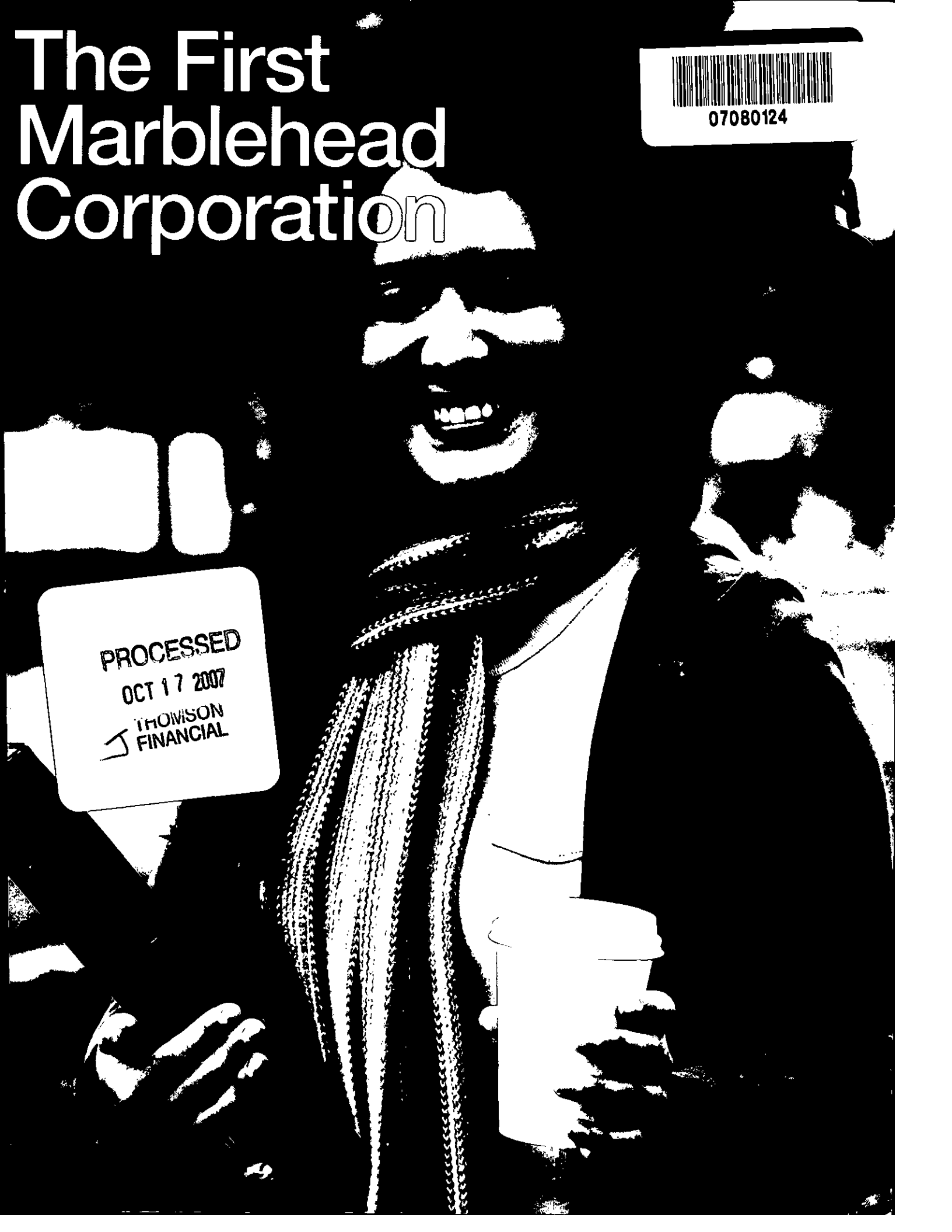


# The First Marblehead Corporation



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# Shareholder Letter

October 5, 2007

Dear Shareholders,

This has been an extraordinary year of progress and success for First Marblehead. We continued to meet the growing demand for private capital, facilitating 429,000 loans while helping students fulfill their education dreams. First Marblehead had a record fiscal year, generating total revenue of \$881 million, up 55% from last year. Our net income for the fiscal year was \$371 million, up 57% over last year, and earnings were \$3.92 per diluted share, an increase of 60% over the prior year. Our four-year compound annual growth rate of 80% for earnings per share exceeded that of 95% of S&P 500 companies. We are very proud of this exceptional level of performance. Our company has continued to produce consistently outstanding results against the backdrop of volatile credit market cycles and necessary legislative reform efforts in the student lending industry.

The terrific results in revenue and earnings growth for the fiscal year were driven by significant growth in our facilitated loan volume, superior execution in our securitization program, a focus on our core competencies and enhanced operating capabilities. We have continued to help meet the growing demand for private education loans by providing an integrated suite of services for student loan programs to banks and other financial services companies and marketers. Senior management and our employees at First Marblehead are dedicated to being the leading provider of financial solutions that help students achieve their education dreams.

## Highlights of Fiscal Year 2007

### Diversifying our Revenue Base

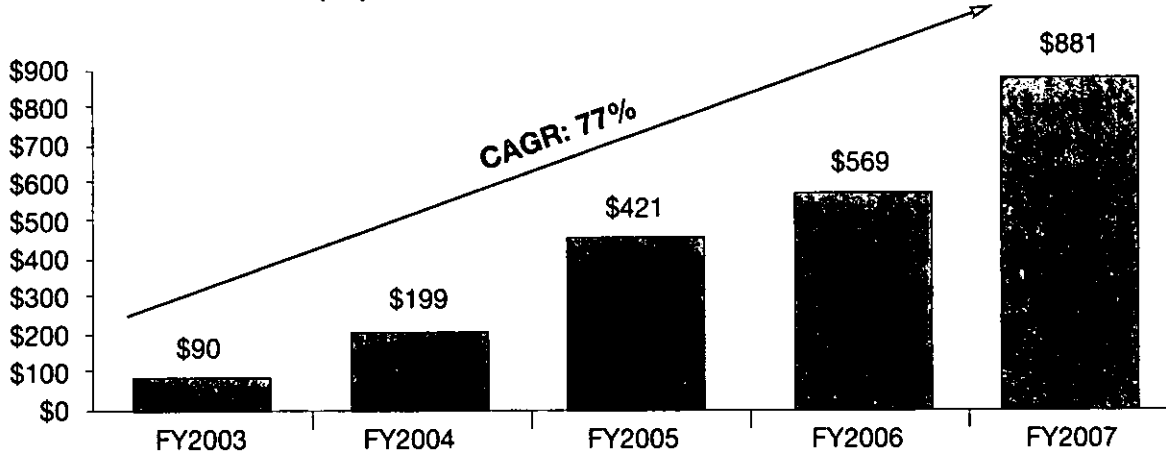
- Fiscal 2007 was a significant year in terms of expanding our business and client bases. We acquired or expanded relationships with 30 clients in fiscal 2007 and had no attrition of any significant clients during the fiscal year. We added 20 new clients in fiscal 2007, representing a cross section of banks, consumer finance companies, affinity-focused financial services companies and marketing companies. We help our clients deliver competitive education finance solutions to their customer and member bases.

### Capital Markets

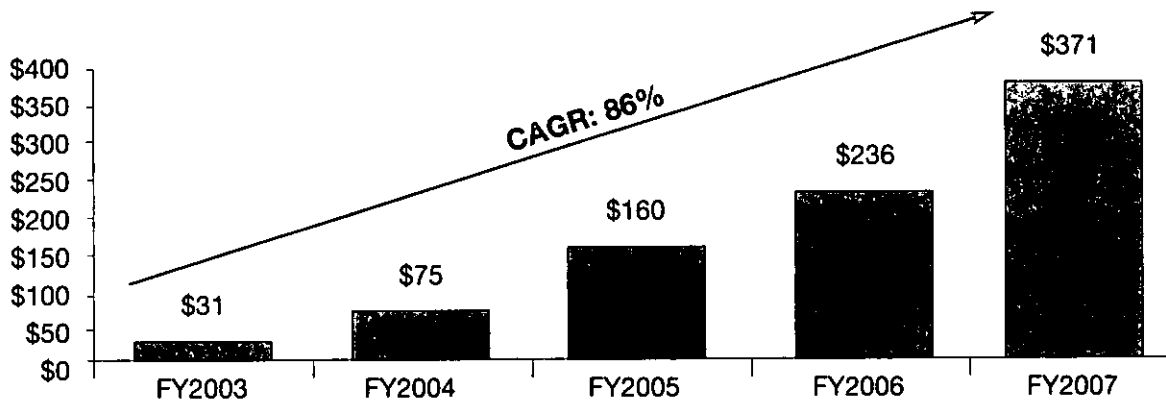
- For fiscal 2007, we securitized \$3.75 billion of private student loans. The blended yield was over 18% with approximately \$457 million coming in the form of upfront cash at the time of closing. Investor demand in our securitization program has been diverse and strong.
- For fiscal 2007, the mix of direct-to-consumer to school channel loans available for securitization was 79% to 21%. We continued to see increasing consumer demand as borrowers sought a range of options in a direct relationship with a lender; however, the school channel remains an important and viable growth channel where we plan to continue to allocate meaningful resources.

# Solid Operating Results

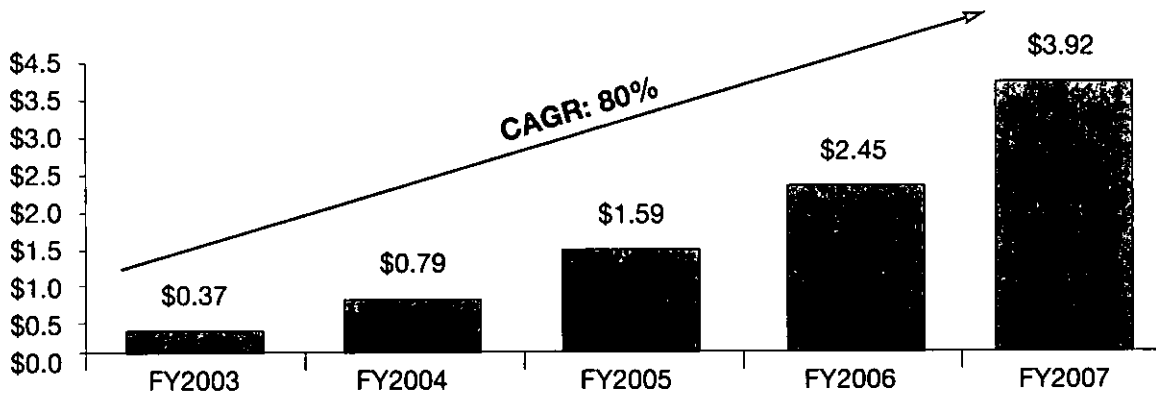
## Total Revenue \$(M)



## Net Income \$(M)



## Earnings Per Share<sup>1</sup>



<sup>1</sup>Earnings per share adjusted to reflect post-split values

- The rolling 12-month volume of loans available for securitization as of June 30, 2007 increased 33% over the last fiscal year to \$3.9 billion.

#### **Processing Efficiency**

- We processed a record 1.3 million loan applications that helped provide approximately 429,000 student loans to finance education at 5,800 schools. Our facilitated volume for the year was \$4.3 billion, an increase of 28% over last fiscal year.

#### **Marketing Expertise**

- We continued to supplement our clients' brand and distribution skills with our knowledge of the marketplace. The growth of our marketing services enabled us to offer our clients a more complete suite of products and support than ever before. We continue to design and test products, channels and messaging through our proprietary brands and take our knowledge back to our existing client base.
- Loans branded under our original proprietary brand, Astrive® Student Loans, represented approximately 12% of our overall facilitated loan volume for the fiscal year. Additionally, we rolled out two new proprietary brands during fiscal 2007 to enhance our knowledge regarding subsegments of the student loan marketplace. These brands will complement the learnings and volumes of our Astrive loans. We believe that as a result of the use of our proprietary brands, we have enabled clients for whom we coordinate marketing services to increase their loan volume.

#### **Enhancing our Core Capabilities**

- We added significantly to our operating capabilities – investing in our people, processes and technology. We added experienced leadership talent, bringing in over a dozen executives, with an average of 20+ years of experience in critical areas of information technology (IT), marketing, sales and strategic planning. We expanded our internal training, employee engagement, and learning and development initiatives. We invested heavily in upgrading and expanding our core IT infrastructure to build in significant disaster recovery and back-up capabilities and to prepare us for the growth we expect.
- We completed the acquisition of Union Federal Saving Bank, a federally-chartered thrift located in Rhode Island, in November 2006.

#### **Returning Capital to our Shareholders**

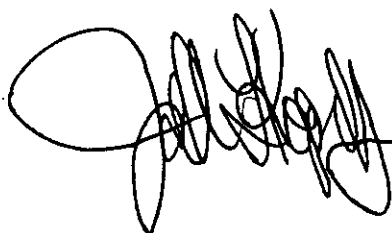
- Our company paid \$59 million in dividends to shareholders and repurchased \$61 million of stock this fiscal year. In the fourth quarter, our board increased the quarterly cash dividend to \$0.25 per share from \$0.15, an increase of 67%. This was the fourth consecutive quarterly increase and, overall, dividends increased 94% for fiscal 2007 as compared with fiscal 2006. First Marblehead also repurchased 1.76 million shares during the fiscal year. We continue to look for opportunities to enhance shareholder value through stock buy-backs, dividends and investments in the company.

## **Our Future**

The student loan financing industry continues to evolve. The funding gap between the cost of a college education and traditional sources of funding continues to widen and is estimated to be \$122 billion. First Marblehead has long been a proponent of the principles

of smart borrowing, encouraging students to access grants and low-cost loans to achieve their education dreams before considering private loan solutions, and our business model supports responsible borrowing for all students. We see great opportunity in the future as we continue to enable private capital to meet the borrowing needs of students. The market for private student loans has been growing at a rate of 30% annually. We have built a strong foundation to position the company to meet the needs of students in the future. Looking forward to 2008, we are already off to a fast start. Demand is very strong as we have worked with our clients to bring even more private student loan solutions to borrowers.

First Marblehead has delivered strong, quality growth to our shareholders, and we remain proud of the performance of the company. We appreciate the efforts of all 1,000 of our dedicated employees as they focus on our mission of helping students and executing on our plan to continue enhancing value for you—our shareholders.



**Jack L. Kopnisky**  
Chief Executive Officer, President &  
Chief Operating Officer



**Peter B. Tarr**  
Chairman and General Counsel

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K

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(Mark One)

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

For the fiscal year ended: June 30, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-31825

THE FIRST MARBLEHEAD CORPORATION

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

04-3295311  
(I.R.S. Employer  
Identification No.)

The Prudential Tower  
800 Boylston Street, 34<sup>th</sup> Floor  
Boston, Massachusetts  
(Address of principal executive offices)

02199-8157  
(Zip Code)

Registrant's telephone number, including area code: (617) 638-2000

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$.01 par value  
(Title of each class)

New York Stock Exchange  
(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant (without admitting that any person whose shares are not included in the calculation is an affiliate) was approximately \$3,171,000,000 based on the last reported sale price of the common stock on the New York Stock Exchange on December 30, 2006.

Number of shares of the registrant's class of common stock outstanding as of July 31, 2007: 93,405,267

DOCUMENTS INCORPORATED BY REFERENCE

The registrant intends to file a proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended June 30, 2007. Pursuant to Paragraph G(3) of the General Instructions to Form 10-K, information required by items 10, 11, 12, 13 and 14 of Part III have been omitted from this report (except for information required with respect to our executive officers and code of ethics, which is set forth under "Executive Officers" and "Code of Ethics" in Part I of this report) and are incorporated by reference to the definitive proxy statement to be filed with the Securities and Exchange Commission.

**THE FIRST MARBLEHEAD CORPORATION**

**ANNUAL REPORT ON FORM 10-K  
For the Fiscal Year Ended June 30, 2007**

**TABLE OF CONTENTS**

<b>PART I</b> .....	1
ITEM 1. BUSINESS .....	1
ITEM 1A. RISK FACTORS .....	20
ITEM 1B. UNRESOLVED STAFF COMMENTS .....	36
ITEM 2. PROPERTIES .....	36
ITEM 3. LEGAL PROCEEDINGS .....	36
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS .....	36
<b>PART II</b> .....	37
ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES .....	37
ITEM 6. SELECTED FINANCIAL DATA .....	40
ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS .....	42
ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK .....	65
ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA .....	66
ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE .....	66
ITEM 9A. CONTROLS AND PROCEDURES .....	66
ITEM 9B. OTHER INFORMATION .....	67
<b>PART III</b> .....	68
ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE .....	68
ITEM 11. EXECUTIVE COMPENSATION .....	68
ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS .....	68
ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE .....	68
ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES .....	69
<b>PART IV</b> .....	70
ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES .....	70

FIRST MARBLEHEAD and ASTRIVE are either registered trademarks or trademarks of The First Marblehead Corporation. All other trademarks, service marks or trade names appearing in this annual report are the property of their respective owners.

All share and per share information in this annual report give effect to a three-for-two stock split of our common stock which was effected in the form of a stock dividend in December 2006.

This annual report includes forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and Section 27A of the Securities Act of 1933, as amended, or the Securities Act. For this purpose, any statements contained herein regarding our strategy, future operations, financial position, future revenues, projected costs, market position, prospects, plans and objectives of management, other than statements of historical facts, are forward-looking statements. The words “anticipates,” “believes,” “estimates,” “expects,” “intends,” “may,” “plans,” “projects,” “will,” “would” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We cannot guarantee that we actually will achieve the plans, intentions or expectations expressed or implied in our forward-looking statements. Matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, regulatory, competitive and other factors, which may cause actual results, levels of activity, performance or the timing of events to be materially different than those exposed or implied by forward-looking statements. Important factors that could cause or contribute to such differences include our “critical accounting estimates” described in Item 7 of Part II of this annual report, and the factors set forth under the caption “Risk Factors” in Item 1A of Part I of this annual report. Although we may elect to update forward-looking statements in the future, we specifically disclaim any obligation to do so, even if our estimates change, and readers should not rely on those forward-looking statements as representing our views as of any date subsequent to August 28, 2007.



## PART I

### Item 1. Business

We use the terms "First Marblehead," "we," "us" and "our" in this annual report to refer to the business of The First Marblehead Corporation and its subsidiaries.

#### Overview

The First Marblehead Corporation provides outsourcing services for private education lending in the United States. We help meet the growing demand for private education loans by providing national and regional financial institutions and educational institutions, as well as businesses, education loan marketers and other enterprises, with an integrated suite of design, implementation and securitization services for student loan programs. Using our services, our clients can offer borrowers access to competitive, customized student loan products. We receive fees for the services we provide in connection with processing and securitizing our clients' loans. We focus primarily on loan programs for undergraduate, graduate and professional education, and, to a lesser degree, on the primary and secondary school market. Private education loans are not guaranteed by the U.S. government and are funded by private sector lenders. They are intended to be used by borrowers who have first considered other sources of education funding, including the federally guaranteed loan programs, grants and other aid.

We enable our clients to offer student and parent borrowers competitive loan products, while managing the complexities and risks of these products. We provide our clients with a continuum of services, from the initial phases of program design through application processing and support to the ultimate disposition of the loans through securitization transactions that we structure and administer. We have developed loan processing and support systems that are designed to accommodate new clients, additional loan products and incremental loan volume. We also own a proprietary database of more than 20 years of historical information on private student loan performance, which helps us to facilitate the structuring and pricing of our clients' loan programs and to supervise the servicing and default management processes for the securitized loans. In addition, our proprietary database increases the efficiency of the securitizations of our clients' loans by enabling us to provide to participants in the securitization process historical payment, default and recovery data on which to base estimates as to credit losses and reserves.

The following table presents certain financial and operating information for the fiscal years ended June 30, 2007, 2006 and 2005. For additional information about our financial performance for each of the last three fiscal years, including our total assets, we refer you to the audited consolidated financial statements and accompanying notes attached as Appendix A to this annual report.

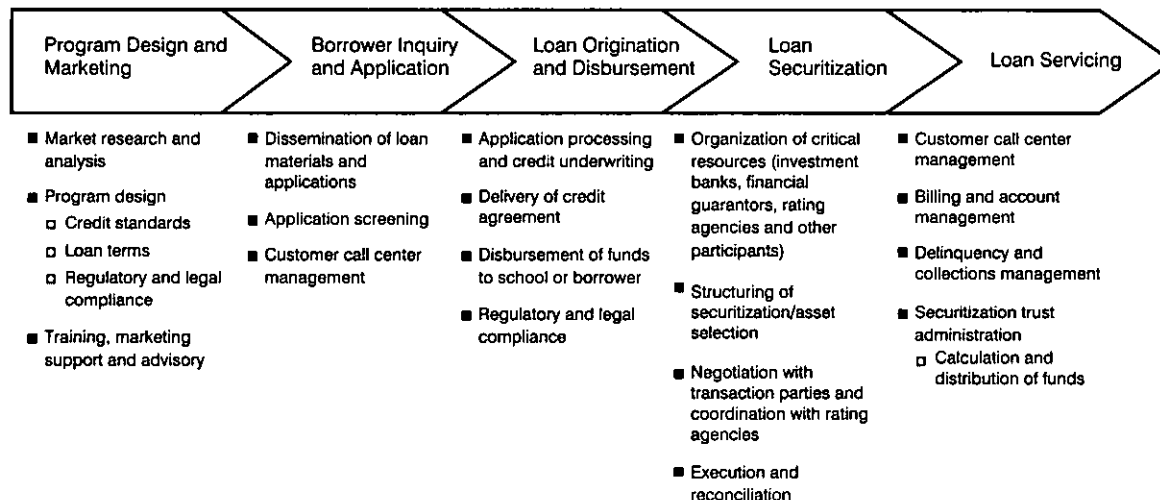
	Fiscal year ended June 30,		
	2007	2006	2005
	(dollars in thousands)		
Total revenues .....	\$ 880,704	\$ 569,035	\$ 421,265
Net income .....	\$ 371,331	\$ 235,960	\$ 159,665
Approximate student loan applications processed .....	1,325,000	938,000	876,000
Approximate number of schools with loans facilitated .....	5,800	5,600	5,300
Principal amount of student loans facilitated .....	\$4,292,528	\$3,362,565	\$2,662,106
Principal amount of student loans facilitated that were also available to us for securitization .....	\$3,873,048	\$2,920,048	\$2,179,524
Principal and accrued interest balance of student loans securitized .....	\$3,750,043	\$2,762,368	\$2,262,493
Principal balance of student loans facilitated and available to us at year end for later securitization .....	\$ 831,912	\$ 663,800	\$ 385,804

We have provided structural advisory and other services for 36 securitization transactions since our formation in 1991. We facilitated five securitizations in fiscal 2007, four securitizations in fiscal 2006 and five securitizations in fiscal 2005.

**Private Student Lending Overview**

The lifecycle of a private student loan, which can be over 20 years long, consists of a series of processes and involves many distinct parties. Because the activities of these parties are largely uncoordinated but heavily regulated, the processes associated with designing, implementing, financing and administering student loan programs are complex, resource intensive and costly.

Set forth below is a chart outlining the series of processes in the private student loan lifecycle:



**Program Design and Marketing**

Lenders, education loan marketers and educational institutions face an array of choices in attempting to satisfy their strategic and financial goals, as well as the needs of student borrowers. If an organization decides to initiate a loan program, it typically needs to make significant investments in staffing and infrastructure in order to support the program. In designing loan programs, the factors that these organizations generally consider include:

- borrower creditworthiness criteria, including acceptable credit scores, credit bureau ratings and cosigner requirements, as well as factors such as employment and income history and any past derogatory credit events;
- borrower eligibility criteria, including enrollment status, academic progress and citizenship or residency;
- loan limits, including minimum and maximum loan amounts on both an annual and aggregate basis;
- interest rates, including the frequency and method of adjustment;
- amount of fees charged to the borrower, including origination, guarantee and late fees;
- repayment terms, including maximum repayment term, minimum monthly payment amounts, rate reduction incentive programs and prepayment penalties, and deferment and forbearance options;
- loan guarantee arrangements to ensure repayment of defaulted principal and interest payments;

- loan servicing, default management and collection arrangements;
- asset financing or loan disposition alternatives; and
- legal compliance with numerous federal laws and regulations, including but not limited to the Truth-in-Lending Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, the Federal Trade Commission, or FTC, Act, the FTC Telemarketing Sales Rule, and numerous state laws that replicate and, in some cases, expand upon the requirements of federal laws.

In creating their loan marketing programs, institutions face choices in the channels and media available to them to reach potential student borrowers, including financial aid offices, online advertising, direct mail campaigns, e-mail campaigns, telemarketing, and print, radio and television advertising.

### ***Borrower Inquiry and Application***

Prospective and current students and their families confront a complicated process in applying for financial aid. Because private student loans are often used to bridge the gap between school costs and available funds, including family resources and federal and state loans and grants, many borrowers must navigate multiple application processes. In order to respond to questions about these processes from student borrowers, lenders and educational institutions must invest in an appropriate infrastructure, including a staff of customer service personnel who have a thorough understanding of both the terms and competitive advantages of their private loan program and the financial aid process as a whole. In addition to a customer service function, these institutions must respond to requests for loan materials and loan applications.

### ***Loan Origination and Disbursement***

Once a loan provider has received a loan application and determined that it is complete, it must then evaluate the information provided by the applicant against the eligibility and creditworthiness criteria of the loan program. This underwriting process, which is subject to a variety of state and federal regulations, typically involves communication with credit bureaus in order to generate a credit score for the applicant and either an approval or denial of the loan.

If the applicant satisfies the loan program criteria, the loan provider then prepares a legal instrument, known as a credit agreement, reflecting the terms and conditions under which the loan will be made. If the borrower signs and returns the credit agreement, the loan provider either (a) contacts the school to confirm the student's enrollment status and financial need and then disburses funds either to the borrower or, more commonly, directly to the school, or (b) receives evidence of the borrower's enrollment directly from the student, and disburses funds to the borrower.

### ***Loan Securitization***

Although some lenders originate loans and then hold them for the life of the loan, many lenders originate and then seek to dispose of the loans, either through a sale of whole loans or by means of a securitization. Whole loans are typically purchased by other financial institutions, which add them to an existing portfolio, or by entities that serve to warehouse the loans for some period of time, pending eventual securitization. Securitization provides several benefits to lenders and has developed into a diverse, flexible funding mechanism, well-suited to the financing of student loan pools. According to industry sources, the new issuance volume of student loan-backed securities totaled approximately \$86 billion in 2006, \$74 billion in 2005 and \$60 billion in 2004. These balances include both federally guaranteed and private student loans. Securitization enables lenders to sell potentially otherwise illiquid assets in both the public and private securities markets, and can help lenders manage concentration risk and meet applicable regulatory capital adequacy requirements.

In a typical student loan securitization, the loans are purchased, pooled and deposited in a special purpose, bankruptcy remote entity. The special purpose entity issues and sells to investors securities collateralized by the student loans. Following the sale of these asset-backed securities, a trustee, or a servicer on behalf of a trustee, collects the payments of principal and interest generated by the underlying loans and makes disbursements to the asset-backed investors and service providers according to the terms of the documents governing the transaction.

Securitization enables the reallocation or transfer of risk through the use of derivative products such as interest rate swaps or caps, a senior-subordinated liability securities structure, financial guarantee insurance for the securities issued, loan guarantees from third-party debt guarantors, the tiering of securities maturities, and the issuance of several different types of securities matching projected pool repayment characteristics. Although this flexibility adds to the complexity of the funding process, it also enables the securitizer to reduce the cost of financing, thereby improving the economics of the loan program and/or improving loan terms by passing incremental savings back to the borrower.

Securitizations require a high level of specialized knowledge and experience regarding both the capital markets generally, and the repayment characteristics and defaults on the part of student borrowers specifically. The process of issuing asset-backed securities requires compliance with state and federal securities laws, as well as coordination among originating lenders, securities rating agencies, attorneys, securities dealers, loan guarantors, structural advisors, trust management providers and auditors.

### ***Loan Servicing***

While student loans are outstanding, lenders or special purpose entities must provide administrative services relating to the loans, even if their terms permit borrowers to defer payments of principal and interest while enrolled in school. These administrative services include processing deferment and forbearance requests, sending out account statements and accrual notices, responding to borrower inquiries, and collecting and crediting payments received from borrowers. Many lenders, and all special purpose entities, outsource their servicing responsibilities to third-party providers. In addition to administrative duties, servicers also play an active role, in conjunction with the guarantor, in default prevention activities. Servicers generally rely on collection agencies to establish and maintain contact with defaulted borrowers, manage loans that are delinquent and collect defaulted loans. Loans are ultimately extinguished through scheduled repayment, prepayment or default. Once the borrower makes the final loan payment, the servicer sends a notice to the borrower and the credit bureaus confirming that the loan has been repaid in full.

### **Our Service Offerings**

We offer prospective clients the opportunity to outsource all of the key components of their loan programs to us by providing a full complement of services, including program design, application processing, underwriting, loan documentation and disbursement, technical support, customer support and facilitation of loan securitization. This approach enables our clients to focus their efforts on the initial marketing of their programs, for which we also offer marketing coordination services.

We primarily offer services in connection with private label loan products offered through two marketing channels:

- “direct to consumer,” which are programs marketed directly to prospective student borrowers and their families by:
  - lenders; and

- third parties that are not themselves lenders but which market loans on behalf of the lenders that fund the loans. We refer to these third parties as loan marketers, and we refer to the lenders that fund these loans as program lenders; and
- “school channel,” which are programs marketed directly to educational institutions by:
  - lenders; and
  - education loan marketers on behalf of program lenders.

Although we offer our clients a fully integrated suite of outsourcing services, we do not charge separate fees for many of these services. Moreover, although we receive fees for providing loan processing services to The Education Resources Institute, Inc., or TERI, in connection with TERI-guaranteed loans, and fees from certain of our clients for marketing coordination services, these fees represent reimbursement of the direct expenses we incur. Accordingly, we do not earn a profit on these fees. Although we provide these various services without charging a separate fee, or at cost in the case of processing TERI-guaranteed loans and marketing coordination services, we generally enter into agreements with the private label lenders giving us the exclusive right to securitize the loans that they do not intend to hold, and we receive structural advisory fees and residuals for facilitating securitizations of these loans. Our level of profitability depends on our ability to earn structural advisory fees and residuals from facilitating securitizations of private label loans. We may in the future enter into arrangements with private label lenders under which we provide outsourcing services but do not have the exclusive right to securitize the loans that they originate. We also receive fees as the administrator of the trusts that have purchased the private label loans, and in this capacity monitor the performance of the loan servicers. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

The primary driver of our results of operations and financial condition is the volume of loans for which we provide outsourcing services from loan origination through securitization. The volume of loans for which we structured securitizations increased to approximately \$3.8 billion in fiscal 2007 from approximately \$2.8 billion in fiscal 2006 and approximately \$2.3 billion in fiscal 2005.

#### ***Program Design and Marketing Coordination***

We help our clients design their private loan programs. Our loan program design approach begins with a standard set of pricing options, legal agreements and third-party relationships that we can then customize for our clients in order to satisfy their particular needs. In addition, we assist certain clients with the design and execution of their marketing programs.

#### ***Program Design***

We have developed strong relationships with lenders and other organizations through active marketing by our field sales force and business development executives. Our private label clients are typically lenders or educational loan marketers that desire to supplement their existing federal loan or other consumer lending programs with a private loan offering. Increasingly, these lenders or marketers are responding to competitive pressures to offer private loan programs. They are attracted to an opportunity to extend their existing brand in the federal loan or consumer lending marketplace to the private student loan marketplace.

Beyond federal student loan lenders, our approach is flexible enough to facilitate private student loan programs for a range of clients, who, in turn, serve a variety of consumers. We believe a private label opportunity exists with any business, union, affinity group or other organization that has employees, customers, members or other constituencies who are concerned about education costs. We can assist such organizations in partnering with a lender and in designing a program that provides tangible benefits to their constituencies, while simultaneously generating additional revenue. Regardless of whether the client

is a commercial bank, marketing company, affinity organization or a large corporation, we can contribute our specialized knowledge, experience and capabilities to assist these entities in the development of a private loan program to meet their needs, while minimizing their resource commitment and exposure to credit risk.

One of the key components of our private label programs is the opportunity for our lender clients to mitigate their credit risk through a loan repayment guarantee by TERI. TERI guarantees repayment of the borrowers' loan principal, together with capitalized and/or accrued interest on defaulted loans. For additional information on TERI, see "—Relationship with The Education Resources Institute." If the lender disposes of the loan in a securitization, this guarantee remains in place and serves to enhance the terms on which asset-backed securities are offered to investors.

Private label clients fall into two categories:

- *Make and sell.* In this category, lenders select credit criteria and loan terms tailored to meet their needs and then outsource to us all operating aspects of loan origination and customer support, and typically hold the loans on their balance sheets for some limited period of time. Lenders that wish to have their loans guaranteed by TERI are required to meet TERI's underwriting criteria. In the case of clients that do not desire, or do not have the ability, to fund the loans initially, we arrange for them to work with a program lender in marketing their programs to customers. In both cases, after the holding period, we will facilitate a securitization to enable lenders to dispose of the loans, from which we generate structural advisory fees and residuals. See "—Securitization."
- *Make and hold.* In this category, clients outsource all operating aspects of loan origination and customer support, but finance the loans on their balance sheets and generally continue to hold the loans through the scheduled repayment, prepayment or default. Clients retain the ability to securitize the loans through us, even if they elect not to do so initially. Unless clients securitize their make and hold loans through us, the revenues we generate on these loans are limited to the processing fees that we receive from TERI, which represent reimbursement of the direct expenses we incur in originating the loans.

The following table presents information regarding the aggregate principal and accrued interest balance of private label loans that we processed during the fiscal years ended June 30, 2007, 2006 and 2005:

	Fiscal year ended June 30,		
	2007	2006	2005
	(dollars in billions)		
Approximate "make and sell" volume processed . . . . .	\$3.8	\$2.8	\$2.1
Approximate "make and hold" volume processed . . . . .	0.4	0.4	0.5
Approximate total volume processed . . . . .	<u>\$4.2</u>	<u>\$3.2</u>	<u>\$2.6</u>

*Marketing Coordination*

We provide marketing coordination services intended to enable our lender and loan marketer clients to increase loan volume and resulting program revenue. We have established an in-house department that works in collaboration with clients, third-party agencies and vendors to support the development, execution and analysis of direct response marketing programs, including direct mail, direct response television, and Internet-based marketing campaigns. These programs are designed to drive direct-to-consumer loan program volume and generate learnings that inform ongoing marketing optimization and refinement.

Our marketing services group also coordinates marketing for our proprietary loan programs, including the Astrive Student Loan Program, which provides valuable insights with regard to product features and the effectiveness of various marketing channels and tactics. These assessments enable us to further serve our clients. Charter One Bank, N.A. serves as a lender for our proprietary loan programs. In addition, on November 30, 2006, we completed the acquisition of Union Federal Savings Bank, a community savings bank located in North Providence, Rhode Island. Union Federal is a federally chartered thrift that offers residential retail mortgage loans, retail savings products, time deposit products and, as of April 2007, our proprietary private student loans. Union Federal had total assets of approximately \$41 million as of the acquisition date. The financial results of Union Federal subsequent to the acquisition date are included in our financial statements for the fiscal year ended June 30, 2007.

### ***Borrower Inquiry and Application***

We have developed proprietary processing platforms, applications and infrastructure, supplemented by customized vendor solutions, which we use to provide loan application services for our private label programs. We enable borrowers to submit applications by web, telephone, facsimile or mail. In fiscal 2007, we received via the Internet approximately 62% of the approximately 1,305,000 private label loan applications that we processed. In fiscal 2006, we received via the Internet approximately 58% of the approximately 914,000 private label loan applications that we processed. In fiscal 2005, we received via the Internet approximately 64% of the approximately 849,000 private label loan applications that we processed. We have designed our online systems to be E-sign compliant for delivery of consumer disclosures, and we have implemented electronic signature capabilities.

Once a potential borrower submits an application for processing, our system automatically generates and sends a confirmation notice, typically via email, to the applicant. The customized third-party credit decision software that we use then analyzes, often within minutes, the submitted application. Application data is automatically sent to credit bureaus, which generate and return a credit report. The credit decision software then applies the credit report data and all scoring parameters associated with the loan type, and a credit decision is generated. This automated underwriting process allows us to deliver a loan application decision with respect to a significant majority of applications. Applications with either incomplete information, information mismatches or with scores close to cut-off are automatically sent to a credit analyst for review. At this point in the process, we communicate the initial determination to the applicant, primarily through email, informing him or her whether the application is conditionally approved, rejected or in review. The applicant receives instructions as to next steps and is provided a website navigation link to check his or her loan status. Access requires use of security protocols established during the application process, to avoid unauthorized disclosure. Simultaneously, our customer service platforms, including our automated voice response unit, online status and customer service applications, are updated.

To help applicants through the loan application process, we have an internal customer service department comprised of 145 full-time employees. We supplement our internal department with contract customer service employees and outsourced customer service representatives. Our internal customer service department is divided into five areas:

- Inbound and Outbound Customer Service, which provides end-to-end service and support for borrower inquiries throughout the application process;
- Customer Resource Group, which provides specially trained credit analysts for borrower support on advanced needs loan processing and issue resolution;
- Customer Support Services, which provides dedicated account representatives trained to support our lender and marketer clients;
- Priority Services, which provides specially trained representatives to support schools; and

- Telesales, which provides inbound application-capture services.

The performance of each customer service area is monitored closely and detailed performance metrics, such as abandonment rates and service levels, are tracked daily. We use outsourced customer service representatives primarily to support our inbound application-capture services and inbound status-related inquiries.

### *Loan Origination and Disbursement*

For our private label loan programs, once a loan application is approved, we generate a credit agreement, a legal contract between the borrower and lender which contains the terms and conditions of the loan, for the borrower based on one of over 1,200 lender and product specific templates. For those lenders and borrowers that prefer electronic document delivery, an automated email is sent to the borrower, which contains a navigation link to prompt the borrower to access a secure website to retrieve the credit agreement and certain regulatory disclosures. The credit agreement can be viewed, downloaded and printed by the borrower and faxed or mailed back to us. For those borrowers that prefer paper documentation, we print and mail a pre-filled credit agreement to the borrower for him or her to sign and return to us by mail. Approximately 86% of approved applicants during fiscal 2007, 79% of approved applicants during fiscal 2006 and 72% of approved applicants during fiscal 2005 requested on their application that the credit agreement we generated be made available electronically.

We assist the lenders in our loan programs in selecting the underwriting criteria used in deciding whether a student loan will be made to an applicant. However, each lender has ultimate control over the selection of these criteria, and in providing our services, we are obligated by contract to observe them. Lenders that wish to have their loans guaranteed by TERI are required to meet TERI's underwriting criteria.

Together with TERI, we collaborate with our clients to comply with applicable laws and regulations in loan documentation, disclosure and processing. TERI assumes, and delegates to us, responsibility for compliance with federal and Massachusetts law regarding loan documentation and disclosure. We, in turn, work with lenders to prepare lender specific note templates. We maintain and utilize these templates, which reflect applicable legal requirements and lender preferences. We also deliver each lender's privacy policy and prepare and deliver truth-in-lending and various state law disclosures to borrowers.

We monitor developments in state and federal requirements for loan processing and implement changes to our systems and processes based on our analysis and input we receive from lenders and industry groups. For example, we designed and made available to lenders a customer identification program in connection with our private label loans. This program was designed to meet USA Patriot Act requirements that lenders gather identifying data, verify applicant identity and maintain records of the process. The requirements present a challenge for lenders whose borrowers apply for loans using an Internet based system, telephone or mail. We have also completed similar process improvements in the area of secure access to pending loan information, in order to comply with federal privacy and state identity theft laws. Contractual liability for identification of state law process requirements rests with the lenders, unless TERI or we undertake to comply with a particular requirement.

For our private label loan programs, once we obtain all applicant data, including the signed credit agreement, evidence of enrollment and any income verification, we disburse the loan funds on behalf of TERI, with funds made available to TERI by the lenders. Depending on the loan program and type of disbursement, funds are either sent to the borrower, directly to the school or to a central disbursing agent such as New York Higher Education Services Corporation or ELM Resources, which then pass the funds along to the school. We receive fees from TERI, which consist of reimbursement of expenses that we incur relating to loan processing services that we perform on behalf of TERI. These fees are recognized as services are performed.



## ***Securitization***

In addition to providing loan program design, marketing coordination, application and origination services, we also serve as an intermediary between our clients and the capital markets. We form bankruptcy remote, qualified special purpose statutory trusts to purchase private label loans from the originating lenders. The proceeds from bonds issued by the trusts are used to purchase student loans, which are used as security for repayment of the bonds. The securitizations that we structure and administer provide our lender clients with the ability to limit or eliminate credit and interest rate risk, and generate liquidity for their private student loan programs. In addition to structural advisory and administrative and other fees, we are entitled to a residual interest in the securitization trusts as part of our compensation in connection with the securitizations.

We have been a leader in facilitating the securitization of private student loans, having structured and facilitated 36 securitizations consisting entirely of private student loans, more than any other entity. During calendar year 2006, the securitization trusts that we advised were, in the aggregate, the fourth largest issuer of student loan-backed securities. Our capital markets group has a history of innovation, having been the first to employ several of the structures and risk-reducing techniques in this sector that are in use today. We have securitized loan pools using various financing structures, including both public offerings registered with the Securities and Exchange Commission, or SEC, and private placements, and have utilized various asset-backed securities, including commercial paper, London Interbank Offered Rate, or LIBOR, floating rate notes, auction-rate debt and senior-subordinated and third-party credit enhanced debt. In connection with our "make and sell" private label programs, we generally enter into agreements with the originating lenders giving us the exclusive right to securitize their program loans.

The extensive database provided by our private label repayment statistics dating back to 1986 is another key to optimizing the financing of the student loan pools our clients generate. We use this data to estimate the default, recovery and prepayment characteristics of the different types of loans that constitute a loan pool. We believe the historical data and our use of standard consumer credit score-based risk assessment give added comfort to the rating agencies, insurance providers, underwriters and securities investors, resulting in a more cost-effective securitization.

We receive several types of fees in connection with our securitization services:

- *Structural advisory fees.* We charge structural advisory fees that are paid in two portions:
  - *Up-front.* We receive a portion of the structural advisory fees when the securitization trust purchases the loans, or shortly thereafter; and
  - *Additional.* We receive a portion of the structural advisory fees over time, based on the amount of loans outstanding in the trust from time to time over the life of the trust.

In exchange for these structural advisory fees, we structure the securities sold in the securitization, coordinate the attorneys, accountants, trustees, loan servicers, loan originators and other transaction parties and prepare cash flow modeling for the rating agencies.

- *Residuals.* We also have the right to receive a portion of the residual interests that these trusts create. This interest is junior in priority to the rights of the holders of the debt sold in the securitizations as well as the additional structural advisory fees above.

Our residual interest is derived almost exclusively from the services we have performed in connection with each securitization rather than from a direct cash contribution to the securitization trust.

We also receive administrative fees from the trusts as further described below under "—Loan Servicing."

For a discussion of our revenue recognition policies and the assumptions we use, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Executive Summary—Recognition and Valuation of Service Revenue” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Executive Summary—Application of Critical Accounting Policies and Estimates—Service Revenue and Receivables.”

In recent years, we have derived a significant portion of our revenue and substantially all of our income from structuring securitizations on behalf of qualified special purpose entities. Revenues from new securitizations involving private label loan trusts represented 78% of our total revenue in fiscal 2007, 74% of our total revenue in fiscal 2006 and 75% of our total revenue in fiscal 2005. These securitization trusts purchased private student loans from several lenders, including JPMorgan Chase Bank, N.A. and Bank of America, N.A. Although we do not receive fees directly from these lender clients, structural advisory fees and residuals from securitizations of the private label loans of JPMorgan Chase Bank and Bank of America, represented approximately 29% and 15%, respectively, of our total revenue in fiscal 2007 and approximately 26% and 16%, respectively, of our total revenue in fiscal 2006. We structure and support private student loan programs for a number of companies that assist lenders such as Charter One Bank in marketing their programs to customers. Structural advisory fees and residuals from securitization of loans marketed under our proprietary brand, Astrive, and funded by Charter One Bank or our wholly owned subsidiary, Union Federal, represented approximately 12% of our total revenue for fiscal 2007, and approximately 4% of our total revenue for fiscal 2006.

### *Loan Servicing*

There are currently seven loan servicers for newly originated TERI guaranteed loans, with the Pennsylvania Higher Education Assistance Agency, or PHEAA, servicing a majority of the loans we facilitate. The remaining clients opt either to outsource the servicing of their loans to organizations with which they have existing relationships or service their loans using affiliated servicers. For securitized loans, these servicing agreements, which typically extend over the life of the loan pool, are assigned to the purchasing trust.

As administrator of the trusts that have purchased private label loans, we monitor the performance of the loan servicers. In this capacity, we confirm compliance with servicing guidelines and review default prevention and collection activities. We receive administrative fees from the trusts ranging from 5 to 20 basis points per year of the student loan balance in the trust for daily management of the trusts and for the services we provide in obtaining information from the loan servicer and reporting this and other information to the parties related to the securitization.

During the first 60 days of any loan delinquency, the servicer performs collection activities in accordance with contractual requirements outlined in the servicing guidelines of the loan program. These guidelines establish certain required collection activities, such as attempted telephone contacts to borrowers and co-borrowers within prescribed delinquency intervals, as well as requirements for the mailing of delinquency notices and skip trace activities for borrowers whose addresses have changed.

Once the loan has been delinquent for 60 days, we provide pre-claims assistance. We assign delinquent accounts to one of several external collection agencies, which work to cure the account by bringing it current. During this period, the servicer remains responsible for invoicing and posting payments. We monitor these external collection agencies that perform pre-claims default prevention activities and share their performance with their peers. Our strategy is to award the highest percentage of new accounts to the agency whose performance has been strongest in the prior period. In addition to this incentive, we provide performance bonuses to agencies performing above established performance expectations for cure rates. If a delinquent loan becomes less than 60 days past due, collection efforts are returned to the servicer for routine processing.

Loans are ultimately extinguished through scheduled repayment, prepayment or default. Once the borrower makes the final loan payment, the servicer sends a notice to the borrower and the credit bureaus confirming that the loan has been repaid in full.

#### **Relationship with The Education Resources Institute**

TERI is the nation's oldest and largest guarantor of private student loans. As a not-for-profit corporation, TERI's main operating purpose is to provide students with access to educational opportunities through educational finance and counseling services. To help accomplish this, TERI offers guarantee products for student loan programs pursuant to which TERI agrees to reimburse lenders for all unpaid principal and interest on their defaulted student loans, in exchange for a fee based on the loan type and risk profile of the borrower. Since its inception in 1985, TERI has guaranteed approximately \$17.7 billion of private education loans for students at more than 6,800 schools nationally and internationally.

In 2001, we acquired TERI's historical database and loan processing operations, but not its investment assets or guarantee liabilities. We issued promissory notes totaling \$7.9 million and paid approximately \$1.0 million in cash to TERI in connection with the transaction. TERI remains, however, an independent, private, not-for-profit organization with its own management and board of directors.

In connection with the transaction, we entered into a series of agreements with respect to loan processing services, database updates and the securitization of TERI-guaranteed loans. These include a master servicing agreement, a database purchase and supplementation agreement and a master loan guaranty agreement. In October 2004, we renewed our agreements with TERI, in each case for an additional term through June 2011. Pursuant to the master servicing agreement, TERI engages us to provide loan origination, pre-claims, claims and default management services. Under TERI's agreements with lenders, lenders delegate their loan origination functions to TERI, and TERI has the right to subcontract these functions. Pursuant to the database purchase and supplementation agreement, TERI provides updated information to us about the performance of the student loans it has guaranteed, so that we can continue to supplement and enhance our database.

Under the terms of the master loan guaranty agreement, we agreed to provide a beneficial interest for TERI of 25% of the residual value of TERI-guaranteed program loans owned by the securitization trusts that purchase the loans, and a right of first refusal to guarantee our private label clients' existing and future loan programs. The master loan guaranty agreement generally provides that the guarantee fees earned by TERI upon the disbursement of student loans are placed in a segregated reserve account which is held as collateral to secure TERI's obligation to purchase defaulted student loan principal and interest. This account is held by a third-party financial institution for the benefit of the program lender until the student loans are securitized, at which point the account is pledged to the securitization trust that purchases the loans. The master loan guaranty agreement, as implemented through guaranty agreements with individual lenders, entitles TERI to retain a portion of its guaranty fees as an administrative fee rather than place them in the pledged account.

In October 2005, we entered into a supplement to the master loan guaranty agreement for securitizations of TERI-guaranteed loans during fiscal 2006. In accordance with the 2005 supplement, the administrative fee for securitizations of TERI-guaranteed loans in fiscal 2006 was 240 basis points multiplied by the principal balance of the loans originated and securitized. For securitizations completed during fiscal 2006, TERI's ownership of the residual value of the TERI-guaranteed loans securitized ranged from 12 to 15 percent.

In August 2006, we entered into a supplement to the master loan guaranty agreement that provided as follows:

- For each securitization closing between August 1, 2006 and June 30, 2007, TERI would be entitled to elect to adjust the amount of its administrative fee, and adjust the amount deposited into the pledged account, within specified parameters. As a result, the amount of the administrative fee applicable to securitizations closing between August 1, 2006 and June 30, 2007 could have ranged from 150 basis points to 240 basis points, at TERI's election and subject to the parameters of each securitization trust. We agreed to attempt in good faith to structure our securitization transactions to accommodate TERI's election.
- For each securitization for which TERI elected to adjust the administrative fee, we made a corresponding adjustment to our relative ownership percentages of the residual interests in the applicable securitization trust. To the extent TERI elected to increase the amount of its administrative fee above 150 basis points, such an adjustment resulted in an increase in our ownership percentage and a decrease in the ownership interest of TERI, by a percentage that resulted in an equivalent dollar reduction in the fair value of TERI's residual ownership interest at the time of the securitization.

TERI received administrative fees ranging from 175 basis points to 221 basis points for the securitization transactions we completed in fiscal 2007. We expect to allow TERI to elect to adjust the amount of its administrative fee, and adjust the amount deposited into the pledged account, within specified parameters for the securitization transaction we plan to complete in the first quarter of fiscal 2008.

Through June 2006, we paid TERI a monthly fee of approximately \$62,000 pursuant to the database purchase and supplementation agreement. Beginning in July 2006, monthly payments pursuant to the database sale and supplementation agreement were reduced to approximately \$21,000. TERI also maintains a perpetual right to access the data we own solely for use in its guarantee business.

The master loan guaranty agreement was intended in part to create a framework for structuring future relationships among lenders, TERI and us. The master loan guaranty agreement contemplates several ancillary documents that set forth the various obligations among the parties, including:

- program guidelines for each prospective lender establishing acceptable terms for the origination, underwriting and servicing of program loans, including the borrower eligibility criteria, credit requirements, loan limits, deferral options and repayment terms, as well as the lender's forms of application and credit agreement or promissory note;
- a form of guaranty agreement between TERI and a prospective lender providing for a full and unconditional guarantee of principal and accrued interest when a program loan becomes more than 180 days delinquent, the borrower dies or the borrower seeks discharge of the loan in a bankruptcy proceeding;
- a form of loan origination agreement between TERI and a prospective lender pursuant to which the lender delegates its loan origination functions to TERI, and TERI agrees to receive loan applications, perform underwriting according to the standards in the program guidelines and approve and deny applications. TERI has agreed to subcontract these loan origination functions to us pursuant to the master servicing agreement described above;
- a form of note purchase agreement between us and a prospective lender setting forth the terms and conditions under which a special purpose entity, such as a securitization trust, that we establish purchases program loans from the lender; and

- a form of deposit and security agreement, or a security agreement alone, providing for the payment of a portion of the guarantee fee under the guaranty agreement between TERI and a prospective lender to an account at a national bank and subject to a security interest to pay guarantee claims.

As contemplated by the master loan guaranty agreement, prospective lenders agree to provide initial loan funding and own the loans until they are purchased in a securitization transaction that we facilitate. The lender provides representations and warranties that support the loan for the securitization pursuant to the requirements of the rating agencies.

Processing fees from TERI represented approximately 15% of our total revenue during fiscal 2007, 19% of our total revenue during fiscal 2006 and 19% of our total revenue during fiscal 2005.

## Competition

The private student loan industry is highly competitive with dozens of active participants. We derive a substantial portion of our revenue from providing to lenders outsourced services for their private student loan programs. Private student loan originators include large financial institutions and their affiliates, such as JPMorgan Chase Bank, Citigroup, Charter One Bank, Bank of America, Wells Fargo & Company and KeyCorp, as well as specialized educational finance providers including SLM Corporation, which is also known as Sallie Mae, and Access Group, Inc. Some of these loan originators are currently our clients, although we generally do not have long-term contracts with our clients.

To the extent that lenders possess or choose now or in the future to develop an internal capability to provide any of the services that we currently provide, they would compete directly with us. On April 16, 2007, an investor group that included Bank of America and JPMorgan Chase Bank, our two largest lender clients, announced that they signed a definitive agreement to purchase Sallie Mae. Further consolidation could result in a loss of business if one or more of our clients were acquired by, or acquired, a competitor or a lender that is not our client, or could result in the emergence of a new competitor with the ability to offer outsourced services, including securitization services, for private student loans.

In addition, lenders in the education loan market historically have primarily focused their lending activities on federal loans because of the relative size of the federal loan market and because the federal government guarantees repayment of those loans. The demand for our services could decline if lenders place additional emphasis on the private education loan market and offer the services we provide. We believe the most significant competitive factors in terms of developing private student loan programs are technical and legal competence, cost, knowledge of the performance of student loans, capital markets experience, reliability, quality and speed of service.

We coordinate a range of services in connection with private loan programs, including program design, application processing, credit underwriting, customer service, loan documentation, disbursement, technical support, legal and compliance support and advisory services in connection with loan marketing and financing. We differentiate ourselves from other service providers as a result of the range of services we can provide our clients. We may face competition from third parties who decide to expand their services to include the suite of services that we provide. We are aware of three principal competitors, Sallie Mae, Servus Financial Corporation, an affiliate of Wells Fargo Company, and Student Loan Corporation, an 80% owned subsidiary of Citibank, N.A., that offer a similar range of services to lenders. Our business could also be adversely affected if Sallie Mae's program to market private student loans directly to consumers continues to grow, if Sallie Mae seeks to market more aggressively to third parties the full range of services for private loan programs that we provide or if Sallie Mae's private loan consolidation product results in increased consolidation of private student loans held by the securitization trusts we have facilitated. We are also aware of smaller privately held venture backed companies that are developing systems and expertise with plans to compete directly with us. In addition, our clients retain PHEAA as the loan servicer for a significant portion of the loans that serve as collateral in the securitization transactions

that we facilitate. If PHEAA expands its service offerings to cover some or all of the services that we facilitate, it could become our competitor.

Many of our current and potential competitors have longer operating histories and significantly greater financial, marketing, technical or other competitive resources, as well as greater name recognition, than we do. As a result, our competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or may be able to devote greater resources to the promotion and sale of their services. In addition, competitors may be able to adopt more aggressive pricing policies in order to attract potential clients. We cannot assure you that we will be able to compete successfully with new or existing competitors. To remain competitive, we will need to continue to invest in information technology, sales and marketing, legal and compliance, and product development.

### **Proprietary Systems and Processes**

In addition to our proprietary database that tracks historical student loan performance, we maintain advanced proprietary information processing systems. We use these information systems to analyze loan applications efficiently, expedite loan processing and enhance our loan securitization and default management services.

Key benefits of our information processing systems include:

- the ability to analyze and assess loan applications based on a variety of underwriting and program factors, including flexibility to adapt to different program parameters required in customized client implementations;
- a batch transaction/application processing system that includes automated updating of a borrower's loan status that a borrower can access online or telephonically;
- automated preparation and secure electronic delivery of loan documents, including credit agreement and legal disclosures;
- online certification tools enabling financial aid offices to speed loan disbursement by quickly confirming student borrowers' enrollment status and financial need;
- online reporting tools enabling our management, lender clients and financial aid offices to track and sort information about student borrowers, including application status and disbursement dates;
- custom built data transmission techniques designed to ensure that data are compiled, integrated and properly migrated both across our enterprise and to external third parties such as servicers, collection and placement agencies and other third-party vendors; and
- interface with internal accounting systems intended to ensure proper booking and tracking of loan information for our clients, as well as support for our capital markets group in its securitization activities.

We use a number of leading commercial products to secure, protect, manage and back-up these data, including products that provide backup of data and server recovery plans.

### **Trademarks**

First Marblehead owns the following federally registered trademarks: FIRST MARBLEHEAD, prepGATE and National Collegiate Trust. The federal registrations for our registered trademarks expire at various times between 2007 and 2016, but the registrations may be renewed for additional 10-year terms provided that First Marblehead continues to use the trademarks. ASTRIVE is also our common law trademark. A federal trademark application to register this trademark is pending with the U.S. Patent and Trademark Office. In addition, we have filed federal trademark applications with respect to existing or

planned uses of the marks ME MONEY, EDUCATION FOR LIFE, IGNITE, LAUREL COLLEGIATE LOANS and MONTICELLO STUDENT LOANS.

### **Student Loan Market Seasonality**

Origination of student loans is generally subject to seasonal trends, with the volume of loan applications increasing with the approach of tuition payment dates. In general, we process the greatest application volume during the summer months, as students and their families seek to borrow money in order to pay tuition costs for the fall semester or the entire school year. We also tend to process increased volume of loan applications during November, December and January, as students and their families seek to borrow money to pay tuition costs for the spring semester. This seasonality of loan originations impacts the amount of processing fees from TERI that we earn in a particular quarter. It may also influence the size and timing of our securitization transactions, which affects our revenue and profitability.

### **Government Regulation**

We provide services in connection with the creation, management and disposition of education loans, a form of consumer loan asset. This business is highly regulated at both the state and federal level, through statutes and regulations that focus upon:

- licensure and examination of industry participants;
- regulation and disclosure of consumer loan terms;
- regulation of loan origination processing;
- regulation of loan collection and servicing; and
- regulation of marketing practices.

Failure to conform to any of these statutes or regulations may result in civil and/or criminal fines, and may affect the enforceability of the underlying consumer loan assets.

Although we are subject to certain state and federal consumer protection laws, we believe our operations currently do not require us to be licensed or registered with any regulatory body outside the Commonwealth of Massachusetts, other than the federal Office of Thrift Supervision of the United States Department of Treasury, or OTS. While we believe that our prior consultations with regulatory counsel and, in some cases, local counsel identified all material licensing, registration and other regulatory requirements that could be applicable to us, we will continue to review state licensing, registration and other regulatory requirements that may become applicable to us, based upon the expansion of the scope of the services we provide and the time that has elapsed since our prior review.

All of our operations relating to education loan processing are located in Massachusetts. In 2001, we received determination letters from the Massachusetts Division of Banks confirming that our business of providing consumer loan origination and underwriting under contract to TERI was exempt from licensing under the Massachusetts Small Loan Act. The Small Loan Act requires any person that is engaged, for compensation, in the business of making small loans, or in aiding or assisting the borrower or the lender in procuring or making such loans, to obtain a license. Under the statute, the business of making small loans includes the making of loans of \$6,000 or less with interest rates and expenses of more than 12% per year. The Massachusetts Division of Banks ruled that our business with TERI is not subject to licensure because, as a provider of loan origination outsourcing services, we do not conduct a lending business with consumers in our own name and our processing centers are not generally open to the public.

We could become subject to the Massachusetts Small Loan Act in the future if, for example, the Massachusetts legislature modifies the statutory requirements or the Massachusetts Division of Banks revokes its previous determination that our operations are exempt. We could also become subject to licensing laws in Massachusetts and other states if we engage in licensable activities in the future, or if our operations became sufficiently localized in other states to trigger licensing.

However, even if we are not physically present in a state, its regulators may take the position that licensing or registration is required because we provide services by mail, telephone, the Internet or other remote means. If we identify any states in which licensing or registration is required, we intend to proceed with licensing or registration in the affected state. If any state asserts jurisdiction over our business, we will consider whether to challenge the assertion or proceed with licensing or registration in the affected state. Compliance with such requirements could involve additional costs, which could have a material adverse effect on our business. Our failure to comply with these laws could lead to, among other things: (a) curtailment of our ability to continue to conduct business in the relevant jurisdiction, pending processing of our license application or registration, (b) administrative enforcement actions, (c) class action lawsuits, (d) the assertion of legal defenses delaying or otherwise affecting the enforcement of loans and (e) criminal as well as civil liability. This could have a material adverse effect on our business. However, if required to obtain a license or to register, we do not anticipate difficulty meeting the licensing or registration requirements.

While our licensing requirements are currently limited, the consumer assets with which we deal are subject to the full panoply of state and federal regulation, and a defect in such assets could affect our business. Similarly, the growing complexity of regulation of loan origination and collection may affect the cost and efficiency of our operations. We have sought to minimize the risk created by consumer loan regulation in a number of ways. The securitizations that we facilitate currently involve sales by FDIC-insured financial institutions and other parties which represent and warrant that the assets in question have been originated in compliance with all applicable law and are valid, binding and enforceable in accordance with their terms. Similarly, the securitization trusts benefit from an assignment of representations and warranties made by the lender and by the applicable loan servicer regarding compliance with law in the origination and servicing of loan assets. Thus, our residual interest in securitizations is buffered from regulatory risk to the extent that lenders, TERI and servicing providers stand behind the legal compliance of their activities. TERI may nonetheless have recourse to us to the extent that a regulatory failure in loan origination by us breaches the standards of care under the master servicing agreement between TERI and us.

The risk of noncompliance with regulatory requirements by our lender clients and their marketing partners has been highlighted by recent state and federal investigations into school channel marketing practices, particularly the payment of marketing fees directly to schools in exchange for loan referrals. None of our contracts with lenders or marketers involves the payment of fees to schools for loan volume. We are not aware of any judgments or consent decrees entered into by any of our lender or marketer clients with respect to any of the loan products we coordinate. However, state and federal regulatory authorities have sought information from some of our clients and us regarding the loan programs we coordinate, and it is possible that some marketing or underwriting practices associated with the programs we coordinate and assets we securitize will be challenged as a result of such investigations.

The regulatory actions described above have also prompted state and federal legislation that will affect our operations. The State of New York has enacted legislation that may impede accepted marketing practices in the school channel, such as school endorsement of loan products that the school believes are beneficial to students. In addition, the New York legislation will require additional disclosures that will increase our costs. Similarly, proposed legislation in the United States Senate and The Student Loan Sunshine Act already passed by the U.S. House of Representatives would impose significant additional disclosure and processing burdens on our loan origination operations. Other proposals which have not yet



passed in either house of Congress, would reduce protection of the loans we securitize in bankruptcy proceedings.

In addition, in delivering services, we must cause our operations to conform to consumer loan regulation that applies to TERI and the lenders. This regulation includes compliance with the federal Truth-in-Lending Act, the Fair Credit Reporting Act, the USA PATRIOT Act, the Equal Credit Opportunity Act, the Gramm Leach Bliley Act, the Federal Trade Commission Act, the Fair Debt Collection Practices Act, and numerous state laws that replicate and expand upon the requirements of federal law. In addition, there is increasing regulation of the type of electronic loan application processing that we conduct, as well as regulation of access to and use of consumer information databases. A growing number of states are imposing disparate and costly requirements on our operations, including protections against identity theft, privacy protection and data security protection. In addition, the Fair and Accurate Credit Transactions Act of 2003 imposed significant federal law requirements on loan application processors, including requirements with respect to resolving address inconsistencies, responding to “red flags” of potential identity theft and processing identity theft notices and other requirements that required both changes to automated loan processing and the creation of manual exception systems. These requirements strained, and future legislation or regulation may also strain, systems already undergoing rapid change due to loan volume growth. Failure to comply with these requirements will violate our obligations to the lenders we serve and could subject them to regulatory action and result in termination of our processing contracts.

**Employees**

At June 30, 2007, we had 1,028 full-time employees and 14 part-time employees as follows:

<u>Department</u>	<u>Full-time</u>	<u>Part-time</u>
Loan Origination .....	187	4
Information Technology .....	186	0
Administration and Support Functions .....	174	4
Customer Service .....	145	1
Corporate Planning and Implementation Support .....	128	3
Business Development .....	55	0
Collections and Default Management .....	39	1
Operations .....	36	0
Marketing Coordination .....	26	0
Trust Administration .....	21	0
Capital Markets .....	16	0
Union Federal Savings Bank .....	15	1
Total .....	<u>1,028</u>	<u>14</u>

We are not subject to any collective bargaining agreements, and we believe our relationships with our employees are good.

**Our Corporate Information**

We were formed as a limited partnership in 1991 and were incorporated in Delaware in August 1994. Our principal executive offices are located at The Prudential Tower, 800 Boylston Street, 34<sup>th</sup> Floor, Boston, Massachusetts 02199. The telephone number of our principal executive offices is (617) 638-2000.

## Available Information

Our Internet address is <http://www.firstmarblehead.com>. The contents of our website are not part of this annual report on Form 10-K, and our Internet address is included in this document as an inactive textual reference only. We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports available free of charge on our website as soon as reasonably practicable after we file such reports with, or furnish such reports to, the SEC.

## Executive Officers

The following table sets forth information regarding our executive officers, including their ages as of June 30, 2007.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Jack L. Kopnisky .....	51	Chief Executive Officer, President, Chief Operating Officer and Director
Peter B. Tarr .....	56	Chairman of the Board of Directors and General Counsel
John A. Hupalo .....	47	Senior Executive Vice President and Chief Financial Officer
Anne P. Bowen .....	55	Executive Vice President, Chief Administrative Officer
Andrew J. Hawley .....	43	Executive Vice President, President of First Marblehead Education Resources, Inc.
Greg D. Johnson .....	44	Executive Vice President, Chief Marketing Officer
Sandra M. Stark .....	48	Executive Vice President, Business Development
Kenneth S. Klipper .....	48	Senior Vice President, Treasurer and Chief Accounting Officer

Set forth below is certain information regarding the business experience of each of the above-named persons.

*Jack L. Kopnisky* has served as our Chief Executive Officer, President and Chief Operating Officer since September 2005 and as a Director since November 2006. Prior to joining First Marblehead, Mr. Kopnisky served as the President of the Consumer Banking Group at KeyCorp, a financial services firm, where he was responsible for Retail Banking, Business Banking, Consumer Finance and Community Development from June 2000 to August 2005. During those years, Mr. Kopnisky served as Chief Executive Officer and President of KeyBank USA's Consumer Finance Business, which included Auto, Student, Mortgage, Recreational and Home Equity Lending. Mr. Kopnisky received a B.A. in Economics and Business Administration from Grove City College.

*Peter B. Tarr* has served as our General Counsel since July 2005 and as Chairman of the Board of Directors since October 2005. Mr. Tarr served as Vice Chairman of the Board of Directors from August 2005 until his election as Chairman. From 1986 to June 2005, Mr. Tarr was a senior partner in the corporate law department and a member of the Executive Committee at the law firm of Wilmer Cutler Pickering Hale and Dorr LLP. Mr. Tarr's practice focused on advising boards of directors on corporate governance, strategic transactions and public offerings of securities. Mr. Tarr received a B.A. from Yale College, an M.A.R. from Yale Divinity School and a J.D. from the University of Virginia School of Law.

*John A. Hupalo* has served as our Senior Executive Vice President and Chief Financial Officer since November 2006 and as Group Head, Capital Markets since March 2003. Mr. Hupalo served as Executive Vice President from March 2003 to November 2006. From March 1999 to March 2003, Mr. Hupalo served as a Managing Director in the Education Loan Group of UBS Paine Webber, a diversified financial institution. From 1991 to 1999, Mr. Hupalo served as a Director in the Education Loan Group of Salomon Smith Barney, an investment bank. From 1987 to 1991, Mr. Hupalo served in a similar group at Manufacturers Hanover Securities Corporation. Prior to entering the field of investment banking, Mr. Hupalo worked for a Member of the U.S. Congress and the National Association of Manufacturers.

Mr. Hupalo received a B.A. in Political Science from Boston University and an M.B.A. in Finance from New York University's Stern School of Business.

*Anne P. Bowen* has served as our Executive Vice President and Chief Administrative Officer since March 2006. Ms. Bowen served as our Executive Vice President, Corporate Planning from April 2004 to March 2006. From August 2002 to July 2003, Ms. Bowen was a Senior Vice President for State Street Corporation, a financial services firm, where she was responsible for acquisition integration. From October 1999 to July 2002, she served as a Senior Vice President of eBusiness at State Street. From December 1994 to September 1999, Ms. Bowen served as a Senior Vice President of Global Financial Technical Services at State Street. Ms. Bowen served as a Director with Coopers & Lybrand Consulting, Inc. from 1992 to 1994, specializing in the banking practice. From 1978 to 1992, Ms. Bowen served as a Director of Bank of Boston, managing the Corporate Credit, Real Estate and Corporate Audit functions. Ms. Bowen received a B.S. from Boston University and an M.B.A. from Simmons College.

*Andrew J. Hawley* has served as our Executive Vice President and President of First Marblehead Education Resources, Inc. since May 2004. From 1994 to April 2004, Mr. Hawley held positions with Pittiglio, Rabin, Todd & McGrath, a management consulting firm, where he consulted with U.S. companies on operations improvements, growth strategies and organized restructuring, most recently serving as a Lead Director. From 1989 to 1992, Mr. Hawley held several positions with Cambridge Strategic Management Group, a strategic consulting firm, with a focus on growth strategies for international companies in Asia, Latin America and Europe. Mr. Hawley received an A.B. from Harvard College and an M.B.A. from Boston College.

*Greg D. Johnson* has served as our Executive Vice President, Chief Marketing Officer since January 2007. From September 2003 to January 2007, Mr. Johnson held positions with Arnold Worldwide, an advertising agency, where he was an executive vice president and director of Arnold One, Arnold's interactive and direct marketing division. From April 2000 to September 2003, Mr. Johnson was a founder and managing principal of a management consulting firm, Epoch Strategy, and from 1999 to 2000, a principal of DiaLogos. From 1996 to 1999, Mr. Johnson held leadership positions with the company now known as Digitas. Mr. Johnson began his career in research and analytics with Epsilon and the Gillette Company. Mr. Johnson is a graduate of Babson College.

*Sandra M. Stark* has served as our Executive Vice President, Business Development since December 2005. Prior to joining First Marblehead, Ms. Stark was President of The Masix Group, a consulting firm she founded in 2004 focused on helping mid-size companies develop and execute growth strategies, and was Senior Executive with the Riverside Company, a private equity firm focused on middle market companies. From 1999 to 2004, Ms. Stark served in a variety of positions with Baldwin-Wallace College, most recently as the Director of the Entrepreneurship Center. From 1978 to 1999, Ms. Stark held a variety of leadership positions at KeyCorp, a financial services firm, in both the retail and Small Business areas. Most recently she served as Vice Chairman of the Small Business Services Group, where she developed and implemented Key's national small business strategy. Ms. Stark received a B.A. in Business and an M.B.A. from Baldwin-Wallace College.

*Kenneth S. Klipper* has served as our Treasurer and Chief Accounting Officer since November 2006 and as Senior Vice President, Finance since March 2005. From January 2003 to March 2005, Mr. Klipper served as the Chief Executive Officer of BrownCo., an online brokerage firm owned by JPMorgan at the time. From May 2002 to January 2003, Mr. Klipper served as the Chief Financial Officer of Park Street Capital, a private equity firm. From January 2000 to April 2002, Mr. Klipper served as the Chief Financial Officer of Tucker Anthony Sutro, Inc., a publicly traded securities brokerage firm. Prior to joining Tucker Anthony, Mr. Klipper served for five years as both the Chief Financial Officer and Controller for the securities brokerage unit of Fidelity Investments, and he held positions with KPMG LLP, a registered

public accounting firm, for eleven years. Mr. Klipper received a B.S. degree from the University of Richmond and is a Certified Public Accountant.

### **Code of Ethics**

We have adopted a code of conduct that applies to our employees and officers, including our principal executive officer, principal financial officer, principal accounting officer, or persons serving similar functions. We have also adopted a statement of business ethics that applies to our directors. We will provide a copy of our code of conduct and statement of business ethics for our board of directors to any person without charge, upon written request to: Corporate Secretary, The First Marblehead Corporation, The Prudential Tower, 800 Boylston Street, 34<sup>th</sup> Floor, Boston, Massachusetts 02199. Our code of conduct and statement of business ethics for our board of directors, as well as our corporate governance guidelines and the charters of the standing committees of our board of directors, are posted on our website at [www.firstmarblehead.com](http://www.firstmarblehead.com), and each of these documents is available in print to any stockholder who submits a written request to our corporate secretary. On April 24, 2007, our board of directors amended our code of conduct to revise our policy with regard to gifts and gratuities. Specifically, the board amended the definition of "items of insignificant value" to mean items of less than \$50 from any party in any calendar year. Previously, the policy defined "items of insignificant value" to mean items of less than \$250. If we amend our code of conduct in the future or grant a waiver under our code of conduct to an officer or anyone functioning as our principal accounting officer, we intend to post information about such amendment or waiver on our website.

### **Item 1A. Risk Factors**

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below in addition to the other information included in this annual report. If any of the following risks actually occurs, our business, financial condition or results of operations would likely suffer. In that case, the trading price of our common stock could fall.

*We derive a significant portion of our revenue and substantially all of our income from structuring securitization transactions; our financial results and future growth would be adversely affected if we are unable to structure securitizations.*

Securitization refers to the technique of pooling loans and selling them to a special purpose, bankruptcy remote entity, typically a trust, which issues securities to investors backed by those loans. As of the date of this report, we have provided structural advisory and other services for 36 loan securitizations since our formation in 1991. In connection with securitizations, we receive compensation in the form of structural advisory fees, residuals and administrative fees for management of the trusts. The amount and timing of the fees we recognize are affected, in part, by the timing, size and structure of the securitization transactions, as well as the composition of loan pools to be securitized, the return expectations of investors and assumptions we make regarding loan portfolio performance, including defaults, recoveries, prepayments and the cost of funding. Revenue from new securitizations constituted 78% of our total revenue for fiscal 2007, 74% of our total revenue for fiscal 2006 and 75% of our total revenue for fiscal 2005. Substantially all of our net income in those fiscal periods was attributable to securitization-related revenue.

*A number of factors, some of which are beyond our control, may adversely affect our securitization activities and thereby adversely affect our results of operations.*

Our financial performance and future growth depend in part on our continued success in structuring securitizations. Several factors may affect both our ability to structure securitizations and the revenue we generate for providing our structural advisory and other services, including the following:

- degradation of the credit quality or performance of the loan portfolios of the trusts we structure, which could reduce or eliminate investor demand for future securitizations that we facilitate, particularly for subordinate classes of asset-backed securities, or result in rating agencies modifying their assumptions with respect to the securitization trusts;
- prolonged volatility in the capital markets generally or in the student loan asset-backed securities sector specifically, which could restrict or delay our access to the capital markets;
- the timing and size of student loan-backed securitizations that other parties facilitate, or the adverse performance of, or other problems with, such securitizations, could impact pricing or demand for our securitizations;
- challenges to the enforceability of student loans based on violations of federal or state consumer protection laws and related regulations, or imposition of penalties or liability on assignees of student loans for violation of such laws and regulations;
- any material downgrading or withdrawal of ratings given to securities previously issued in securitizations that we structured, or any occurrence of an event of default with respect to such securities, which could reduce demand for additional securitizations that we structure; and
- unwillingness of financial guarantee providers to offer credit insurance in the securitizations that we structure or in student loan-backed securitizations generally.

A portion of the securities issued since 1998 in securitization transactions that we structured were sold to asset-backed commercial paper conduits. If these or similar asset-backed conduits cease to purchase securities in the securitizations that we structure, we may experience a delay in the timing of our securitizations as we seek to find alternate channels of distribution.

Under the terms of some of our contracts with key lender clients, we have an obligation to securitize loans originated by those lenders periodically. We may agree with other lenders to securitize more frequently in the future. If we do not honor these obligations, we may be required to pay liquidated or other damages, which could adversely affect our results of operations.

*In connection with our recognition of revenue from securitization transactions, if the estimates we make, or the assumptions on which we rely, in preparing our financial statements prove inaccurate, our actual results may vary materially from those reflected in our financial statements.*

We receive structural advisory fees for our services in connection with securitization transactions. We receive an up-front portion of these structural advisory fees when the securitization trust purchases the loans. We receive an additional portion of these structural advisory fees over time, based on the amount of loans outstanding in the trust from time to time over the life of the trust. We also have the right to receive a portion of any residual interests that the trust creates. As required under accounting principles generally accepted in the United States of America, or GAAP, we recognize as revenue an estimate of the fair value of the additional portion of the structural advisory fees and residuals at the time the securitization trust purchases the loans because these revenues are deemed to be earned before they are actually paid to us. We record additional structural advisory fees and residuals as receivables on our balance sheet at our estimate of their fair value. Because there are no quoted market prices for our additional structural advisory fees or residuals receivable, accounting rules require that we use discounted cash flow modeling techniques and certain assumptions to estimate fair value. We estimate the fair value both initially and in

each subsequent quarter and reflect the change in our estimate of fair value in earnings for that period. Our key assumptions to estimate the fair value include prepayment and discount rates, interest rates and the expected credit losses from the underlying securitized loan portfolio, net of recoveries. If the actual performance of some or all of the securitization trusts varies from the key assumptions we use, the actual additional structural advisory fees and residuals that we receive from the trusts could be significantly less than reflected in our current financial statements, and we may incur a material negative adjustment to our earnings in the period in which our assumptions change. In addition, our securitization yields, or our structural advisory fees and residuals from a new securitization transaction expressed as a percentage of the total principal and accrued interest securitized, realized on future securitized transactions could decrease if the actual performance of some or all of the securitization trusts varies from the key assumptions we have historically used. During the third quarter of fiscal 2007, we altered certain key assumptions which could negatively impact future securitization yields. For a discussion of these changes and the sensitivity of the additional structural advisory fees and residuals to variations in our assumptions and estimates, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Executive Summary—Application of Critical Accounting Policies and Estimates—Sensitivity Analysis." In particular, economic, regulatory, competitive and other factors affecting prepayment, default and recovery rates on the underlying securitized loan portfolio, including full or partial prepayments and prepayments as a result of loan consolidation activity, could cause or contribute to differences between the actual performance of the securitization trusts and our key assumptions.

Our residuals and additional structural advisory fees in each securitization we have facilitated are subordinate to securities issued to investors in such securitizations and may fail to generate any cash flow for us if the securitized assets only generate enough cash flow to pay the debt holders.

***The timing of our securitization activities and size and structure of our securitization transactions will greatly affect our quarterly financial results.***

Our quarterly revenue, operating results and profitability have varied and may continue to vary significantly on a quarterly basis. In fiscal 2007, we recognized 35%, 22%, 20% and 23% of our total revenue in the respective fiscal quarters of fiscal 2007. We facilitated one securitization in the first, second and third quarters, and two securitizations in the fourth quarter. Our quarterly revenue varied primarily because of the size of the securitizations that we structured. Variations in the size or structure of each securitization transaction, as well as the composition of the loan pools being securitized, will continue to result in variability of our operating results on a quarterly basis, even if we complete securitizations each quarter. The timing, size and structure of our planned securitization activities may be affected by the seasonality of student loan applications and loan originations, conditions in the asset-backed securities market, as well as the other factors that could adversely affect our securitization activities. Recent volatility in the asset-backed securities market could effect the timing, size, structure or profitability of future capital markets transactions, including any capital markets transaction that we plan to facilitate in the first quarter of fiscal 2008. Origination of student loans is generally subject to seasonal trends, with the volume of loan applications increasing with the approach of tuition payment dates. In fiscal 2007, we processed 39% of our total loan facilitation volume in the first quarter ended September 2006, and 18%, 24% and 19% of our total loan facilitation volume in the respective successive quarters.

***Our financial results could be adversely affected if we were required to consolidate the financial results of the entities that we use for securitizations that we facilitate.***

We provide structural advisory and other services for loan securitizations undertaken through statutory trusts. We do not consolidate the financial results of the trusts with our own financial results. For a discussion of our decision not to consolidate, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Executive Summary—Application of Critical Accounting Policies and Estimates—Consolidation" included in this annual report. Some of the accounting rules relevant to

this issue are in the process of being amended. If we were required to consolidate the financial results of one or more trusts with our own financial results as a result of amendments or changes in accounting rules, or if the SEC or other accounting authorities do not agree with our current approach, our financial results could be adversely affected.

*If our relationships with key clients terminate, our revenue and results of operations would be adversely affected.*

We structure and support private student loan programs for commercial banks, including JPMorgan Chase Bank and Bank of America. Structural advisory fees and residuals from securitization of JPMorgan Chase Bank loans represented approximately 29% of our total revenue for fiscal 2007 and approximately 26% of our total revenue for fiscal 2006. Structural advisory fees and residuals from securitization of Bank of America loans represented approximately 15% of total revenue for fiscal 2007 and approximately 16% of total revenue for fiscal 2006. We also structure and support private student loan programs for companies that assist lenders such as Charter One Bank in marketing their programs to customers. Structural advisory fees and residuals from securitization of loans marketed under our proprietary brand, Astrive, and funded by Charter One Bank, or our wholly owned subsidiary Union Federal, represented approximately 12% of our total revenue for fiscal 2007 and approximately 4% of our total revenue for fiscal 2006.

We have agreements with lenders that govern the purchase of loans for securitization. Our agreement with JPMorgan Chase Bank is scheduled to terminate in March 2010. Our agreements pursuant to which Charter One Bank serves as a program lender are generally scheduled to terminate in April 2008. Our agreement with Bank of America governing the purchase of direct-to-consumer loans expires on May 31, 2008, provided that either party may terminate this agreement upon 90 days notice. Our agreement with Bank of America governing the purchase of school channel loans expires on June 30, 2008, provided that the agreement automatically renews for successive one-year terms after that date and can be terminated at any time upon 180 days notice. Each client above has the right to terminate its agreement on short notice, generally 30 days or less, if we materially breach our agreement, including our failure to perform at service levels specified in those contracts. In addition, under the terms of our lender clients' guaranty agreements with TERI, both the lender and TERI may propose modifications to loan program guidelines during the first calendar quarter of each year. If the parties are unable to agree on a proposed modification, such as an adjustment of the guarantee fees, the party proposing the modification has the option of terminating the guaranty agreement, effective as of May 1 of that calendar year. Under its master loan guaranty agreement with us, TERI may not propose a change to program guidelines without our consent. Similarly, under our agreements with lenders that have multi-year terms, the lender cannot change the program guidelines without our consent, which we cannot unreasonably withhold.

A significant decline in services to JPMorgan Chase Bank, Bank of America, or Charter One Bank, or the termination of guaranty agreements between those lenders and TERI, could reduce the overall volume of loans we facilitate, which could be difficult to replace through arrangements with other lenders. Our revenue, business and financial results could suffer as a result.

*The outsourcing services market for education lending is highly competitive and if we are not able to compete effectively, our revenue and results of operations may be adversely affected.*

We assist national and regional financial institutions and educational institutions, as well as businesses, education loan marketers and other enterprises, in structuring and supporting their private education loan programs. We receive fees for services we provide primarily in connection with the securitization of our clients' loans. The outsourcing services market in which we operate includes a large number of service providers, some of which have greater financial, technical and marketing resources, larger customer bases, greater name recognition and more established relationships with their clients than we have. Larger competitors with greater financial resources may be better able than us to respond to the

need for technological changes, compete for skilled professionals, build upon efficiencies based on a larger volume of loan transactions, fund internal growth and compete for market share generally. We may face competition from our clients if they choose, or acquire the ability, to provide directly the services that we provide. In addition, we may face competition from third parties who decide to expand their services to include the suite of services that we provide. We are aware of three principal competitors, Sallie Mae, Servus Financial Corporation, an affiliate of Wells Fargo Company, and Student Loan Corporation, an 80% owned subsidiary of Citibank, N.A., that offer a similar range of services to lenders. Our business could also be adversely affected if Sallie Mae's program to market private student loans directly to consumers continues to grow, if Sallie Mae seeks to market more aggressively to third parties the full range of services for private loan programs that we provide or if Sallie Mae's private loan consolidation product results in increased consolidation of private student loans held by the securitization trusts we have facilitated. We are also aware of smaller privately held venture backed companies that are developing systems and expertise with plans to compete directly with us. If we are not able to compete effectively, our revenue and results of operations may be adversely affected. In addition, if third parties choose to provide the range of services that we provide, pricing for our services may become more competitive, which could lower our profitability.

In addition, there has been significant consolidation within the banking and financial services industry. On April 16, 2007, an investor group that included Bank of America and JPMorgan Chase Bank, our two largest lender clients, announced that they signed a definitive agreement to purchase Sallie Mae. The investment in Sallie Mae by these lender clients could result in reduction or possible termination of future loan originations from these lenders. It may also impact our ability to negotiate favorable fees when negotiating future contracts with these lender clients. Further consolidation could result in a loss of business if one or more of our clients were acquired by a competitor or a lender that is not our client.

Historically, lenders in the education loan market have focused their lending activities on federal loans because of the relative size of the federal loan market and because the federal government guarantees repayment of these loans, thereby significantly limiting the lenders' credit risk. The demand for our services could decline if lenders place additional emphasis on the private education loan market and offer the services we provide, including in response to legislative initiatives affecting the availability and profitability of federal loans.

***If our clients do not successfully market and originate student loans, our business will be adversely affected.***

We provide outsourcing services to lenders, loan marketers and educational institutions, as well as businesses and other organizations, in structuring and supporting their private education loan programs. We rely on our clients to market and originate education loans to student borrowers. If they do not devote sufficient time and resources to their marketing efforts, or if they are otherwise not successful in these efforts, then we may experience a reduction in the volume of loans that we process and securitize, and our business will be adversely affected. In addition, if the loans were marketed by our clients in a manner that is unfair or deceptive, or if the marketing, origination or servicing violated any applicable law, state unfair and deceptive practices acts could impose liability on a securitization trust holding the loan or create defenses to the enforceability of the loan. In response to recent legislative initiatives, lenders may increasingly focus on the direct to consumer marketing channel, increasing competition within the channel for private student loans. Investigations by the New York Attorney General, the Attorneys General of other states, the United States Congress or a recently announced federal task force into the relationship between lenders and college financial aid officers could have a negative impact on the ability of our clients, and Union Federal, to market student loans.



***In structuring and facilitating securitizations of our clients' loans and as holders of rights to receive residual cash flows in those trusts, we may incur liabilities to investors in the asset-backed securities those trusts issue.***

We have facilitated and structured a number of different special purpose trusts that have been used in securitizations to finance student loans that our clients originate. Under applicable state and federal securities laws, if investors incur losses as a result of purchasing asset-backed securities that those trusts issue, we could be deemed responsible and could be liable to those investors for damages. If we failed to cause the trusts to disclose adequately all material information regarding an investment in the asset-backed securities or if the trust made statements that were misleading in any material respect in information delivered to investors, it is possible that we could be held responsible for that information or omission. In addition, under various agreements entered into with underwriters or financial guarantee insurers of those asset-backed securities, we are contractually bound to indemnify those persons if investors are successful in seeking to recover losses from those parties and the trusts are found to have made materially misleading statements or to have omitted material information.

If we are liable for losses investors incur in any of the securitizations that we facilitate or structure and any insurance that we may have does not cover this liability or proves to be insufficient, our profitability or financial position could be materially adversely affected.

***If our relationship with TERI terminates, our business could be adversely affected.***

In June 2001, we purchased the loan processing operations of TERI and entered into a series of agreements to govern future securitizations of TERI-guaranteed loans. TERI continues to provide private student loan guarantee, education information and counseling services for students, and is the exclusive third-party provider of borrower default guarantees for our clients' private label loans. We have entered into an agreement to provide various services for TERI and received fees from TERI for services performed of \$134.8 million, or 15% of total revenue, for fiscal 2007, and \$106.1 million or 19% of total revenue, for fiscal 2006. We also have entered into an agreement to receive from TERI updated information about the performance of the student loans it has guaranteed, to allow us to supplement our database. Each of these agreements with TERI had an initial term through June 2006. In October 2004, we exercised our option to renew each agreement for an additional five-year term, through June 2011. If our agreements with TERI terminate for any reason, or if TERI fails to comply with its obligations, our business would be adversely affected and the value of our intangible assets could be impaired for the following reasons:

- we may not be able to offer our clients guarantee services from another guarantor and, accordingly, our access to loans and our opportunities to structure securitization transactions may diminish significantly;
- we may not be successful in establishing an arrangement with a third-party to provide the warranties that TERI currently provides to lenders related to origination services. In such case, we may be required to provide such warranties;
- if TERI is unable to provide guarantee services for loans, any financial guarantee insurance coverage we obtain in securitization transactions could be costly, if available at all; and
- we could lose access to continuing updates to the database of TERI-guaranteed loan performance data.

In such events, demand for our services, including opportunities to structure and facilitate securitization transactions, could decline, which would adversely affect our business. In addition, the value of the loans in the securitization transactions we facilitate could decline and the value of our residuals could be reduced.

***Our business could be adversely affected if TERI's ratings are downgraded.***

In its role as guarantor in the private education lending market, TERI agrees to reimburse lenders for unpaid principal and interest on defaulted loans. TERI is the exclusive provider of borrower default guarantees for our clients' private label loans. As of June 30, 2007, TERI had a Baa3 counterparty rating from Moody's Investors Service, which is the lowest investment grade rating, and an insurer financial strength rating of A+ from Fitch Ratings which was reaffirmed on April 2, 2007. TERI also held a rating of A from Dominion Bond Rating Service as of June 30, 2007. If TERI's ratings were downgraded, our clients may not wish to enter into guarantee arrangements with TERI, our upfront structural advisory fee yields could decline, or market conditions could dictate that we obtain additional credit enhancement for the asset-backed securitizations that we structure, the cost of which could result in lower revenues. In addition, the inability of TERI as student loan guarantor to meet its guaranty obligations could reduce the amount of principal or interest paid to the holders of asset-backed securities, which could adversely affect our residual interests in securitization trusts or harm our ability to structure securitizations in the future. Finally, if TERI's ratings were downgraded below the ratings TERI held in January 2003, or if a rating agency were to place a negative watch on TERI, our agreement with Bank of America relating to the purchase of direct-to-consumer loans could be terminated. In January 2003, TERI had a Baa3 counterparty rating from Moody's Investors Service and an insurer financial strength rating of A from Fitch Ratings. If TERI experiences a material adverse financial change such as a reduction of its credit rating below investment grade, Bank of America could suspend the processing of new application for school channel loans. In each such case, our business would be adversely affected.

***Our business could be adversely affected if PHEAA fails to provide adequate or timely services or if our relationship with PHEAA terminates.***

As of June 30, 2007, PHEAA serviced a majority of loans whose origination we support. This arrangement allows us to increase the volume of loans in our clients' loan programs without incurring the overhead investment in servicing operations. Our reliance on an external service provider for loan servicing subjects us to risks associated with inadequate or untimely services, such as inadequate notice of developments in prepayments, delinquencies and defaults. A substantial increase in these rates could adversely affect our ability to access profitably the securitization markets for our clients' loans and the value of our additional structural advisory fees and residuals receivables. In addition, if our relationship with PHEAA terminates, we would either need to expand or develop a relationship with another TERI-approved loan servicer, which could be time consuming and costly. In such event, our business could be adversely affected. Although we periodically review the costs associated with establishing servicing operations to service loans, we have no plans to establish and perform servicing operations at this time.

***The growth of our business could be adversely affected by changes in federal student loan programs or expansions in the population of students eligible for loans under federal student loan programs.***

We focus our business exclusively on the market for private education loans, and more than 90% of our business is concentrated in loan programs for post-secondary education. The availability and terms of loans that the federal government originates or guarantees affects the demand for private student loans because students and their families often rely on private loans to bridge a gap between available funds, including family savings, grants and federal and state loans, and the costs of post-secondary education. The federal government currently places both annual and aggregate limitations on the amount of federal loans that any student can receive and determines the criteria for student eligibility. These guidelines are adjusted in connection with funding authorizations from the United States Congress for programs under the Higher Education Act. During February 2006, Congress passed, and the President signed, the Deficit Reduction Act of 2005. The Deficit Reduction Act of 2005 includes several changes to federal student loan programs. Although aggregate borrowing limits did not change, the Deficit Reduction Act of 2005

increased amounts that first and second year college students may borrow and makes Parent Loans for Undergraduate Students, or PLUS, loans available to graduate and professional students. Loans to fund graduate level education represented approximately 11% during fiscal 2007, 15% during fiscal 2006 and 13% during fiscal 2005 of our total loan facilitation volume. The loan limit increases took effect July 1, 2007 while most other provisions took effect July 1, 2006. Recent legislation, as well as future legislation, could weaken the demand for private student loans, or result in increased competition in the market for private student loans which could adversely affect the volume of private loans and the securitization transactions that we facilitate and structure and, as a result, the growth of our business.

***Access to alternative means of financing the costs of education may reduce demand for private student loans.***

The demand for private student loans could weaken if student borrowers use other vehicles to bridge the gap between available funds and costs of post-secondary education. These vehicles include, among others:

- home equity loans, under which families borrow money based on the value of their real estate;
- pre-paid tuition plans, which allow students to pay tuition at today's rates to cover tuition costs in the future;
- 529 plans, which are state-sponsored investment plans that allow a family to save funds for education expenses; and
- education IRAs, now known as Coverdell Education Savings Accounts, under which a holder can make annual contributions for education savings.

If demand for private student loans weakens, we would experience reduced demand for our services, which would seriously harm our financial results.

***If competitors acquire or develop a student loan database or advanced loan information processing systems, our business could be adversely affected.***

We own a proprietary database of historical information on private student loan performance that we use to help us establish the pricing provisions of new loan programs on behalf of lenders, determine the terms of securitization transactions and establish the fair value of the structural advisory fees and residuals that we recognize as revenue. We also have developed a proprietary loan information processing system to enhance our application processing and loan origination capabilities. Our student loan database and loan information processing system provide us with a competitive advantage in offering our services. Third parties could create or acquire databases and systems such as ours. For example, as lenders and other organizations in the student loan market originate or service loans, they compile over time information for their own student loan performance database. If a third party creates or acquires a student loan database or develops a loan information processing system, our competitive positioning, ability to attract new clients and business could be adversely affected.

***Changes in interest rates could affect the value of our additional structural advisory fees and residuals receivable, as well as demand for private student loans and our services.***

Student loans typically carry floating interest rates. Higher interest rates would increase the cost of the loan to the borrower, which in turn, could cause an increase in default rates for outstanding student loans. In addition, higher interest rates, or the perception that interest rates could increase in the future, could cause an increase in prepayments, including full or partial prepayments or prepayments as a result of loan consolidation activity. In particular, prepayments may increase during periods in which long-term interest rates, such as interest rates on mortgages, are lower than short-term interest rates, including rates on student loans. If the prepayment or default rates increase for the student loans held by the securitization

trusts, we may experience a decline in the value of our additional structural advisory fees and residuals receivable, which could cause a decline in the price of our common stock and could cause future securitization transactions to be less profitable for us. In addition, most of the student loans that our clients originate carry floating rates of interest tied to prevailing short-term interest rates. An increase in interest rates could reduce borrowing for education generally, which, in turn, could cause the overall demand for our services to decline.

*If we are unable to protect the confidentiality of our proprietary database and information systems and processes, the value of our services and technology will be adversely affected.*

We rely on trade secret laws and restrictions on disclosure to protect our proprietary database and information systems and processes. We have entered into confidentiality agreements with third parties and with some of our employees to maintain the confidentiality of our trade secrets and proprietary information. These methods may neither effectively prevent disclosure of our confidential information nor provide meaningful protection for our confidential information if there is unauthorized use or disclosure.

We own no patents and have filed no patent applications with respect to our proprietary database or loan information processing systems. Accordingly, our technology is not covered by patents that would preclude or inhibit competitors from entering our market. Monitoring unauthorized use of the systems and processes that we developed is difficult, and we cannot be certain that the steps that we have taken will prevent unauthorized use of our technology. Furthermore, others may independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our proprietary information. If we are unable to protect the confidentiality of our proprietary information and know-how, the value of our technology and services will be adversely affected.

*An interruption in or breach of our information systems may result in lost business.*

We rely heavily upon communications and information systems to conduct our business. As we implement our growth strategy and increase our volume of business, that reliance will increase. Our systems and operations are potentially vulnerable to damage or interruption from network failure, hardware failure, software failure, power or telecommunications failures, computer viruses and worms, penetration of our network by hackers or other unauthorized users and natural disasters. Any failure or interruption, or breach in security, of our information systems or the third-party information systems on which we rely could cause underwriting or other delays and could result in fewer loan applications being received, slower processing of applications and reduced efficiency in loan processing. A failure, interruption or breach in security could also result in an obligation to notify clients in states such as California that require such notification, with possible civil liability resulting from such failure, interruption or breach. We cannot assure you that such failures, interruptions or breaches will not occur, or if they do occur that we or the third parties on whom we rely will adequately address them. The precautionary measures that we have implemented to avoid systems outages and to minimize the effects of any data or telephone systems interruptions may not be adequate, and we may not have anticipated or addressed all of the potential events that could threaten or undermine our information systems. In addition, we have not instituted redundancy for key systems. The occurrence of any failure, interruption or breach could significantly impair the reputation of our brand, diminish the attractiveness of our services and harm our business.

***If we experience a data security breach and confidential customer information is disclosed, we may be subject to penalties imposed by regulators, civil actions for damages and negative publicity, which could affect our customer relationships and have a material adverse effect on our business. In addition, current state and federal legislative proposals, if enacted, may impose additional requirements on us to safeguard confidential customer information, which may result in increased compliance costs. We have devoted significant technological resources to address new federal requirements for authentication of Internet customers.***

Recently, data security breaches suffered by well-known companies and institutions have attracted a substantial amount of media attention, prompting state and federal legislative proposals addressing data privacy and security. If some of the current proposals are adopted, we may be subject to more extensive requirements to protect the borrower information that we process in connection with the loans. Implementation of systems and procedures to address these requirements would increase our compliance costs. If we were to experience a data security breach, or if we or the securitization trusts that we administer otherwise improperly disclose confidential customer information, such breach or other disclosure could generate negative publicity about us and could adversely affect our relationships with our clients, including the lenders and educational institutions with which we do business. This could have a material adverse effect on our business. In addition, pending legislative proposals, if adopted, likely would result in substantial penalties for unauthorized disclosure of confidential consumer information. New requirements issued by the Federal Financial Institutions Examination Council regarding authentication of customers accessing account information became effective January 1, 2007. Those requirements have posed technology challenges for us, and we have implemented additional authentication procedures in order to comply with those requirements. Failure to comply with those requirements could result in regulatory sanctions imposed on our client lenders and loss of business for us.

***The loan origination process is becoming increasingly dependent upon technological advancement, and we could lose clients and market share if we are not able to keep pace with rapid changes in technology.***

Our ability to handle an increasing volume of transactions is based in large part on the systems and processes we have implemented and developed. The loan origination process is becoming increasingly dependent upon technological advancement such as the ability to process loans over the Internet, accept electronic signatures and provide process updates instantly. Our future success depends in part on our ability to develop and implement technology solutions that anticipate and keep pace with these and other continuing changes in technology, industry standards and client preferences. We may not be successful in anticipating or responding to these developments on a timely basis. If competitors introduce products, services, systems and processes that are better than ours or that gain greater market acceptance, those that we offer or use may become obsolete or noncompetitive. Any one of these circumstances could have a material adverse effect on our ability to obtain and retain key clients.

We may be required to expend significant funds to develop or acquire new technologies. If we cannot offer new technologies as quickly as our competitors, we could lose clients and market share. We also could lose market share if our competitors develop more cost effective technologies than those we offer or develop.

***We have expanded our operations rapidly in recent years, and if we fail to manage effectively our growth, our financial results could be adversely affected.***

From our inception to June 30, 2007, our assets have grown to \$1.2 billion. Our revenue increased to \$880.7 million for fiscal 2007 from \$569.0 million for fiscal 2006. Our growth may place a strain on our management, systems and resources. We must continue to refine and expand our business development capabilities, our systems and processes and our access to financing sources. As we grow, we must continue to hire, train, supervise and manage new employees.

We have recently begun to co-source some borrower service functions, including some call center operations, in an effort to reduce costs and enhance our ability to process an increasing volume of loans. We have limited experience with our co-sourcing vendor and rely on the vendor to provide a high level of customer service. Our reliance on this external service provider subjects us to risks associated with inadequate or untimely services, and could result in a lower number of loans than we would experience if we performed the service function in-house.

We recently completed our acquisition of Union Federal Savings Bank, North Providence, Rhode Island. We may face challenges in integrating our products, services and employees.

We cannot assure you that we will be able to:

- expand our systems effectively;
- allocate our human resources optimally;
- identify and hire qualified employees or vendors; or
- incorporate effectively the components of any business that we may acquire in our effort to achieve growth.

If we are unable to manage our growth, our operations and our financial results could be adversely affected.

***We may be subject to state registration or licensing requirements in jurisdictions where we are not currently registered or licensed. If we determine that we are subject to the registration or licensing requirements of any jurisdiction, our compliance costs could increase significantly and other adverse consequences may result.***

Based on the advice of our regulatory counsel and, in some states, additional local counsel opinions and informal advice from state regulators, we have been operating on the basis that no registrations or licenses are required of us under laws applicable to loan brokers, small lenders and loan arrangers, and other similar laws. We will continue to review state registration and licensing requirements that may become applicable to us in the future, in view of the expansion of the scope of the services we provide, our plans for future activities and the time that has elapsed since our prior review. As a result of this continuing review, we may determine that registration or licensing is required in jurisdictions where we are not currently registered or licensed. Even if we are not physically present in a state, its regulators may take the position that registration or licensing is required because we provide services by mail, telephone, the Internet or other remote means. If we identify any states in which registration or licensing is required, we will proceed with registration or licensing in the affected state. If any state asserts jurisdiction over our business, we will consider whether to challenge the assertion or proceed with registration or licensing in the affected state. Compliance with such requirements could involve additional costs, which could have a material adverse effect on our business. Our failure to comply with these laws could lead to, among other things:

- curtailment of our ability to continue to conduct business in the relevant jurisdiction, pending processing of registration or a license application;
- administrative enforcement actions;
- class action lawsuits;
- the assertion of legal defenses delaying or otherwise affecting the enforcement of loans; and
- criminal as well as civil liability. This could have a material adverse effect on our business.

Our new wholly owned subsidiary, Union Federal, may conduct business without regard to such state licensing laws and requirements, because it is chartered by the federal Office of Thrift Supervision, or OTS. Certain of our advertising and marketing coordination employees who focus on our proprietary brand loans have become employees of Union Federal, and will support those brands. To the extent that our engagement in marketing related activities becomes part of the business of Union Federal, the likelihood of assertion of state regulatory requirements affecting loan brokers, small lenders and credits services organizations will be reduced.

*If the regulatory exemptions or rulings that allow us to conduct our business without registration or licensing are modified or revoked, or the statutory and regulatory requirements change in the future, our compliance costs could increase substantially.*

The Massachusetts Division of Banks ruled that our business with TERI is not subject to licensing because, as a provider of loan origination outsourcing services, we do not conduct a lending business with consumers in our own name and our processing centers are not generally open to the public. The Massachusetts Small Loan Act requires any person that is engaged, for compensation, in the business of making small loans, or in aiding or assisting the borrower or the lender in procuring or making such loans, to obtain a license. Under the statute, the business of making small loans includes the making of loans of \$6,000 or less with interest rates and expenses of more than 12% per year. The TERI-guaranteed loans that we facilitate include amounts as small as \$1,000, and a portion of those loans have combined interest rates and fees exceeding 12%. We could therefore become subject to the Small Loan Act with respect to these loans if the Massachusetts Division of Banks revokes its previous determination that our operations are exempt or determines that our activities exceed the scope of the determination.

We could also become subject to registration or licensing requirements due to changes in existing federal and state laws and regulations. The Massachusetts legislature could, for example, modify the statutory requirements under the Small Loan Act. If the Massachusetts legislature, or any other state or federal regulatory authority, changes existing laws and rules, or enacts new laws or rules, we could be forced to make changes in our relationships with lenders, educational institutions, guarantors, servicers or the trusts involved in the securitizations that we facilitate. Specifically, changes in existing laws and rules could also require us to implement additional or different programs and information technology systems and could impose licensing, capital and reserve requirements and additional costs, including administrative, compliance and third-party service costs.

*We may be exposed to liability for failures of third parties with which we do business to comply with the registration, licensing and other requirements that apply to them.*

Third parties with which we do business, including federal and state chartered financial institutions, non-bank loan marketers, as well as TERI, are subject to registration, licensing and extensive governmental regulations, including Truth-in-Lending laws and other consumer protection laws and regulations. For example, some of the third-party marketers with which we do business may be subject to state registration or licensing requirements and laws and regulations, including those relating to small loans, loan brokers and credit services organizations. As a result of the activities that we conduct for our clients, it may be asserted that we have some responsibility for compliance by third parties with which we do business with the laws and regulations applicable to them, whether on contractual or other grounds. If it is determined that we have failed to comply with our obligations with respect to these third parties, we could be subject to civil or criminal liability.

***We could also become subject to registration or licensing and other regulatory requirements in Massachusetts and other states by expanding the scope or extent of our services.***

We are in the process of expanding the scope of the services we provide on behalf of lenders to include certain advertising and marketing coordination functions. As a result of this expansion of our services, or if we expand our services in the future to include, among others, loan guarantees or direct solicitation of consumers, our current exemption from the Massachusetts Small Loan Act could be invalidated, and consequently, we may need to obtain a license from the Massachusetts Division of Banks or secure an alternative exemption. In addition, we may become subject to the laws and regulations of other states governing such expanded services. We may also become subject to state regulatory requirements if the extent of the activities that we conduct in a particular state expands. Compliance with such requirements could involve additional costs, which could have a material adverse effect on our business. To the extent that our engagement in marketing related activities becomes part of the business of Union Federal, such activities will not be subject to licensing requirements imposed under the laws of the Commonwealth of Massachusetts or other state laws.

***Failure to comply with consumer protection laws could subject us to civil and criminal penalties and have a material adverse effect on our business.***

The federal government and state governments regulate extensively the financial institutions and other entities that originate loans in the student loan market. These regulations include bankruptcy, tax, usury, disclosure, credit reporting, identity theft, privacy, fraud and abuse and other laws to protect borrowers. Changes in consumer protection laws or related regulations, or in the prevailing interpretations thereof, may expose us to litigation, result in greater compliance costs, adversely affect the collection of balances due on the loan assets held by securitization trusts or otherwise adversely affect our business. For example, the enactment in October 2006 of 10 U.S.C. section 987 (“Limitations on Terms of Consumer Credit Extended to Service Members and Dependents”) imposed extensive new disclosure requirements on all consumer loans made to military service members and their dependents other than mortgages and personal property finance. Proposed regulations recently issued by the Department of Defense would limit application of the Act to loans that have repayment terms of less than 91 days, are made in amounts of less than \$2,000 and have certain additional terms. If the proposed regulations are not adopted, we could incur substantial additional expense complying with the requirements of the Act, and may be required to create new types of products for persons covered by the Act. The requirements of the Act become effective October 1, 2007. Moreover, changes in the consumer protection laws and related regulations, or in the prevailing interpretations thereof, could invalidate or call into question the legality of certain of our services and business practices.

The risk of noncompliance with regulatory requirements by our lender clients and their marketing partners has been highlighted by recent state and federal investigations into school channel marketing practices, particularly the payment of marketing fees directly to schools in exchange for loan referrals. None of our contracts with lenders or marketers involves the payment of fees to schools for loan volume. We are not aware of any judgments or consent decrees entered into by any of our lender or marketer clients with respect to any of the loan products we coordinate. However, state and federal regulatory authorities have sought information from some of our clients and us regarding the loan programs we coordinate, and it is possible that some marketing or underwriting practices associated with the programs we coordinate and assets we securitize will be challenged as a result of such investigations.

The regulatory actions described above have also prompted state and federal legislation that will affect our operations. The State of New York has enacted legislation that may impede accepted marketing practices in the school channel, such as school endorsement of loan products that the school believes are beneficial to students. In addition, the New York legislation will require additional disclosures that will increase our costs. Similarly, proposed legislation in the United States Senate and The Student Loan



Sunshine Act already passed by the U.S. House of Representatives would impose significant additional disclosure and processing burdens on our loan origination operations. Other proposals, which have not yet passed in either house of Congress, would reduce protection of the loans we securitize in bankruptcy proceedings.

Violations of the laws or regulations governing our operations, or the operations of TERI or our other clients, could result in the imposition of civil or criminal penalties, the cancellation of our contracts to provide services or our exclusion from participating in education loan programs. These penalties or exclusions, were they to occur, would negatively impair our ability to operate our business. In addition, the loan assets held by securitization trusts that we have structured could be adversely impacted by violation of tax or consumer protection laws. In such event, the value of our residual interests could also be adversely impacted. In some cases, such violations may render the loan assets unenforceable.

*Recent litigation has sought to re-characterize certain loan marketers and other originators as lenders; if litigation on similar theories were successful against us or any third-party marketer, the loans that we securitize would be subject to individual state consumer protection laws.*

We provide financial and educational institutions, as well as other organizations, with an integrated suite of services in support of private student loan programs. All of the lenders with which we work are federally-insured banks and credit unions and, therefore, are not subject to many state consumer protection laws, including limitations on certain interest rates, fees and other charges. In providing our private student loan services to our clients, we do not act as a lender, guarantor or loan servicer, and the terms of the loans that we securitize are regulated in accordance with the laws and regulations applicable to the lenders.

The association between high-interest “payday loans” marketers and out-of-state national banks has come under recent scrutiny. Recent litigation asserts that payday loan marketers use out-of-state lenders in order to evade the usury and interest rate caps, and other consumer protection laws, imposed by the states where they do business. Such litigation has sought, successfully in some instances, to re-characterize the loan marketer as the lender for purposes of state consumer protection law restrictions. Similar civil actions have been brought in the context of gift cards. We believe that our activities, and the activities of third parties whose marketing on behalf of lenders is coordinated by us, are distinguishable from the activities involved in these cases.

Additional state consumer protection laws would be applicable to the loans we facilitate if we, or any third-party loan marketer whose activities we coordinate, were re-characterized as a lender, and the loans (or the provisions governing interest rates, fees and other charges) could be unenforceable. In addition, we could be subject to claims by consumers, as well as enforcement actions by regulators. Even if we were not required to cease doing business with residents of certain states or to change our business practices to comply with applicable laws and regulations, we could be required to register or obtain licenses or regulatory approvals that could impose a substantial cost on us. To date, there have been no actions taken or threatened against us on the theory that we have engaged in unauthorized lending. However, such actions could have a material adverse effect on our business.

*The price of our common stock may be volatile.*

The trading price of our common stock may fluctuate substantially, depending on many factors, some of which are beyond our control and may not be related to our operating performance. These fluctuations could cause you to lose part or all of your investment in our shares of common stock. Those factors that could cause fluctuations include, but are not limited to, the following:

- actual or anticipated changes in our earnings or fluctuations in our operating results or in the expectations of securities analysts;

- difficulties we may encounter in the securitizations that we structure or the loss of opportunities to structure securitization transactions;
- any variance between the actual performance of the securitization trusts and the key assumptions that we have used to estimate the fair value of our additional structural advisory fees and residuals receivables;
- changes in the key assumptions we use to estimate the fair value of our additional structural advisory fees and residuals receivables, including discount, default and prepayment rates;
- announcement by us, our competitors or our potential competitors of acquisitions, new products or services, significant contracts, commercial relationships or capital commitments;
- price and volume fluctuations in the overall stock market from time to time;
- significant volatility in the market price and trading volume of financial services and process outsourcing companies;
- general economic conditions and trends;
- negative publicity about the student loan market generally or us specifically;
- legislative initiatives effecting federal or private student loans;
- major catastrophic events;
- loss of a significant client or clients;
- purchases or sales of large blocks of our stock; or
- departures of key personnel.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been brought against that company. Due to the potential volatility of our stock price, we may therefore be the target of securities litigation in the future. Securities litigation could result in substantial costs and divert management's attention and resources from our business.

***If a substantial number of shares become available for sale and are sold in a short period of time, the market price of our common stock could decline.***

Future sales of a substantial number of shares of our common stock in the public market, or the perception that such sales may occur, could adversely affect the then-prevailing market price of our common stock. As of July 31, 2007, we had 93,405,267 shares of common stock outstanding. Subject to limitations under federal securities laws, including in some cases the volume limitations of Rule 144, these shares are eligible for sale in the public market. The market price of shares of our common stock may drop significantly if our existing stockholders sell a substantial number of shares. A decline in the price of shares of our common stock might impede our ability to raise capital through the issuance of additional shares of our common stock or other equity securities.

***Insiders have substantial control over us and could limit your ability to influence the outcome of key transactions, including a change of control.***

Our directors and executive officers, and entities affiliated with them, beneficially own approximately 30% of the outstanding shares of our common stock. As a result, these stockholders, if acting together, could substantially influence matters requiring approval by our stockholders, including the election of directors and the approval of mergers or other extraordinary transactions. They may also have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your

interests. The concentration of ownership may have the effect of delaying, preventing or deterring a change of control of our company, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and might ultimately affect the market price of our common stock.

***We are subject to regulation as a savings and loan holding company, and Union Federal Savings Bank is regulated extensively.***

As a result of our acquisition of Union Federal Savings Bank on November 30, 2006, we are now subject to regulation as a savings and loan holding company and our business is limited to activities that are financial or real-estate related. We have registered with the OTS and are required to file periodic reports. In addition, we are subject to examination by the OTS, which has certain types of enforcement powers over us, including the ability to issue cease-and-desist orders, force divestiture of Union Federal and impose civil and monetary penalties for violations of federal banking laws and regulations or for unsafe or unsound banking practices.

In addition, Union Federal is subject to extensive regulation, supervision and examination by the OTS and the Federal Deposit Insurance Corporation. Such regulation covers all banking business, including activities and investments, lending practices, safeguarding deposits, capitalization, risk management policies and procedures, relationships with affiliated companies, recordkeeping and conduct and qualifications of personnel. In particular, the failure to meet minimum capital requirements could initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material adverse effect on our operations and financial statements.

There is a risk that we could incur additional costs in complying with regulations applicable to savings and loan holding companies and savings banks, or significant penalties if we fail to comply. Our ability to comply with all applicable laws and rules will depend largely on our establishment and maintenance of a system to ensure such compliance, as well as our ability to attract and retain qualified compliance personnel. We have relatively limited experience with these regulations, and we could be subject to disciplinary or other actions due to claimed noncompliance in the future, which could have an adverse effect on our business, financial condition and operating results.

***Some provisions in our restated certificate of incorporation and amended and restated by-laws may deter third-parties from acquiring us.***

Our restated certificate of incorporation and amended and restated by-laws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors, including the following:

- only our board of directors, the chairman of our board of directors or our president may call special meetings of our stockholders;
- our stockholders may take action only at a meeting of our stockholders and not by written consent;
- we have authorized undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval;
- our directors may be removed only for cause by the affirmative vote of a majority of the directors present at a meeting duly held at which a quorum is present, or by the holders of 75% of the votes that all stockholders would be entitled to cast in the election of directors; and
- we impose advance notice requirements for stockholder proposals.

These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult

for you and other stockholders to elect directors of your choosing or cause us to take other corporate actions you desire.

*Section 203 of the Delaware General Corporation Law may delay, defer or prevent a change in control that our stockholders might consider to be in their best interests.*

We are subject to Section 203 of the Delaware General Corporation Law which, subject to certain exceptions, prohibits “business combinations” between a Delaware corporation and an “interested stockholder,” which is generally defined as a stockholder who becomes a beneficial owner of 15% or more of a Delaware corporation’s voting stock, for a three-year period following the date that such stockholder became an interested stockholder. Section 203 could have the effect of delaying, deferring or preventing a change in control that our stockholders might consider to be in their best interests.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We lease buildings for our executive offices and operations. Our headquarters are located in Boston, Massachusetts, and we have additional offices in Medford, Massachusetts and North Providence, Rhode Island. The following table summarizes information with respect to the principal facilities that we lease:

<u>Location</u>	<u>Principal activities</u>	<u>Area (sq. feet)</u>	<u>Lease expiration date</u>
Boston, MA (Boylston Street) .....	Headquarters	51,972	2014
Boston, MA (St. James Avenue) .....	Loan processing	133,971	2014
Medford, MA .....	Loan processing	136,496	2012
Providence, RI .....	Union Federal	13,064	2007

We do not anticipate significant difficulty in obtaining lease renewals or alternate space as needed.

**Item 3. Legal Proceedings**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

#### Market Information and Holders

Our common stock is listed on the New York Stock Exchange under the trading symbol FMD. The following table sets forth the high and low sales prices of our common stock, as reported by the New York Stock Exchange, and cash dividends declared per then outstanding share of our common stock, for each quarterly period within our two most recent fiscal years.

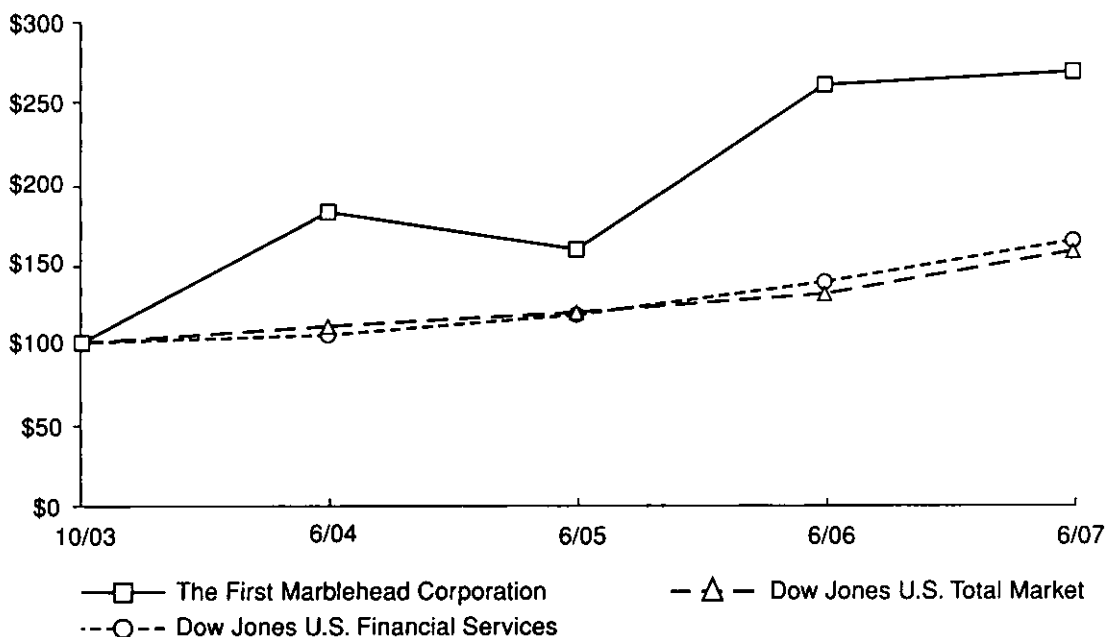
	<u>High</u>	<u>Low</u>	<u>Cash Dividends</u>
<b>Fiscal 2007</b>			
First Quarter.....	\$47.67	\$29.07	\$0.10
Second Quarter.....	55.25	40.75	0.12
Third Quarter.....	57.56	40.60	0.15
Fourth Quarter.....	45.70	30.62	0.25
<b>Fiscal 2006</b>			
First Quarter.....	\$24.25	\$14.00	\$0.08
Second Quarter.....	23.67	13.93	0.08
Third Quarter.....	33.33	20.96	0.08
Fourth Quarter.....	38.84	28.40	0.08

Computershare Trust Company, N.A. is the transfer agent and registrar for our common stock. As of the close of business on July 26, 2007, we had 35 holders of record of our common stock. This number does not include stockholders for whom shares are held in "street" or nominee name.

## Performance Graph

The following graph compares the cumulative 44-month total return to stockholders of our common stock relative to the cumulative total returns of the Dow Jones U.S. Total Market index and the Dow Jones U.S. Financial Services index. An investment of \$100 (with reinvestment of all dividends) is assumed to have been made in our common stock and in each of the indexes on October 31, 2003, the effective date of our initial public offering, and its relative performance is tracked through June 30, 2007. In accordance with the rules of the SEC, cumulative total return data for our common stock is based on the closing sale price of our common stock on the New York Stock Exchange of \$14.77 per share on October 31, 2003, rather than the initial public offering price of \$10.67 per share.

**COMPARISON OF 44 MONTH CUMULATIVE TOTAL RETURN\***  
Among The First Marblehead Corporation, The Dow Jones U.S. Total Market Index  
And The Dow Jones U.S. Financial Services Index



\* \$100 invested on 10/31/03 in stock or index, including reinvestment of dividends. Fiscal year ending June 30.

The information included under the heading "Performance Graph" is "furnished" and not "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liabilities of that section, nor shall it be deemed to be "soliciting material" subject to Regulation 14A or incorporated by reference in any filing under the Securities Act or the Exchange Act.

## Dividends

Although we will continue to retain earnings for use in the operation and expansion of our business, we have returned cash to our stockholders through a regular quarterly cash dividend. We paid cash dividends in amounts between \$0.08 and \$0.25 per outstanding share of our common stock in each quarter of fiscal 2007 and 2006.

Although it is our current intention to pay quarterly cash dividends in fiscal 2008, any decision to pay future cash dividends will be made by our board of directors and will depend upon our earnings, financial condition, capital requirements and such other factors as the board of directors deems relevant.

#### Use of Proceeds from Sale of Registered Securities

In our initial public offering, or IPO, we sold 11,859,375 shares of common stock, including an over-allotment option of 1,547,625 shares, pursuant to a registration statement on Form S-1 (File No. 333-108531) that was declared effective by the SEC on October 30, 2003. We received aggregate net proceeds of approximately \$115.1 million, after deducting underwriting discounts and commissions of approximately \$8.9 million and expenses of the offering of approximately \$2.5 million. From the effective date of the registration statement through June 30, 2007, we have not spent any of the net proceeds from the IPO, which have been invested in cash, cash equivalents and investments. Accordingly, none of the net proceeds of the IPO has been paid by us, directly or indirectly, to any director, officer, or general partner of us, or any of their associates, or to any person owing ten percent or more of any class of our equities securities or any of our affiliates.

#### Issuer Purchases of Equity Securities

On April 24, 2007, our board of directors authorized the repurchase of up to an aggregate of 10,000,000 shares of our common stock. Under a previous repurchase program, our board of directors authorized on September 29, 2005 the repurchase of up to an aggregate of 7,500,000 shares of our common stock. The 10,000,000 shares authorized for repurchase on April 24, 2007 included 3,393,300 shares available for repurchase under the previously authorized repurchase plan. The current repurchase program does not have a fixed expiration date.

<u>Period</u>	<u>Total number of shares purchased(1)</u>	<u>Average price paid per share(2)</u>	<u>Total number of shares purchased as part of publicly announced plan or programs</u>	<u>Maximum number of shares that may yet be purchased under the plans or programs</u>
April 1, 2007 to April 30, 2007 .	150,660	\$ 33.62	150,000	10,000,000(3)
May 1, 2007 to May 31, 2007 . .	1,174,101	36.16	1,169,100	8,830,900
June 1, 2007 to June 30, 2007 . .	897	38.77	—	8,830,900
	<u>1,325,658</u>		<u>1,319,100</u>	

- (1) Total number of shares purchased includes shares forfeited by employees to satisfy statutory minimum tax withholding obligations as equity compensation awards vest.
- (2) Average price paid per share excludes commissions that we paid to the brokers that affected these repurchases.
- (3) Through April 24, 2007, we had repurchased an aggregate of 4,106,700 shares under the repurchase program authorized by our board of directors on September 29, 2005, at an average price paid per share, excluding commissions, of \$20.41.

## Item 6. Selected Financial Data

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this filing. We have derived the data from consolidated financial statements, which were audited by KPMG LLP, independent registered public accounting firm. The historical results presented here are not necessarily indicative of future results.

	Fiscal year ended June 30,				
	2007	2006	2005	2004	2003
(in thousands, except per share data)					
<b>Consolidated Statements of Income Data:</b>					
Service revenues:					
Up-front structural advisory fees .....	\$457,352	\$208,178	\$168,166	\$83,896	\$33,312
Additional structural advisory fees:					
From new securitizations .....	43,984	33,685	27,520	13,650	5,452
Trust updates .....	1,363	1,241	1,767	(351)	573
Total additional structural advisory fees ..	45,347	34,926	29,287	13,299	6,025
Residuals:					
From new securitizations .....	182,744	177,309	121,187	57,935	27,498
Trust updates .....	29,548	28,239	17,593	6,960	2,529
Total residual revenues .....	212,292	205,548	138,780	64,895	30,027
Processing fees from TERI .....	134,845	106,072	78,200	35,056	20,577
Administrative and other fees .....	21,497	8,848	3,544	2,114	1,415
Total service revenues .....	871,333	563,572	417,977	199,260	91,356
Net interest income (expense) .....	9,371	5,463	3,288	73	(1,456)
Total revenues .....	880,704	569,035	421,265	199,333	89,900
Non-interest expenses:					
Compensation and benefits .....	111,364	89,214	67,608	34,839	19,816
General and administrative expenses .....	141,591	98,593	76,568	35,693	16,071
Total non-interest expenses .....	252,955	187,807	144,176	70,532	35,887
Income from operations .....	627,749	381,228	277,089	128,801	54,013
Other .....	16	2,526	—	—	—
Income before income tax expense .....	627,765	383,754	277,089	128,801	54,013
Income tax expense .....	256,434	147,794	117,424	53,530	22,514
Net income .....	<u>\$371,331</u>	<u>\$235,960</u>	<u>\$159,665</u>	<u>\$75,271</u>	<u>\$31,499</u>
<b>Income Per Share Data:</b>					
Net income per common share:					
Net income per share, basic .....	\$ 3.94	\$ 2.47	\$ 1.64	\$ 0.85	\$ 0.40
Net income per share, diluted .....	3.92	2.45	1.59	0.79	0.37
Cash dividends declared per share .....	0.62	0.32	—	—	—
Weighted average shares outstanding, basic .....	94,296	95,366	97,550	88,572	79,649
Weighted average shares outstanding, diluted ...	94,845	96,258	100,206	95,274	85,247



	June 30,				
	2007	2006	2005	2004	2003
	(in thousands)				
<b>Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents .....	\$ 106,271	\$ 75,711	\$193,796	\$168,712	\$18,327
Investments .....	128,650	67,250	—	—	—
Loans held for sale .....	37,052	—	—	—	—
Service receivables .....	809,668	551,567	309,590	148,881	56,905
Total assets .....	1,214,463	770,346	558,193	360,056	87,053
Total liabilities .....	371,843	194,177	136,627	81,920	34,629
Total stockholders' equity .....	842,620	576,169	421,566	278,136	52,424

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*You should read the following discussion and analysis of our financial condition and results of operations together with our "Selected Financial Data" and consolidated financial statements and accompanying notes attached as Appendix A to this annual report. In addition to the historical information, the discussion contains certain forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those expressed or implied by the forward-looking statements due to applications of our critical accounting policies and factors including, but not limited to, those set forth under the caption "Risk Factors" in Item 1A of Part I of this annual report.*

### **Executive Summary**

#### **Overview**

We offer our clients, national and regional financial institutions and educational institutions, as well as businesses, education loan marketers and other organizations, a suite of outsourcing services for private education lending in the United States. We currently focus on facilitating private student loans for undergraduate, graduate and professional education, although we also provide service offerings for continuing education programs, the primary and secondary school market, career training and study abroad programs. We provide services in connection with each of the five typical phases of the student loan lifecycle, offering our clients a single point of interface for:

- program design and marketing coordination;
- borrower inquiry and application;
- loan origination and disbursement;
- loan securitization; and
- loan servicing.

We receive fees for the services we provide in connection with our clients' private student loans, including processing and structuring and administering securitizations of those loans. Securitization refers to the technique of pooling loans and selling them to a special purpose, bankruptcy remote entity, typically a trust, which issues securities to investors backed by those loans. We have provided structural, advisory and other services for 36 securitization transactions since our formation in 1991.

We do not take a direct ownership interest in the student loans our clients generate, nor do we serve as a guarantor with respect to any student loan programs that we facilitate. We assist the lenders in our loan programs in selecting the underwriting criteria used in deciding whether a student loan will be made to an applicant. However, each lender has ultimate control over the selection of these criteria, and in providing our services, we are obligated by contract to observe them. Our lender clients have the opportunity to mitigate their credit risk through a loan repayment guarantee by TERI pursuant to which TERI guarantees repayment of the borrower's loan principal, together with capitalized or accrued interest, on defaulted loans. Lenders that wish to have their loans guaranteed by TERI are required to meet TERI's underwriting criteria. Beginning in April 2007, our wholly-owned subsidiary Union Federal, began serving as an additional lender for our proprietary brand of private student loans. Although we oversee loan servicing as a component of our administrative duties, we do not act as a loan servicer.

The primary driver of our results of operations and financial condition is the volume of student loans for which we provide outsourcing services from loan origination through securitization. The following table presents certain financial and operating information for the fiscal years ended June 30, 2007, 2006 and 2005.

	Fiscal year ended June 30,		
	2007	2006	2005
	(dollars in thousands)		
Approximate student loan applications processed. . . . .	1,325,000	938,000	876,000
Approximate number of student loans facilitated . . . . .	429,000	358,000	297,000
Approximate number of student loans facilitated that were also available to us for securitization . . . . .	366,000	296,000	231,000
Principal amount of student loans facilitated . . . . .	\$4,292,528	\$3,362,565	\$2,662,106
Principal amount of student loans facilitated that were also available to us for securitization . . . . .	\$3,873,048	\$2,920,048	\$2,179,524
Principal and accrued interest balance of student loans securitized. . . . .	\$3,750,043	\$2,762,368	\$2,262,493
Principal balance of student loans facilitated and available to us at year end for later securitization . . .	\$ 831,912	\$ 663,800	\$ 385,804

The principal balance of loans facilitated and available to us for later securitization fluctuates as a result of several factors including (a) the timing of securitizations, (b) the cut off date for loan purchases as securitizations take place, (c) the loan purchase eligibility criteria included in the various note purchase agreements that govern the purchase of loans for securitization and (d) the daily volume of loans facilitated prior to period end.

In June 2001, we acquired TERI's loan processing operations, including its historical database, but not its investment assets or guarantee liabilities. In connection with this acquisition, we entered into a master servicing agreement pursuant to which TERI engages us to provide loan origination and processing services with respect to the student loans generated through the private label programs we facilitate, as well as other TERI-guaranteed loans. TERI reimburses us for the expenses we incur in providing these services. Under the terms of a master loan guaranty agreement that we have entered into with TERI, we have also agreed to provide a beneficial interest for TERI in a portion of the residual value of securitization trusts that purchase TERI-guaranteed loans, and granted to TERI a right of first refusal to provide a third-party guarantee of our private label clients' existing and future loan programs. In October 2004, we renewed our master servicing agreement, master loan guaranty agreement and certain additional agreements with TERI, in each case for an additional term through June 2011.

Although we offer our clients a fully integrated suite of outsourcing services, we do not charge separate fees for many of these services. Moreover, although we receive fees for providing loan processing services to TERI in connection with TERI-guaranteed loans, and fees from certain of our clients for marketing coordination services, these fees represent reimbursement of the direct expenses we incur. Accordingly, we do not earn a profit on these fees. Although we provide these various services without charging a separate fee, or at "cost" in the case of processing services for TERI-guaranteed loans and marketing coordination services, we generally enter into agreements with the private label lenders giving us the exclusive right to securitize the student loans that they do not intend to hold. We receive structural advisory fees and residuals for facilitating securitizations of these loans. Our level of profitability depends on our ability to earn these structural advisory fees and residuals. We discuss the manner in which we recognize them as revenue in greater detail below. We may in the future enter into arrangements with private label lenders under which we would provide outsourcing services, but would not have the exclusive right to securitize the student loans that they originate.

Changes in any of the following factors can materially affect our financial results:

- the demand for private education financing;
- the competition for providing private education financing;
- the education financing preferences of students and their families;
- applicable laws and regulations, which may affect the terms upon which our clients agree to make private student loans and the cost and complexity of our loan facilitation operations;
- the private student loan securitization market, including the costs or availability of financing and market receptivity to Triple B rated student loan asset backed notes and auction rate notes;
- the general interest rate environment, including its effect on our discount and prepayment rates;
- our critical accounting policies and estimates;
- borrower default rates and our ability to recover principal and interest from such borrowers;
- prepayment rates, including prepayments through loan consolidation of private student loans held by our trusts; and
- the availability of student loans or grants through federal programs.

On November 30, 2006, we completed the acquisition of Union Federal, a community savings bank located in North Providence, Rhode Island. Union Federal is a federally chartered thrift that offers residential retail mortgage loans, retail savings products, time deposit products and, as of April 2007, private student loans. Union Federal had total assets of approximately \$41 million as of the acquisition date. The financial results of Union Federal subsequent to the acquisition date are included in our financial statements. The purchase price was allocated to acquired assets and liabilities based on their respective fair values at November 30, 2006. We recorded additional goodwill of \$1.7 million and a core deposit intangible of \$1.3 million as a result of this acquisition. Goodwill will be reviewed for impairment at least annually. The core deposit intangible represented the present value of the difference in expected future cash flows between the costs to replace such deposits (based on applicable equivalent borrowing rates) versus the then-current yield on core deposits acquired. The aggregate future cash flows are based on the average expected life of the deposits acquired for each product less the cost to service them. The core deposit intangible will be amortized on a straight-line basis over a five year period and will be reviewed for impairment when it is determined that facts or circumstances may affect the recoverability of the asset.

#### ***Securizations and Related Revenue***

We structure and facilitate securitization transactions for our clients through a series of bankruptcy remote, qualified special purpose statutory trusts. The trusts obtain through the securitization process private student loans from the originating lenders or their assignees, which relinquish to the trust their ownership interest in the loans. The debt instruments that the trusts issue to finance the purchase of these student loans are obligations of the trusts, rather than our obligations or those of originating lenders or their assignees. We refer to the trusts utilized in the securitization of TERI-guaranteed private label loans as private label loan trusts.

Under the terms of some of our contracts with key lender clients, we have an obligation to securitize periodically the private student loans that these clients originate. If we do not honor our obligations to these lenders, we may be required to pay liquidated damages, generally not exceeding an amount equal to 1% of the face amount of the loans available for securitization.

We receive several types of fees in connection with our securitization services:

- *Structural advisory fees.* We charge structural advisory fees that are paid in two portions:
  - *Up-front.* We receive a portion of the structural advisory fees at the time the securitization trust purchases the loans, or shortly thereafter. In exchange for these fees, we structure the debt securities sold in the securitization, coordinate the attorneys, accountants, trustees, loan servicers, loan originators and other transaction participants and prepare the cash flow modeling for rating agencies as needed. For the securitizations of TERI-guaranteed loans that we facilitated in fiscal 2007, these fees ranged from 11.7% to 13.1% of the aggregate principal and capitalized interest of the loans securitized. For the securitizations of TERI-guaranteed loans we facilitated in fiscal 2006, these fees ranged from 7.5% to 8.4% of the aggregate principal and capitalized interest of the loans securitized. The private label loan trusts we facilitated in fiscal 2007 issued Triple B rated securities, the only such issuances by any of our securitizations trusts. The issuance of Triple B rated securities enabled us to increase the up-front structural advisory fee yield, with a decrease in the amount of residuals we expect to receive, from these securitization transactions; and
  - *Additional.* We receive a portion of the structural advisory fees over time, based on the amount of loans outstanding in the private label loan trust from time to time over the life of the trust. This portion accumulates monthly from the date of a securitization transaction at a rate of 15 to 30 basis points per year. We begin to receive this additional portion, plus interest, once the ratio of trust assets to trust liabilities, which we refer to as the “parity ratio,” reaches a stipulated level, which ranges from 103% to 105%. The level applicable to a particular private label loan trust is determined at the time of securitization. We currently expect to receive the additional fees beginning five to seven years after the date of a particular securitization transaction.
- *Residual.* We also have the right to receive a portion of the residual interests that these private label loan trusts create. This interest is junior in priority to the rights of the holders of the debt sold in the securitizations and additional structural advisory fees, and entitles us to receive 66% to 88% of the net cash flows of the particular private label loan trust once a parity ratio of 103% to 103.5%, depending on the particular trust, is reached and maintained.

Our residual interest derives almost exclusively from the services we perform in connection with each securitization rather than from a direct cash contribution to the securitization trust. In the case of securitizations of exclusively private label loans, we currently expect to receive the residuals beginning approximately five to seven years after the date of a particular securitization.

- *Administrative and other fees.* Our administrative and other fees represent the reimbursement of out of pocket costs we receive at the time of securitization related to marketing coordination services performed for some of our clients. Our administrative and other fees also include the administrative fees we receive from the trusts for their daily management and services we provide in obtaining information from the loan servicers and reporting this and other information to the parties related to the securitization. Our fees for performing these services range from 5 to 20 basis points per year based on the student loan balance in the trust.

#### ***Processing Fees from TERI***

We provide outsourcing services for TERI, including loan origination, customer service, default processing, default prevention and administrative services under a master servicing agreement between TERI and us. We recognize as revenue the monthly reimbursement that TERI provides us for the expenses we incur in providing these services.

### ***Recognition and Valuation of Service Revenue***

We recognize up-front structural advisory fees as revenue at the time the securitization trust purchases the loans. In order for the securitization trust to purchase the loans, all of the applicable services must be performed, rating agencies must deliver their ratings letters, transaction counsel must deliver the required legal opinions and the underwriters must receive the debt securities issued by the securitization trust. These events indicate that the securitization transaction has been properly structured and loans have been properly sold to the securitization trust.

As required under GAAP, we also recognize the fair value of additional structural advisory fees and residuals as revenue at that time, as they are deemed to be earned at the time of the securitization but before we actually receive payment. These amounts are deemed earned because evidence of an arrangement exists, we have provided the services, the fee is fixed and determinable based upon a discounted cash flow analysis, there are no future contingencies or obligations and collection is reasonably assured.

Under GAAP, we are required to estimate the fair value of the additional structural advisory fees and residuals as if they are investments in debt securities classified as available-for-sale or trading, similar to retained interests in securitizations. Accordingly, we record additional structural advisory fees and residuals receivable on our balance sheet at estimated fair value using a discounted cash flow model. Because there are no quoted market prices for our additional structural advisory fees and residuals receivable, we use certain key assumptions to estimate their values. See “—Application of Critical Accounting Policies and Estimates—Service Revenue and Receivables.” We estimate the fair value both initially and at each subsequent quarter and reflect the change in the value in earnings for that period.

We generally recognize administrative and other fees, as well as processing fees from TERI, as revenue at the time that we perform the underlying services. We recognize marketing coordination fees, which are a component of administrative and other fees, at the time the securitization trust purchases the loans derived from the related marketing coordination services.

### ***Quarterly Fluctuations***

Our quarterly revenue, operating results and profitability have varied and may continue to vary on a quarterly basis primarily because of the timing, size and structure of the securitizations that we facilitate. In fiscal 2007, we facilitated one securitization in each of the first, second and third quarters and two securitizations in the fourth quarter. In fiscal 2006, we facilitated one securitization in the second quarter, one securitization in the third quarter and two securitizations in the fourth quarter. We expect to facilitate securitizations in each quarter of fiscal 2008, although the timing, size or structure of any capital markets transactions could be affected by recent volatility in the capital markets. Variations in the size or structure of each securitization transaction could continue to result in variability of our operating results on a quarterly basis. The following tables set forth our quarterly revenue and net income (loss) for each quarter of fiscal 2007 and 2006:

	<b>Fiscal 2007</b>				
	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>	<b>Total</b>
			(in thousands)		
Total revenues .....	\$302,945	\$197,766	\$180,163	\$199,830	\$880,704
Net income .....	141,008	81,151	71,172	78,000	371,331

	Fiscal 2006				Total
	First Quarter	Second Quarter	Third Quarter (in thousands)	Fourth Quarter	
Total revenues . . . . .	\$36,300	\$232,130	\$150,543	\$150,062	\$569,035
Net income (loss) . . . . .	(5,442)	111,361	59,222	70,819	235,960

***Application of Critical Accounting Policies and Estimates***

Our consolidated financial statements have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities and the reported amounts of income and expenses during the reporting periods. We base our estimates, assumptions and judgments on historical experience and on various other factors that we believe are reasonable under the circumstances. Actual results may differ from these estimates under varying assumptions or conditions.

Our significant accounting policies are more fully described in Note 2 of the notes to the audited consolidated financial statements for the fiscal year ended June 30, 2007, which are attached as Appendix A to this document. On an ongoing basis, we evaluate our estimates and judgments, particularly as they relate to accounting policies that we believe are most important to the portrayal of our financial condition and results of operations. We regard an accounting estimate or assumption underlying our financial statements to be a “critical accounting estimate” where:

- the nature of the estimate or assumption is material due to the level of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and
- the impact of the estimates and assumptions on our financial condition or operating performance is material.

We have discussed our accounting policies with the audit committee of our board of directors, and we believe that our estimates relating to the recognition and valuation of our securitization-related revenue and receivables, as described below, fit the definition of critical accounting estimates. We also consider our policy with respect to the determination of whether or not to consolidate the financial results of the securitization trusts that we facilitate to be a critical accounting policy.

***Service Revenue and Receivables***

For a discussion of our revenue recognition policies, see “—Recognition and Valuation of Service Revenue.”

Because there are no quoted market prices for our additional structural advisory fees or residuals receivable, we use discounted cash flow modeling techniques and the following key assumptions to estimate their values:

- the discount rate, which we use to calculate the fair value of our additional structural advisory fees and residuals;
- the annual rate of student loan prepayments;
- the trend of interest rates over the life of the loan pool, including the forward LIBOR curve, and the spread between LIBOR and auction rates;
- expected loan defaults; and
- expected recoveries of defaulted loans.

We base these estimates on our proprietary historical data, third-party data and our industry experience, adjusting for specific program and borrower characteristics such as loan type and borrower creditworthiness. We also monitor trends in loan performance over time and make adjustments we believe are necessary to value properly our receivables balances at each balance sheet date.

The following table shows the approximate weighted average loan performance assumptions at June 30, 2007 for our private label loan trusts:

Trust	Percentage rate			Percentage discount rate	
	Default	Recovery	Prepayments	Residuals	Structural advisory fees
Private label loan trusts . . . . .	9.38%	40%	8%	11.59%	7.02%

In selecting loan performance assumptions, we consider the underlying creditworthiness of the student loan borrowers as well as the type of loans being securitized. We analyze creditworthiness in several tiers, and select what we believe to be appropriate loan performance assumptions based on those tiers. Our private label loan programs, under which approximately 83% of the borrowers have creditworthy co-borrowers, typically a family member, have an extensive credit underwriting process.

*Prepayment Rates.* Loans in the securitization trusts have been experiencing higher prepayment rates than we had estimated would occur at these points in the life of the trusts as a result of a number of factors, including a prolonged and unfavorable interest rate environment. During the third quarter of fiscal 2007, we altered our assumption regarding the annual rate of prepayments that we use to estimate the fair value of our residual and structural advisory fee receivables. The increase of this assumption from an average over the life of the trusts of 7% to 8% resulted in a decrease in the fair value of the residual receivable of \$36.2 million and a decrease in the fair value of the additional structural advisory fee receivable of \$3.5 million during the third quarter of fiscal 2007.

*Discount Rate—Residuals.* In determining an appropriate discount rate for valuing our residuals, we historically have reviewed the rates used by student loan securitizers as well as rates used in the much broader asset-backed securities, or ABS, market. Prior to fiscal 2007, we applied a discount rate of 12% in estimating the present value of our residuals, based on the expected timing of cash flows and the maximum 24-year life of the trust assets and residuals.

During fiscal 2007, we facilitated four securitization transactions involving the issuance of Triple B-rated securities, the only such issuances by any of our securitization trusts. Triple B-rated issuances have, in effect, allowed us to monetize a portion of our securitization-related revenues that previously would have been recognized as residuals. Accordingly, we believe that market developments have now provided us with a meaningful basis for the discount rate to be applied in estimating the fair value of pre-fiscal 2007 private label securitization trust residuals. Beginning with the third quarter of fiscal 2007, we applied a discount rate equal to the trailing 12-month average of the one-month LIBOR + 1.75% to value the portion of the residuals that we believe qualifies as investment grade in pre-fiscal 2007 private label trusts. That portion of the residuals that we believe does not qualify as investment grade is discounted at 13%, as it is in the securitization trusts that have issued Triple B-rated securities. The decrease in the aggregated average discount rate in the third quarter of fiscal 2007 resulted in an increase in the fair value of our residual receivable of \$26.7 million.

*Discount Rate—Additional Structural Advisory Fees.* We base the discount rate that we use to calculate the fair value of our additional structural advisory fees on the 10-year U.S. Treasury Note rate plus 200 basis points. We believe that such a spread is an appropriate discount rate based on the priority payment status of additional structural advisory fees in the flow of funds out of the securitization trusts and comparable spreads on structural and corporate debt securities. During fiscal 2007 and 2006, the 10-year U.S. Treasury Note rate decreased 14 basis points. We applied a discount rate of 7.02% at June 30, 2007



and 7.16% at June 30, 2006. A decrease in the 10-year U.S. Treasury Note rate has the effect of increasing the estimated fair value of our structural advisory fees receivable, while an increase in the rate has the opposite effect on our estimate of fair value.

Two private label loan trusts have issued predominately senior auction rate notes to finance the purchase of student loans. Interest rates for the auction rate notes are determined from time to time at auction. At June 30, 2007, we used a 10 basis point spread over LIBOR to project the future cost of funding of the senior auction rate notes issued by the trusts. Since inception of the first trust, the average spread over LIBOR for the senior auction rate notes issued by the trust has been 4.9 basis points. Since the inception of the second trust, the average spread over LIBOR for the senior auction rate notes issued by the trust has been 5.9 basis points.

Except for the changes to the prepayment rate and the discount rates applied to residuals and additional structural advisory fees, we did not materially change any valuation assumptions during fiscal 2007 or 2006. During the second quarter of fiscal 2006, we increased our estimate of the fair value of structural advisory fees by approximately \$0.5 million and increased our estimate of the fair value of residuals receivable by approximately \$3.1 million as a result of refinements to our prepayment rate assumptions and the use of an enhanced cash flow model. We will continue to monitor the performance of the trust assets against our expectations, and will make such adjustments to our estimates as we believe are necessary to value properly our receivables balances at each balance sheet date.

#### *Sensitivity Analysis*

Increases in our estimates of defaults, prepayments and discount rates, increases in the spread between LIBOR and auction rates indices, as well as decreases in default recovery rates and the multi-year forward estimates of LIBOR, would have a negative effect on the value of our additional structural advisory fees and residuals. Student loan prepayments include either full or partial payments by a borrower in advance of the maturity schedule specified in the credit agreement, including payments as a result of loan consolidation activity. Because most credit defaults are reimbursable by third parties, increases in defaults generally have the same effect as increases in prepayments. If defaults increase beyond the level of expected third-party reimbursement, then these changes will have an additional negative effect on the value of our additional structural advisory fees and residuals. LIBOR is the reference rate for a substantial majority of the loan assets and, we believe, a reasonable index for borrowings of the trusts. Because the trusts' student loan assets earn interest based on LIBOR and some trusts have outstanding securities that pay interest based on the results of auction rates, changes in the spread between LIBOR and the auction rate can affect the performance of the trusts which have issued auction rate notes.

The following table shows the estimated change in our structural advisory fees and residuals receivable balances at June 30, 2007 based on changes in our loan performance assumptions. The effect on the fair value of the structural advisory fees and residuals receivables are based on variations of 10% or 20%, except for the forward LIBOR rates, which are based on variations of 1% and 2% from the forward LIBOR rates at June 30, 2007, and changes in the assumed spread between 1-month LIBOR rates and auction rates, which are based on .05% and .10% changes from the assumed levels for each key assumption:

<u>Structural advisory fees</u>	<u>Percentage change in assumptions</u>		<u>Receivables balance</u> (dollars in thousands)	<u>Percentage change in assumptions</u>	
	<u>Down 20%</u>	<u>Down 10%</u>		<u>Up 10%</u>	<u>Up 20%</u>
Default rate:					
Total structural advisory fees . . . . .	\$ 134,732	\$ 134,188	\$ 133,644	\$ 133,100	\$ 132,557
Change in receivables balance . . . . .	0.81%	0.41%		(0.41)%	(0.81)%
Default recovery rate:					
Total structural advisory fees . . . . .	\$ 133,644	\$ 133,644	\$ 133,644	\$ 133,644	\$ 133,644
Change in receivables balance . . . . .	0.00%	0.00%		0.00%	0.00%
Annual prepayment rate:					
Total structural advisory fees . . . . .	\$ 140,164	\$ 136,798	\$ 133,644	\$ 130,667	\$ 127,879
Change in receivables balance . . . . .	4.88%	2.36%		(2.23)%	(4.31)%
Discount rate:					
Total structural advisory fees . . . . .	\$ 144,324	\$ 138,846	\$ 133,644	\$ 128,699	\$ 123,995
Change in receivables balance . . . . .	7.99%	3.89%		(3.70)%	(7.22)%
	<u>Change in assumption</u>	<u>Change in assumption</u>	<u>Receivables balance</u>	<u>Change in assumption</u>	<u>Change in assumption</u>
	<u>Down 200 basis points</u>	<u>Down 100 basis points</u>	<u>balance</u>	<u>Up 100 basis points</u>	<u>Up 200 basis points</u>
			(dollars in thousands)		
Forward LIBOR rates:					
Total structural advisory fees . . . . .	\$ 124,758	\$ 129,076	\$ 133,644	\$ 138,196	\$ 142,886
Change in receivables balance . . . . .	(6.65)%	(3.42)%		3.41%	6.92%

<u>Residuals</u>	<u>Percentage change in assumptions</u>		<u>Receivables balance</u> (dollars in thousands)	<u>Percentage change in assumptions</u>	
	<u>Down 20%</u>	<u>Down 10%</u>		<u>Up 10%</u>	<u>Up 20%</u>
<b>Default rate:</b>					
Total residual fees . . . . .	\$679,567	\$672,343	\$665,115	\$657,907	\$650,676
Change in receivables balance . . . . .	2.17%	1.09%		(1.08)%	(2.17)%
<b>Default recovery rate:</b>					
Total residual fees . . . . .	\$664,957	\$665,036	\$665,115	\$665,192	\$665,270
Change in receivables balance . . . . .	(0.02)%	(0.01)%		0.01%	0.02%
<b>Annual prepayment rate:</b>					
Total residual fees . . . . .	\$739,711	\$701,341	\$665,115	\$630,907	\$598,543
Change in receivables balance . . . . .	11.22%	5.45%		(5.14)%	(10.01)%
<b>Discount rate:</b>					
Total residual fees . . . . .	\$791,550	\$724,900	\$665,115	\$611,476	\$563,123
Change in receivables balance . . . . .	19.01%	8.99%		(8.06)%	(15.33)%
	<u>Change in assumption</u>			<u>Change in assumption</u>	
	<u>Down 200 basis points</u>	<u>Down 100 basis points</u>	<u>Receivables balance</u>	<u>Up 100 basis points</u>	<u>Up 200 basis points</u>
			(dollars in thousands)		
<b>Forward LIBOR rates:</b>					
Total residual fees . . . . .	\$644,220	\$655,288	\$665,115	\$671,231	\$673,325
Change in receivables balance . . . . .	(3.14)%	(1.48)%		0.92%	1.23%
	<u>Change in assumption</u>			<u>Change in assumption</u>	
	<u>Tighten 10 basis points</u>	<u>Tighten 5 basis points</u>	<u>Receivables balance</u>	<u>Widen 5 basis points</u>	<u>Widen 10 basis points</u>
			(dollars in thousands)		
<b>Change in assumed spread between LIBOR and auction rate indices:</b>					
Total residual fees . . . . .	\$670,993	\$668,054	\$665,115	\$662,179	\$659,243
Change in receivables balance . . . . .	0.88%	0.44%		(0.44)%	(0.88)%

These sensitivities are hypothetical and should be used with caution. The effect of each change in assumption must be calculated independently, holding all other assumptions constant. Because the key assumptions may not in fact be independent, the net effect of simultaneous adverse changes in key assumptions may differ materially from the sum of the individual effects calculated above.

### *Consolidation*

Our consolidated financial statements include the accounts of The First Marblehead Corporation and its subsidiaries, after eliminating inter-company accounts and transactions. We have not consolidated the financial results of the securitization trusts purchasing loans that we have facilitated. Prior to July 1, 2003, this accounting treatment was in accordance with various Emerging Issues Task Force issues and related interpretations. We considered, among other things, the following factors in assessing consolidation of the securitization trusts:

- we did not have unilateral decision-making abilities related to significant matters affecting the securitization trusts, such as asset acquisition, prepayment of debt, placement of debt obligations and modification of trust documents;
- we did not have substantially all the risks and rewards of ownership, as TERI provides substantially all of the student loan guarantees;
- we were a facilitator of securitization transactions, for which we receive market-based fees, and we were not the transferor of assets to the securitization trusts; and
- our continuing involvement in the trusts is limited to a passive residual interest and our role as an administrator for the trust for which we receive market-based fees.

Beginning July 1, 2003, and for securitization trusts created after January 31, 2003, we applied Financial Accounting Standards Board, or FASB, Interpretation No. 46, "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51," or FIN No. 46, in assessing consolidation. FIN No. 46 provided a new framework for identifying variable interest entities and determining when a company should include the assets, liabilities, non-controlling interests and results of activities of a variable interest entity in its consolidated financial statements.

On December 24, 2003, the FASB issued FIN No. 46 (revised December 2003), "Consolidation of Variable Interest Entities," or FIN No. 46R, which addressed how a business enterprise should evaluate whether it has a controlling interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN No. 46R has replaced FIN No. 46. At June 30, 2007, each securitization trust created after January 31, 2003 has met the criteria to be a qualified special-purpose entity, or QSPE, as defined in paragraph 35 of FASB Statement No. 140, "Accounting for the Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." Accordingly, we did not consolidate these existing securitization trusts in our financial statements. In addition, the securitization trusts created prior to January 31, 2003 in which we hold a variable interest that could result in us being considered the primary beneficiary of such trust, have been amended in order for them to be considered QSPEs. The adoption of FIN No. 46R, which we began to apply in December 2003, did not have a material impact on our consolidated financial condition, results of operations, earnings per share or cash flows.

The FASB has issued an exposure draft that would amend FASB Statement No. 140. The proposed amendment would, among other things, change the requirements that an entity must meet to be considered a QSPE. We are monitoring the status of the exposure draft to assess its impact, if any, on our financial statements.

## Results of Operations

Years ended June 30, 2007, June 30, 2006 and June 30, 2005

### Revenue Related to Securitization Transactions

We primarily offer services in connection with private label loan products offered through two marketing channels: (a) direct to consumer, which generally refers to programs that lenders market directly to prospective borrowers and their families, and (b) school channel, which refers to programs that lenders market indirectly to student borrowers and their families through educational institutions. In either case, lenders may engage third parties that are not themselves lenders but which market loans on behalf of lenders that fund the loans. We refer to these third parties as loan marketers, and we refer to the lenders that fund these loans as program lenders.

Our estimates of the allocation by marketing channel of our securitization revenues for fiscal 2007, 2006 and 2005, expressed as a percentage of the total principal and accrued interest of private label loans securitized in each channel at the date of securitization, are as follows:

Month and year of private label securitization	Marketing channel	Volume of loans securitized	Percentage yield				
			Up-front structural advisory fees (dollars in millions)	Additional structural advisory fees	Residuals	Total(2)	
June 2007.....	Direct to consumer	\$ 619	81%	12.6%	1.1%	5.9%	19.6%
	School channel	148	19	7.9	1.1	2.2	11.2
	Total	<u>\$ 767</u>					
	Blended yield(1)			11.7	1.1	5.2	18.0
March 2007 .....	Direct to consumer	\$ 583	75	14.7	1.2	5.2	21.1
	School channel	193	25	8.5	1.2	2.0	11.6
	Total	<u>\$ 776</u>					
	Blended yield(1)			13.1	1.2	4.4	18.7
December 2006....	Direct to consumer	\$ 676	93	12.6	1.2	7.0	20.8
	School channel	48	7	7.3	1.2	2.1	10.6
	Total	<u>\$ 724</u>					
	Blended yield(1)			12.2	1.2	6.7	20.1
September 2006 ...	Direct to consumer	\$ 973	70	14.7	1.2	5.1	21.0
	School channel	413	30	7.3	1.2	1.7	10.2
	Total	<u>\$1,386</u>					
	Blended yield(1)			12.5	1.2	4.1	17.8
Fiscal 2007.....	<b>Blended yield(1)</b>	<b>\$3,653</b>		<b>12.4</b>	<b>1.2</b>	<b>4.9</b>	<b>18.5</b>
June 2006.....	Direct to Consumer	\$ 490	89%	8.8%	1.5%	8.0%	18.3%
	School Channel	62	11	5.8	1.2	3.2	10.2
	Total	<u>\$ 552</u>					
	Blended Yield(1)			8.4	1.5	7.5	17.4
March 2006 .....	Direct to Consumer	\$ 527	71	8.7	1.2	7.7	17.5
	School Channel	214	29	5.9	1.2	3.2	10.3
	Total	<u>\$ 741</u>					
	Blended Yield(1)			7.9	1.2	6.4	15.5
October 2005.....	Direct to consumer	\$ 921	73	8.8	1.2	7.5	17.5
	School channel	344	27	4.1	1.2	2.6	7.8
	Total	<u>\$1,265</u>					
	Blended yield(1)			7.5	1.2	6.2	14.9
Fiscal 2006.....	<b>Blended Yield(1)</b>	<b>\$2,558</b>		<b>7.9</b>	<b>1.2</b>	<b>6.5</b>	<b>15.6</b>

Month and year of private label securitization	Marketing channel	Volume of loans securitized		Percentage yield			Total(2)
				Up-front structural advisory fees (dollars in millions)	Additional structural advisory fees	Residuals	
June 2005.....	Direct to Consumer	\$ 388	84%	9.3%	1.1%	6.5%	16.9%
	School Channel	<u>74</u>	16	4.5	1.1	2.6	8.2
	Total	<u>\$ 462</u>					
	Blended Yield(1)			8.5	1.1	5.9	15.5
June 2005.....	School Channel	<u>\$ 174</u>		1.6	1.9	0.6	4.1
February 2005.....	Direct to Consumer	\$ 445	62	9.6	1.1	6.1	16.7
	School Channel	<u>270</u>	38	4.4	1.1	1.4	6.9
	Total	<u>\$ 715</u>					
	Blended Yield(1)			7.6	1.1	4.4	13.1
October 2004.....	Direct to consumer	\$ 744	92	8.4	1.2	7.5	17.1
	School channel	<u>63</u>	8	4.3	1.0	2.2	7.5
	Total	<u>\$ 807</u>					
	Blended yield(1)			8.1	1.2	7.1	16.4
<b>Fiscal 2005.....</b>	<b>Blended Yield(1)</b>	<b><u>\$2,158</u></b>		<b>7.5</b>	<b>1.2</b>	<b>5.4</b>	<b>14.1</b>

- (1) Blended yield represents securitization revenues as a percentage of the total principal and accrued interest balance of the loans securitized from all marketing channels at the date of securitization.
- (2) Due to rounding and the complex nature of these calculations, which involve allocating the total revenue for a securitization across the different marketing channels based on the aggregate profitability of each marketing channel, the total yield by marketing channel and securitization may not represent the sum of the individual yields by revenue source.

These yields by marketing channel represent an approximate allocation of revenues and costs based on various estimates and assumptions regarding the relative profitability of these loans, and should be read with caution. Furthermore, these yields are dependent on a number of factors, including the mix of loans between marketing channels that are included in a particular securitization, the average life of loans, which can be impacted by prepayments, the time of year that the loans are securitized and the relative mix of loans from students with various expected terms to graduation, the structure of, and prevailing market conditions at the time of, a securitization, the marketing fees which our clients earn on loans we securitize for them, along with a number of other factors. Therefore, readers are cautioned that the approximated blended yields and yields by marketing channel above may not be indicative of yields that we may be able to achieve in future securitizations.

#### *Up-front structural advisory fees*

The up-front component of structural advisory fees increased to \$457.4 million in fiscal 2007 from \$208.2 million in fiscal 2006 and \$168.2 million in fiscal 2005. The increase in up-front structural advisory fees between periods was primarily due to an increase in up-front structural advisory fees as a percentage of the private label loan volume securitized, or up-front structural advisory fee yield, and an increase in loan facilitation volume, which enabled us to securitize a greater amount of loans. The securitization trusts we facilitated in fiscal 2007 issued Triple B-rated securities, the only such issuances by any of our securitization trusts. The issuance of Triple B-rated securities enabled us to increase during fiscal 2007 the

up-front structural advisory fee yield, with a decrease in the amount of residuals we expect to receive, from these securitization transactions. The increase in up-front structural advisory fees for fiscal 2006 compared to fiscal 2005 was primarily due to an increase in loan facilitation volume and, to a lesser extent, an increase in up-front structural advisory fee yield resulting from an increased balance of student loans securitized, a change in the mix of student loans securitized and the introduction of new securitization features.

The following table reflects the changes in up-front structural advisory fees attributable to the changes in securitization volume, changes in the fee yield and loan mix, and the receipt of cost of issuance funds for fiscal 2007, 2006 and 2005:

<u>Fiscal Year</u>	<u>Up-front structural advisory fees</u>				
	<u>Total volume of loans securitized</u>	<u>Change attributable to increase securitization volume</u>	<u>Change attributable to change in fee yield and loan mix</u>	<u>Receipt of cost of issuance funds</u>	<u>Total change</u>
			(in thousands)		
2007 .....	\$3,750,043	\$73,988	\$174,550	\$ 636	\$249,174
2006 .....	2,762,368	36,932	2,841	239	40,012
2005 .....	2,262,493	68,563	14,700	1,007	84,270

The receipt of cost of issuance funds represents the receipt of remaining funds in a trust's cost of issuance account once the trust has paid all costs associated with its issuance of asset-backed securities.

#### *Additional structural advisory fees*

The additional component of structural advisory fees increased to \$45.3 million in fiscal 2007 from \$34.9 million in fiscal 2006 and \$29.3 million in fiscal 2005. The increase in additional structural advisory fees between periods was primarily due to increases in the aggregate securitization volume. The increase in additional structural advisory fees for fiscal 2007 compared to fiscal 2006 was partially offset by an increase in our prepayment assumption.

The following table reflects the changes in additional structural advisory fees attributable to the changes in securitization volume, changes in fee yield and loan mix, and the updates to prior trusts for fiscal 2007, 2006 and 2005:

<u>Fiscal Year</u>	<u>Additional structural advisory fees</u>				
	<u>Total volume of loans securitized</u>	<u>Change attributable to increase securitization volume</u>	<u>Change attributable to change in fee yield and loan mix</u>	<u>Change attributable to trust updates</u>	<u>Total change</u>
			(in thousands)		
2007 .....	\$3,750,043	\$12,044	\$(1,744)	\$ 121	\$10,421
2006 .....	2,762,368	6,080	85	(526)	5,639
2005 .....	2,262,493	11,155	2,715	2,118	15,988

The following table summarizes the changes in our estimate of the fair value of the structural advisory fees receivable for the fiscal years ended June 30, 2007, 2006 and 2005:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(in thousands)		
Fair value at beginning of period .....	\$ 88,297	\$53,371	\$ 24,084(1)
Additions from new securitizations .....	43,984	33,685	27,520
Trust updates			
Passage of time (present value accretion)...	7,503	4,347	2,165
Impact of change in average prepayment rate assumption .....	(3,529)	—	—
Other factors .....	(2,611)	(3,106)	(398)
Net accretion .....	<u>1,363</u>	<u>1,241</u>	<u>1,767</u>
Fair value at end of period .....	<u>\$133,644</u>	<u>\$88,297</u>	<u>\$ 53,371</u>

(1) Excludes a \$10.25 million structural advisory fee receivable from a December 2003 securitization transaction that we collected in July 2004.

On a quarterly basis, we update our estimate of the fair value of our additional structural advisory fees, which we expect to begin to receive approximately five to seven years after the date of a particular securitization transaction. In doing so, we give effect to the passage of time, which results in the accretion of the discounting inherent in the fair value estimates, and we also adjust for any change in the discount rate and other assumptions that we use in estimating the fair value of these receivables. We monitor the performance of trust assets, including default, recovery, prepayment and forward LIBOR rate experience, which we also consider in our estimates. We use an implied forward LIBOR curve to estimate trust cash flows. For a discussion of the assumptions we make in estimating our additional structural advisory fees, see “—Executive Summary—Application of Critical Accounting Policies and Estimates—Service Revenue and Receivables.”

During fiscal 2007, our estimates of the fair value of our additional structural advisory fees resulted in an increase in their carrying value of approximately \$1.4 million. This increase was primarily due to the accretion of the discounting inherent in the fair value estimates, offset in part by the impact of an increase in our assumption regarding future prepayments that we use to estimate the fair value of this receivable and the effect of higher prepayment rates than we had estimated would occur during the period. During fiscal 2006, our estimates of the fair value of our additional structural advisory fees resulted in an increase in their carrying value of approximately \$1.2 million. This increase was primarily due to the accretion of discounting inherent in the fair value estimates and the impact of an increase in the implied forward LIBOR curve during the period, offset by an increase in the discount rate.

For a discussion of changes we made during fiscal 2007 to certain assumptions we use to estimate the fair value of our additional structural advisory fees receivable, see “—Executive Summary—Application of Critical Accounting Policies and Estimates—Service Revenue and Receivables.”



## Residuals

Service revenues from residuals increased to \$212.3 million in fiscal 2007 from \$205.5 million in fiscal 2006 and \$138.8 million in fiscal 2005. The increase in service revenues from residuals in fiscal 2007 compared to fiscal 2006 was primarily a result of an increase in securitization volume, the positive impact of accretion of the discounting inherent in the fair value estimates due to the passage of time and a decrease in the discount rate assumption we use to value the residual receivable for certain securitization trusts, offset in part by the impact of a higher up-front structural advisory fee yield in the fiscal 2007 period and an increase in our assumption for future prepayments that we use to value the residual receivable. The issuance of Triple B-rated securities in the securitizations completed during fiscal 2007 enabled us to increase the up-front structural advisory fee yield, but decreased the amount of residuals we expect to receive, from these securitizations. The increase in service revenues from residuals in fiscal 2006 compared to fiscal 2005 was primarily a result of an increase in securitization volume and an increase in the residual yield.

The following table reflects the changes in residuals attributable to the changes in securitization volume, changes in the fee yield and loan mix, and the updates to prior trusts:

Fiscal Year	Total volume of loans securitized	Residuals			Total change
		Change attributable to increased securitization volume	Change attributable to change in yield and loan mix (in thousands)	Change attributable to trust updates	
2007	\$3,750,043	\$63,396	\$(57,961)	\$ 1,309	\$ 6,744
2006	2,762,368	26,775	29,347	10,646	66,768
2005	2,262,493	47,348	15,904	10,633	73,885

The following table summarizes the changes in our estimate of the fair value of the residuals receivable for the years ended June 30, 2007, 2006 and 2005:

	2007	2006	2005
	(in thousands)		
Fair value at beginning of period	\$452,823	\$247,275	\$108,495
Additions from new securitizations	182,744	177,309	121,187
Trust updates			
Passage of time (present value accretion)	66,428	39,950	19,712
Impact of change in average prepayment rate assumption	(36,236)	—	—
Impact of change in discount rate assumption	26,680	—	—
Other factors	(27,324)	(11,711)	(2,119)
Net accretion	29,548	28,239	17,593
Fair value at end of period	<u>\$665,115</u>	<u>\$452,823</u>	<u>\$247,275</u>

As we do with our additional structural advisory fees, on a quarterly basis, we update our estimate of the fair value of our residuals. In doing so, we give effect to the passage of time, which results in the accretion of the discounting inherent in these fair value estimates, and we also adjust for any change in the discount rate or other assumptions that we use in estimating the fair value of these receivables. We used a 12% discount rate during the first six months of fiscal 2007 and throughout fiscal 2006 in valuing residuals for securitizations completed prior to fiscal 2007. As a result of our Triple B financing structure, we used a 13% discount rate in valuing residuals for the securitizations completed in fiscal 2007. We also monitor the performance of trust assets, including default, recovery, prepayment and forward LIBOR rates experience, which we also consider in our estimates. We use an implied forward LIBOR curve to estimate trust cash

flows. For a discussion of the assumptions we make in estimating our residuals, see “—Executive Summary—Application of Critical Accounting Policies and Estimates—Service Revenue and Receivables.” Loans in the securitization trusts have been experiencing higher prepayment rates than we had estimated would occur at these points in the life of the trusts. As a result, during the third quarter of fiscal 2007, we increased our prepayment assumption from an average over the life of the loan of 7% to 8%, which offset the positive net accretion that comes from updating the carrying value of our additional structural advisory fees and residuals receivables for the passage of time. The negative effect of the increase in our prepayment rate assumptions was offset in part by a reduction in the discount rates we use to estimate the fair value of a portion of our residuals receivable.

Our estimates of the fair value of our residuals receivable resulted in an increase in their aggregate carrying value of approximately \$29.6 million during fiscal 2007 and \$28.2 million during fiscal 2006. During fiscal 2007, the positive impact of the passage of time and the decrease in our discount rate assumption was partially offset by the net negative impact of changes to the prepayment assumptions we use to estimate the fair value of this receivable as well as the negative impact of other factors, including the negative impact of a higher rate of prepayments during the period than we had estimated would occur. During fiscal 2006, the increase in the fair value of our residual receivable was primarily due to the passage of time.

We believe that the 13% discount rate we used for fiscal 2007 securitization trusts for cash flows lower in priority to those received by holders of Triple B-rated securities (or which we believe would not qualify as investment grade for pre-fiscal 2007 private label trusts) is appropriate given the maximum 24-year life of the trust assets and residuals. For a discussion of changes we made during fiscal 2007 to certain assumptions, see “—Executive Summary—Application of Critical Accounting Policies and Estimates—Sensitivity Analysis.”

#### *Processing fees from TERI*

Processing fees from TERI increased to \$134.8 million in fiscal 2007 from \$106.1 million in fiscal 2006 and \$78.2 million in fiscal 2005. The increase was primarily due to increased reimbursable expenses required to process the increased volume of private label loans that we actively disbursed during fiscal 2007. The volume of private label loans we actively disbursed increased to \$3.8 billion in fiscal 2007 from \$2.8 billion in fiscal 2006 and \$2.2 billion in fiscal 2005.

#### *Administrative and other fees*

Administrative and other fees increased to \$21.5 million in fiscal 2007 from \$8.8 million in fiscal 2006 and \$3.5 million in fiscal 2005. The increases were primarily due to increased reimbursed expenses that we generated between periods from marketing coordination services provided to some of our clients as well as to our proprietary brand. To a lesser extent, the increase was also due to increasing student loan balances in the securitization trusts during fiscal 2007 compared to the fiscal 2006 and 2005 periods. We generated approximately \$15.6 million in reimbursable expenses from marketing coordination services in fiscal 2007, compared to approximately \$4.0 million in reimbursable expenses from marketing coordination services in fiscal 2006. We did not generate any fees from marketing coordination services in fiscal 2005. We earned administrative fees for the daily management of the securitization trusts of approximately \$5.8 million in fiscal 2007, \$4.2 million in fiscal 2006 and \$2.8 million in fiscal 2005.

#### *Net Interest Income*

Net interest income increased to \$9.4 million in fiscal 2007 from \$5.5 million in fiscal 2006 and \$3.3 million in fiscal 2005. The increases in net interest income in the fiscal 2007, 2006 and 2005 periods

were due primarily to higher average cash balances available for investment, higher average yields and, in fiscal 2007, the net interest income from Union Federal.

#### *Non-interest Expenses*

Total non-interest expenses increased to \$253.0 million in fiscal 2007 from \$187.8 million in fiscal 2006 and \$144.2 million in fiscal 2005. Compensation and benefits increased to \$111.4 million in fiscal 2007 from \$89.2 million in fiscal 2006 and \$67.6 million in fiscal 2005. General and administrative expenses increased to \$141.6 million in fiscal 2007 from \$98.6 million in fiscal 2006 and \$76.6 million in fiscal 2005.

The increase in compensation and benefits expense was primarily due to an increase in accruals related to our employee incentive compensation plans, primarily as a result of our positive financial results in fiscal 2007. The increase in compensation and benefits expense is also the result of an increase in personnel. Our average total number of employees during fiscal 2007 was 10% higher than our average number of employees during fiscal 2006. We hired additional personnel during fiscal 2007 to meet the needs of our growing loan processing and securitization activities. Our average total number of employees during fiscal 2006 was 17% higher than our average number of employees during fiscal 2005. During fiscal 2006, we outsourced some customer service, loan facilitation and operations functions, resulting in a reduction in headcount for those areas, which was offset by an increase in headcount in information technology personnel. The increase in the number of information technology employees contributed to an overall increase in compensation and benefits expense in fiscal 2006. We hired additional personnel to meet the operating and information systems requirements from our growing loan processing and securitization activities.

General and administrative expenses also increased in fiscal 2007 as compared to fiscal 2006 and fiscal 2005 as a result of increases in several categories of expenses. Marketing coordination expenses increased to \$29.0 million in fiscal 2007 from \$12.1 million in fiscal 2006 and \$4.5 million in fiscal 2005. The increase in marketing coordination expense was primarily due to the expansion of our marketing coordination services to a larger client base as well as the testing of our proprietary brands. Depreciation and amortization expense increased to \$16.5 million in fiscal 2007 from \$14.9 million in fiscal 2006 and \$7.2 million in fiscal 2005. The increase in depreciation and amortization expense is due to the expansion of our loan processing operations which resulted in additional purchases of fixed assets as well as the amortization of capitalized software development costs. Equipment expenses increased to \$12.5 million in fiscal 2007 from \$10.9 million in fiscal 2006 and \$5.7 million in fiscal 2005. The increase in equipment expenses was primarily due to an increase in software maintenance and license costs. Temporary employment services costs increased to \$5.4 million in fiscal 2007 from \$4.2 million in fiscal 2006 and \$3.8 million in fiscal 2005. External call center costs increased to \$21.4 million in fiscal 2007 from \$10.0 million in fiscal 2006 and \$5.5 million in fiscal 2005. The increases in temporary employment services expense and external call center costs were primarily due to increases in personnel necessary to process the increasing volume of loans facilitated between periods and the expansion of our marketing expenses in the television medium that need call center support. Consulting fees were \$13.5 million in fiscal 2007 compared to \$12.4 million in fiscal 2006 and \$16.1 million in fiscal 2005. The changes between periods were primarily due to fluctuations in external consulting costs used in the evaluation and improvement of our loan facilitation systems.

We expect that our operating expenses will continue to increase as we devote additional resources to marketing coordination services and the expected increasing loan volumes facilitated for our existing and new clients.

### ***Income Tax Expense***

Income tax expense increased to \$256.4 million in fiscal 2007 from \$147.8 million in fiscal 2006 and \$117.4 million in fiscal 2005. The increase in income tax expense was primarily the result of an increase in the amount of income before income tax expense between periods. In fiscal 2007, our effective tax rate, or the income tax expense as a percentage of income before income tax expense, increased to 40.85% from an effective tax rate of 38.50% for all of fiscal 2006. The increase in our effective tax rate was primarily due to the change in the relative sources of total revenues as our up-front structural advisory fees increased and our residual revenues decreased in fiscal 2007 as compared to fiscal 2006. Our effective tax rate applicable to up-front structural advisory fees is greater than our effective tax rate applicable to residual revenues.

### **Financial Condition, Liquidity and Capital Resources**

Our liquidity requirements have historically consisted, and we expect that they will continue to consist of, capital expenditures, working capital, business development expenses, general corporate expenses, repurchases of our common stock, quarterly cash dividends and potential acquisitions.

#### ***Short-term Funding Requirements***

We expect to fund our short-term liquidity requirements through cash flow from operations. We believe, based on our current operating plan, that our current cash and cash equivalents will be sufficient to fund our operations through at least fiscal 2008.

#### ***Long-term Funding Requirements***

We expect to fund the growth of our business through cash flow from operations and through issuances of common stock, promissory notes or other securities. We expect to assess our financing alternatives periodically and access the capital markets opportunistically. If our existing resources are insufficient to satisfy our liquidity requirements, or if we enter into an acquisition or strategic arrangement with another company, we may need to sell additional equity or debt securities. Any sale of additional equity or convertible debt securities may result in additional dilution to our stockholders, and we cannot be certain that additional public or private financing will be available in amounts or on terms acceptable to us, if at all. If we are unable to obtain this additional financing, we may be required to delay, reduce the scope of, or eliminate one or more aspects of our business development activities, which could harm the growth of our business, or we may be required to reduce or eliminate our quarterly cash dividends to our stockholders.

Our actual liquidity and capital funding requirements may depend on a number of factors, including:

- the timing, size and structure of the securitization transactions that we structure, as well as the composition of the loan pool being securitized;
- the amount and timing of receipt of additional structural advisory fees and residuals;
- our operating and information systems needs;
- the extent to which our services gain increased market acceptance and remain competitive;
- the extent to which we repurchase shares of our common stock or pay cash dividends to our stockholders;
- regulatory capital requirements applicable to Union Federal;
- the timing and magnitude of income tax payments; and
- the costs and timing of acquisitions of complementary businesses.

### ***Treasury Stock***

We had treasury stock of \$183.1 million at June 30, 2007 and \$121.5 million at June 30, 2006. Our treasury stock balance was primarily derived from the repurchases of our common stock in open market transactions. Treasury stock also includes shares of our stock forfeited by employees to satisfy statutory minimum withholding obligations as equity compensation awards vest. Our board of directors approved the repurchase of 2,250,000 shares of our common stock in the fourth quarter of fiscal 2005 and approved the repurchase of an additional 7,500,000 shares of our common stock in the first quarter of fiscal 2006. On April 24, 2007, our board of directors approved the repurchase of up to 10,000,000 shares of our common stock. The 10,000,000 shares authorized for repurchase included 3,393,300 shares available for repurchase as of April 25, 2007 under the previously authorized repurchase programs. As of June 30, 2007, we had repurchased an aggregate of 7,525,800 shares at an average price, excluding commissions, of \$24.27 per share. At June 30, 2007 a maximum of 8,830,900 shares may be repurchased under the repurchase program approved by the board of directors on April 24, 2007.

### ***Cash, Cash Equivalents and Investments***

At June 30, 2007, we had \$234.9 million in cash, cash equivalents and investments. At June 30, 2006, we had \$143.0 million in cash, cash equivalents and investments. The increase in cash, cash equivalents and investments is primarily due to cash generated from our 2007 securitization transactions, offset by cash used to fund operations, cash dividends and repurchases of our common stock during fiscal 2007. Cash, cash equivalents and investments at June 30, 2007 primarily included investments in variable rate demand notes, mortgage backed securities, Federal Home Loan Bank bonds and funds deposited in a money market fund that invests in short-term obligations of the U.S. Treasury and repurchase agreements fully collateralized by obligations of the U.S. Treasury.

### ***Loans Held for Sale***

At June 30, 2007, we had loans held for sale of \$37.1 million as compared to no loans at June 30, 2006. The increase in loans held for sale resulted from our acquisition of Union Federal on November 30, 2006. Our loans held for sale at June 30, 2007 were comprised of education and mortgage loans.

### ***Service Receivables***

Our service receivables increased to \$809.7 million at June 30, 2007 from \$551.6 million at June 30, 2006, primarily as a result of the additional structural advisory fees and residuals generated from the 2007 securitization transactions. The increase in service receivables was also due to a net increase in our estimate of the fair value of our residuals receivable of \$29.5 million during fiscal 2007, primarily as a result of the accretion of the discounting inherent in the fair value estimates due to the passage of time, resulting in an increase of \$66.4 million, which was partially offset by changes in assumptions and the negative impact of other factors such as a higher rate of prepayments during the period than we estimated would occur having a net negative impact of \$36.9 million.

### ***Property and Equipment, net***

In fiscal 2007, our property and equipment, net increased by \$5.2 million, as \$15.6 million of depreciation expense recorded during the period was more than offset by \$19.9 million we spent on the expansion and improvement of our loan processing facilities and systems. In fiscal 2007, we financed the acquisition of \$0.7 million in equipment through capital leases.

### ***Prepaid Income Taxes***

At June 30, 2007, we had prepaid income taxes of \$49.3 million as compared to \$11.6 million at June 30, 2006. The increase in prepaid income taxes balance at June 30, 2007 compared to June 30, 2006 was primarily due to a favorable ruling from the Internal Revenue Service regarding the the timing of our recognition of additional structural advisory fees as income for tax purposes. As a result of the ruling, we pay income tax upon receipt, rather than recognition, of such fees. At June 30, 2006, this balance was primarily derived from the income tax benefit of employee stock option exercises and tax allocation strategies implemented in the fourth quarter of fiscal 2006.

### ***Other Prepaid Expenses***

Other prepaid expenses increased to \$26.9 million at June 30, 2007 from \$17.3 million at June 30, 2006, primarily due to an increase in prepaid marketing expenses of approximately \$12.2 million.

### ***Other Assets***

Other assets increased to \$7.2 million at June 30, 2007 from \$5.1 million at June 30, 2006 primarily due to \$1.0 million in principal and fees owed to Union Federal, our subsidiary, as a result of cancelled loans from borrowers.

### ***Deposits***

At June 30, 2007, we had deposits of \$53.5 million as compared to no deposits at June 30, 2006. The increase in deposits resulted from our acquisition of Union Federal on November 30, 2006. Included in deposits at June 30, 2007 is \$10.9 million of brokered deposits, primarily brokered certificates of deposits.

### ***Accounts Payable and Accrued Expenses***

Accounts payable and accrued expenses increased to \$59.0 million at June 30, 2007 from \$34.4 million at June 30, 2006. Our accrued bonuses were approximately \$8.5 million higher at June 30, 2007 as compared to June 30, 2006 due to an increase in accruals related to our employee incentive compensation plans, primarily as a result of our positive financial results in fiscal 2007. Our accounts payable were \$12.9 million higher at June 30, 2007 as compared to June 30, 2006 primarily due to the timing of the receipt and processing of invoices.

### ***Net Deferred Income Tax Liability***

Our net deferred income tax liability increased to \$247.7 million at June 30, 2007 from \$144.2 million at June 30, 2006. We have a net deferred income tax liability primarily because, under GAAP, we recognize additional structural advisory fees and residuals in financial statement income earlier than they are recognized for income tax purposes. Our net deferred income tax liability increased primarily as a result of the increase in residual revenue recognized during fiscal 2007, which more than offset the recognition of our share of taxable income from the securitization trusts. Our net deferred income tax liability also increased in fiscal 2007 as a result of the favorable ruling from the Internal Revenue Service regarding the timing of our recognition of additional structural advisory fees in taxable income.

### ***Capital Lease Obligations***

Capital lease obligations decreased to \$5.5 million at June 30, 2007 from \$8.8 million at June 30, 2006, primarily due to scheduled principal payments made during fiscal 2007.

### Notes Payable to TERI

Notes payable to TERI decreased to \$3.7 million at June 30, 2007 from \$4.5 million at June 30, 2006. The balance relates to two acquisition notes we issued to finance the acquisition of TERI's loan processing operations, as well as its loan database in 2001. The decrease in notes payable to TERI was due to the scheduled principal payments made during fiscal 2007.

### Other Liabilities

Other liabilities increased to \$2.3 million at June 30, 2007 from \$2.2 million at June 30, 2006. The balance at the end of each fiscal period related primarily to deferred rent related to several operating leases for office space.

### Contractual Obligations

In addition to our notes payable and the agreement with TERI to purchase updates to the student loan database, we have future cash obligations under various types of contracts. We lease office space and office equipment under long-term operating and capital leases. The table below summarizes the dollar amounts of our contractual obligations as of June 30, 2007 for the periods specified:

Fiscal year	Contractual obligations				Total
	Long-term debt	Database purchases	Operating lease obligations (in thousands)	Capital lease obligations	
2008 .....	852	248	12,259	3,611	16,970
2009 .....	904	248	9,711	1,343	12,206
2010 .....	960	248	9,444	843	11,495
2011 .....	1,018	248	9,439	—	10,705
2012 .....	—	—	8,461	—	8,461
Total .....	<u>\$3,734</u>	<u>\$ 992</u>	<u>\$49,314</u>	<u>\$5,797</u>	<u>\$59,837</u>

### Cash Flows

Our net cash provided by operating activities increased to \$195.4 million in fiscal 2007, compared to cash provided by operating activities of \$49.7 million in fiscal 2006. The increase in cash provided by operations resulted primarily from increases in net income, which includes our increased up-front structural advisory fee revenue, and an increase in accounts payable, accrued expenses and other liabilities, offset in part by increases in residual receivables and structural advisory fee receivables.

Our cash used in investing activities decreased to \$66.0 million in fiscal 2007, compared to \$78.0 million used in investing activities in fiscal 2006. Net cash used in investing activities decreased in fiscal 2007 primarily as a result of a decrease in net purchases of investments, partially offset by an increase in capital expenditures related to the expansion and improvement of our loan processing facilities and systems.

Net cash used in financing activities increased to \$98.8 million in fiscal 2007, compared to \$89.8 million in fiscal 2006. Net cash used in financing activities increased in fiscal 2007 primarily as a result of an increase in cash used for dividends, offset in part by an increase in deposits.

We expect that our capital expenditure requirements for fiscal 2008 will be approximately \$26.7 million. We expect to use these funds primarily for the expansion of our loan processing operations and the purchase of computer and office equipment.

### **Borrowings**

In June 2001, we issued two acquisition notes to TERI totaling \$7.9 million to finance the acquisition of TERI's loan processing operations as well as its loan database. Principal and interest at an annual rate of 6% is payable on these notes in 120 monthly payments of \$87,706 commencing on July 20, 2001 and ending on June 20, 2011. At June 30, 2007, outstanding principal on these notes totaled \$3.7 million as compared to \$4.5 million at June 30, 2006.

### **Off-Balance Sheet Transactions**

We offer outsourcing services in connection with the lifecycle of a private student loan, from program design and marketing coordination through loan administration and, ultimately, to the sale and securitization of the loans. We also structure and facilitate the securitization of student loans for our clients through a series of bankruptcy remote, qualified special purpose trusts.

The principal uses of these trusts are to:

- generate sources of liquidity for our clients' assets sold into such trusts and to reduce their credit risk;
- make available more funds to students and colleges; and
- leverage the capital markets to reduce borrowing costs to students.

See “—Executive Summary—Application of Critical Accounting Policies and Estimates—Consolidation” for a discussion of our determination to not consolidate these securitization trusts.

### **Recent Accounting Pronouncements**

In February 2007, the FASB issued *Statement of Financial Accounting Standards, or SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities, an amendment of FASB Statements No. 115*. SFAS No. 159 will be effective for us beginning in the first quarter of fiscal 2009. The statement permits entities to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The adoption of SFAS No. 159 is not expected to have a material impact on our consolidated financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which provides guidance for using fair value to measure assets and liabilities. The statement also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS No. 157 applies whenever other standards require or permit assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. Under SFAS No. 157, fair value refers to the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect the adoption of SFAS No. 157 to have a material impact on our results of operations and financial position.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* (FIN No. 48). FIN No. 48 clarifies the accounting for



uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. Consistent with its requirements, we will adopt FIN No. 48 on July 1, 2007. We do not expect the adoption of FIN No. 48 to have a material impact on our results of operations and financial position.

In March 2006, the FASB issued SFAS No. 156, *Accounting For Servicing of Financial Assets, an Amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, which requires that all separately recognized servicing assets and liabilities be initially measured at fair value, if practicable, and requires entities to elect either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of FASB Statement No. 140 for subsequent measurement. SFAS No. 156 will be effective for us beginning in the first quarter of fiscal 2008. The adoption of SFAS No. 156 is not expected to have a material impact on our consolidated financial condition or results of operations.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140*. SFAS No. 155 will be effective for the Company beginning in the first quarter of fiscal 2008. The statement permits interests in hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation, to be accounted for as a single financial instrument at fair value, with changes in fair value recognized in earnings. This election is permitted on an instrument-by-instrument basis for all hybrid financial instruments held, obtained, or issued as of the adoption date. The adoption of SFAS No. 155 is not expected to have a material impact on our consolidated financial condition or results of operations.

#### **Inflation**

Inflation was not a material factor in either revenue or operating expenses during the periods presented.

#### **Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

##### ***Risks Related to Cash, Cash Equivalents and Investments***

We have market risk exposure related to changes in interest rates applicable to our cash, cash equivalents and investments. We manage our market risk through a conservative investment policy, the primary objective of which is preservation of capital. At June 30, 2007, cash, cash equivalents and investments consisted primarily of investments in variable rate demand notes and money market funds, all of which were due on demand or within one year. As a result, we do not believe a change in interest rate would have a material impact on the fair value of cash, cash equivalents and investments.

##### ***Risks Related to Loans Held for Sale and Deposits***

We also have market risk exposure related to our loans held for sale and deposits. Our loans held for sale at June 30, 2007 consisted of \$12.6 million in mortgage loans and \$24.5 million in education loans. Our loans held for sale are recorded at lower of cost or fair value and are primarily sensitive to interest rates. At June 30, 2007, our mortgage loans had an average interest rate of approximately 6.3% and our student loans had an average interest rate of approximately 11.3%. All of our education loans and approximately 72% of our mortgage loans have variable interest rates. We held deposits of \$53.5 million at June 30, 2007. Our deposits are recorded at the amount owed. Our deposit balances are subject to changes in economic value based on varying market conditions, primarily changes in the levels of interest rates. At June 30, 2007, our deposits had an average interest rate of approximately 5.3%. Less than 5% of our deposits have fixed interest rates in excess of 12 months. Approximately 76% of our deposits have fixed interest rates of

6 months or less. We do not believe a change in interest rates would have a material impact on the fair value of our loans held for sale or deposits since the majority of these assets and liabilities carry interest rates that are variable and any loss we may incur would not be material relative to our consolidated financial statements.

***Risk Related to Structural Advisory Fees and Residuals***

Because there are no quoted market prices for our additional structural advisory fees and residuals receivables, we use discounted cash flow modeling techniques and various assumptions to estimate their values. We base these estimates on our proprietary historical data, third-party data and our industry experience, adjusting for specific program and borrower characteristics such as loan type and borrower creditworthiness. Increases in our estimates of defaults, prepayments and discount rates, increases in the spread between LIBOR and auction rate indices, as well as decreases in default recovery rates and the multi-year forward estimates of the LIBOR rate, which is the reference rate for the loan assets and borrowings of the securitization trusts, would have a negative effect on the value of our additional structural advisory fees and residuals. For an analysis of the estimated change in our structural advisory fees and residuals receivables balance at June 30, 2007 based on changes in these loan performance assumptions, see “Management’s Discussion and Analysis of Financial Conditions and Results of Operations—Executive Summary—Application of Critical Accounting Policies and Estimates—Sensitivity Analysis.”

**Item 8. Financial Statements and Supplementary Data**

All financial statements and schedules required to be filed hereunder are included as Appendix A hereto and incorporated in this report by reference.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

*Disclosure Controls and Procedures*

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2007. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2007, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

*Management's Annual Report on Internal Control over Financial Reporting*

The report required to be filed hereunder is included in Appendix A hereto and incorporated in this report by reference.

*Attestation Report of our Independent Registered Public Accounting Firm*

The report required to be filed hereunder is included in Appendix A hereto and is incorporated in this report by reference.

*Change in Internal Control over Financial Reporting*

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fourth quarter of the fiscal year ended June 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

Not applicable.

### PART III

Pursuant to Paragraph G(3) of the General Instructions to Form 10-K, information required by Part III (Items 10, 11, 12, 13 and 14) is being incorporated by reference herein from our definitive proxy statement to be filed with the SEC within 120 days of the end of the fiscal year ended June 30, 2007 in connection with our 2007 annual meeting of stockholders, which we refer to below as our 2007 Proxy Statement.

#### **Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this item with respect to our executive officers and code of ethics is included in Item 1 of Part I of this report.

The information required by this item with respect to directors will be contained in our 2007 Proxy Statement under the caption "Discussion of Proposals—Proposal One: Election of Directors" and is incorporated in this report by reference.

The information required by this item with regard to Section 16(a) beneficial ownership reporting compliance will be contained in our 2007 Proxy Statement under the caption "Other Information—Section 16(a) Beneficial Ownership Reporting Compliance" and is incorporated in this report by reference.

The information required by this item with respect to corporate governance matters will be contained in our 2007 Proxy Statement under the caption "Information About Corporate Governance—Board Committees" and is incorporated in this report by reference. Complete copies of the audit committee charter, as well as our corporate governance guidelines and the charters of the compensation committee and nominating and corporate governance committees, are available on our website at [www.firstmarblehead.com](http://www.firstmarblehead.com). Alternatively, paper copies of these documents may be obtained free of charge by writing to Investor Relations, The First Marblehead Corporation, The Prudential Tower, 800 Boylston Street, 34<sup>th</sup> Floor, Boston, Massachusetts 02199 or emailing Investor Relations at [info@firstmarblehead.com](mailto:info@firstmarblehead.com).

#### **Item 11. Executive Compensation**

The other information required by this item will be contained in our 2007 Proxy Statement under the captions "Information About Corporate Governance" and "Information About Our Executive Officers" and is incorporated in this report by this reference.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by this item with regard to security ownership of certain beneficial owners and management will be contained in our 2007 Proxy Statement under the caption "Other Information—Principal Stockholders" and is incorporated in this report by reference.

The information required by this item with regard to securities authorized for issuance under equity compensation plans will be contained in our 2007 Proxy Statement under the caption "Information About Corporate Governance" and is incorporated in this report by reference.

#### **Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information required by this item with regard to certain relationships and related-party transactions will be contained in our 2007 Proxy Statement under the caption "Information About Our Executive Officers" and is incorporated in this report by reference.

The information required by this item with regard to director independence will be contained in our 2007 Proxy Statement under the caption “Information About Corporate Governance” and is incorporated in this report by reference.

**Item 14. Principal Accountant Fees and Services**

The information required by this item will be contained in our 2007 Proxy Statement under the caption “Discussion of Proposals—Proposal Three: Ratification of Appointment of Independent Registered Public Accounting Firm” and is incorporated in this report by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a) The following documents are filed as part of this annual report:

(1) Financial Statements.

The consolidated financial statements are included as Appendix A hereto (see index on page F-1) and are filed as part of this annual report. The consolidated financial statements include:

Management's Report on Internal Control Over Financial Reporting .....	F-2
Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting.....	F-3
Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements .....	F-4
Consolidated Balance Sheets as of June 30, 2007 and 2006 .....	F-5
Consolidated Statements of Income for the years ended June 30, 2007, 2006 and 2005....	F-6
Consolidated Statements of Changes in Stockholders' Equity for the years ended June 30, 2007, 2006 and 2005.....	F-7
Consolidated Statements of Cash Flows for the years ended June 30, 2007, 2006 and 2005 .....	F-8
Notes to Consolidated Financial Statements .....	F-9

(2) Financial Statement Schedules.

None.

(3) Exhibits.

The exhibits set forth on the Exhibit Index following Appendix A to this annual report are filed as part of this annual report. This list of exhibits identifies each management contract or compensatory plan or arrangement required to be filed as an exhibit to this annual report.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on August 28, 2007.

### THE FIRST MARBLEHEAD CORPORATION

By: /s/ JACK L. KOPNISKY

Jack L. Kopnisky  
*Chief Executive Officer, President and Chief  
Operating Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on August 28, 2007:

<u>Signature</u>	<u>Title(s)</u>
<u>/s/ JACK L. KOPNISKY</u> Jack L. Kopnisky	Chief Executive Officer, President, Chief Operating Officer and Director (Principal Executive Officer)
<u>/s/ JOHN A. HUPALO</u> John A. Hupalo	Senior Executive Vice President and Chief Financial Officer (Principal Financial Officer)
<u>/s/ KENNETH S. KLIPPER</u> Kenneth S. Klipper	Senior Vice President, Treasurer and Chief Accounting Officer (Principal Accounting Officer)
<u>/s/ PETER B. TARR</u> Peter B. Tarr	Chairman of the Board and General Counsel
<u>/s/ LESLIE L. ALEXANDER</u> Leslie L. Alexander	Director
<u>/s/ STEPHEN E. ANBINDER</u> Stephen E. Anbinder	Director
<u>/s/ WILLIAM R. BERKLEY</u> William R. Berkley	Director
<u>/s/ DORT A. CAMERON III</u> Dort A. Cameron III	Director

/s/ GEORGE G. DALY  
George G. Daly Director

/s/ PETER S. DROTCH  
Peter S. Drotch Director

/s/ WILLIAM D. HANSEN  
William D. Hansen Director



**APPENDIX A**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	<u>Page</u>
<b>The First Marblehead Corporation and Subsidiaries</b>	
Management's Report on Internal Control Over Financial Reporting .....	F-2
Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting .....	F-3
Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements.....	F-4
Consolidated Balance Sheets as of June 30, 2007 and 2006 .....	F-5
Consolidated Statements of Income for the years ended June 30, 2007, 2006 and 2005 .....	F-6
Consolidated Statements of Changes in Stockholders' Equity for the years ended June 30, 2007, 2006 and 2005 .....	F-7
Consolidated Statements of Cash Flows for the years ended June 30, 2007, 2006 and 2005 .....	F-8
Notes to Consolidated Financial Statements .....	F-9

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of The First Marblehead Corporation and subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, the company's principal executive and principal financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of June 30, 2007. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework.

Based on our assessment, management concluded that, as of June 30, 2007, the Company's internal control over financial reporting is effective based on those criteria.

The Company's independent auditors have issued an audit report on the Company's assessment of its internal control over financial reporting. That report appears on page F-3.

/s/ JACK L. KOPNISKY  
*Chief Executive Officer, President and Chief Operating Officer*

/s/ JOHN A. HUPALO  
*Senior Executive Vice President and Chief Financial Officer*

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
The First Marblehead Corporation:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that The First Marblehead Corporation and subsidiaries (the "Company") maintained effective internal control over financial reporting as of June 30, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of June 30, 2007, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by COSO. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of June 30, 2007 and 2006, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2007, and our report dated August 28, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Boston, Massachusetts  
August 28, 2007

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
The First Marblehead Corporation:

We have audited the accompanying consolidated balance sheets of The First Marblehead Corporation and subsidiaries (the "Company") as of June 30, 2007 and 2006, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended June 30, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The First Marblehead Corporation and subsidiaries as of June 30, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2007, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of June 30, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated August 28, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Boston, Massachusetts  
August 28, 2007

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**June 30, 2007 and 2006**

**(in thousands, except per share amounts)**

	<u>2007</u>	<u>2006</u>
<b>ASSETS</b>		
Cash and cash equivalents .....	\$ 106,271	\$ 75,711
Investments .....	128,650	67,250
Loans held for sale .....	37,052	—
Service receivables:		
Structural advisory fees .....	133,644	88,297
Residuals .....	665,115	452,823
Processing fees from The Education Resources Institute (TERI) .....	10,909	10,447
Total service receivables .....	<u>809,668</u>	<u>551,567</u>
Property and equipment .....	81,090	60,358
Less accumulated depreciation and amortization .....	<u>(39,179)</u>	<u>(23,615)</u>
Property and equipment, net .....	<u>41,911</u>	<u>36,743</u>
Goodwill .....	4,878	3,176
Intangible assets, net .....	2,597	1,897
Prepaid income taxes .....	49,345	11,649
Other prepaid expenses .....	26,904	17,272
Other assets .....	7,187	5,081
Total assets .....	<u>\$1,214,463</u>	<u>\$ 770,346</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Deposits .....	\$ 53,523	\$ —
Accounts payable and accrued expenses .....	59,044	34,430
Net deferred income tax liability .....	247,748	144,240
Capital lease obligations .....	5,517	8,789
Notes payable to TERI .....	3,734	4,537
Other liabilities .....	2,277	2,181
Total liabilities .....	<u>371,843</u>	<u>194,177</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value \$0.01 per share; 20,000 shares authorized; no shares issued or outstanding .....	—	—
Common stock, par value \$0.01 per share; 150,000 shares authorized at June 30, 2007 and 2006; 100,874 and 100,334 shares issued at June 30, 2007 and 2006, respectively; 93,342 and 94,564 shares outstanding at June 30, 2007 and 2006, respectively .....	1,009	1,004
Additional paid-in capital .....	232,664	217,620
Retained earnings .....	791,953	479,090
Treasury stock, 7,532 and 5,770 shares held at June 30, 2007 and 2006, respectively, at cost .....	<u>(183,070)</u>	<u>(121,545)</u>
Accumulated other comprehensive income .....	64	—
Total stockholders' equity .....	<u>842,620</u>	<u>576,169</u>
Total liabilities and stockholders' equity .....	<u>\$1,214,463</u>	<u>\$ 770,346</u>

See accompanying notes to consolidated financial statements.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**Years ended June 30, 2007, 2006 and 2005**  
**(in thousands, except per share amounts)**

	<u>2007</u>	<u>2006</u>	<u>2005</u>
<b>Service revenues:</b>			
Up-front structural advisory fees .....	\$457,352	\$208,178	\$168,166
<b>Additional structural advisory fees:</b>			
From new securitizations .....	43,984	33,685	27,520
Trust updates .....	<u>1,363</u>	<u>1,241</u>	<u>1,767</u>
Total additional structural advisory fees .....	45,347	34,926	29,287
<b>Residuals:</b>			
From new securitizations .....	182,744	177,309	121,187
Trust updates .....	<u>29,548</u>	<u>28,239</u>	<u>17,593</u>
Total residuals .....	212,292	205,548	138,780
Processing fees from TERI .....	134,845	106,072	78,200
Administrative and other fees .....	<u>21,497</u>	<u>8,848</u>	<u>3,544</u>
Total service revenues .....	871,333	563,572	417,977
Net interest income .....	<u>9,371</u>	<u>5,463</u>	<u>3,288</u>
Total revenues .....	<u>880,704</u>	<u>569,035</u>	<u>421,265</u>
<b>Non-interest expenses:</b>			
Compensation and benefits .....	111,364	89,214	67,608
General and administrative expenses .....	<u>141,591</u>	<u>98,593</u>	<u>76,568</u>
Total non-interest expenses .....	<u>252,955</u>	<u>187,807</u>	<u>144,176</u>
Income from operations .....	627,749	381,228	277,089
Other income .....	<u>16</u>	<u>2,526</u>	<u>—</u>
Income before income tax expense .....	627,765	383,754	277,089
Income tax expense .....	<u>256,434</u>	<u>147,794</u>	<u>117,424</u>
Net income .....	<u>\$371,331</u>	<u>\$235,960</u>	<u>\$159,665</u>
Net income per share, basic .....	\$ 3.94	\$ 2.47	\$ 1.64
Net income per share, diluted .....	3.92	2.45	1.59
Cash dividends declared per share .....	0.62	0.32	—
Weighted average shares outstanding, basic .....	94,296	95,366	97,550
Weighted average shares outstanding, diluted .....	94,845	96,258	100,206

See accompanying notes to consolidated financial statements.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

Years ended June 30, 2007, 2006 and 2005  
(in thousands, except per share amounts)

	Common stock		In treasury	Additional Paid-in capital	Retained earnings	Deferred compensation	Accumulated other comprehensive income (loss), net of tax	Total stockholders' equity
	Issued	Shares						
<b>Balance at June 30, 2004</b>	95,963	\$ 960	—	\$163,252	\$113,924	—	—	\$278,136
Comprehensive income (loss)	—	—	—	—	159,665	—	—	159,665
Net income	—	—	—	—	—	—	(343)	(343)
Accumulated other comprehensive loss, net of tax	—	—	—	—	—	—	—	—
Total comprehensive income	—	—	—	—	—	—	—	—
Options exercised	3,515	35	—	4,046	—	—	—	4,081
Stock purchases through employee stock purchase plan	75	1	—	898	—	—	—	899
Repurchase of common stock	—	—	(2,203)	(55,665)	—	—	—	(55,665)
Tax benefit from employee stock options	—	—	—	34,322	—	—	—	34,322
Grants of restricted stock units	—	—	—	3,602	—	(3,602)	—	—
Amortization of deferred compensation	—	—	—	—	—	471	—	471
<b>Balance at June 30, 2005</b>	99,553	996	(2,203)	206,120	273,589	(3,131)	(343)	421,566
Comprehensive income (loss)	—	—	—	—	235,960	—	343	235,960
Net income	—	—	—	—	—	—	—	—
Accumulated other comprehensive income, net of tax	—	—	—	—	—	—	—	—
Total comprehensive income	—	—	—	—	—	—	—	—
Adoption of FAS 123(R)	—	—	—	(3,131)	—	3,131	—	—
Options exercised	744	7	—	1,776	—	—	—	1,783
Stock issuance through employee stock purchase plan	37	1	—	710	—	—	—	711
Repurchase of common stock	—	—	(3,567)	(65,880)	—	—	—	(65,880)
Stock-based compensation	—	—	—	2,917	—	—	—	2,917
Cash dividends declared (\$0.32 per share)	—	—	—	—	(30,459)	—	—	(30,459)
Tax benefit from employee stock options	—	—	—	9,228	—	—	—	9,228
<b>Balance at June 30, 2006</b>	100,334	1,004	(5,770)	217,620	479,090	—	—	576,169
Comprehensive income (loss)	—	—	—	—	371,331	—	64	371,331
Net income	—	—	—	—	—	—	—	—
Accumulated other comprehensive income, net of tax	—	—	—	—	—	—	—	—
Total comprehensive income	—	—	—	—	—	—	—	—
Options exercised	439	4	—	1,362	—	—	—	1,366
Stock issuance through employee stock purchase plan	37	—	—	886	—	—	—	886
Stock issuance from vesting of restricted stock units	67	1	—	(1)	—	—	—	—
Repurchase of common stock	—	—	(1,762)	(61,525)	—	—	—	(61,525)
Stock-based compensation	—	—	—	6,493	—	—	—	6,493
Cash dividends declared (\$0.62 per share)	—	—	—	—	(58,321)	—	—	(58,321)
Cash paid in lieu of fractional shares in effecting stock split	(3)	—	—	—	(147)	—	—	(147)
Tax benefit from employee stock options	—	—	—	6,304	—	—	—	6,304
<b>Balance at June 30, 2007</b>	100,874	\$1,009	(7,532)	\$232,664	\$791,953	\$—	\$ 64	\$842,620

See accompanying notes to consolidated financial statements.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**Years ended June 30, 2007, 2006 and 2005**

**(in thousands)**

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:			
Net income .....	\$ 371,331	\$ 235,960	\$ 159,665
Adjustments to reconcile net income to net cash provided by operating activities net of effects of acquisition:			
Depreciation and amortization .....	16,326	14,912	7,167
Deferred income tax expense .....	103,508	59,794	44,308
Tax benefit from employee stock options .....	—	—	34,322
Stock-based compensation .....	6,493	2,917	471
Change in assets/liabilities:			
(Increase) in loans held for sale .....	(19,935)	—	—
(Increase) in structural advisory fees .....	(45,347)	(34,926)	(19,037)
(Increase) in residuals .....	(212,292)	(205,548)	(138,780)
(Increase) in processing fees from TERI .....	(462)	(1,503)	(2,892)
(Increase) decrease in prepaid income taxes .....	(37,696)	(9,055)	17,673
(Increase) in other prepaid expenses .....	(9,611)	(13,109)	(1,400)
(Increase) in other assets .....	(1,309)	(1,922)	(913)
Increase in accounts payable, accrued expenses, and other liabilities .....	24,397	2,183	7,829
Net cash provided by operating activities .....	<u>195,403</u>	<u>49,703</u>	<u>108,413</u>
Cash flows from investing activities net of effects of acquisition :			
Dispositions of investments .....	70,809	8,200	—
Purchases of investments .....	(116,206)	(75,450)	—
Net cash paid for acquisition .....	(471)	—	—
Purchases of property and equipment .....	(19,902)	(9,954)	(22,564)
Payments to TERI for loan database updates .....	(248)	(748)	(748)
Net cash used in investing activities .....	<u>(66,018)</u>	<u>(77,952)</u>	<u>(23,312)</u>
Cash flows from financing activities net of effects of acquisition:			
Increase in deposits .....	17,395	—	—
Repayment of capital lease obligations .....	(3,980)	(4,464)	(8,620)
Repayment of notes payable due to TERI .....	(803)	(755)	(712)
Tax benefit from stock-based compensation .....	6,304	9,228	—
Issuances of common stock .....	2,252	2,494	4,980
Repurchases of common stock .....	(61,525)	(65,880)	(55,665)
Cash dividends on common stock and cash paid in lieu of fractional shares .....	(58,468)	(30,459)	—
Net cash used in financing activities .....	<u>(98,825)</u>	<u>(89,836)</u>	<u>(60,017)</u>
Net increase (decrease) in cash and cash equivalents .....	30,560	(118,085)	25,084
Cash and cash equivalents, beginning of year .....	75,711	193,796	168,712
Cash and cash equivalents, end of year .....	<u>\$ 106,271</u>	<u>\$ 75,711</u>	<u>\$ 193,796</u>
Supplemental disclosures of cash flow information:			
Interest paid .....	<u>\$ 1,788</u>	<u>\$ 959</u>	<u>\$ 835</u>
Income taxes paid .....	<u>\$ 180,737</u>	<u>\$ 84,529</u>	<u>\$ 21,115</u>
Supplemental disclosure of non-cash activities:			
Acquisition of property and equipment through capital leases .....	<u>\$ 723</u>	<u>\$ 1,135</u>	<u>\$ 11,568</u>

See accompanying notes to consolidated financial statements.



## THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2007, 2006 and 2005

(dollars and shares in thousands, except per share amounts)

#### (1) Nature of Business

The First Marblehead Corporation (FMC, and together with its subsidiaries, the Company) provides outsourcing services for private education lending in the United States. The Company helps meet the growing demand for private education loans by providing national and regional financial institutions and educational institutions, as well as businesses and other enterprises, with an integrated suite of services for designing and implementing student loan programs for their respective customers, students, employees and members. The Company focuses primarily on private student loan programs for undergraduate, graduate and professional education, and, to a lesser degree, on continuing education programs, the primary and secondary school market, career training and study abroad programs. The Company is entitled to receive structural advisory fees and residuals for its services in connection with securitizations of loans generated by the loan programs that it facilitates. The Company also receives reimbursement from The Education Resources Institute, Inc. (TERI) for outsourced services the Company performs on TERI's behalf, fees for marketing coordination services it provides to certain clients and fees for administrative services that the Company provides to the discrete trust vehicles that the Company forms for securitizations it facilitates.

The Company offers services primarily in connection with private label loan products. To date, the Company has used discrete trust vehicles for the securitizations that it facilitates. Private label loans guaranteed by TERI, a not-for-profit organization that functions as a guarantor of student loans, have generally been purchased by private label loan trusts designated as a series of The National Collegiate Student Loan Trusts.

FMC has nine direct or indirect subsidiaries:

- First Marblehead Education Resources, Inc. (FMER), which was incorporated as a wholly owned subsidiary of FMC under the laws of the State of Delaware on March 8, 2001, provides outsourced loan origination, customer service, default prevention, default processing and administrative services to TERI;
- GATE Holdings, Inc. (GATE Holdings), which was incorporated as a wholly owned subsidiary of FMC under the laws of the State of Delaware on October 29, 1996, holds FMC's title to residual interests in securitization trusts purchasing primarily non-TERI-guaranteed loans. GATE Holdings has a residual interest ranging between 10% and 100% of the funds available for distribution from these securitization trusts;
- The National Collegiate Funding LLC, which was formed as a limited liability company under the laws of the State of Delaware on March 13, 2003 and a wholly owned subsidiary of GATE Holdings, is a depositor used in securitizations involving the private label loan trusts and holds FMC's title to residual interests in the private label loan trusts. The National Collegiate Funding LLC has a residual interest ranging between 66% and 88% of the funds available for distribution from the private label loan trusts;
- First Marblehead Data Services, Inc. (FMDS), which was incorporated as a wholly owned subsidiary of FMC under the laws of the Commonwealth of Massachusetts on April 1, 1996, provides administrative services to the securitization trusts that own the education loans once securitized;

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(1) Nature of Business (Continued)**

- First Marblehead Securities Corporation and First Marblehead Securities Corporation II, which were established as securities corporations on March 30, 2004 and June 29, 2005, respectively, under the laws of the Commonwealth of Massachusetts, were formed to hold, buy and sell securities on behalf of FMC, their corporate parent;
- TERI Marketing Services, Inc., which was incorporated as a wholly owned subsidiary of FMER under the laws of the State of Delaware on May 14, 2001, provides marketing services to TERI; and
- Union Federal Savings Bank (UFSB), a wholly owned subsidiary of FMC, is a federally chartered thrift. UFSB is a community savings bank located in North Providence, Rhode Island which offers retail mortgage loans, retail savings products, time deposit products and, as of April 2007, private education loans.
- UFSB Private Loan SPV, LLC (UFSB-SPV), a wholly owned subsidiary at UFSB, is a limited liability company formed pursuant to the Delaware Limited Liability Company Act on July 13, 2007. UFSB-SPV provides short-term financing for private education loans originated by UFSB by periodically purchasing loans from UFSB (see Note 6(a)).

On June 20, 2001, FMC acquired TERI's loan processing operations, including its historical database and workforce-in-place. FMER provides to TERI, under a Master Servicing Agreement, outsourced services including loan origination, customer service, default prevention, default processing and administrative services. TERI reimburses FMER on a monthly basis for expenses incurred relating to the services being performed on TERI's behalf based on the terms of the Master Servicing Agreement (see Note 10).

**(2) Summary of Significant Accounting Policies**

**(a) Cash and Cash Equivalents**

Cash and cash equivalents at June 30, 2007 included \$95,937 held in money market funds and \$10,334 of federal funds sold. Included in cash and cash equivalents are compensating balances held in money market funds supporting various financing arrangements of \$8,168 and \$10,158 at June 30, 2007 and June 30, 2006, respectively.

**(b) Investments**

The Company classifies all of its short-term investments as either held-to-maturity or available-for-sale investments. Held-to-maturity investments are carried at amortized cost. Available-for-sale investments are carried at fair value. The Company reports unrealized holding gains and losses within comprehensive income. Investments at June 30, 2007 primarily consist of variable rate demand notes. Variable rate demand notes may be redeemed as interest rates reset, which occurs at least monthly in the case of all securities held by the Company at June 30, 2007.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

(dollars and shares in thousands, except per share amounts)

**(2) Summary of Significant Accounting Policies (Continued)**

*(c) Loans held for sale*

Loans held for sale at June 30, 2007 are comprised of education and mortgage loans. Loans held for sale are carried at the lower of cost or fair value.

*(d) Property and Equipment*

The Company provides for depreciation using the straight-line method at rates adequate to depreciate the appropriate assets over their estimated useful lives. Leasehold improvements are amortized over the shorter of the lease terms or the estimated useful lives of the improvements. Software under development includes amounts capitalized in accordance with Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use (SOP 98-1). Once certain criteria are met, SOP 98-1 requires the Company to capitalize certain payroll-related costs of employees directly associated with developing software, in addition to consulting costs incurred from third parties. Computer software costs that are incurred in the preliminary project stage are expensed as incurred. Once certain capitalization criteria have been met during the other stages of the software's development, directly attributable costs are capitalized. Property and equipment at June 30, 2007 and 2006 was as follows:

	<u>2007</u>	<u>2006</u>	<u>Useful life</u>
Equipment.....	\$ 18,270	\$ 13,331	3 - 5 years
Software.....	20,525	16,683	3 years
Software under development.....	13,377	2,799	
Leasehold improvements.....	11,610	9,999	lesser of 5 years or lease term
Capital leases (equipment, furniture and fixtures)...	14,575	14,885	lease term
Furniture and fixtures.....	2,733	2,661	5 - 7 years
	<u>81,090</u>	<u>60,358</u>	
Less accumulated depreciation and amortization ...	<u>(39,179)</u>	<u>(23,615)</u>	
Total property and equipment, net.....	<u>\$ 41,911</u>	<u>\$ 36,743</u>	

*(e) Use of Estimates*

The preparation of financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions (including the determination of the present value of expected future cash flows) that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change relate to the recognition and valuation of structural advisory fees and residuals. The Company considers the methods by which it makes these estimates and assumptions, as well as its policy with respect to the determination of whether or not to consolidate the securitization vehicles that it facilitates, to be critical accounting policies.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(2) Summary of Significant Accounting Policies (Continued)**

**(f) Revenue Recognition**

*Structural Advisory Fees—General*

Structural advisory fees are paid to the Company from securitization trusts for structuring and facilitating the securitization of the student loans and are recognized in service revenue when the loans are securitized. A portion of such fees is based upon a percentage of the loan balance in the loan pool securitized. The Company is entitled to these up-front structural advisory fees at the time of securitization. The Company is entitled to additional structural advisory fees over the life of the securitization trust once the assets of a securitization trust exceed its liabilities by amounts stipulated in the related indenture, which excess thresholds range from 3.0% to 5.0%. For the securitizations conducted in fiscal 2007, 2006 and 2005, additional structural advisory fees generally ranged between 0.15% and 0.30% of the student loan balances outstanding in the trusts and are accrued over the life of the securitization trusts and paid upon the achievement of the established threshold.

*Residuals—General*

The Company is entitled to receive over the life of the trust 66% to 88% of the residuals in private label loan trusts once the balance of the loans in each trust exceeds the balance of the debt issued by the trust by a fixed percentage ranging from 3.0% to 3.5%.

*Structural Advisory Fees and Residuals—Policy*

The estimated fair value of the additional structural advisory fees and residuals, net of prepayment, default and recovery assumptions, is deemed earned at the time a securitization transaction is completed because evidence of an arrangement exists, services have been provided, the fee is fixed and determinable based on discounted cash flow analyses, there are no future contingencies or obligations and collectibility is reasonably assured.

Structural advisory fees and residuals receivables are carried on the balance sheet at estimated fair value and are evaluated on a periodic basis based on the present value of expected future cash flows, using management's estimates. These estimates are based on historical and third-party data, and the Company's industry experience with the assumptions for default, prepayments, recoveries and discount rates commensurate with the risk involved, considering current outstanding student loan balances and current outstanding balances of borrowings in the securitization trusts.

*Processing Fees from TERI*

Processing fees from TERI consist of reimbursement of expenses incurred by FMER or FMC relating to services performed on behalf of TERI under the terms of the Master Servicing Agreement. Processing fees from TERI are recognized as services are performed.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(2) Summary of Significant Accounting Policies (Continued)**

*Administrative and Other Fees*

Administrative fees are paid by securitization trusts to FMDS periodically for the daily management of the trusts and for the services FMDS provides in obtaining information from the loan servicers and reporting this and other information to the parties related to the securitization. The fee is based upon a percentage of the outstanding principal balance of the debt of each of the trusts. The fee varies with each separate securitization and can range from 5 basis points to 20 basis points. The Company recognizes such fees in service revenue when earned, as administrative services are provided.

The Company also records as other fees the reimbursement of out of pocket costs it receives from the private label trusts related to marketing coordination services performed for some of its clients.

*(g) Goodwill and Intangible Assets*

*TERI*

The Company has recorded goodwill in the amount of the excess of the purchase price paid to acquire TERI's loan processing operations over the fair value of those assets. The goodwill consists of the fair value of workforce-in-place as well as certain direct acquisition costs and a fair value adjustment for liabilities assumed. Goodwill is not amortized but is evaluated for impairment at least annually, and the Company has concluded that goodwill was not impaired as of June 30, 2007.

The Company also recorded in 2001 intangible assets in the amount of the fair value of the loan database acquired from TERI. This database includes information such as borrower credit characteristics, borrowing practices, interest rates, fees and default rates and provides several significant competitive advantages. The data allows the Company to analyze risk trends and the amount of risk specific to the loans that become part of the securitizations that it structures. Additionally, the data assists in the Company's default prevention efforts by providing a basis by which it monitors borrower default experiences. The Company also utilizes the database information to monitor and analyze student loan information in order to customize loan products for the Company's third-party lender clients and to assist them in the risk-based pricing of the loan products. This loan database was valued based upon an appraisal obtained from an independent third party.

Intangible assets are amortized over their estimated useful life of five years, using the straight-line method. Capitalized costs paid to TERI for monthly database updates are amortized over five years from the date of capitalization. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

As of June 30, 2007, the Company had approximately \$7,985 in gross identifiable intangible assets. During the year ended June 30, 2007, \$248 of additional intangible assets was recognized relating to updates which add significant value and extend the useful life of the loan database purchased.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**June 30, 2007, 2006 and 2005**  
**(dollars and shares in thousands, except per share amounts)**

**(2) Summary of Significant Accounting Policies (Continued)**

Total amortization expense associated with these intangible assets in fiscal 2007, 2006 and 2005 was \$702, \$1,467 and \$1,317, respectively. Estimated future amortization expense for these assets during the next five fiscal years is as follows:

2008 .....	\$602
2009 .....	502
2010 .....	402
2011 .....	302
2012 .....	225

*Union Federal Savings Bank*

On November 30, 2006, the Company completed its acquisition of UFSB, a federally chartered community savings bank located in North Providence, Rhode Island with total assets and total liabilities at the time of acquisition of approximately \$40,853 and \$36,441, respectively. The financial results of UFSB are included in the Company's financial statements subsequent to the acquisition date. The purchase price was allocated to acquired assets and liabilities based on their respective fair values at November 30, 2006. The Company recorded goodwill of \$1,701 and a core deposit intangible of \$1,311 as a result of this acquisition. The Company has concluded the goodwill was not impaired at June 30, 2007. The core deposit intangible will be amortized on a straight-line basis over a five year period and will be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

*(h) Fair Value of Financial Instruments*

The carrying values of the Company's cash, cash equivalents and investments equals or approximates their fair value because of the short-term nature of these instruments. The carrying value of the loans held for sale and service receivables equals their fair value. The Company calculated the fair value of its debt using a discounted cash flow model and an estimate of current borrowing rates. The Company believes the carrying value of these instruments approximates their fair value.

*(i) Consolidation*

The Company's consolidated financial statements include the accounts of FMC and its subsidiaries, after eliminating inter-company accounts and transactions. The Company has not consolidated the financial results of the securitization trusts purchasing loans that it has facilitated. Prior to July 1, 2003, this accounting treatment was in accordance with various Emerging Issues Task Force issues and related interpretations. The Company considered, among other things, the following factors in assessing consolidation of the securitization trusts:

- it did not have unilateral decision-making abilities related to significant matters affecting the securitization trusts, such as asset acquisition, prepayment of debt, placement of debt obligations and modification of trust documents;

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(2) Summary of Significant Accounting Policies (Continued)**

- it did not have substantially all the risks and rewards of ownership, as TERI provides all of the student loan guarantees with respect to loans held by the private label trust;
- it was a facilitator of securitization transactions, for which it receives market-based fees, and it was not the transferor of assets to the securitization trusts; and
- its continuing involvement in the trusts is limited to a passive residual interest and its role as an administrator for the trust for which it receives market-based fees.

Beginning July 1, 2003, and for securitization trusts created after January 31, 2003, the Company applied Financial Accounting Standards Board (FASB), Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin (ARB) No. 51, (FIN No. 46) in assessing consolidation. FIN No. 46 provided a new framework for identifying variable interest entities and determining when a company should include the assets, liabilities, non-controlling interests and results of activities of a variable interest entity in its consolidated financial statements.

On December 24, 2003, the FASB issued FIN No. 46 (revised December 2003), Consolidation of Variable Interest Entities (FIN No. 46R), which addressed how a business enterprise should evaluate whether it has a controlling interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN No. 46R has replaced FIN No. 46. At June 30, 2007, the securitization trusts created after January 31, 2003 have met the criteria to be a qualified special-purpose entity (QSPE) as defined in paragraph 35 of FASB Statement No. 140, Accounting for the Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Accordingly, the Company did not consolidate these existing securitization trusts in its financial statements. In addition, the securitization trusts created prior to January 31, 2003 in which the Company holds a variable interest that could result in the Company being considered the primary beneficiary of such trust, have been amended in order for them to be considered QSPEs. The adoption of FIN No. 46R, which the Company began to apply in December 2003, did not have a material impact on its consolidated financial condition, results of operations, earnings per share or cash flows.

The FASB has issued an exposure draft that would amend FASB Statement No. 140. The FASB has announced that it expects to issue final guidance in 2008. The Company is monitoring the status of the exposure draft to assess its impact, if any, on its financial statements.

**(j) Income Taxes**

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income in the period that includes the enactment date.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(2) Summary of Significant Accounting Policies (Continued)**

**(k) Stock Options**

At June 30, 2007, the Company had four stock-based compensation plans. Prior to July 1, 2005, the Company accounted for those plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (Opinion 25), and related Interpretations, as permitted by FASB Statement No. 123, Accounting for Stock-Based Compensation (Statement 123). The Company did not recognize any compensation cost related to option grants in its consolidated statements of income for the years ended on or prior to June 30, 2005, as options granted under the plans had an exercise price equal to or greater than fair market value of the underlying common stock on the date of grant. Effective July 1, 2005, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), Share-Based Payment (Statement 123(R)), using the modified-prospective transition method.

For purposes of pro forma disclosures for periods prior to July 1, 2005, the estimated fair value of the stock options is amortized to expense over the vesting period of the options. The Company's consolidated pro forma net income and net income per share for the year ended June 30, 2005, had the Company elected to recognize compensation expense for the granting of options under Statement 123 using the Black-Scholes option pricing model, is as follows:

	<u>2005</u>
Net income—as reported .....	\$159,665
Add: Total stock-based employee compensation expense included in reported net income, net of tax .....	276
Less: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of tax .....	<u>(2,640)</u>
Net income—pro forma .....	<u>\$157,301</u>
Net income per share—basic—as reported .....	\$ 2.46
Net income per share—basic—pro forma .....	2.42
Net income per share—diluted—as reported .....	2.39
Net income per share—diluted—pro forma .....	2.35

For purposes of the table above and for grants made in fiscal 2006, the Company estimated the fair value of each option grant at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

<u>Assumption</u>	<u>2006</u>	<u>2005</u>
Expected risk-free interest rate .....	4.21%	4.18%
Expected dividend yield .....	\$0.48	n/a
Expected average life in years .....	5	5
Volatility .....	35%	32%



**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(2) Summary of Significant Accounting Policies (Continued)**

The weighted average grant date fair market value of stock options granted during fiscal 2006 and 2005, based on the Black-Scholes option pricing model, was \$10.30 and \$4.39, respectively. The Company did not grant any stock options in fiscal 2007.

**(l) Net Income Per Share**

Basic net income per share is computed by dividing net income by the basic weighted-average number of shares outstanding for the periods presented. Diluted net income per share is computed by dividing net income by the diluted weighted average shares outstanding and common equivalent shares outstanding during the period. The weighted average shares outstanding and common equivalent shares outstanding have been determined in accordance with the treasury stock method. Common stock equivalents consist of stock issuable upon (a) the exercise of outstanding stock options, (b) the exercise of options to purchase stock under the Company's employee stock purchase plan and (c) the vesting of restricted stock units.

**(m) Treasury Stock**

The Company's treasury stock includes primarily shares of the Company's stock purchased in open market transactions pursuant to repurchase programs approved by the Company's Board of Directors. Treasury stock also includes shares of the Company's stock forfeited by employees to satisfy statutory minimum withholding obligations as equity compensation awards vest. On September 29, 2005, the Company's Board of Directors approved a repurchase program of up to 7,500 shares of common stock. Through April 24, 2007, the Company repurchased an aggregate of 4,107 shares of its common stock under this program. On April 24, 2007, the Company's Board of Directors approved the repurchase of up to 10,000 shares of common stock. The 10,000 shares authorized for repurchase under the current program included 3,393 shares available for repurchase as of April 25, 2007 under the previously authorized repurchase program. Through June 30, 2007, the Company had repurchased an aggregate of 7,526 shares of its common stock under these programs. The Company records treasury stock at cost including commissions. As of June 30, 2007, 8,831 shares of the Company's common stock may be purchased under the current repurchase program, which does not have a fixed expiration date.

**(n) New Accounting Pronouncements**

In February 2007, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 159, *Fair Value Option for Financial Assets and Financial Liabilities, an amendment of FASB Statements No. 115*. SFAS No. 159 will be effective for the Company beginning in the first quarter of fiscal 2009. The statement permits entities to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The adoption of SFAS No. 159 is not expected to have a material impact on the Company's consolidated financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which provides guidance for using fair value to measure assets and liabilities. The standard also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(2) Summary of Significant Accounting Policies (Continued)**

earnings. SFAS No. 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. Under SFAS No. 157, fair value refers to the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not expect the adoption of SFAS No. 157 to have a material impact on its results of operations and financial position.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* (FIN No. 48). FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. Consistent with its requirements, the Company will adopt FIN No. 48 on July 1, 2007. The Company does not expect the adoption of FIN No. 48 to have a material impact on its results of operations and financial position.

In March 2006, the FASB issued SFAS No. 156, *Accounting For Servicing of Financial Assets, an Amendment of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS No. 156), which requires that all separately recognized servicing assets and liabilities be initially measured at fair value, if practicable, and requires entities to elect either fair value measurement with changes in fair value reflected in earnings or the amortization and impairment requirements of FASB Statement No. 140 for subsequent measurement. SFAS No. 156 will be effective for the Company beginning in the first quarter of fiscal 2008. The adoption of SFAS No. 156 is not expected to have a material impact on the Company's consolidated financial condition or results of operations.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140*. SFAS No. 155 will be effective for the Company beginning in the first quarter of fiscal 2008. The statement permits interests in hybrid financial instruments that contain an embedded derivative that would otherwise require bifurcation, to be accounted for as a single financial instrument at fair value, with changes in fair value recognized in earnings. This election is permitted on an instrument-by-instrument basis for all hybrid financial instruments held, obtained, or issued as of the adoption date. The adoption of SFAS No. 155 is not expected to have a material impact on the Company's consolidated financial condition or results of operations.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

(dollars and shares in thousands, except per share amounts)

**(3) Industry Segment Information**

The Company's activities are considered to be in a single industry segment for financial reporting purposes. The Company is engaged in the business of private education financial services and related activities. Substantially all income is derived from these activities.

**(4) Service Receivables**

***Balance Sheet Data***

Structural advisory fees and residuals receivables represent the present value of additional structural advisory fees and residuals expected to be collected over the life of the securitization trusts, net of prepayment, default and recovery estimates. The fees are expected to be paid from the various securitization trusts to the Company. Processing fees receivable from TERI represents amounts due from TERI for expenses incurred by FMER or FMC on TERI's behalf.

The following table summarizes the changes in the fair value of the structural advisory fees receivable for the fiscal years ended June 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Fair value at beginning of period .....	\$ 88,297	\$53,371
Additions from new securitizations .....	43,984	33,685
Trust updates		
Passage of time (present value accretion).....	7,503	4,347
Impact of change in average prepayment rate assumption .	(3,529)	—
Other factors .....	<u>(2,611)</u>	<u>(3,106)</u>
Net accretion .....	1,363	1,241
Fair value at end of period .....	<u>\$133,644</u>	<u>\$88,297</u>

The following table summarizes the changes in the fair value of the residuals receivable for the fiscal years ended June 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Fair value at beginning of period .....	\$452,823	\$247,275
Additions from new securitizations .....	182,744	177,309
Trust updates		
Passage of time (present value accretion).....	66,428	39,950
Impact of change in average prepayment rate assumption .	(36,236)	—
Impact of change in discount rate assumption.....	26,680	—
Other factors .....	<u>(27,324)</u>	<u>(11,711)</u>
Net accretion .....	29,548	28,239
Fair value at end of period .....	<u>\$665,115</u>	<u>\$452,823</u>

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(4) Service Receivables (Continued)**

The Company used the following loan performance assumptions for private label loan securitizations closed during fiscal 2007, 2006 and 2005:

<u>Fiscal Year</u>	<u>Percentage rate</u>			<u>Discount rate</u>	
	<u>Default</u>	<u>Recovery</u>	<u>CPR</u>	<u>Structural advisory fees</u>	<u>Residuals</u>
2007 .....	10.32%	40%	8%	7.02%	13%
2006 .....	9.22	40	7	7.16	12
2005 .....	8.7	40	7	5.96	12

The above receivables are anticipated to be collected over the estimated lives of the securitization trusts. For fiscal 2007 securitizations, the cash flows of the securitization trusts are expected to be collected over approximately 26 to 28 years and, based on the assumptions used, the structural advisory fees and residuals receivables are anticipated to be collected beginning in 2012. For the fiscal 2006 securitizations, the cash flows of the securitization trusts are expected to be collected over approximately 23 to 26 years and, based on the assumptions used, the structural advisory fees and residuals receivables are anticipated to be collected beginning in 2010. For the fiscal 2005 securitizations, the cash flows of the securitization trusts are expected to be collected over approximately 17 to 22 years and, based on the assumptions used, the structural advisory fees and residuals receivables are anticipated to be collected beginning in fiscal 2009. As the receivables are determined using various assumptions and factors, actual results may differ from these estimates.

The effect on the fair value of the structural advisory fees and residuals receivables based on variations of 10% or 20%, except for the forward LIBOR rates, which are based on variations of 1% and 2% from the forward LIBOR rates at June 30, 2007, and changes in the assumed spread between 1 month LIBOR rates and auction rates, which are based on .05% and .10% changes, from the assumed levels for each key assumption is as follows:

<u>Structural advisory fees</u>	<u>Percentage change in assumptions</u>		<u>Receivables balance</u> (dollars in thousands)	<u>Percentage change in assumptions</u>	
	<u>Down 20%</u>	<u>Down 10%</u>		<u>Up 10%</u>	<u>Up 20%</u>
<b>Default rate:</b>					
Total structural advisory fees .....	\$134,732	\$134,188	\$133,644	\$133,100	\$132,557
Change in receivables balance .....	0.81%	0.41%		(0.41)%	(0.81)%
<b>Default recovery rate:</b>					
Total structural advisory fees .....	\$133,644	\$133,644	\$133,644	\$133,644	\$133,644
Change in receivables balance .....	0.00%	0.00%		0.00%	0.00%
<b>Annual prepayment rate:</b>					
Total structural advisory fees .....	\$140,164	\$136,798	\$133,644	\$130,667	\$127,879
Change in receivables balance .....	4.88%	2.36%		(2.23)%	(4.31)%
<b>Discount rate:</b>					
Total structural advisory fees .....	\$144,324	\$138,846	\$133,644	\$128,699	\$123,995
Change in receivables balance .....	7.99%	3.89%		(3.70)%	(7.22)%

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

(dollars and shares in thousands, except per share amounts)

**(4) Service Receivables (Continued)**

	<u>Change in assumption</u>		<u>Receivables balance</u>	<u>Change in assumption</u>	
	<u>Down 200 basis points</u>	<u>Down 100 basis points</u>		<u>Up 100 basis points</u>	<u>Up 200 basis points</u>
			(dollars in thousands)		
Forward LIBOR rates:					
Total structural advisory fees . . . . .	\$124,758	\$129,076	\$133,644	\$138,196	\$142,886
Change in receivables balance . . . . .	(6.65)%	(3.42)%		3.41%	6.92%

	<u>Percentage change in assumptions</u>		<u>Receivables balance</u>	<u>Percentage change in assumptions</u>	
	<u>Down 20%</u>	<u>Down 10%</u>		<u>Up 10%</u>	<u>Up 20%</u>
			(dollars in thousands)		
<b>Residuals</b>					
Default rate:					
Total residual fees . . . . .	\$679,567	\$672,343	\$665,115	\$657,907	\$650,676
Change in receivables balance . . . . .	2.17%	1.09%		(1.08)%	(2.17)%
Default recovery rate:					
Total residual fees . . . . .	\$664,957	\$665,036	\$665,115	\$665,192	\$665,270
Change in receivables balance . . . . .	(0.02)%	(0.01)%		0.01%	0.02%
Annual prepayment rate:					
Total residual fees . . . . .	\$739,711	\$701,341	\$665,115	\$630,907	\$598,543
Change in receivables balance . . . . .	11.22%	5.45%		(5.14)%	(10.01)%
Discount rate:					
Total residual fees . . . . .	\$791,550	\$724,900	\$665,115	\$611,476	\$563,123
Change in receivables balance . . . . .	19.01%	8.99%		(8.06)%	(15.33)%

	<u>Change in assumption</u>		<u>Receivables balance</u>	<u>Change in assumption</u>	
	<u>Down 200 basis points</u>	<u>Down 100 basis points</u>		<u>Up 100 basis points</u>	<u>Up 200 basis points</u>
			(dollars in thousands)		
Forward LIBOR rates:					
Total residual fees . . . . .	\$644,220	\$655,288	\$665,115	\$671,231	\$673,325
Change in receivables balance . . . . .	(3.14)%	(1.48)%		0.92%	1.23%

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

(dollars and shares in thousands, except per share amounts)

**(4) Service Receivables (Continued)**

	<u>Change in assumption</u>		<u>Receivables balance</u>	<u>Change in assumption</u>	
	<u>Tighten 10 basis points</u>	<u>Tighten 5 basis points</u>		<u>Widen 5 basis points</u>	<u>Widen 10 basis points</u>
	(dollars in thousands)				
Change in assumed spread between LIBOR and auction rate indices:					
Total residual fees . . . . .	\$670,993	\$668,054	\$665,115	\$662,179	\$659,243
Change in receivables balance . . . . .	0.88%	0.44%		(0.44)%	(0.88)%

These sensitivities are hypothetical and should be used with caution. The effect of each change in assumption must be calculated independently, holding all other assumptions constant. Because the key assumptions may not in fact be independent, the net effect of simultaneous adverse changes in key assumptions may differ from the sum of the individual effects above.

**(5) Related Party Transaction**

At June 30, 2007, the Company had invested approximately \$84,329 of cash equivalents in a money market fund. The investment adviser for this fund is Milestone Capital Management, LLC (MCM), an institutional money management firm. In addition, approximately \$118,043 of investments were invested by MCM on behalf of the Company under an investment management agreement. MCM receives a fee for services it performs under this agreement. MCM is a wholly owned subsidiary of Milestone Group Partners. Members of the immediate family of one of the Company's directors own approximately 65% of Milestone Group Partners.

**(6) Borrowings**

**(a) Education Loan Warehouse Facility**

In July 2007, UFSB-SPV entered into a \$300,000 education loan warehouse facility to fund the purchase of education loans from UFSB. The facility will terminate on July 16, 2008 or earlier if certain covenants are not maintained. Under the facility, UFSB-SPV pledges the purchased education loans as collateral for the advances it receives from conduit lenders. UFSB-SPV expects to repay advances it receives as education loans held by UFSB-SPV and pledged as collateral are securitized and transferred to the securitization trusts.

**(b) Equipment Line of Credit**

In January 2005, the Company entered into an equipment financing lease agreement which it used to finance purchases of furniture and equipment. The agreement, which expired on December 30, 2005, allowed the Company to finance up to \$20,000 worth of furniture and equipment purchased before December 30, 2005. The Company expects to repay amounts drawn down on the line of credit at terms ranging from three to five years. At June 30, 2007, the outstanding principal balance on amounts borrowed under this line of credit was \$4,529.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(6) Borrowings (Continued)**

**(c) TERI**

The Company entered into a Note Payable Agreement with TERI on June 20, 2001, in the principal amount of \$3,900, to fund the Company's acquisition of TERI's loan processing operations. Of the principal amount, \$2,000 related to the acquisition of TERI's software and network assets and \$1,900 related to the acquired workforce-in-place. Under the terms of the note payable, principal and interest at an annual rate of 6% are payable in 120 monthly installments of \$43 commencing on July 20, 2001 and ending on June 20, 2011. The note payable is secured by the software and network assets. The outstanding principal balance of this note payable at June 30, 2007 amounted to \$1,843.

The Company also entered into a second note payable with TERI on June 20, 2001, in the principal amount of \$4,000, to fund the acquisition of TERI's loan database. Principal and interest at an annual rate of 6% are payable in 120 monthly installments of \$44 commencing on July 20, 2001 and ending on June 20, 2011. The note payable is secured by the loan database. The outstanding principal balance of this note payable at June 30, 2007 amounted to \$1,891.

Principal payments due on notes payable to TERI in each fiscal year subsequent to June 30, 2007 are as follows:

2008 .....	\$ 852
2009 .....	904
2010 .....	960
2011 .....	<u>1,018</u>
	<u>\$3,734</u>

**(7) Retirement Plans**

**(a) Defined Contribution Plans—401(k)**

At June 30, 2007, the Company maintained a 401(k) retirement savings plan for the benefit of all full time employees. Eligible employees can join the plan after three months of employment. Investment decisions are made by individual employees. The Company, at its option, can contribute to the plan for the benefit of its employees. Employee and employer contributions vest immediately. The Company made contributions of \$3,093, \$2,143 and \$1,146 during the fiscal years ended June 30, 2007, 2006 and 2005, respectively.

**(b) Pension Plan**

FMER had a non-contributory defined benefit pension plan, funded through group annuities, that covered certain FMER employees. During the second quarter of fiscal 2005, the Company recorded a net curtailment gain of \$655 as the benefits under the plan were frozen. During the fourth quarter of fiscal 2007, the Company recorded a net settlement loss of \$587 as the plan was terminated and all outstanding benefits were settled. The Company made a final contribution to the plan of \$956 in the fourth quarter of fiscal 2007 to settle the \$3,891 of benefits outstanding under the plan.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(8) 2003 Employee Stock Purchase Plan**

In October 2003, the Board of Directors and stockholders approved the Company's 2003 employee stock purchase plan (Stock Purchase Plan). A total of 600 shares of common stock are authorized for issuance under this plan. The Stock Purchase Plan permits eligible employees to purchase shares of common stock at the lower of 85% of the fair market value of the common stock at the beginning or at the end of each offering period. Participation is voluntary and eligible employees can participate in the Stock Purchase Plan after six months of employment. Employees who own 5% or more of the Company's common stock are not eligible to participate in the Stock Purchase Plan. Under the Stock Purchase Plan, 37, 37 and 76 shares were issued during fiscal 2007, 2006 and 2005, respectively. In addition, 15 shares were issued in fiscal 2008.

**(9) Commitments and Contingencies**

*Leases*

The Company leases office space and equipment under non-cancelable operating leases expiring at various times through April 2014. Rent expense pursuant to these operating leases for the periods ended June 30, 2007, 2006 and 2005 was approximately \$11,105, \$10,060 and \$8,169, respectively. Rent expense was net of sublease revenue of \$655, \$512 and \$443 for the years ended June 30, 2007, 2006 and 2005, respectively.

At June 30, 2007, the Company had financed through non-cancelable capital leases furniture and equipment at a cost of \$14,575 and accumulated depreciation of \$8,793.

The future minimum lease payments required under these leases for each of the five fiscal years subsequent to June 30, 2007 and thereafter are as follows:

<u>Fiscal year ending June 30,</u>	<u>Capital leases</u>	<u>Operating leases</u>
2008 .....	\$ 3,611	\$12,259
2009 .....	1,343	9,711
2010 .....	843	9,444
2011 .....	—	9,439
2012 .....	—	8,461
Thereafter .....	—	<u>11,655</u>
Total minimum lease payments .....	<u>5,797</u>	<u>\$60,969</u>
Less amounts representing interest .....	<u>(280)</u>	
Present value of future minimum lease payments .....	5,517	
Less current portion .....	<u>(3,432)</u>	
Long-term portion .....	<u>\$ 2,085</u>	



**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

(dollars and shares in thousands, except per share amounts)

**(9) Commitments and Contingencies (Continued)**

The amounts the Company is entitled to receive under non-cancelable subleases of office space for each of the five fiscal years subsequent to June 30, 2007 are as follows:

<u>Fiscal year ending June 30,</u>	<u>Sublease payments</u>
2008 .....	\$ 862
2009 .....	887
2010 .....	1,011
2011 .....	1,011
2012 .....	219
Total.....	<u>\$3,990</u>

***Loan Database***

Under the terms of a database purchase and supplementation agreement dated June 30, 2001 between FMER and TERI, the Company pays a monthly purchase fee. The payments commenced on July 20, 2001 and are paid as consideration for the right to receive updates and queries to the loan database acquired in June 2001. In October 2004, this agreement, which had an initial term of five years, was renewed for an additional five-year term with monthly payments reduced from \$62 to \$21 commencing in July 2007.

***Legal Proceedings***

The Company is involved from time to time in routine legal proceedings occurring in the ordinary course of business. In the opinion of management, final disposition of these proceedings is not expected to have a material adverse effect on the financial condition or results of operations of the Company.

***Agreements with Lenders***

Under the terms of some of FMC's contracts with key lender clients, FMC has an obligation to securitize loans originated by those lenders periodically, typically twice per year. FMC may agree with certain lenders to securitize more frequently in the future. If FMC does not honor these obligations, FMC may be required to pay liquidated damages, generally not to exceed 1% of the face amount of the loans available for securitization. FMC has complied with the terms of these contracts and, accordingly, no liability has been accrued.

**(10) Concentrations**

***TERI***

TERI is a private, not-for-profit Massachusetts organization as described under section 501(c)(3) of the Internal Revenue Code. Incorporated in 1985, TERI is the oldest and largest guarantor of alternative, or private, education loans. In its role as guarantor in the private education lending market, TERI agrees to reimburse lenders or securitization trusts for unpaid principal and interest on defaulted loans. TERI is the exclusive third-party provider of borrower default guarantees for the Company's clients' private education

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(10) Concentrations (Continued)**

loans. As of June 30, 2007, TERI had a Baa3 counterparty rating from Moody's Investors Service, which is the lowest investment grade rating, and an insurer financial strength rating of A+ from Fitch Ratings which was reaffirmed on April 2, 2007. TERI also had a rating of A from Dominion Bond Rating Service as of June 30, 2007. If these ratings are lowered, FMC's clients may not wish to enter into guarantee arrangements with TERI. In addition, FMC's up-front structural advisory fee yields could decline or market conditions could dictate that FMC obtain additional credit enhancement for the asset-backed securitizations that it structures, the cost of which could result in lower revenues. Finally, if TERI's ratings were downgraded below the ratings TERI held in January 2003, or if a rating agency were to place a negative watch on TERI, FMC's agreement with Bank of America relating to the purchase of direct-to-consumer loans could be terminated. In January 2003, TERI had a Baa3 counterparty rating from Moody's Investors Service and an insurer financial strength rating of A from Fitch Ratings. If TERI experiences a material adverse financial change such as a reduction of its credit rating below investment grade, Bank of America could suspend the processing of new applications for school channel loans.

In February 2001, the Company and TERI entered into a two-year Master Loan Guaranty Agreement, which granted TERI a right of first refusal to guarantee loans under existing and future private label loan programs facilitated by FMC, as well as new loan programs jointly created by FMC and TERI. In addition, the Master Loan Guaranty Agreement provides a beneficial interest for TERI in a portion of the residual value of securitization trusts that purchase TERI-guaranteed loans. In June 2001, the Company acquired TERI's loan processing operations and the Master Loan Guaranty Agreement was automatically extended for a five-year term from the date of the acquisition closing. The loans guaranteed pursuant to the Master Loan Guaranty Agreement comprise only a portion of TERI's guarantee business, and the Master Loan Guaranty Agreement does not preclude TERI from continuing to provide its guarantees to loan originators not associated with FMC. In October 2004, the Company renewed the Master Loan Guaranty Agreement and certain additional agreements with TERI, in each case for an additional term through June 2011.

The Master Loan Guaranty Agreement generally provides that the guarantee fees earned by TERI upon the disbursement of student loans are placed in a segregated reserve account which is held as collateral to secure TERI's obligation to purchase defaulted education loans. This pledge account is held by a third-party financial institution for the benefit of the program lender until the student loans are securitized, at which point the account is pledged to the securitization trust that purchases the loans. The Master Loan Guaranty Agreement, as implemented through guaranty agreements with individual lenders, entitles TERI to retain a portion of its guaranty fees as an administrative fee rather than place them in the pledged account.

In October 2005, the Company entered into a supplement to the Master Loan Guaranty Agreement for securitizations of TERI-guaranteed loans during fiscal 2006. In accordance with the 2005 supplement, the administrative fee for securitizations of TERI-guaranteed loans in fiscal 2006 was 240 basis points multiplied by the principal balance of the loans originated and securitized. For securitizations completed during fiscal 2006, TERI's ownership of the residual value of the TERI-guaranteed loans securitized ranged from 12 to 15 percent.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(10) Concentrations (Continued)**

In August 2006, the Company entered into a supplement to the Master Loan Guaranty Agreement that provided as follows:

- For each securitization closing between August 1, 2006 and June 30, 2007, TERI would be entitled to elect to adjust the amount of its administrative fee, and adjust the amount deposited into the pledged account, within specified parameters. As a result, the amount of the administrative fee applicable to securitizations closing between August 1, 2006 and June 30, 2007 may have ranged from 150 basis points to 240 basis points, at TERI's election and subject to the parameters of each securitization trust. The Company agreed to attempt in good faith to structure its securitization transactions to accommodate TERI's election.
- For each securitization for which TERI elected to adjust the administrative fee, the Company made a corresponding adjustment to the relative ownership percentages of the residual interests in the applicable securitization trust. To the extent TERI elected to increase the amount of its administrative fee above 150 basis points, such an adjustment resulted in an increase in the Company's ownership percentage, and a decrease in the ownership interest of TERI, by a percentage that resulted in an equivalent dollar reduction in the fair value of TERI's residual ownership interest at the time of the securitization.

TERI received an administrative fee of 175 basis points for the securitization transaction the Company completed in the first quarter of fiscal 2007, 221 basis points for the securitization transaction the Company completed in the second quarter of fiscal 2007, 215 basis points for the securitization transaction the Company completed for the third quarter of fiscal 2007 and 212 basis points for the securitization transaction the Company completed in the fourth quarter of fiscal 2007. The Company expects to allow TERI to elect to adjust the amount of its administrative fee, and adjust the amount deposited into the pledged account, within specified parameters for the securitization transaction the Company plans to complete in the first quarter of fiscal 2008.

Under a Master Servicing Agreement with a term through June 2011, FMER provides to TERI underwriting, documentation and other origination services, as well as technical support, disbursements, customer service, collections, default prevention, default processing, accounting services and guarantee claims management and administrative services, in support of TERI's loan guarantee function. FMC guarantees the full and timely performance by FMER of its obligations pursuant to this Master Servicing Agreement. FMC uses the acquired TERI assets, including historical loan data, to support the design and implementation of loan programs facilitated by FMC and loan programs jointly created by FMC and TERI. In addition, TERI has the right to designate one of three representatives to serve on the board of directors of FMER. During fiscal 2007, processing fees from TERI represented approximately 15% of the Company's total revenue.

***PHEAA***

As of June 30, 2007, there were seven TERI-approved loan servicers. Servicers provide administrative services relating to loans, including processing deferment and forbearance requests, sending out account statements and accrual notices, responding to borrower inquiries, and collecting and crediting payments

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(10) Concentrations (Continued)**

received from borrowers. As of June 30, 2007, the Company utilized six of these servicers. As of June 30, 2007, Pennsylvania Higher Education Assistance Agency (PHEAA) serviced a majority of the loans for which the Company facilitates origination. PHEAA also operates under the name American Education Services (AES). If the Company's relationship with PHEAA terminates, the Company would either need to expand or develop a relationship with another TERI-approved loan servicer, which could be time-consuming and costly.

**Revenue Concentration**

Securitization-related fees from securitization trusts represented approximately 78% of total revenue in fiscal 2007. Securitization-related fees from securitization trusts represented approximately 74% of total revenue in fiscal 2006. Securitization-related fees from securitization trusts represented approximately 75% of total revenue in fiscal 2005. These securitization trusts purchased private student loans from several lenders including JP Morgan Chase Bank, N.A., Bank of America, N.A., and Charter One Bank, N.A. The Company did not recognize more than 10% of total service revenue from any other customer. Charter One Bank, N.A. serves as a program lender for the Company's proprietary loan program as well as for additional education loan programs marketed by third parties and funded by Charter One Bank, N.A.

**(11) Income Taxes**

Components of income tax expense attributable to income from operations for the years ended June 30, 2007, 2006 and 2005 were as follows:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Current:			
Federal .....	\$118,067	\$ 69,602	\$ 56,649
State .....	34,859	18,398	16,467
Total current tax expense .....	<u>152,926</u>	<u>88,000</u>	<u>73,116</u>
Deferred:			
Federal .....	81,899	57,916	33,228
State .....	21,609	1,878	11,080
Total deferred income tax expense .....	<u>103,508</u>	<u>59,794</u>	<u>44,308</u>
Income tax expense .....	<u>\$256,434</u>	<u>\$147,794</u>	<u>\$117,424</u>

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(11) Income Taxes (Continued)**

The following table reconciles the expected federal income tax expense (computed by applying the federal statutory tax rate to income before taxes) to recorded income tax expense for the years ended June 30, 2007, 2006 and 2005:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Computed federal tax expense .....	\$219,718	\$134,314	\$ 96,981
State tax, net of federal benefits .....	36,704	13,179	17,906
Other .....	12	301	2,537
Income tax expense .....	<u>\$256,434</u>	<u>\$147,794</u>	<u>\$117,424</u>

The tax effects of temporary differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases that give rise to significant deferred tax assets and deferred tax liabilities at June 30, 2007 and 2006 were as follows:

	<u>2007</u>	<u>2006</u>
Deferred tax assets:		
Deferred compensation .....	\$ 2,911	\$ 2,103
Other .....	1,369	—
Total net deferred tax asset .....	<u>4,280</u>	<u>2,103</u>
Deferred tax liability:		
Residual fees, net .....	(187,412)	(137,095)
Structural advisory fees .....	(56,006)	—
Deferred recognition of intercompany income for tax .....	(3,852)	(3,548)
Deferred advertising costs .....	(3,976)	(2,039)
Depreciation .....	(782)	(2,461)
Other .....	—	(1,200)
Total deferred tax liability .....	<u>(252,028)</u>	<u>(146,343)</u>
Net deferred tax liability .....	<u>\$(247,748)</u>	<u>\$(144,240)</u>

During fiscal 2007, the Internal Revenue Service approved a change in the timing of the Company's recognition of additional structural advisory fees as taxable income. As a result, the Company will pay income tax upon receipt, rather than recognition under GAAP, of such fees.

**(12) Stockholders' Equity and Stock Options**

**Stock Options**

Under the 1996 stock option plan (1996 Plan), the Company could grant either incentive stock options (pursuant to Section 422 of the Internal Revenue Code) or non-statutory stock options to its officers and employees, and non-statutory stock options to consultants, for up to 10,500 shares of common stock. Options granted under the 1996 Plan generally vest ratably over four years in five equal installments beginning on the date of grant, and the term of each incentive stock option granted under the 1996 Plan

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(12) Stockholders' Equity and Stock Options (Continued)**

cannot exceed a period of ten years from the date of its grant. The 1996 Plan stipulates that the exercise price with respect to incentive stock options shall not be less than the fair market value of the stock on the day of grant as determined in good faith by the Board of Directors or the Compensation Committee of the Board of Directors. The Company has not granted stock options under the 1996 Plan since the adoption of the Company's 2003 stock incentive plan (2003 Plan). During fiscal 2007, the 1996 Plan expired. As a result, the Company is no longer able to grant awards under this plan.

Under the 2002 director stock plan (2002 Plan), the Company may grant non-statutory stock options to non-employee members of its Board of Directors for up to 300 shares of common stock. Under the terms of the 2002 Plan, each non-employee director was granted an option to purchase 6 shares of common stock (i) as of the date of his or her initial election to the Board of Directors and (ii) annually on each September 20 (beginning September 20, 2003) if on that date the non-employee director had served on the Board of Directors for at least 180 days. The term of each option was ten years, and each option was immediately exercisable upon grant. The exercise price was set at the closing price of the Company's common stock on the New York Stock Exchange on the last trading day immediately preceding the date of grant. On August 15, 2006, the Board of Directors suspended new awards under the 2002 Plan and adopted in their place a program under the 2003 Plan for grants of stock units to non-employee directors. As a result, each non-employee director of the Company will receive:

- on the date of his or her initial election to the Board of Directors, 3 stock units under the 2003 Plan; and
- an annual grant of 3 stock units under the 2003 Plan on September 20 of each year, if the non-employee director has then served on the Board of Directors for at least 180 days.

In each case, each stock unit represents the right to receive one share of common stock of the Company. A director may elect to defer delivery of the underlying shares until a later date in accordance with the requirements of Section 409A of the Internal Revenue Code of 1986, as amended.

In September 2003, the Board of Directors and stockholders approved the 2003 Plan and reserved 1,800 shares of common stock for issuance under this plan. In fiscal 2006, the Board of Directors and stockholders approved an increase in the number of shares of common stock reserved for issuance under the 2003 Plan from 1,800 to 4,050. Under the 2003 Plan, the Board of Directors, or one or more sub-committees of the Board, may grant options or other stock based awards to employees, directors, consultants or advisors. Prior to June 30, 2004, no options or awards had been issued under this plan. Through June 30, 2007, the Company granted in aggregate 993 restricted stock units to certain employees, of which 85 were canceled prior to June 30, 2007 as a result of voluntary terminations prior to vesting and 67 converted to shares of common stock of the Company upon vesting. In addition, the Company granted 1,200 stock options under this plan during fiscal 2005. These stock options were canceled in fiscal 2006 as a result of voluntary termination and are available for re-grant under the 2003 Plan. At June 30, 2007, 3,142 shares were available for future grant under the 2003 Plan.

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

(dollars and shares in thousands, except per share amounts)

**(12) Stockholders' Equity and Stock Options (Continued)**

The following table summarizes information about stock options outstanding at June 30, 2007:

<u>Exercise prices</u>	<u>Number outstanding</u>	<u>Weighted- average remaining contractual life</u>	<u>Weighted- average exercise price</u>	<u>Number exercisable</u>
\$0.67 .....	6	3.00	\$ 0.67	6
\$3.33 .....	38	5.16	3.33	38
\$4.67 .....	90	5.67	4.67	90
\$8.10 .....	30	6.19	8.10	30
\$10.00 .....	6	6.28	10.00	6
\$19.04 .....	30	8.22	19.04	30
\$32.97 .....	36	7.22	32.97	36
	<u>236</u>	6.17	11.08	<u>236</u>

The following table presents stock option activity for the fiscal years ended June 30, 2007, 2006 and 2005:

	<u>Number of options</u>	<u>Weighted- average exercise price per share</u>	<u>Aggregate intrinsic value</u>
Outstanding options at June 30, 2004 .....	5,381	\$ 1.65	
Granted .....	1,236	49.51	
Exercised .....	(3,515)	1.16	\$119,016
Canceled .....	(465)	1.46	
Outstanding options at June 30, 2005 .....	2,637	24.77	
Granted .....	36	19.04	
Exercised .....	(744)	2.39	15,623
Canceled .....	(1,232)	48.84	
Outstanding options at June 30, 2006 .....	697	5.85	
Granted .....	—	—	
Exercised .....	(438)	3.11	17,805
Canceled .....	(23)	4.67	
Outstanding options at June 30, 2007 .....	<u>236</u>	11.08	6,492
Outstanding exercisable at June 30, 2007 .....	<u>236</u>	11.08	6,492

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

**(dollars and shares in thousands, except per share amounts)**

**(12) Stockholders' Equity and Stock Options (Continued)**

The Company did not grant any restricted stock units prior to fiscal 2005. The following table presents restricted stock unit activity for the fiscal years ended June 30, 2007, 2006 and 2005.

	Number of restricted stock units	Weighted- average grant date fair value per share
Outstanding restricted stock units at June 30, 2004.....	—	—
Granted.....	125	33.43
Common stock issued at vest date .....	—	—
Canceled .....	(17)	32.44
Outstanding restricted stock units at June 30, 2005.....	108	33.58
Granted.....	489	21.66
Common stock issued at vest date .....	—	—
Canceled .....	(14)	39.88
Outstanding restricted stock units at June 30, 2006.....	583	23.43
Granted.....	379	34.23
Common stock issued at vest date .....	(67)	33.97
Canceled .....	(54)	30.70
Outstanding restricted stock units at June 30, 2007.....	841	26.99

As of June 30, 2007, there was \$17,927 of total unrecognized compensation cost related to nonvested share-based compensation arrangements (including stock options and restricted stock units). That cost is expected to be recognized over a weighted-average period of approximately 2.1 years.



**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

June 30, 2007, 2006 and 2005

(dollars and shares in thousands, except per share amounts)

**(13) Net Income per Share**

The following table sets forth the computation of basic and diluted net income per share of the Company's common stock:

	Year ended June 30,		
	2007	2006	2005
Net income .....	<u>\$371,331</u>	<u>\$235,960</u>	<u>\$159,665</u>
Shares used in computing net income per common share—			
basic .....	94,296	95,366	97,550
Effect of dilutive securities:			
Stock options .....	253	825	2,650
Restricted stock units .....	296	67	6
Dilutive potential common shares .....	<u>549</u>	<u>892</u>	<u>2,656</u>
Shares used in computing net income per common share—			
diluted .....	<u>94,845</u>	<u>96,258</u>	<u>100,206</u>
Net income per common share:			
Basic .....	<u>\$ 3.94</u>	<u>\$ 2.47</u>	<u>\$ 1.64</u>
Diluted .....	<u>\$ 3.92</u>	<u>\$ 2.45</u>	<u>\$ 1.59</u>

**(14) Unaudited Quarterly Information**

The table below summarizes unaudited quarterly information for each of the three months in the fiscal years ended June 30, 2007 and 2006:

	Three months ended			
	September 30, 2006	December 31, 2006	March 31, 2007	June 30, 2007
	(in thousands, except per share data)			
Total revenues .....	\$302,945	\$197,766	\$180,163	\$199,830
Non-interest expenses .....	65,599	58,983	60,897	67,476
Other income .....	—	—	13	3
Income tax expense .....	96,338	57,632	48,107	54,357
Net income .....	<u>\$141,008</u>	<u>\$ 81,151</u>	<u>\$ 71,172</u>	<u>\$ 78,000</u>
Net income per share:				
Basic .....	\$ 1.50	\$ 0.86	\$ 0.75	\$ 0.83
Diluted .....	1.49	0.85	0.75	0.83

**THE FIRST MARBLEHEAD CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**June 30, 2007, 2006 and 2005**

(dollars and shares in thousands, except per share amounts)

**(14) Unaudited Quarterly Information (Continued)**

	Three months ended			
	September 30, 2005	December 31, 2005	March 31, 2006	June 30, 2006
	(in thousands, except per share data)			
Total revenue .....	\$36,300	\$232,130	\$150,543	\$150,062
Non-interest expenses .....	45,667	44,051	49,248	48,841
Other income .....	—	2,501	25	—
Income tax expense (benefit) .....	(3,925)	79,219	42,098	30,402
Net income (loss) .....	<u>\$ (5,442)</u>	<u>\$111,361</u>	<u>\$ 59,222</u>	<u>\$ 70,819</u>
Net income (loss) per share:				
Basic .....	\$ (0.06)	\$ 1.17	\$ 0.63	\$ 0.75
Diluted .....	(0.06)	1.16	0.62	0.74

The Company's quarterly revenue, operating results and profitability have varied and are expected to continue to vary on a quarterly basis primarily because of the timing, size and structure of the securitizations that it structures. In fiscal 2006, the Company facilitated one securitization in the second quarter, one securitization in the third quarter, and two securitizations in the fourth quarter, but none in the first quarter. In fiscal 2007, the Company facilitated one securitization in each of the first three quarters and two securitizations in the fourth quarter.

## EXHIBIT INDEX

<u>Number</u>	<u>Description</u>
3.1(1)	Restated Certificate of Incorporation of the Registrant, as amended
3.2(2)	Amended and Restated By-laws of the Registrant
10.1(2)†	Amended and Restated Note Purchase Agreement (Education One Loan Program) between the Registrant and Bank One, National Association, dated May 1, 2002, as amended
10.2(3)††	Sixth Amendment to Program Agreements (Bank One Campus Loan Program) among the Registrant, Bank One, National Association, The Education Resources Institute, Inc. and U.S. Bank, N.A., dated as of November 12, 2004
10.3(4) ††	Eleventh Amendment to Program Agreements (Education One Loan Program) among the Registrant, JPMorgan Chase Bank, N.A., successor by merger to Bank One, National Association and The Education Resources Institute, Inc., dated as of November 10, 2005
10.4††	Thirteenth Amendment to Program Agreements among the Registrant, JPMorgan Chase Bank, N.A., successor by merger to Bank One, N.A., The Education Resources Institute, Inc., and US Bank, National Association, dated as of May 1, 2006
10.5(5)††	Fifteenth Amendment to Program Agreements between the Registrant and JPMorgan Chase Bank, N.A., successor by merger to Bank One N.A., dated as of October 2, 2006
10.6(6)††	Note Purchase Agreement (Bank of America DTC Program) between the Registrant and Bank of America, N.A., dated as of April 1, 2006
10.7(6)	Amended and Restated Bank of America Direct to Consumer Loan Program: Umbrella Agreement between the Registrant and Bank of America, N.A., dated as of April 1, 2006
10.8(7)††	Amended and Restated Note Purchase Agreement (Bank of America School Channel Loan Programs) between the Registrant and Bank of America, N.A., dated as of June 30, 2006
10.9(7)	Bank of America School Channel Loan Programs: Amended and Restated Umbrella Agreement between the Registrant and Bank of America, N.A., dated June 30, 2006
10.10††	Note Purchase Agreement between the Registrant and Charter One Bank, N.A., dated March 25, 2004 (Astrive and astriveAlliance Loan Program f/k/a START)
10.11††	Marketing Coordination Agreement between the Registrant and Charter One Bank, N.A., dated as of April 26, 2005 (Astrive and astriveAlliance Loan Program f/k/a START), as amended
10.12(5)††	Amended and Restated Private Student Loan Servicing Agreement between the Registrant and Pennsylvania Higher Education Assistance Agency, dated as of September 28, 2006
10.13(2)†	Master Loan Guaranty Agreement between the Registrant and The Education Resources Institute, Inc., dated February 9, 2001
10.14(8)	Ninth Supplement to Master Loan Guaranty Agreement between the Registrant and The Education Resources Institute, Inc., dated July 28, 2006
10.15(2)†	Master Servicing Agreement between The Education Resources Institute, Inc. and First Marblehead Education Resources, Inc., dated July 1, 2001. The Registrant joins in the agreement for the limited purposes set forth therein
10.16(2)†	Marketing Services Agreement between The Education Resources Institute, Inc. and TERI Marketing Services, Inc., dated July 1, 2001

Number	Description
10.17(9)	Assignment and Assumption Agreement among The Education Resources Institute, Inc., TERI Marketing Services, Inc. and First Marblehead Education Resources, Inc., dated as of January 1, 2004
10.18(2)†	Database Sale and Supplementation Agreement among The Education Resources Institute, Inc. and First Marblehead Education Resources, Inc., dated June 20, 2001. The Registrant joins in the agreement for the limited purposes set forth therein
10.19(2)#	1996 Stock Option Plan, as amended to date
10.20(2)#	2002 Director Stock Plan
10.21(2)#	2003 Employee Stock Purchase Plan
10.22(10)#	2003 Stock Incentive Plan, as amended
10.23(11)#	Executive Incentive Compensation Plan
10.24(9)#	Form of Non-statutory Stock Option Agreement evidencing grants under the 2002 Director Stock Plan
10.25(11)#	Forms of Incentive Stock Option Agreement and Non-statutory Stock Option Agreement evidencing grants under the 2003 Stock Incentive Plan
10.26(11)#	Form of Restricted Stock Unit Agreement evidencing grants under the 2003 Stock Incentive Plan
10.27#	Form of Deferred Stock Unit Agreement evidencing director grants under the 2003 Stock Incentive Plan
10.28#	Form of Performance-based Restricted Stock Unit Agreement evidencing performance-based grants under the 2003 Stock Incentive Plan
10.29(12)#	Registration Rights Agreement among the Registrant and the Holders, as defined therein, dated as of November 3, 2004
10.30(11)#	Letter Agreement between the Registrant and Jack L. Kopnisky, dated August 16, 2005
10.31(11)#	Letter Agreement between the Registrant and Peter B. Tarr, dated June 10, 2005
10.32(2)#	Letter Agreement between the Registrant and John Hupalo, dated February 24, 2003
10.33(13)#	Letter Agreement between the Registrant and John Hupalo, dated October 14, 2005
10.34(7)#	Letter Agreement between the Registrant and Anne P. Bowen, dated April 28, 2004
10.35#	Letter Agreement between the Registrant and Andrew J. Hawley, dated April 9, 2004
10.36(14)#	Letter Agreement between the Registrant and Stephen E. Anbinder, dated June 27, 2006
10.37(15)#	Letter Agreement between the Registrant and Stephen E. Anbinder, dated May 8, 2007
10.38(11)#	Restricted Stock Unit Agreement between the Registrant and Peter B. Tarr, dated July 11, 2005
10.39(16)#	Restricted Stock Unit Agreement between the Registrant and Anne P. Bowen, dated October 26, 2004
10.40(16)#	Restricted Stock Unit Agreement between the Registrant and Andrew J. Hawley, dated October 26, 2004
10.41#	Summary of Director Compensation
10.42(13)	Form of Invention, Non-disclosure, Non-competition and Non-solicitation Agreement
10.43(2)	Indenture of Lease between the Registrant and BP Prucenter Acquisition LLC, dated September 5, 2003
10.44(17)	First Amendment, dated October 7, 2004, to Indenture of Lease between the Registrant and BP Prucenter Acquisition LLC

Number	Description
10.45(18)	Amended and Restated Standard Form Commercial Lease between the Registrant and OMV Associates Limited Partnership for 31 St. James Avenue, Boston, MA, dated February 18, 2004
10.46(19)	Second Amendment, dated September 30, 2004, to Amended and Restated Standard Form Commercial Lease between the Registrant and OMV Associates Limited Partnership
10.47(9)	Commercial Lease between the Registrant and Cabot Road Partners, LLC for One Cabot Road, Medford, MA, dated August 13, 2004
21.1	List of Subsidiaries
23.1	Consent of KPMG LLP
31.1	Chief Executive Officer—Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Chief Financial Officer—Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Chief Executive Officer—Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Chief Financial Officer—Certification pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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- (1) Incorporated by reference to the exhibits to the Registrant's registration statement on Form S-3 (File No. 333-120740).
  - (2) Incorporated by reference to the exhibits to the Registrant's registration statement on Form S-1 (File No. 333-108531).
  - (3) Incorporated by reference to the exhibits to the Registrant's current report on Form 8-K filed with the SEC on December 14, 2004.
  - (4) Incorporated by reference to the exhibit to the Registrant's current report on Form 8-K filed with the SEC on November 16, 2005.
  - (5) Incorporated by reference to the exhibits to the Registrant's quarterly report on Form 10-Q filed with the SEC on November 8, 2006.
  - (6) Incorporated by reference to the exhibits to the Registrant's quarterly report on Form 10-Q filed with the SEC on May 10, 2006.
  - (7) Incorporated by reference to the exhibits to the Registrant's annual report on Form 10-K filed with the SEC on September 12, 2006.
  - (8) Incorporated by reference to the exhibit to the Registrant's current report on Form 8-K filed with the SEC on August 21, 2006.
  - (9) Incorporated by reference to the exhibits to the Registrant's annual report on Form 10-K filed with the SEC on September 15, 2004.
  - (10) Incorporated by reference to the exhibit to the Registrant's current report on Form 8-K filed with the SEC on October 31, 2005.

- (11) Incorporated by reference to the exhibits to the Registrant's annual report on Form 10-K filed with the SEC on September 7, 2005.
- (12) Incorporated by reference to the exhibits to the Registrant's current report on Form 8-K filed with the SEC on November 12, 2004.
- (13) Incorporated by reference to the exhibits to the Registrant's quarterly report on Form 10-Q filed with the SEC on November 8, 2005.
- (14) Incorporated by reference to the exhibit to the Registrant's current report on Form 8-K filed with the SEC on June 30, 2006.
- (15) Incorporated by reference to the exhibit to the Registrant's quarterly report on Form 10-Q filed with the SEC on May 10, 2007.
- (16) Incorporated by reference to the exhibits to the Registrant's current report on Form 8-K/A filed with the SEC on November 23, 2004.
- (17) Incorporated by reference to the exhibits to the Registrant's current report on Form 8-K filed with the SEC on October 8, 2004.
- (18) Incorporated by reference to the exhibits to the Registrant's quarterly report on Form 10-Q filed with the SEC on May 14, 2004.
- (19) Incorporated by reference to the exhibits to the Registrant's quarterly report on Form 10-Q filed with the SEC on November 12, 2004.

† Confidential treatment has been granted for certain provisions of this Exhibit pursuant to Rule 406 promulgated under the Securities Act of 1933.

†† Confidential treatment has been granted or requested for certain provisions of this Exhibit pursuant to Rule 24b-2 promulgated under the Securities Exchange Act of 1934.

# This Exhibit is a management contract or compensatory plan.

## First Marblehead Corporate Information—2007 Annual Report

### Board of Directors:

Peter B. Tarr  
*Chairman*

Stephen E. Anbinder  
*Vice Chairman*

William R. Berkley (2) (3&)  
*Lead Director—Chairman of the Board of Directors and Chief Executive Officer of W.R. Berkley Corporation*

Leslie L. Alexander (2) (3)  
*Institutional Investor, The Alexander Group and Owner of the Houston Rockets and Houston Comets professional basketball teams*

Dort A. Cameron III (2&) (3)  
*Managing Member of the Airlie Group*

George G. Daly (1) (2) (3)  
*Dean of the Robert Emmett McDonough School of Business at Georgetown University*

Peter S. Drotch (1&)\*  
*Retired Partner, PricewaterhouseCoopers LLP (1975-2000)*

William D. Hansen (1) (2)  
*Senior Managing Director of Chartwell Education Group LLC*

Jack L. Kopnisky  
*Chief Executive Officer, President and Chief Operating Officer*

### Executive Officers:

Jack L. Kopnisky  
*Chief Executive Officer, President and Chief Operating Officer*

Peter B. Tarr  
*Chairman of the Board of Directors and General Counsel*

John A. Hupalo  
*Senior Executive Vice President, Chief Financial Officer and Group Head, Capital Markets*

Anne P. Bowen  
*Executive Vice President, Chief Administrative Officer*

Andrew J. Hawley  
*Executive Vice President, Client Services and President, First Marblehead Education Resources, Inc.*

Greg D. Johnson  
*Executive Vice President, Chief Marketing Officer*

Sandra M. Stark  
*Executive Vice President, Business Development*

Kenneth S. Klipper  
*Senior Vice President, Finance, Chief Accounting Officer and Treasurer*

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### Committee Membership

- (1) Audit Committee
- (2) Compensation Committee
- (3) Nominating and Corporate Governance Committee

\* Audit Committee Financial Expert  
& Chairperson

*Office Locations:*

The First Marblehead Corporation  
The Prudential Tower  
800 Boylston Street, 34<sup>th</sup> Floor  
Boston, MA 02199  
(617) 638-2000  
(800) 895-4283

*Subsidiaries:*

First Marblehead Education Resources, Inc.  
31 St. James Street, 6<sup>th</sup> Floor  
Boston, MA 02116

First Marblehead Education Resources, Inc.  
One Cabot Road  
Medford, MA 02155

Union Federal Savings Bank  
1565 Mineral Spring Avenue  
North Providence, Rhode Island 02904

*Transfer Agent:*

Computershare Trust Company, N.A.  
250 Royall Street, Mailstop 3B  
Canton, MA 02021  
(781) 575-3400

*Legal Counsel:*

Wilmer Cutler Pickering Hale and Dorr LLP  
60 State Street  
Boston, MA 02109

Pierce Atwood, LLP  
One Monument Square  
Portland, ME 04101

*Independent Registered Public Accounting Firm:*

KPMG LLP  
99 High Street  
Boston, MA 02109

*Investor Relations:*

Investor Relations  
The First Marblehead Corporation  
800 Boylston Street, 34<sup>th</sup> Floor  
Boston, MA 02199  
(617) 638-2000  
(800) 895-4283  
Info@firstmarblehead.com

*Common Stock:*

New York Stock Exchange:  
Ticker Symbol: FMD

*Annual Meeting:*

Our annual meeting of stockholders will take place on Thursday, November 8, 2007 at 12:00 p.m. at The Princeton Club of New York, 15 West 43<sup>rd</sup> Street, New York, New York, 10036. A formal notice of the meeting, along with a proxy statement and a form of proxy, is being mailed to stockholders with this annual report.

*Dividends:*

We have returned cash to our stockholders through regular quarterly cash dividends. In the second quarter of fiscal 2007, the Board of Directors approved a three-for-two split of the Company's common stock in the form of a stock dividend. The Company's Board also declared a regular quarterly cash dividend on the Company's post-split common stock of \$0.12 per share, paid in the second fiscal quarter. In the third fiscal quarter, we increased the quarterly cash dividend to \$0.15 per share. In the fourth fiscal quarter, we increased the quarterly cash dividend to \$0.25 per share. In the first quarter of fiscal 2008, we increased the quarterly cash dividend to \$0.275 per share. This dividend was paid on September 28, 2007 to stockholders of record at the close of business on September 24, 2007. Although it is our current intention to pay quarterly dividends in the remaining quarters of fiscal 2008, our board of directors has discretion in determining whether to declare or pay dividends, which depends on our earnings, financial condition, capital requirements and such factors as our board of directors deems relevant.

*Number of Stockholders:*

As of the close of business on September 21, 2007 we had 40 stockholders of record of our common stock, and we estimate we had approximately 38,000 beneficial stockholders.

*Number of Full-time Employees:*

As of June 30, 2007, we had 1,028 full-time employees and 14 part-time employees.

*Certifications:*

Our annual report on Form 10-K for the fiscal year ended June 30, 2007 contains the certifications of the Chief Executive Officer and Chief Financial Officer provided to the Securities and Exchange Commission as required by Section 302 of the Sarbanes-Oxley Act of 2002. These certifications were included as exhibits 31.1 and 31.2 to the Form 10-K.

Our Chief Executive Officer submitted an annual certification to the New York Stock Exchange (NYSE) on December 5, 2006 stating that he was not aware of any violation by us of the NYSE corporate governance listing standards.



**Safe Harbor:**

*Statements contained in this annual report regarding our competitive position and growth prospects, the future success of our products and services, our outlook for the industry and our future performance, and any other statements that are not purely historical, constitute forward-looking statements for purposes of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on our historical performance and on our plans, estimates and expectations as of October 5, 2007. The inclusion of this forward-looking information should not be regarded as a representation by us or any other person that the future results, plans, estimates or expectations contemplated by us will be achieved. You are cautioned that matters subject to forward-looking statements involve known and unknown risks and uncertainties, including economic, legislative, regulatory, competitive and other factors, that may cause our actual performance or achievements to be materially different than those expressed or implied by our forward-looking statements. Important factors that could cause or contribute to such differences include: our success in structuring future securitization transactions, our relationships with key clients, the timing, size and structure of our future securitizations, the estimates we make and the assumptions on which we rely in preparing our financial statements, any variance between the actual performance of securitization trusts and the key assumptions we use to estimate the present value of additional structural advisory fees and residual revenues and the other factors detailed from time to time in our periodic reports filed with the Securities and Exchange Commission, including the factors set forth under the caption "Risk Factors" in our annual report on Form 10-K filed with the Securities and Exchange Commission on August 28, 2007. We specifically disclaim any obligation to update our forward-looking statements in the future, even if our estimates change, and you should not rely on these forward-looking statements as representing our views as of any date subsequent to October 5, 2007.*

This has been an extraordinary year of progress and success for First Marblehead. We continued to meet the growing demand for private capital, facilitating 429,000 loans while helping students fulfill their education dreams.