as of September 30, 2014 and December 31, 2013 consisted of non-maturity savings deposits and brokered and retail certificates of deposit, as discussed further below, and brokered money market deposits. These deposit products are serviced by third party providers. Placement fees associated with the brokered certificates of deposit are amortized into interest expense using the effective interest rate method. We recognized placement fee expense of $2,326 and $2,249 for the three months ended September 30, 2014 and 2013, respectively, and $7,548 and $7,128 for the nine months ended September 30, 2014 and 2013, respectively. We paid $5,533 in fees to third party brokers related to these certificates of deposit during the three and nine months ended September 30, 2014. No fees were paid to third party brokers related to these certificates during the three and nine months ended September 30, 2013.

In the past, we offered debit cards associated with interest bearing consumer deposit (“NOW”) accounts to facilitate the distribution of financial aid refunds and other payables to students. These debit cards were serviced by third party providers. As of April 30, 2014, we no longer offer these debit cards.

Interest bearing deposits at September 30, 2014 and December 31, 2013 are summarized as follows:

	September 30, 2014			December 31, 2013		
	Amount	Qtr.-End Weighted Average Stated Rate		Amount	Year-End Weighted Average Stated Rate	
Money market	$4,053,209	1.24	%	$3,212,889	0.65	%
Savings	704,383	0.81		743,742	0.81	
NOW	—	—		18,214	0.12	
Certificates of deposit	4,343,899	1.11		4,971,669	1.39	
Deposits - interest bearing	$9,101,491			$8,946,514		

As of September 30, 2014 and December 31, 2013, there were $288,791 and $159,637 of deposits exceeding Federal Deposit Insurance Corporation (“FDIC”) insurance limits. Accrued interest on deposits was $15,736 and $13,097 at September 30, 2014 and December 31, 2013, respectively.

Money market deposits with affiliates

Our Upromise subsidiary maintains a money market deposit at the Bank which totaled $289,344 and $293,040 at September 30, 2014 and December 31, 2013, respectively, which was interest bearing. Interest expense incurred on these deposits during the three months ended September 30, 2014 and 2013 totaled $65 and $64, respectively and for the nine months ended September 30, 2014 and 2013 totaled $182 and $255, respectively. The Company also maintains a money market deposit at the Bank which totaled $273,341 at September 30, 2014 and $0 at December 31, 2013.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
5. Deposits (Continued)

Non Interest Bearing

Non interest bearing deposits were $71,531 and $55,036 as of September 30, 2014 and December 31, 2013, respectively. For both periods these were comprised of money market accounts. The September 30, 2014 balance includes $226 related to our Employee Stock Purchase Plan account. See Note 11, "Stock Based Compensation Plans and Arrangements" for additional details regarding this plan.

6. Borrowed Funds

The Bank maintains discretionary uncommitted Federal Funds lines of credit with various correspondent banks, which totaled $100,000 at September 30, 2014. The interest rate charged to the Bank on these lines of credit is priced at Fed Funds plus a spread at the time of borrowing, and is payable daily. The Bank did not utilize these lines of credit in the nine months ended September 30, 2014 and 2013.
The Bank established an account at the FRB to meet eligibility requirements for access to the Primary Credit borrowing facility at the FRB's Discount Window ("Window"). The Primary Credit borrowing facility is a lending program available to depository institutions that are in generally sound financial condition. All borrowings at the Window must be fully collateralized. We can pledge asset-backed and mortgage-backed securities, as well as FFELP consolidation and Private Education Loans to the FRB as collateral for borrowings at the Window. Generally, collateral value is assigned based on the estimated fair value of the pledged assets. At September 30, 2014 and December 31, 2013, the lendable value of our collateral at the FRB totaled $1,522,172 and $900,217, respectively. The interest rate charged to us is the discount rate set by the FRB. We did not utilize this facility in the nine months ended September 30, 2014 and 2013.

7. Derivative Financial Instruments

We maintain an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize the economic effect of interest rate changes. Our goal is to manage interest rate sensitivity by modifying the repricing frequency and underlying index characteristics of certain balance sheet assets and liabilities so the net interest margin is not, on a material basis, adversely affected by movements in interest rates. We do not use derivative instruments to hedge credit risk associated with debt we issued. As a result of interest rate fluctuations, hedged assets and liabilities will appreciate or depreciate in market value. Income or loss on the derivative instruments that are linked to the hedged assets and liabilities will generally offset the effect of this unrealized appreciation or depreciation for the period the item is being hedged. We view this strategy as a prudent management of interest rate sensitivity.
Although we use derivatives to offset (or minimize) the risk of interest rate changes, the use of derivatives does expose us to both market and credit risk. Market risk is the chance of financial loss resulting from changes in interest rates, foreign exchange rates and market liquidity. Credit risk is the risk that a counterparty will not perform its obligations under a contract and it is limited to the loss of the fair value gain in a derivative that the counterparty owes us. When the fair value of a derivative contract is negative, we owe the counterparty and, therefore, have no credit risk exposure to the counterparty; however, the counterparty has exposure to us. We minimize the credit risk in derivative instruments by entering into transactions with highly rated counterparties that are reviewed regularly by our Credit Department. We also maintain a policy of requiring that all derivative contracts be governed by an International

Swaps and Derivative Association Master Agreement. Depending on the nature of the derivative transaction, bilateral collateral arrangements generally are required as well. When we have more than one outstanding derivative transaction with the counterparty, and there exists legally enforceable netting provisions with the counterparty (i.e., a legal right to offset receivable and payable derivative contracts), the “net” mark-to-market exposure, less collateral the counterparty has posted to us, represents exposure with the counterparty. When there is a net negative exposure, we consider our exposure to the counterparty to be zero. At September 30, 2014 and December 31, 2013, we had a net positive exposure (derivative gain positions to us less collateral which has been posted by counterparties to us) related to derivatives of $42,149 and $3,517, respectively.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
7. Derivative Financial Instruments (Continued)

Accounting for Derivative Instruments
The derivative instruments that we use as part of our interest rate risk management strategy are interest rate swaps. The accounting for derivative instruments requires that every derivative instrument be recorded on the balance sheet as either an asset or liability measured at its fair value. As more fully described below, if certain criteria are met, derivative instruments may be classified and accounted for by us as either fair value or cash flow hedges. If these criteria are not met, the derivative financial instruments are accounted for as trading.

Fair Value Hedges
Fair value hedges are generally used by us to hedge the exposure to changes in fair value of a recognized fixed rate asset or liability. We enter into interest rate swaps to economically convert fixed rate assets into variable rate assets and fixed rate debt into variable rate debt. For fair value hedges, we generally consider all components of the derivative's gain and/or loss when assessing hedge effectiveness and generally hedge changes in fair values due to interest rates.

Cash Flow Hedges
We use cash flow hedges to hedge the exposure to variability in cash flows of floating rate deposits. This strategy is used primarily to minimize the exposure to volatility in cash flows from future changes in interest rates. Gains and losses on the effective portion of a qualifying hedge are recorded in accumulated other comprehensive income and ineffectiveness is recorded immediately to earnings. In assessing hedge effectiveness, generally all components of each derivative's gains or losses are included in the assessment. We hedge exposure to changes in cash flows due to changes in interest rates or total changes in cash flow.
Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on our variable rate deposits. During the next twelve months, we estimate that $20.5 million will be reclassified as an increase to interest expense.

Trading Activities
When derivative instruments do not qualify for hedge accounting treatment, they are accounted for at fair value with all changes in fair value recorded through earnings. All our derivative instruments entered into after December 31, 2013, with a maturity of less than 3 years, are economically hedging risk but do not receive hedge accounting treatment. Trading derivatives also include any hedges that originally received hedge accounting treatment, but lost hedge accounting treatment due to failed effectiveness testing, as well as the activity of certain derivatives prior to them receiving hedge accounting treatment.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
7. Derivative Financial Instruments (Continued)

Summary of Derivative Financial Statement Impact
The following tables summarize the fair values and notional amounts of all derivative instruments at September 30, 2014 and December 31, 2013, and their impact on earnings and other comprehensive income for the three and nine months ended September 30, 2014 and 2013.

Impact of Derivatives on the Consolidated Balance Sheet

		Cash Flow Hedges		Fair Value Hedges		Trading		Total	
		September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
Fair Values[1]	Hedged Risk Exposure								
Derivative Assets:[2]									
Interest rate swaps	Interest rate	$—	$—	$655	$6,335	$279	$426	$934	$6,761
Derivative Liabilities:[2]									
Interest rate swaps	Interest rate	(3,464)	—	(11,515)	(6,149)	(1,350)	—	(16,329)	(6,149)
Total net derivatives		$(3,464)	$—	$(10,860)	$186	$(1,071)	$426	$(15,395)	$612

(1) Fair values reported are exclusive of collateral held and pledged and accrued interest. Assets and liabilities are presented without consideration of master netting agreements. Derivatives are carried on the balance sheet based on net position by counterparty under master netting agreements, and classified in other assets or other liabilities depending on whether in a net positive or negative position.

(2) The following table reconciles gross positions with the impact of master netting agreements to the balance sheet classification:

	Other Assets		Other Liabilities	
	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
Gross position	$934	$6,761	$(16,329)	$(6,149)
Impact of master netting agreement	(934)	(4,981)	934	4,981
Derivative values with impact of master netting agreements (as carried on balance sheet)	—	1,780	(15,395)	(1,168)
Cash collateral (held) pledged[1]	(450)	(5,190)	46,377	40
Net position	$(450)	$(3,410)	$30,982	$(1,128)

(1) Cash collateral amount calculations include outstanding accrued interest payable/receivable.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
7. Derivative Financial Instruments (Continued)

	Cash Flow		Fair Value		Trading		Total	
	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013
Notional Values								
Interest rate swaps	$1,100,226	$—	$2,448,023	$2,089,624	$678,967	$575,131	$4,227,216	$2,664,755

Impact of Derivatives on the Consolidated Statements of Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Fair Value Hedges				
Interest rate swaps:				
Hedge ineffectiveness gains (losses) recorded in earnings	$1,238	$(393)	$1,489	$(71)
Realized gains recorded in interest expense	3,835	6,804	14,081	22,311
Total	$5,073	$6,411	$15,570	$22,240
Cash Flow Hedges				
Interest rate swaps:				
Hedge ineffectiveness losses recorded in earnings	(303)	—	(303)	—
Realized losses recorded in interest expense	(3,587)	—	(3,587)	—
Total	$(3,890)	$—	$(3,890)	$—
Trading				
Interest rate swaps:				
Interest reclassification	$(1,170)	$346	$(3,138)	$973
Change in fair value of future interest payments recorded in earnings	5,636	345	(2,870)	(47)
Total[1]	4,466	691	(6,008)	926
Total	$5,649	$7,102	$5,672	$23,166

(1) Amounts included in "gains (losses) on derivatives and hedging activities, net."

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SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
7. Derivative Financial Instruments (Continued)

Impact of Derivatives on the Statements of Changes in Stockholders' Equity

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Amount of loss recognized in other comprehensive income	$(5,470)	$—	$(5,470)	$—
Amount of loss reclassified in interest expense(1)	3,587	—	3,587	—
Total change in other comprehensive income for unrealized losses on derivatives	$(1,883)	$—	$(1,883)	$—

(1) Amounts included in “realized gains (losses) recorded in interest expense” in the “Impact of Derivatives on the Consolidated
Statements of Income” table.

Cash Collateral

Cash collateral held related to derivative exposure between the Company and its derivatives counterparties was $450 and $5,190 at September 30, 2014 and December 31, 2013, respectively. Collateral held is recorded in “Other Liabilities.” Cash collateral pledged related to derivative exposure between the Company and its derivatives counterparties was $46,377 and $40 at September 30, 2014 and December 31, 2013, respectively.

8. Stockholders' Equity

Preferred Stock

In connection with the Spin-Off, the Company, by reason of a statutory merger, succeeded pre-Spin-Off SLM as the issuer of Series A Preferred Stock and the Series B Preferred Stock, substantially similar to pre-Spin-Off SLM's respective series of preferred stock. At September 30, 2014, we had outstanding 3.3 million shares of 6.97 percent Cumulative Redeemable Preferred Stock, Series A (the “Series A Preferred Stock”) and 4.0 million shares of Floating-Rate Non-Cumulative Preferred Stock, Series B (the “Series B Preferred Stock”). Neither series has a maturity date but can be redeemed at our option. Redemption would include any accrued and unpaid dividends up to the redemption date. The shares have no preemptive or conversion rights and are not convertible into or exchangeable for any of our other securities or property. Dividends on both series are not mandatory and are paid quarterly, when, as, and if declared by the Board of Directors. Holders of Series A Preferred Stock are entitled to receive cumulative, quarterly cash dividends at the annual rate of $3.485 per share. Holders of Series B Preferred Stock are entitled to receive quarterly dividends based on 3-month LIBOR plus 170 basis points per annum in arrears. Upon liquidation or dissolution of the Company, holders of the Series A and Series B Preferred Stock are entitled to receive $50 and $100 per share, respectively, plus an amount equal to accrued and unpaid dividends for the then current quarterly dividend period, if any, pro rata, and before any distribution of assets are made to holders of our common stock.

Common Stock

Our shareholders have authorized the issuance of 1.125 billion shares of common stock (par value of $.20). At September 30, 2014, 423 million shares were issued and outstanding and 39 million shares were unissued but encumbered for outstanding stock options, restricted stock units and dividend equivalent units for employee compensation and remaining authority for stock-based compensation plans.

Post Spin-Off, we do not intend to initiate a publicly announced share repurchase program as a means to return capital to shareholders. We only expect to repurchase common stock acquired in connection with taxes withheld in connection with award exercises and vesting under our employee stock based compensation plans. The following table summarizes our common share repurchases and issuances associated with these programs.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
8. Stockholders' Equity (Continued)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Shares and per share amounts in actuals)	2014	2013	2014	2013
Shares repurchased related to employee stock-based compensation plans[1]	356,622	251,570	715,393	5,616,933
Average purchase price per share	$8.68	$24.73	$8.68	$21.23
Common shares issued[2]	584,787	326,789	1,089,716	8,600,008

(1) Comprises shares withheld from stock option exercises and vesting of restricted stock for employees’ tax withholding obligations and shares tendered by employees to satisfy option exercise costs.
(2) Common shares issued under our various compensation and benefit plans.

The closing price of our common stock on September 30, 2014 was $8.56.

Investment with entities that are now subsidiaries of Navient

Prior to the Spin-Off, there were transactions between us and affiliates of pre-Spin-Off SLM that are now subsidiaries of Navient. As part of the carve-out, these expenses were included in our results even though the actual payments for the expenses were paid by the aforementioned affiliates. As such, amounts equal to these payments have been treated as equity contributions in the table below. Certain payments made by us to these affiliates prior to the Spin-Off transaction were treated as dividends.

Net transfers (to)/from the entity that is now a subsidiary of Navient are included within Navient's subsidiary investment on the consolidated statements of changes in equity. The components of the net transfers (to)/from the entity that is now a subsidiary of Navient are summarized below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Capital contributions:				
Loan origination activities	$—	$35,092	$32,452	$93,721
Loan sales	—	2	45	27
Corporate overhead activities	—	15,321	21,216	48,436
Other	—	(1,766)	492,368	(1,032)
Total capital contributions	—	48,649	546,081	141,152
Dividend	—	—	—	(120,000)
Corporate push-down	—	(5,726)	4,977	(99)
Net change in income tax accounts	—	(58,025)	15,659	(58,025)
Net change in receivable/payable	—	(68,978)	(87,277)	(103,131)
Other	—	—	(31)	564
Total net transfers from/(to) the entity that is now a subsidiary of Navient	$—	$(84,080)	$479,409	$(139,539)

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SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
8. Stockholders' Equity (Continued)

Capital Contributions

During the first four months of 2014 and the three and nine months ended September 30, 2013, pre-Spin-Off SLM contributed capital to the Company by funding loan origination activities, providing corporate overhead functions and other activities.

Capital contributed for loan origination activities reflects the fact that loan origination functions were conducted by a subsidiary of pre-Spin-Off SLM (now a subsidiary of Navient). The Company did not pay for the costs incurred by pre-Spin-Off SLM in connection with these functions. The costs eligible to be capitalized are recorded on the respective balance sheets and the costs not eligible for capitalization have been recognized as expenses in the respective statements of income.

Certain general corporate overhead expenses of the Company were incurred and paid for by pre-Spin-Off SLM.

Corporate Push-Down

The consolidated balance sheets include certain assets and liabilities that have historically been held at pre-Spin-Off SLM but which are specifically identifiable or otherwise allocable to the Company. The cash and cash equivalents held by pre-Spin-Off SLM at the corporate level were not allocated to the Company for any of the periods presented.

Receivable/Payable with Affiliate

Pre-Spin-Off, all significant intercompany payable/receivable balances between the Company and pre-Spin-Off SLM are considered to be effectively settled for cash in the combined financial statements at the time the transaction is recorded.

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SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)

9. Earnings per Common Share

Basic earnings per common share ("EPS") are calculated using the weighted average number of shares of common stock outstanding during each period. The determination of the weighted-average shares and diluted potential common shares for pre-Spin-Off periods are based on the activity at pre-Spin-Off SLM. A reconciliation of the numerators and denominators of the basic and diluted EPS calculations follows.

	Three Months ended September 30,		Nine months ended September 30,	
(In thousands, except per share data)	2014	2013	2014	2013
Numerator:				
Net income attributable to SLM Corporation	$82,926	$49,390	$174,502	$198,743
Preferred stock dividends	4,850	—	8,078	—
Net income attributable to SLM Corporation common stock	$78,076	$49,390	$166,424	$198,743
Denominator:				
Weighted average shares used to compute basic EPS	423,079	436,109	424,187	442,208
Effect of dilutive securities:				
Dilutive effect of stock options, restricted stock and restricted stock units (1)(2)	8,525	8,830	8,137	8,229
Weighted average shares used to compute diluted EPS	431,604	444,939	432,324	450,437
Basic earnings per common share attributable to SLM Corporation:	$0.18	$0.11	$0.39	$0.45
Diluted earnings per common share attributable to SLM Corporation:	$0.18	$0.11	$0.38	$0.44

(1) Includes the potential dilutive effect of additional common shares that are issuable upon exercise of outstanding stock options, non-vested deferred compensation and restricted stock, restricted stock units, and the outstanding commitment to issue shares under the ESPP, determined by the treasury stock method.

(2) For the three months ended September 30, 2014 and 2013, securities covering approximately 3 million and 3 million shares, respectively were outstanding but not included in the computation of diluted earnings per share because they were anti-dilutive. For the nine months ended September 30, 2014 and 2013, securities covering approximately 3 million and 4 million shares, respectively, were outstanding but not included in the computation of diluted earnings per share because they were anti-dilutive.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)

10. Fair Value Measurements

We use estimates of fair value in applying various accounting standards for our financial statements.

We categorize our fair value estimates based on a hierarchical framework associated with three levels of price transparency utilized in measuring financial instruments at fair value. For additional information regarding our policies for determining fair value and the hierarchical framework, see Note 1, “Significant Accounting Policies - Fair Value Measurement” in our historical carved out audited financial statements filed with the SEC on Form 8-K on May 6, 2014, for a full discussion.

The following table summarizes the valuation of our financial instruments that are marked-to-market on a recurring basis.

	Fair Value Measurements on a Recurring Basis							
	September 30, 2014				December 31, 2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Mortgage-backed securities	$—	$153,893	$—	$153,893	$—	$102,105	$—	$102,105
Derivative instruments	—	934	—	934	—	6,761	—	6,761
Total	$—	$154,827	$—	$154,827	$—	$108,866	$—	$108,866

	Fair Value Measurements on a Recurring Basis							
	September 30, 2014				December 31, 2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Liabilities								
Derivative instruments	$—	$(16,329)	$—	$(16,329)	$—	$(6,149)	$—	$(6,149)
Total	$—	$(16,329)	$—	$(16,329)	$—	$(6,149)	$—	$(6,149)

The following table summarizes the change in balance sheet carrying value associated with level 3 financial instruments carried at fair value on a recurring basis for the three and nine months ended September 30, 2013. There were no financial instruments categorized as level 3 at September 30, 2014.

	September 30, 2013	
	Three Months Ended	Nine Months Ended
Balance, beginning of period	$578,783	$532,155
Total gains/(losses) (realized and unrealized):		
Included in earnings	3,466	45,492
Included in other comprehensive income	—	—
Included in earnings - accretion of discount	2,177	6,779

Proceeds from sale	—	—
Transfers in and/or out of level 3	—	—
Balance, end of period[1]	$584,426	$584,426
Change in unrealized gains/(losses) relating to instruments still held at the reporting date	$3,466	$45,492

(1) In October 2013, we sold our asset-backed security portfolio, and as such, we no longer hold asset-backed securities in our investment portfolio.

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SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
10. Fair Value Measurements (Continued)

The following table summarizes the fair values of our financial assets and liabilities, including derivative financial instruments.

	September 30, 2014			December 31, 2013		
	Fair Value	Carrying Value	Difference	Fair Value	Carrying Value	Difference
Earning assets						
Loans held for investment, net	$9,709,012	$9,095,373	$613,639	$8,439,068	$7,931,377	$507,691
Cash and cash equivalents	1,570,378	1,570,378	—	2,182,865	2,182,865	—
Available-for-sale investments	153,893	153,893	—	102,105	102,105	—
Accrued interest receivable	453,522	453,522	—	356,283	356,283	—
Derivative instruments	934	934	—	6,761	6,761	—
Total earning assets	11,887,739	11,274,100	613,639	$11,087,082	$10,579,391	$507,691
Interest-bearing liabilities						
Money-market, savings and NOW accounts	4,829,123	4,829,123	—	$4,029,881	$4,029,881	$—
Certificates of deposit	4,347,562	4,343,899	(3,663)	4,984,114	4,971,669	(12,445)
Accrued interest payable	15,736	15,736	—	13,097	13,097	—
Derivative instruments	16,329	16,329	—	6,149	6,149	—
Total interest-bearing liabilities	$9,208,750	$9,205,087	(3,663)	$9,033,241	$9,020,796	(12,445)
Excess of net asset fair value over carrying value			$609,976			$495,246

The methods and assumptions used to estimate the fair value of each class of financial instruments are as follows:

Cash and cash equivalents

Cash and cash equivalents are carried at cost. Carrying value approximated fair value for disclosure purposes. These are level 1 valuations.

Investments

Investments are classified as available-for-sale and are carried at fair value in the financial statements. Investments in mortgage-backed securities are valued using observable market prices of similar assets. As such, these are level 2 valuations.

Loans held for investment

Our FFELP Loans, Private Education Loans, and other loans are accounted for at net realizable value, or at the lower of cost or market if the loan is held-for-sale. For both FFELP and Private Education Loans, fair value was determined by modeling expected loan level cash flows using stated terms of the assets and internally-developed assumptions to determine aggregate portfolio yield, net present value and average life. The significant assumptions used to determine fair value are prepayment speeds, default rates, cost of funds and required return on equity. We regularly calibrate these models to take into account relevant transactions in the marketplace. Significant inputs into the model are not observable. As such, these are level 3 valuations.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
10. Fair Value Measurements (Continued)

Money market, savings accounts and NOW accounts
The fair value of money market, savings, and NOW accounts equal the amounts payable on demand at the balance sheet date and are reported at their carrying value. These are level 1 valuations.
Certificates of deposit
The fair value of certificates of deposit are estimated using discounted cash flows based on rates currently offered for deposits of similar remaining maturities. These are level 2 valuations.
Derivatives
All derivatives are accounted for at fair value in the financial statements. The fair value of derivative financial instruments was determined by a standard derivative pricing and option model using the stated terms of the contracts and observable market inputs. It is our policy to compare the derivative fair values to those received from our counterparties in order to evaluate the model’s outputs.
When determining the fair value of derivatives, we take into account counterparty credit risk for positions where we are exposed to the counterparty on a net basis by assessing exposure net of collateral held. When the counterparty has exposure to us under derivative contracts with the Company, we fully collateralize the exposure (subject to certain thresholds).
Interest rate swaps are valued using a standard derivative cash flow model with a LIBOR swap yield curve which is an observable input from an active market. These derivatives are level 2 fair value estimates in the hierarchy.
The carrying value of borrowings designated as the hedged item in a fair value hedge is adjusted for changes in fair value due to changes in the benchmark interest rate (one-month LIBOR). These valuations are determined through standard pricing models using the stated terms of the borrowings and observable yield curves.

11. Stock Based Compensation Plans and Arrangements

Effect of Spin-Off on Equity Awards
In connection with the Spin-Off of Navient, we made certain adjustments to the exercise price and number of our stock-based compensation awards with the intention of preserving the intrinsic value of the outstanding awards held by Sallie Mae officers and employees prior to the Spin-Off. In general, holders of awards granted prior to 2014 received both Sallie Mae and Navient equity awards, and holders of awards granted in 2014 received solely equity awards of their post-Spin-Off employer. Stock options, restricted stock, restricted stock units, performance stock units and dividend equivalent units were adjusted into equity in the new companies by a specific conversion ratio per company, which was based upon the volume weighted average prices for each company at the time of the Spin-Off, in an effort to keep the value of the equity awards constant. These adjustments were accounted for as modifications to the original awards. In general, the Sallie Mae and Navient awards will be subject to substantially the same terms and conditions as the original pre-Spin-Off SLM awards. A comparison of the fair value of the modified awards with the fair value of the original awards immediately before the modification resulted in approximately $64 of incremental expense related to fully-vested stock option awards and was expensed immediately and $630 of incremental compensation expense related to unvested restricted stock and restricted stock units which will be recorded over the remaining vesting period of the equity awards.

Employee Stock Purchase Plan

In the third quarter of 2014, the Company resumed offering the opportunity for employees to enroll in our employee stock purchase plan ("ESPP"). Employees may purchase shares of SLM’s common stock under the ESPP at the end of a 12-month offering period at a price equal to the share price at the beginning of the 12-month period, less 15 percent. The purchase price for each offering was determined at the beginning of the offering period on August 1, 2014. We recorded stock-based compensation expense of $33 for the three and nine months ended September 30, 2014 related to this plan.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)

12. Arrangements with Navient Corporation

In connection with the Spin-Off, the Company entered into a separation and distribution agreement with Navient (the "Separation and Distribution Agreement"). In connection therewith, the Company also entered into various other ancillary agreements with Navient to effect the Spin-Off and provide a framework for its relationship with Navient thereafter, such as a transition services agreement, a tax sharing agreement, an employee matters agreement, a loan servicing and administration agreement, a joint marketing agreement, a key services agreement, a data sharing agreement and a master sublease agreement. The majority of these agreements are transitional in nature with most having terms of two years or less from the date of the Spin-Off.

We continue to have significant exposures to risks related to Navient's loan servicing operations and its creditworthiness. If we are unable to obtain services, complete the transition of our origination operations as planned, or obtain indemnification payments from Navient, we could experience higher than expected costs and operating expenses and our results of operations and financial condition could be materially and adversely affected.

We briefly summarize below some of the most significant agreements and relationships we continue to have with Navient. For additional information regarding the Separation and Distribution Agreement and the other ancillary agreements, see our Current Report on Form 8-K filed on May 2, 2014.

Separation and Distribution Agreement

The Separation and Distribution Agreement addresses, among other things, the following ongoing activities:

- the obligation of each party to indemnify the other against liabilities retained or assumed by that party pursuant to the Separation and the Distribution Agreement and in connection with claims of third parties;

- the allocation among the parties of rights and obligations under insurance policies;

- the agreement of the Company and Navient (i) not to engage in certain competitive business activities for a period of five years, (ii) as to the effect of the non-competition provisions on post-spin merger and acquisition activities of the parties and (iii) regarding "first look" opportunities; and

- the creation of a governance structure, including a separation oversight committee, by which matters related to the separation and other transactions contemplated by the Separation and Distribution Agreement will be monitored and managed.

Transition Services

During a transition period, Navient and its affiliates will provide the Bank with significant servicing capabilities with respect to Private Education Loans held by the Company and its subsidiaries. Beyond this transition period, it is currently anticipated that Navient will continue to service Private Education Loans owned by the Company or its subsidiaries with respect to individual borrowers who also have Private Education Loans which are owned by Navient, in order to optimize the customer's experience. In addition, Navient will continue to service and collect the Bank's portfolio of FFELP Loans indefinitely.

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SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
12. Arrangements with Navient Corporation (Continued)

Indemnification Obligations

Navient has also agreed to be responsible, and indemnify us, for all claims, actions, damages, losses or expenses that may arise from the conduct of all activities of pre-Spin-Off SLM occurring prior to the Spin-Off other than those specifically excluded in the Separation and Distribution Agreement. Some significant examples of the types of indemnification obligations Navient has under the Separation and Distribution Agreement and related ancillary agreements include:

- Pursuant to a tax sharing agreement, Navient has agreed to indemnify us for $283 million in deferred taxes that the Company will be legally responsible for but that relate to gains recognized by the Company's predecessor on debt repurchases made prior to the Spin-Off. The remaining amount of this indemnification at September 30, 2014 is $238 million. In addition, Navient has agreed to indemnify us for tax assessments incurred related to identified uncertain tax positions taken prior to the date of the Spin-off transaction. At September 30, 2014, we have recorded a receivable of $16 million related to this indemnification.

- Navient has responsibility to assume new or ongoing litigation matters relating to the conduct of most pre-Spin-Off SLM businesses operated or conducted prior to the Spin-Off.

- At the time of this filing, the Bank remains subject to a Consent Order, Order to Pay Restitution and Order to Pay Civil Money Penalty dated May 13, 2014 issued by the FDIC (the "2014 FDIC Order"). The 2014 FDIC Order replaces a prior cease and desist order jointly issued in August 2008 by the FDIC and the Utah Department of Financial Institutions ("UDFI") which was terminated on July 15, 2014. Specifically, on May 13, 2014, the Bank reached settlements with the FDIC and the Department of Justice (the "DOJ") regarding disclosures and assessments of certain late fees, as well as compliance with the Servicemembers Civil Relief Act ("SCRA"). The DOJ Order was approved by the U.S. District Court for the District of Delaware on September 29, 2014. Under the FDIC's 2014 Order, the Bank agreed to pay $3.3 million in fines and oversee the refund of up to $30 million in late fees assessed on loans owned or originated by the Bank since its inception in November 2005. Navient is responsible for funding all liabilities, restitution and compensation under orders such as these, other than fines directly levied against the Bank.

Long-Term Arrangements

The Loan Servicing and Administration Agreement governs the terms by which Navient provides servicing, administration and collection services for the Bank's portfolio of FFELP Loans and Private Education Loans, as well as servicing history information with respect to private education loans previously serviced by Navient and access to certain promissory notes in Navient's possession. The loan servicing and administration agreement has a fixed term with a renewal option in favor of the Bank.

The Data Sharing Agreement states the Bank will continue to have the right to obtain from Navient certain post-Spin-Off performance data relating to Private Education Loans owned or serviced by Navient to support and facilitate ongoing underwriting, originations, forecasting, performance and reserve analyses.

The Tax Sharing Agreement governs the respective rights, responsibilities and obligations of the Company and Navient after the Spin-Off relating to taxes, including with respect to the payment of taxes, the preparation and filing of tax returns and the conduct of tax contests. Under this agreement, each party is generally liable for taxes attributable to its business. The agreement also addresses the allocation of tax liabilities that are incurred as a result of the Spin-Off and related transactions. Additionally, the agreement restricts the parties from taking certain actions that could prevent the Spin-Off from qualifying for the tax treatment.

SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
12. Arrangements with Navient Corporation (Continued)

Amended Loan participation and purchase agreement

Prior to the Spin-Off, the Bank sold substantially all of its Private Education Loans to several former affiliates, now subsidiaries of Navient (collectively, the "Purchasers"), pursuant to this agreement. This agreement predates the Spin-Off but has been significantly amended and reduced in scope in connection with the Spin-Off. Post-Spin-Off, the Bank retains only the right to require the Purchasers to purchase loans (at fair value) for which the borrower also has a separate lending relationship with Navient ("Split Loans") when the Split Loans either (1) are more than 90 days past due; (2) have been restructured; (3) have been granted a hardship forbearance or more than 6 months of administrative forbearance; or (4) have a borrower or cosigner who has filed for bankruptcy. At September 30, 2014, we held approximately $126 million of Split Loans.

During the three and nine months ended September 30, 2014, the Bank separately sold loans to the Purchasers in the amount of $28,871 and $794,870, respectively, in principal and $542 and $26,339, respectively, in accrued interest income. During the three and nine months ended September 30, 2013, the Bank sold loans to the Purchasers in the amount of $571,946 and $2,281,404, respectively, in principal and $25,244 and $64,439, respectively, in accrued interest income.

The gain resulting from loans sold was $0 and $43,434 in the three months ended September 30, 2014 and 2013, respectively, and $35,848 and $192,097 in the nine months ended September 30, 2014 and 2013, respectively. Total write-downs to fair value for loans sold with a fair value lower than par totaled $4,571 and $15,632 in the three months ended September 30, 2014 and 2013, respectively, and $51,001 and $48,260 in the nine months ended September 30, 2014 and 2013, respectively.

13. Regulatory Capital

The Bank is subject to various regulatory capital requirements administered by federal banking authorities. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on our financial condition. Under the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

"Well capitalized" regulatory requirements are the quantitative measures established by regulation to ensure capital adequacy. The Bank is required to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier I Capital to risk-weighted assets and of Tier I Capital to average assets, as defined by the regulation. The following amounts and ratios are based upon the Bank's assets.

			Well Capitalized Regulatory Requirements	
	Amount	Ratio	Amount	Ratio
As of September 30, 2014:				

Tier I Capital (to Average Assets)	$1,389,122	12.3	%	$565,419	>	5.0	%
Tier I Capital (to Risk Weighted Assets)	$1,389,122	15.7	%	$530,102	>	6.0	%
Total Capital (to Risk Weighted Assets)	$1,454,837	16.5	%	$883,503	>	10.0	%
As of December 31, 2013:							
Tier I Capital (to Average Assets)	$1,221,416	11.7	%	$521,973	>	5.0	%
Tier I Capital (to Risk Weighted Assets)	$1,221,416	16.4	%	$446,860	>	6.0	%
Total Capital (to Risk Weighted Assets)	$1,289,497	17.3	%	$745,374	>	10.0	%

Dividends

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SLM CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, unless otherwise noted)
13. Regulatory Capital (Continued)

The Bank is chartered under the laws of the State of Utah and its deposits are insured by the FDIC. The Bank’s ability to pay dividends is subject to the laws of Utah and the regulations of the FDIC. Generally, under Utah’s industrial bank laws and regulations as well as FDIC regulations, the Bank may pay dividends from its net profits without regulatory approval if, following the payment of the dividend, the Bank’s capital and surplus would not be impaired. The Bank paid no dividends for the three months ended September 30, 2014 and 2013 or for the nine months ended September 30, 2014. For the nine months ended September 30, 2013, the Bank paid dividends of $120 million to an entity that is a subsidiary of Navient.

14. Commitments, Contingencies and Guarantees

Regulatory Matters
At the time of this filing, the Bank remains subject to the 2014 FDIC Order. Specifically, on May 13, 2014, the Bank reached settlements with the FDIC and the DOJ regarding disclosures and assessments of certain late fees, as well as compliance with the SCRA. The DOJ Order was approved by the U.S. District Court for the District of Delaware on September 29, 2014. Under the FDIC’s 2014 Order, the Bank agreed to pay $3.3 million in fines and oversee the refund of up to $30 million in late fees assessed on loans owned or originated by the Bank since its inception in November 2005.
Under the terms of the Separation and Distribution Agreement between the Company and Navient, Navient is responsible for funding all liabilities under the regulatory orders, other than fines directly levied against the Bank in connection with these matters. Under the DOJ Order, Navient is solely responsible for reimbursing SCRA benefits and related compensation on behalf of both its subsidiary, Navient Solutions, Inc., and the Bank.
Contingencies
In the ordinary course of business, we and our subsidiaries are routinely defendants in or parties to pending and threatened legal actions and proceedings including actions brought on behalf of various classes of claimants. These actions and proceedings may be based on alleged violations of consumer protection, securities, employment and other laws. In certain of these actions and proceedings, claims for substantial monetary damage may be asserted against us and our subsidiaries.
We and our subsidiaries and affiliates are subject to various claims, lawsuits and other actions that arise in the ordinary course of business. In addition, it is common for the Company, our subsidiaries and affiliates to receive information and document requests and investigative demands from state attorneys general, legislative committees, and administrative agencies. These requests may be for informational or regulatory purposes and may relate to our business practices, the industries in which we operate, or other companies with whom we conduct business. Our practice has been and continues to be to cooperate with these bodies and be responsive to any such requests.
In view of the inherent difficulty of predicting the outcome of litigation, regulatory and investigative actions, we cannot predict what the eventual outcome of the pending matters will be, what the timing or the ultimate resolution of these matters will be, or what the eventual loss, fines or penalties, if any, related to each pending matter may be.
We are required to establish reserves for litigation and regulatory matters where those matters present loss contingencies that are both probable and estimable. When loss contingencies are not both probable and estimable, we do not establish reserves.
Based on current knowledge, management does not believe there are loss contingencies, if any, arising from pending investigations, litigation or regulatory matters that could have a material adverse effect on our consolidated financial position, liquidity, results of operations or cash flows.

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

The following information is current as of October 22, 2014 (unless otherwise noted) and should be read in connection with SLM Corporation’s Annual Report on Form 10-K for the year ended December 31, 2013 (the “2013 Form 10-K”), the audited carve out financial statements filed on Form 8-K on May 6, 2014, and subsequent reports filed with the Securities and Exchange Commission (the “SEC”). Definitions for capitalized terms in this presentation not defined herein can be found in the 2013 Form 10-K (filed with the SEC on February 19, 2014).

This report contains forward-looking statements and information based on management’s current expectations as of the date of this report. Statements that are not historical facts, including statements about the Company’s beliefs or expectations and statements that assume or are dependent upon future events, are forward-looking statements. Forward-looking statements are subject to risks, uncertainties, assumptions and other factors that may cause actual results to be materially different from those reflected in such forward-looking statements. These factors include, among others, the risks and uncertainties set forth in Item 1A “Risk Factors” and elsewhere in the Company's 2013 Form 10-K, the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, and the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2014; increases in financing costs; limits on liquidity; increases in costs associated with compliance with laws and regulations; changes in accounting standards and the impact of related changes in significant accounting estimates; any adverse outcomes in any significant litigation to which the Company is a party; credit risk associated with the Company’s exposure to third parties, including counterparties to the Company’s derivative transactions; and changes in the terms of student loans and the educational credit marketplace (including changes resulting from new laws and the implementation of existing laws). The Company could also be affected by, among other things: changes in its funding costs and availability; failures of its operating systems or infrastructure, including those of third-party vendors; failure to implement the recently executed separation of the Company into two separate publicly traded companies, including failure to transition its origination and servicing operations as planned, increased costs in connection with being a stand-alone company, and failure to achieve the expected benefits of the separation; damage to its reputation; changes in the demand for educational financing or in financing preferences of lenders, educational institutions, students and their families; changes in law and regulations with respect to the student lending business and financial institutions generally; changes in banking rules and regulations, including increased capital requirements; increased competition from banks and other consumer lenders; the creditworthiness of its customers; changes in the general interest rate environment, including the rate relationships among relevant money-market instruments and those of its earning assets vs. its funding arrangements; and changes in general economic conditions. The preparation of the Company’s consolidated financial statements also requires management to make certain estimates and assumptions including estimates and assumptions about future events. These estimates or assumptions may prove to be incorrect. All forward-looking statements contained in this report are qualified by these cautionary statements and are made only as of the date of this report. The Company does not undertake any obligation to update or revise these forward-looking statements to conform the statement to actual results or changes in its expectations.

The Company reports financial results on a GAAP basis and also provides certain core earnings performance measures. The difference between the Company’s “Core Earnings” and GAAP results for the periods presented were the unrealized, mark-to-market gains/losses on derivative contracts (excluding current period accruals on the derivative instruments), net of tax. These are recognized in GAAP but not in “Core Earnings” results. The Company provides “Core Earnings” measures because this is what management uses when making management decisions regarding the Company’s performance and the allocation of corporate resources. The Company’s “Core Earnings” are not defined terms within GAAP and may not be comparable to similarly titled measures reported by other companies. For additional information, see “Key Financial Measures - 'Core Earnings' ” in this Form 10-Q for the quarter ended September 30, 2014 for a further discussion and a complete reconciliation between GAAP net income and “Core Earnings.”

Certain reclassifications have been made to the balances as of and for the three and nine months ended September 30, 2013 to be consistent with classifications adopted for 2014, and had no effect on net income, total assets, or total liabilities.

Through this discussion and analysis, we intend to provide the reader with some narrative context for how our management views our consolidated financial statements, additional context within which to assess our operating results, and information on the quality and variability of our earnings, liquidity and cash flows.

Selected Financial Information and Ratios

(In millions, except per share data)	Three Months Ended September 30, 2014		2013		Nine Months Ended September 30, 2014		2013	
Net income attributable to SLM Corporation	$83		$49		$174		$199	
Diluted earnings per common share attributable to SLM Corporation	$0.18		$0.11		$0.38		$0.44	
Weighted average shares used to compute diluted earnings per share	432		445		432		450	
Return on assets	3.02	%	2.17	%	2.18	%	2.99	%
Operating efficiency ratio[1]	32	%	46	%	38	%	38	%
Other Operating Statistics								
Ending Private Education Loans, net	$7,779,422		$6,161,411		$7,779,422		$6,161,411	
Ending FFELP Loans, net	1,315,951		1,214,831		1,315,951		1,214,831	
Ending total education loans, net	$9,095,373		$7,376,242		$9,095,373		$7,376,242	
Average education loans	$8,747,522		$7,013,415		$8,768,930		$6,960,300	

(1) Our efficiency ratio is calculated as operating expense, excluding restructuring costs, divided by net interest income after provision for loan losses and other income. See also “Key Financial Measures - Operating Expenses.”

Overview

On April 30, 2014, we completed our plan to legally separate into two distinct publicly-traded entities - an education loan management, servicing and asset recovery business, Navient Corporation (“Navient”), and a consumer banking business, SLM Corporation. The separation of Navient from SLM Corporation (the “Spin-Off”) was preceded by an internal corporate reorganization, which was the first step to separate the education loan management, servicing and asset recovery business from the consumer banking business. For a more detailed discussion of the Spin-Off, risk factors related to the Spin-Off and the business to be conducted by the Company after the Spin-Off, please see our Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC on February 19, 2014, and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 filed with the SEC on July 24, 2014.

On October 13, 2014, we completed the operational separation of our servicing platforms and personnel from Navient and launched our new customer service operation. One major project remains to be completed before full operational separation from Navient can be achieved: establishing the Bank’s own loan originations platform which we currently expect to achieve sometime in the first half of 2015. For a more detailed description of ongoing arrangements among the Company and Navient, see notes to consolidated financial statements contained in this Form 10-Q, Note 12, “Arrangements with Navient Corporation”.

References in this Quarterly Report on Form 10-Q to “we,” “us,” “our,” “Sallie Mae” and the “Company,” refer to SLM Corporation and its subsidiaries, immediately after the Spin-Off (as hereinafter defined) except as otherwise indicated or unless the context otherwise requires. We use “Private Education Loans” to mean education loans to students or their families that are non-federal loans not insured or guaranteed under the previously existing Federal Family Education Loan Program (“FFELP”).

Initiation of Post-Spin-Off Periodic Reporting by SLM Corporation

The timing and steps necessary to complete the Spin-Off and comply with SEC reporting requirements, including the replacement of pre-Spin-Off SLM Corporation with our current publicly-traded registrant, have resulted in our Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC on February 19, 2014, and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 filed with the SEC on May 12, 2014, providing business results and financial information for the periods reported therein on the basis of the consolidated businesses of pre-Spin-Off SLM. Readers are reminded that while information contained in those prior reports may provide meaningful historical context for the Company's business, the Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 was our first periodic report made on the basis of the post-Spin-Off business of the Company.

Recent Developments

New Customer Service Operations Launched

On October 13, 2014, we completed the operational separation of our servicing platforms and personnel from Navient and launched our new customer service operation. One major project remains to be completed before full operational separation from Navient can be achieved: establishing the Bank's own loan originations platform which we currently expect to achieve sometime in the first half of 2015. In related developments, the Company's Office of the Customer Advocate began operating separately from Navient's and the Company and the Consumer Finance Protection Bureau ("CFPB") initiated a separate, dedicated CFPB portal to receive customer inquiries associated with the Company's Private Education Loans[1].

As a result of the launch, the Company and the Bank now have sole responsibility for servicing the 840,000 loans contained within the Bank's existing Private Education Loan portfolio and maintaining customer relationships with the 1 million borrowers and related cosigners to whom these loans have been made. As of the end of the third quarter, the loans in our Private Education Loan portfolio were originated with average FICO scores of 749 and nearly 90 percent of them were cosigned.

Concurrent with the launch of our new customer service operation on October 13, 2014, we launched a new informational section on SallieMae.com that provides comprehensive information for managing private education loans. This section includes information on: the steps customers may take to ease the transition from school to making payments, an overview of payment options, an explanation of payment allocation and an explanation of the assistance available to customers who experience special circumstances, such as life changes or payment difficulties. The site also provides forms for cosigner release and explains special benefits for servicemen and women under the Servicemembers Civil Relief Act, and it includes information on the dedicated Sallie Mae military customer service team.

Private Education Loan Sales

In the third quarter of 2014, we sold $1.2 billion of loans through loan sales and a securitization transaction with third parties (including Navient). As a result of these loans sales we recorded gains of $85 million. See notes to consolidated financial statements, Note 12, "Arrangements with Navient Corporation," for further discussion regarding loan purchase agreements. While there may be near-term Private Education Loan sales to Navient to facilitate an orderly transition after the Spin-Off, neither the Company nor Navient has any ongoing obligation to buy or sell Private Education Loans to or from the other.

Annual Report of the CFPB Student Loan Ombudsman

On October 16, 2014, the CFPB Student Loan Ombudsman's office released its most recent annual report on the private student loan industry. This year's report focused on three primary areas of customer feedback: limited available information on ways to avoid default; a shortage of affordable loan modifications available to private student loan borrowers as compared to Federal student loan products; and the potential risk of improper use of short-term forbearance programs. The report again suggested Congress reconsider whether federal bankruptcy laws preventing the discharge of private student loans in bankruptcy was somehow contributing to the types of complaints being identified in the report.

When customers experience financial difficulty, we strive to work with each individual to understand his or her financial situation and identify alternative payment arrangements. In addition, we provide many repayment options including extended repayment schedules, an interest rate reduction program and, if appropriate, forbearance-all scaled to a customer's individual circumstances and ability. These programs, much like the adjustments available to customers under federal student loan programs, must be used wisely given their potential to significantly increase the overall costs of education financing to customers.

We also recognize that, in some cases, loan modifications and other efforts may be insufficient. That is why Sallie Mae continues to support bankruptcy reform that would permit the discharge of education loans - both private and federal - after sufficient required period of good faith attempts to repay and that is prospective so as not to rewrite existing contracts. Any reform should recognize that education loans have unique characteristics and benefits as compared to other consumer loan classes. We do not believe bankruptcy reform structured along these lines would be detrimental to our business model or future prospects.

1 In connection with the work to establish the new portal we have determined that 105 of the complaints identified in the October 16, 2014 CFPB Student Loan Ombudsman's Report are attributable to our existing loan portfolio.

Key Financial Measures

Set forth below are brief summaries of our key financial measures. Our operating results are primarily driven by net interest income from our Private Education Loan portfolio (which include financing costs), provision for loan losses, gains and losses on loan sales and operating expenses. The growth of our business and the strength of our financial condition are primarily driven by our ability to achieve our annual Private Education Loan originations goals while sustaining credit quality and maintaining diversified, cost-efficient funding sources to support our originations.

Net Interest Income

The most significant portion of our earnings is generated by the spread between the interest income we receive on assets in our education loan portfolios and the interest expense we pay on funds we use to originate these loans. We report these earnings as net interest income.

Net interest income is predominantly determined by the balance of Private Education Loans. As of September 30, 2014, we had $7.8 billion and $1.3 billion of Private Education and FFELP Loans, respectively. For Private Education Loans, net interest margin is determined by interest rates we establish based upon the credit of the customer and any cosigner less our cost of funds. The majority of our Private Education Loans earn variable rate interest and are funded primarily with deposits. Our cost of funds is primarily influenced by competition in the deposit market.

FFELP Loans carry lower risk and have a much lower net interest margin as a result of the federal government guarantee. We do not expect to acquire any more FFELP Loans and the balance of our FFELP portfolio is expected to decline due to normal amortization.

Allowance for Loan Losses

Management estimates and maintains an allowance for loan losses (which we sometimes also refer to as "provision") at a level sufficient to cover charge-offs expected over the next year, plus an additional allowance to cover life-of-loan expected losses for loans classified as a troubled debt restructuring (“TDR”). The allowance for loan losses is increased when we record provision expense and for recoveries and is reduced by charge-offs. Generally, the provision for loan losses and the allowance for loan losses rise when charge-offs are expected to increase and fall when charge-offs are expected to decline. We bear the full credit exposure on our Private Education Loans. Losses on our Private Education Loans are determined by risk characteristics such as loan status (in-school, grace, forbearance, repayment and delinquency), loan seasoning (number of months in active repayment), underwriting criteria (e.g., credit scores), presence of a cosigner and the current economic environment.

Our provision for loan losses on our Private Education Loans was $54 million for the first nine months of 2014 compared with $37 million in the comparable 2013 period. In connection with the Spin-Off, we changed our policy of charging off Private Education Loans when they are delinquent for 212 days to charging off loans after they are 120 days delinquent. In addition, we changed our loss confirmation period for Private Education Loans from two years to one year to reflect the shorter charge-off period and recent changes in our servicing practices.

Our loss exposure and resulting provision for losses is small for FFELP Loans because we generally bear a maximum of three percent loss exposure on them. Our provision for losses in our FFELP Loans portfolio was $1.5 million for the first nine months of 2014 compared with the $2.8 million in the first nine months of 2013.

Charge-Offs and Delinquencies

Delinquencies are a very important indicator of potential future credit performance. When a Private Education Loan reaches 120 days delinquent it is charged against the allowance for loan losses. Charge-off data provides relevant information with respect to the performance of our loan portfolios. Management focuses on delinquencies as well as the progression of loans from early to late stage delinquency. Prior to the Spin-off, the Bank would sell delinquent loans to an entity that is now a subsidiary of Navient prior to the loans becoming 120 days delinquent. As a result, there were no charge-offs recorded in our financial statements prior to April 1, 2014. In addition, because loans were sold earlier in their delinquency status, the historical delinquency statistics are not necessarily indicative of expected future performance.

Private Education Loan delinquencies as a percentage of Private Education Loans in repayment decreased from 1.46 percent at September 30, 2013 to 1.31 percent at September 30, 2014.

Operating Expenses
The operating expenses reported are those that are directly attributable to the Company, the costs of Transition Services Agreements with Navient, and restructuring costs associated with the build-out of our servicing platform and the remaining costs of the Spin-Off. Our efficiency ratio is calculated as operating expense, excluding restructuring costs, divided by net interest income after provision for loan losses and other income. In the third quarter this ratio was 32 percent versus 46 percent in the year-ago quarter. For the nine months ended September 30, 2014 this ratio was 38 percent unchanged from the year-ago period. Year-to-date net gains on loan sales have positively effected the denominator of the efficiency ratio. Consequently, as no more loan sales are contemplated this year and our post-Spin-Off expense levels continue to stabilize, we expect no further improvements and possible volatility in the efficiency ratio for the year. Our long-term objective is to achieve steady declines in this ratio over the next several years as the balance sheet and revenue grows to a level commensurate with our loan origination platform and we control the growth of our expense base.
Core Earnings
We prepare financial statements in accordance with GAAP. However, we also produce and report our after-tax earnings on a separate basis which we refer to as "Core Earnings." While pre-Spin-Off SLM also reported a metric by that name, what we now report and what we describe below is significantly different and should not be compared to any Core Earnings reported by pre-Spin-Off SLM.
"Core Earnings" recognizes the difference in accounting treatment based upon whether the derivative qualifies for hedge accounting treatment and eliminates the earnings impact associated with hedge ineffectiveness and derivatives we use as an economic hedge but do not qualify for hedge accounting treatment. We enter into derivatives instruments to economically hedge interest rate and cash flow risk associated with our portfolio. We believe that our derivatives are effective economic hedges, and as such, are a critical element of our interest rate risk management strategy. Those derivative instruments that qualify for hedge accounting treatment have their related cash flows recorded in interest income or interest expense along with the hedged item. Hedge ineffectiveness related to these derivatives are recorded in "Gains (losses) on derivatives and hedging activities, net." Some of our derivatives do not qualify for hedge accounting treatment and the stand-alone derivative must be marked-to-fair value in the income statement with no consideration for the corresponding change in fair value of the hedged item. These gains and losses, recorded in "Gains (losses) on derivative and hedging activities, net", are primarily caused by interest rate volatility and changing credit spreads during the period as well as the volume and term of derivatives not receiving hedge accounting treatment. Cash flows on derivative instruments that do not qualify for hedge accounting are not recorded in interest income and interest expense, they are recorded in non interest income: "gains (losses) on derivative and hedging activities, net."
The adjustments required to reconcile from our "Core Earnings" results to our GAAP results of operations, net of tax, relate to differing treatments for our use of derivative instruments to hedge our economic risks that do not qualify for hedge accounting treatment or do qualify for hedge accounting treatment but result in ineffectiveness, net of tax. The amount recorded in "Gains (losses) on derivative and hedging activities, net" includes the accrual of the current payment on the swaps on derivatives that do not qualify for hedge accounting treatment as well as the change in fair values related to future expected cash flows for derivatives and accounting hedges. For purposes of "Core Earnings" we are including in GAAP earnings the current period accrual amounts (interest reclassification) on the swaps and excluding the remaining ineffectiveness. "Core Earnings" is meant to represent what earnings would have been had these derivatives qualified for hedge accounting and there was no ineffectiveness.

"Core Earnings" are not a substitute for reported results under GAAP. We provide "Core Earnings" basis of presentation because (i) earnings per share computed on a "Core Earnings" basis is one of several measures we utilize in establishing management incentive compensation and (ii) we believe it better reflects the financial results for derivatives that are economic hedges of interest rate risk but do not qualify for hedge accounting treatment.
GAAP provides a uniform, comprehensive basis of accounting. Our "Core Earnings" basis of presentation differs from GAAP in the way it treats ineffective hedges as described above.

The following table shows the amount in "Gains (losses) on derivative and hedging activities, net" that relates to the interest reclassification on the derivative contracts.

(Dollars in thousands)	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Hedge ineffectiveness gains (losses)	$6,571	$(49)	$(1,684)	$(118)
Interest reclassification	(1,170)	346	(3,137)	973
Gains (losses) on derivatives and hedging activities, net	$5,401	$297	$(4,821)	$855

The following table reflects adjustments associated with our derivative activities.

(Dollars in thousands, except per share amounts)	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
"Core Earnings" adjustments to GAAP:				
GAAP net income attributable to SLM Corporation	$82,926	$49,390	$174,502	$198,743
Preferred stock dividends	4,850	—	8,078	—
GAAP net income attributable to SLM Corporation common stock	$78,076	$49,390	$166,424	$198,743
GAAP net income attributable to SLM Corporation	$82,926	$49,390	$174,502	$198,743
Adjustments:				
Net impact of derivative accounting[(1)]	(6,571)	49	1,684	118
Net tax effect[(2)]				