

NELNET INC  
Form 10-K  
February 28, 2013

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2012

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 001-31924

NELNET, INC.

(Exact name of registrant as specified in its charter)

NEBRASKA

(State or other jurisdiction of incorporation or organization)

84-0748903

(I.R.S. Employer Identification No.)

121 SOUTH 13TH STREET, SUITE 201

LINCOLN, NEBRASKA

68508

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (402) 458-2370

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS: Class A Common Stock, Par Value \$0.01 per Share

NAME OF EACH EXCHANGE ON WHICH REGISTERED: New York Stock Exchange

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 [X]

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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 registrant’s voting common stock held by non-affiliates of the registrant on June 29, 2012 (the last business day of the registrant’s most recently completed second fiscal quarter), based upon the closing sale price of the registrant’s Class A Common Stock on that date of \$23.00 per share, was \$604,976,291. For purposes of this calculation, the registrant’s directors, executive officers, and greater than 10 percent shareholders are deemed to be affiliates.

As of January 31, 2013, there were 35,032,426 and 11,495,377 shares of Class A Common Stock and Class B Common Stock, par value \$0.01 per share, outstanding, respectively (excluding 11,317,364 shares of Class A Common Stock held by wholly owned subsidiaries).

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant’s definitive Proxy Statement to be filed for its 2013 Annual Meeting of Shareholders, scheduled to be held May 23, 2013, are incorporated by reference into Part III of this Form 10-K.

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## FORWARD-LOOKING AND CAUTIONARY STATEMENTS

This report contains forward-looking statements and information that are based on management's current expectations as of the date of this document. Statements that are not historical facts, including statements about the Company's plans and expectations for future financial condition, results of operations or economic performance, or that address management's plans and objectives for future operations, and statements that assume or are dependent upon future events, are forward-looking statements. The words "may," "should," "could," "would," "predict," "potential," "continue," "expect," "anticipate," "future," "intend," "plan," "believe," "estimate," "assume," "forecast," "will," and similar expressions, as well as in future tense, are intended to identify forward-looking statements.

The forward-looking statements are based on assumptions and analyses made by management in light of management's experience and its perception of historical trends, current conditions, expected future developments, and other factors that management believes are appropriate under the circumstances. These statements are subject to known and unknown risks, uncertainties, assumptions, and other factors that may cause the actual results and performance to be materially different from any future results or performance expressed or implied by such forward-looking statements. These factors include, among others, the risks and uncertainties set forth in "Risk Factors" and elsewhere in this report, and include such risks and uncertainties as:

- risks related to the Company's student loan portfolio, such as interest rate basis and repricing risk resulting from the fact that the interest rate characteristics of the Company's student loan assets do not match the interest rate characteristics of the funding for those assets, the risk of loss of floor income on certain student loans originated under the Federal Family Education Loan Program (the "FFEL Program" or "FFELP") of the U.S. Department of Education (the "Department"), risks related to the use of derivatives to manage exposure to interest rate fluctuations, and potential losses from loan defaults, changes in prepayment rates, guaranty rates, loan floor rates, and credit spreads;

- risks related to the Company's funding requirements, including the Company's ability to maintain credit facilities or obtain new facilities, the ability of lenders under the Company's credit facilities to fulfill their lending commitments under these facilities, the Company's ability to satisfy debt obligations secured by student loan assets and related collateral, and changes in the general interest rate environment and in the securitization markets for education loans, which may increase the costs or limit the availability of financings necessary to purchase, refinance, or continue to carry education loans;

- risks from changes in the student loan and educational credit and services marketplace resulting from the implementation of, or changes in, applicable laws, regulations, and government programs, including the discontinuance of private sector student loan originations under the FFEL Program effective July 1, 2010, and new regulations effective July 1, 2011 that could affect enrollment at for-profit schools, the uncertain nature of potential initiatives by the Federal Government to consolidate FFELP loans to the Federal Direct Loan Program, and the Company's ability to maintain or increase volumes under its loan servicing contract with the Department to service federally-owned student loans and to comply with agreements with third-party customers for the servicing of loans under the Federal Direct Loan and FFEL Programs;

- risks from changes in the demand or preferences for educational financing and related services by educational institutions, students, and their families;

- risks related to a breach of the Company's operational or information systems or infrastructure, or those of third-party vendors;

- uncertainties inherent in forecasting future cash flows from student loan assets and related asset-backed securitizations;

risks associated with litigation, complex government regulations, changes in general economic conditions (which have recently led to higher rates of student loan defaults), changes in credit market conditions, and related party transactions; and

uncertainties inherent in the estimates and assumptions about future events that management is required to make in the preparation of the Company's consolidated financial statements.

All forward-looking statements contained in this report are qualified by these cautionary statements and are made only as of the date of this document. Although the Company may from time to time voluntarily update or revise its prior forward-looking statements to reflect actual results or changes in the Company's expectations, the Company disclaims any commitment to do so except as required by securities laws.

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## PART I.

### ITEM 1. BUSINESS

#### Overview

Nelnet, Inc. (the “Company”) is an education services company focused primarily on providing fee-based processing services and quality education-related products and services in four core areas: asset management and finance, loan servicing, payment processing, and enrollment services (education planning). These products and services help students and families plan, prepare, and pay for their education and make the administrative and financial processes more efficient for schools and financial organizations. In addition, the Company earns interest income on a portfolio of federally insured student loans. Substantially all revenue from external customers is earned, and all long-lived assets are located, in the United States.

The Company was formed as a Nebraska corporation in 1977 to service federal student loans for two local banks. The Company built on this initial foundation as a servicer to become a leading originator, holder, and servicer of federal student loans, principally consisting of loans originated under the FFEL Program (a detailed description of the FFEL Program is included in Appendix A to the Company's 2011 Form 10-K filed on February 28, 2012 with the Securities and Exchange Commission (“SEC”).

On March 30, 2010, President Obama signed into law the Health Care and Education Reconciliation Act of 2010 (the “Reconciliation Act of 2010”). Effective July 1, 2010, this law prohibits new loan originations under the FFEL Program and requires that all new federal loan originations be made through the Federal Direct Loan Program. This law does not alter or affect the terms and conditions of existing FFELP loans.

As a result of the Reconciliation Act of 2010, the Company no longer originates new FFELP loans. However, a significant portion of the Company's income continues to be derived from its existing FFELP student loan portfolio and other FFELP service offerings. Interest income on the Company's existing FFELP loan portfolio, as well as fee-based revenue from FFELP guaranty and third-party servicing, will decline over time as the Company's and the Company's third-party lender clients' FFELP loan portfolios are paid down. As of December 31, 2012, the Company has a \$24.8 billion student loan portfolio that will amortize over the next approximately 20 years.

To reduce its reliance on interest income on student loans, the Company has significantly diversified and increased its fee-based education-related services. In addition, the Company believes there will be opportunities to purchase additional FFELP loan portfolios from current FFELP participants looking to adjust their FFELP businesses, which will generate incremental earnings and cash flow. For the year ended December 31, 2012, the Company purchased \$3.9 billion (par value) of FFELP loans.

#### Customers

The Company serves several different groups of customers, including:

##### Students and families

Colleges and universities, specifically financial aid, business, and admissions offices

Private, faith-based, and other K-12 schools

Lenders, servicers, and state agencies in education finance

Government entities

An increase in the size of the education market generally increases the demand for the Company's products and services. As shown in the chart below, total student enrollment is projected to continue to grow for many years. An

increasing number of students are pursuing a higher education, often with the help of financial aid by the federal government, for whom the Company services loans. In addition, as the education market continues to grow, often with budget and funding concerns, schools at all levels have an increasing need to become more efficient, offer consistent and quality services, and recruit and retain students.

(1) Source: Digest of Education Statistics 2011, National Center for Education Statistics, U.S. Department of Education, June 2012, NCES 2012-001

## Operating Segments

The Company operates as four distinct operating segments with several different brands. The Company's operating segments offer a broad range of services designed to simplify education planning and financing for students and families and the administrative and financial processes for schools and financial institutions. The Company's operating segments are:

### Student Loan and Guaranty Servicing

Referred to as Nelnet Diversified Solutions (“NDS”)

Focuses on student loan servicing, student loan servicing-related technology solutions, and outsourcing services for guaranty agencies and other entities

Includes the brands Nelnet Loan Servicing, Firstmark Services, Nelnet Guarantor Solutions, 5280 Solutions, Responsible Repay, and CampusGuard

### Tuition Payment Processing and Campus Commerce

Commonly known as Nelnet Business Solutions (“NBS”)

Focuses on tuition payment plans and online payment processing

Includes the brand FACTS Management

### Enrollment Services

Commonly called Nelnet Enrollment Solutions (“NES”)

Focuses on education planning and enrollment-related services, including inquiry generation and management

Includes the brands CUnet, Peterson's, EssayEdge, and Sparkroom

### Asset Generation and Management

Includes the acquisition and management of the Company's student loan assets

## Segment Operating Results

The Company's operating segments are defined by the products and services they offer or the types of customers they serve, and they reflect the manner in which financial information is currently evaluated by management. The Company includes separate financial information about its operating segments, including revenues, net income or loss, and total assets for each of the Company's segments, for the last three fiscal years in note 14 of the notes to the consolidated financial statements included in this report.



## Fee-Based Operating Segments

### Student Loan and Guaranty Servicing

The primary service offerings of this operating segment include:

#### • Servicing FFELP loans

• Originating and servicing non-federally insured student loans

• Servicing federally-owned student loans for the Department of Education

• Servicing and outsourcing services for FFELP guaranty agencies, including FFELP guaranty collection services

- Providing student loan servicing software and other information technology products and services

As of December 31, 2012, the Company serviced \$97.5 billion of student loans for 5.7 million borrowers. See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Student Loan and Guaranty Servicing Operating Segment - Results of Operations - Student Loan Servicing Volumes" for additional information related to the Company's servicing volume.

The elimination of new FFELP originations in July 2010 will cause the FFELP-related revenue streams in this operating segment to decline as FFELP loan portfolios are paid down. A description of each service offering follows.

#### Servicing FFELP loans

The Student Loan and Guaranty Servicing operating segment provides for the servicing of the Company's student loan portfolio and the portfolios of third parties. The loan servicing activities include loan conversion activities, application processing, borrower updates, payment processing, due diligence procedures, funds management reconciliations, and claim processing. These activities are performed internally for the Company's portfolio in addition to generating external fee revenue when performed for third-party clients.

The Company's student loan servicing division uses proprietary systems to manage the servicing process. These systems provide for automated compliance with most of the federal student loan regulations adopted under Title IV of the Higher Education Act of 1965, as amended (the "Higher Education Act").

The Company serviced FFELP loans on behalf of approximately 50 third-party servicing customers as of December 31, 2012. The Company's FFELP servicing customers include national and regional banks, credit unions, and various state and non-profit secondary markets. The majority of the Company's external FFELP loan servicing activities are performed under "life of loan" contracts. Life of loan contract servicing essentially provides that as long as the loan exists, the Company shall be the sole servicer of that loan; however, the agreement may contain "deconversion" provisions where, for a fee, the lender may move the loan to another servicer.

#### Originating and servicing non-federally insured student loans

The Student Loan and Guaranty Servicing operating segment provides origination and servicing activities for non-federally insured loans. Although similar in terms of activities and functions as FFELP servicing (i.e., disbursement processing, application processing, payment processing, statement distribution, and reporting), non-federally insured loan servicing activities are not required to comply with provisions of the Higher Education Act and may be more customized to individual client requirements. The Company serviced non-federally insured loans on behalf of approximately 20 third-party servicing customers as of December 31, 2012.

Servicing federally-owned student loans for the Department of Education

In June 2009, the Company was one of four private sector companies awarded a student loan servicing contract by the Department of Education to provide additional servicing capacity for loans owned by the Department. These loans include Federal Direct Loan Program loans originated directly by the Department and FFEL Program loans purchased by the Department. The Company earns a monthly fee from the Department for each unique borrower who has loans owned by the Department and serviced by the Company. In September 2009, the Department began assigning purchased FFELP loans to the four servicers. Beginning with the second year of servicing in June 2010, the Department began allocating new loan volume among the four servicers based on five performance metrics.

Three metrics measure the satisfaction among separate customer groups, including borrowers, financial aid personnel at postsecondary schools participating in the federal student loan program, and Federal Student Aid and other federal agency personnel or contractors who work with the servicers.

Two performance metrics measure the success of default prevention efforts as reflected by the percentage of borrowers and percentage of dollars in each servicer's portfolio that go into default.

Pursuant to the contract terms related to annual volume allocation of new loans, the maximum any servicer can be awarded is 40 percent of new borrowers in that contract year. Based on the most recent survey results, the Company was ranked first out of the four private sector companies and will be allocated 30 percent of new loan volume originated by the Department during the period from August 15, 2012 through August 14, 2013 (the fourth year of the servicing contract). The Department projects it will originate new loans for 3.6 million borrowers in total during the fourth year of this contract, which is currently being allocated to the four servicers. The Company is focused on maintaining its current first place ranking out of the four servicers established by the Department and will continue to search for areas that could be improved in order to do so.

The servicing contract with the Department spans five years (through June 2014), with one five-year renewal at the option of the Department. Although the Company currently anticipates that the Department will exercise its option to renew the servicing contract for five years at the end of the current term in 2014, there can be no assurance of such renewal.

Servicing and outsourcing services for FFELP guaranty agencies, including FFELP guaranty collection services

The Student Loan and Guaranty Servicing operating segment provides servicing support for guaranty agencies, which are the organizations that serve as the intermediary between the U.S. federal government and FFELP lenders, and are responsible for paying the claims made on defaulted loans. The Department has designated approximately 30 guarantors that have been formed as either state agencies or non-profit corporations that provide FFELP guaranty services in one or more states. Approximately half of these guarantors contract externally for operational or technology services. The services provided by the Company include providing software and data center services, borrower and loan updates, default aversion tracking services, claim processing services, and post-default collection services. A significant portion of guaranty servicing revenue earned by the Company relates to rehabilitating delinquent loans (collection services).

The Company's three guaranty servicing customers include Tennessee Student Assistance Corporation, College Assist (which is the Colorado state-designated guarantor of FFELP student loans), and the National Student Loan Program.

Providing student loan servicing software and other information technology products and services

The Student Loan and Guaranty Servicing operating segment provides student loan servicing software, which is used internally by the Company and licensed to third-party student loan holders and servicers. These software systems have been adapted so that they can be offered as hosted servicing software solutions that can be used by third-parties to service various types of student loans, including Private, Federal Direct Loan Program, and FFEL Program loans. The Company earns a monthly fee from its remote hosting customers for each unique borrower on the Company's platform, with a minimum monthly charge for most contracts. As of December 31, 2012, 6.9 million borrowers were hosted on the Company's hosted servicing software solution platforms. In addition, this operating segment has historically provided information technology products and services, with core areas of business in educational loan software solutions, technical consulting services, enterprise content management solutions, and outsourcing and back office support services. However, the elimination of new loan originations under the FFEL Program has reduced these service offerings over the past few years.

## Competition

The Company's scalable servicing platform allows it to provide compliant, efficient, and reliable service at a low cost, giving the Company a competitive advantage over others in the industry for all of this segment's services, which are discussed below.

## Loan servicing

The principal competitor for existing and prospective FFELP and non-federally insured student loan servicing business is SLM Corporation, the parent company of Sallie Mae. Sallie Mae is the largest for-profit provider of servicing functions, as well as one of the largest service providers of non-federally insured student loans. In contrast to its competitors, the Company has segmented its non-federally insured loan servicing on a distinct platform, created specifically to meet the needs of non-federally insured student loan borrowers, their families, the schools they attend, and the lenders who serve them. This ensures access to specialized teams with a dedicated focus on servicing these assets.

With the elimination of new loan originations under the FFEL Program, four servicers (referred to as Title IV Additional Servicers, or "TIVAS"), including the Company, were named by the Department as servicers of federally owned loans. The three competitors for gaining future servicing volume from the Department are Great Lakes Educational Loan Services Inc. ("Great Lakes"), Pennsylvania Higher Education Assistance Agency ("PHEAA"), and Sallie Mae.

In addition, non-profit organizations were authorized in 2012 to begin servicing loans for up to 100,000 borrower accounts on behalf of the Department. As of December 31, 2012, there are 13 non-profit organizations servicing loans on behalf of the Department. The ability of the non-profit organizations to retain or increase their borrower accounts will depend on their ability to maintain compliance and meet performance requirements under their agreement with the Department. The non-profit organizations will have their performance measured by the Department using the same performance metrics as described previously for the four private sector companies awarded a servicing contract in June 2009. If a non-profit organization servicing score is equal to or higher than that of the lowest score for each of the four incumbent Federal Direct Loan Program servicers for each of the five performance metrics, the non-profit organization will be allowed to compete with the TIVAS for a percentage of new borrowers for the next allocation year. The Company currently licenses its hosted servicing software to four of the awarded non-profit organizations. PHEAA is the only other TIVAS servicer offering a hosted Federal Direct Loan Program servicing solution to non-profit organization servicers.

#### Guaranty servicing

With the elimination of new loan originations under the FFEL Program, services provided to guaranty agencies will continue for agencies' existing portfolios; however, no new portfolios will be created. The Company currently anticipates continuing to serve its existing guaranty customers as their portfolios pay down, but does not expect to increase the number of its guaranty servicing customers.

#### Software and technology

The Company is one of the leaders in the education loan software processing industry. Many lenders in the FFEL Program utilize the Company's software either directly or indirectly. Management believes the Company's competitors in this segment are much smaller than the Company and do not have the depth of knowledge or products offered by the Company. The Company's primary method of competition in this segment is based on its depth of knowledge, experience, and product offerings in the education loan industry. In addition, the Company believes the investments it has made to scale its systems and to create a secure infrastructure to support the Department of Education volume and requirements increases its presence and attraction as a long-term partner in the remote servicing market.

#### Tuition Payment Processing and Campus Commerce

The Company's Tuition Payment Processing and Campus Commerce operating segment provides products and services to help students and families manage the payment of education costs at all levels (K-12 and higher education). It also provides innovative education-focused technologies, services, and support solutions to help schools with the everyday challenges of collecting and processing commerce data. See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Tuition Payment Processing and Campus Commerce Operating Segment - Results of Operations" for a discussion of the seasonality of the business in this operating segment.

K-12

According to the National Center for Education Statistics, the K-12 market consists of nearly 22,500 private and faith-based education institutions with over 50 students enrolled in 2009, the most current data available. In the K-12 market, the Company offers tuition management services, as well as assistance with financial needs assessment and donor management.

The Company is the market leader, having actively managed tuition payment plans in place at over 4,800 K-12 educational institutions. Tuition management services include payment plan administration, incidental billing, accounts receivable management, and record keeping. K-12 educational institutions contract with the Company to administer deferred payment plans that allow the responsible party to make monthly payments over 6 to 12 months. The Company collects a fee from either the institution or the payer as an administration fee.

The Company's financial needs assessment service, which serves over 3,600 schools and dioceses, helps K-12 schools evaluate and determine the amount of grants and financial aid to disburse to the families it serves. The Company's donor services allow schools to assess and deliver strategic fundraising solutions using the latest technology.

## Higher Education

The higher education market consists of nearly 4,400 colleges and universities. The Company offers two principal products to the higher education market: actively managed tuition payment plans, and campus commerce technologies and payment processing.

The Company has actively managed tuition payment plans in place at approximately 650 colleges and universities. Higher education institutions contract with the Company to administer payment plans that allow the student and family to make monthly payments on either a semester or annual basis. The Company collects a fee from the student or family as an administration fee.

The Company's suite of campus commerce solutions provides services that allow for families' electronic billing and payment of campus charges. Campus commerce includes cashiering for face-to-face transactions, campus-wide commerce management, and refunds management, among others. The Company earns revenue for e-billing, hosting/maintenance, credit card convenience fees, and e-payment transaction fees, which are powered by the Company's QuikPAY system, a secure payment processing engine.

QuikPAY, a campus commerce product, is sold as a subscription service to colleges and universities. QuikPAY processes payments through the appropriate channels in the banking or credit card networks to make deposits into the client's bank account. It can be further deployed to other departments around campus as requested (e.g., application fees, alumni giving, parking, events, etc.). Approximately 240 colleges and universities, representing over 380 campuses, use the QuikPAY system.

## Competition

The Company is the largest provider of tuition management services to the private and faith-based K-12 market in the United States. Competitors include financial institutions, tuition management providers, financial needs assessment providers, accounting firms, and a myriad of software companies.

In the higher education market, the Company targets business offices at colleges and universities. In this market, the primary competition is limited to three campus commerce and tuition payment providers, as well as solutions developed in-house by colleges and universities.

The Company's principal competitive advantages are (i) the customer service it provides to institutions, (ii) the information management tools provided with the Company's service, and (iii) the Company's ability to interface with the institution clients. The Company believes its clients select products primarily on technological superiority and feature functionality, but price and service also impact the selection process.

## Enrollment Services

The Enrollment Services operating segment offers products and services that are focused on helping colleges recruit and retain students and helping students plan and prepare for life after high school and/or military service. The following are the primary products and services the Company offers as part of the Enrollment Services segment:

• **Inquiry Generation** - Inquiry generation services include delivering qualified inquiries or clicks to third-party customers, primarily higher education institutions.

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Inquiry Management (Agency) - Agency services include managing the marketing activities for third-party customers, primarily higher education institutions, in order to provide qualified inquiries or clicks.

Inquiry Management (Software) - Software services include the licensing of software to third-party customers, primarily higher education institutions. This software is also used internally by the Company. The inquiry management software has been adapted so that it can be offered as a hosted software solution that can be used by third parties to manage and obtain qualified inquiries or clicks.

Digital Marketing - Digital marketing services include interactive services to connect students to colleges and universities and are sold primarily based on subscriptions. Digital marketing services also include editing services for admission essays.



Content Solutions - Content solutions includes test preparation study guides, school directories and databases, career exploration guides, on-line courses, scholarship search and selection data, career planning, and on-line information about colleges and universities. Content solutions also includes providing list marketing services to help higher education institutions and businesses reach the middle school, high school, college bound high school, college, and young adult market places.

The Company delivers products and services in this segment through four primary customer channels: higher education, corporate and government, K-12, and direct-to-consumer. Many of the Company's products in this segment are electronically transmitted or distributed online or in other digital media; however, products such as test preparation study guides, school directories, and career exploration guides are also distributed as printed materials.

Significantly all inquiry generation and management revenue (which makes up approximately 80 percent of total revenue included in this segment) is generated from for-profit schools. Ongoing regulatory uncertainty regarding recruitment and marketing to potential students in the for-profit college industry has caused schools to decrease spending on marketing efforts and has negatively impacted the operating results of this segment.

#### Competition

In this segment, the primary areas in which the Company competes are: inquiry generation and management, test preparation study guides, and on-line courses. Several large competitors exist in the areas of inquiry generation and test preparation, but the Company does not believe any one competitor has a dominant position in all of the product and service areas offered by the Company.

The Company competes through various methods, including price, brand awareness, depth of product and service selection, and customer service. The Company is a "one stop shop" for the education seeking family looking for career assessment, test preparation, and college information. The Company also offers its institutional clients a range of services unrivaled in the education industry.

#### Asset Generation and Management Operating Segment

The Asset Generation and Management operating segment includes the acquisition, management, and ownership of the Company's student loan assets, which was historically the Company's largest product and service offering. As of December 31, 2012, the Company's student loan portfolio was \$24.8 billion. The Company generates a substantial portion of its earnings from the spread, referred to as the Company's student loan spread, between the yield it receives on its student loan portfolio and the associated costs to finance such portfolio. See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Asset Generation and Management Operating Segment - Student Loan Spread Analysis," for further details related to the student loan spread. The student loan assets are held in a series of education lending subsidiaries and associated securitization trusts designed specifically for this purpose. In addition to the student loan spread earned on its portfolio, all costs and activity associated with managing the portfolio, such as servicing of the assets and debt maintenance, are included in this segment.

Student loans consist of federally insured student loans and non-federally insured student loans. Federally insured student loans were made under the FFEL Program. The Company's portfolio of federally insured student loans is subject to minimal credit risk as these loans are guaranteed by the Department at levels ranging from 97 percent to 100 percent. Substantially all of the Company's loan portfolio (99.9 percent as of December 31, 2012) is federally insured. The Company's portfolio of non-federally insured loans is subject to credit risk similar to other consumer loan assets.

The Higher Education Act regulates every aspect of the federally insured student loan program, including certain communications with borrowers, loan originations, and default aversion. Failure to service a student loan properly could jeopardize the guarantee on federal student loans. In the case of death, disability, or bankruptcy of the borrower, the guarantee covers 100 percent of the loan's principal and accrued interest.

FFELP loans are guaranteed by state agencies or non-profit companies designated as guarantors, with the Department providing reinsurance to the guarantor. Guarantors are responsible for performing certain functions necessary to ensure the program's soundness and accountability. Generally, the guarantor is responsible for ensuring that loans are serviced in compliance with the requirements of the Higher Education Act. When a borrower defaults on a FFELP loan, the Company submits a claim to the guarantor who provides reimbursements of principal and accrued interest, subject to the applicable risk share percentage.

## Origination and Acquisition

The Reconciliation Act of 2010 resulted in the Company discontinuing originations of new FFELP loans effective July 1, 2010. However, the Company believes there will be opportunities to continue to purchase FFELP loan portfolios from current FFELP participants looking to adjust their FFELP businesses. For example, during 2012, 2011, and 2010, the Company purchased \$3.9 billion, \$2.8 billion, and \$3.4 billion, respectively, of FFELP student loans from various third-parties. The Company's competition for the purchase of student loan portfolios and residuals includes large banks, hedge funds, and other student loan finance companies.

## Future Cash Flow From Portfolio

The majority of the Company's portfolio of student loans is funded in asset-backed securitizations that are structured to substantially match the maturity of the funded assets, thereby minimizing liquidity risk. In addition, due to the difference between the yield the Company receives on the loans and cost of financing within these transactions, the Company has created a portfolio that will generate earnings and significant cash flow over the life of these transactions. Based on cash flow models developed to reflect management's current estimate of, among other factors, prepayments, defaults, deferment, forbearance, and interest rates, as of December 31, 2012, the Company currently expects future undiscounted cash flows from its portfolio of student loans funded in asset-backed securitizations to be approximately \$1.97 billion. The forecasted cash flow does not include cash flows that the Company expects to receive related to loans funded through the Department's conduit facility and other warehouse facilities or loans acquired subsequent to December 31, 2012. See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources," for further details related to the estimated future cash flow from the Company's portfolio.

## Interest Rate Risk Management

Because the Company generates a significant portion of its earnings from its student loan spread, the interest rate sensitivity of the Company's balance sheet is very important to its operations. The current and future interest rate environment can and will affect the Company's interest income and net income. The effects on the Company's results of operations as a result of the changing interest rate environments are further outlined in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Asset Generation and Management Operating Segment - Student Loan Spread Analysis" and Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk - Interest Rate Risk."

## Intellectual Property

The Company owns numerous trademarks and service marks ("Marks") to identify its various products and services. As of December 31, 2012, the Company had 76 registered Marks. The Company actively asserts its rights to these Marks when it believes infringement may exist. The Company believes its Marks have developed and continue to develop strong brand-name recognition in the industry and the consumer marketplace. Each of the Marks has, upon registration, an indefinite duration so long as the Company continues to use the Mark on or in connection with such goods or services as the Mark identifies. In order to protect the indefinite duration, the Company makes filings to continue registration of the Marks. The Company owns one patent application that has been published, but has not yet been issued, and has also actively asserted its rights thereunder in situations where the Company believes its claims may be infringed upon. The Company owns many copyright protected works, including its various computer system codes and displays, Web sites, books and other publications, and marketing collateral. The Company also has trade secret rights to many of its processes and strategies and its software product designs. The Company's software products are protected by both registered and common law copyrights, as well as strict confidentiality and ownership provisions placed in license agreements, which restrict the ability to copy, distribute, or improperly disclose the

software products. The Company also has adopted internal procedures designed to protect the Company's intellectual property.

The Company seeks federal and/or state protection of intellectual property when deemed appropriate, including patent, trademark/service mark, and copyright. The decision whether to seek such protection may depend on the perceived value of the intellectual property, the likelihood of securing protection, the cost of securing and maintaining that protection, and the potential for infringement. The Company's employees are trained in the fundamentals of intellectual property, intellectual property protection, and infringement issues. The Company's employees are also required to sign agreements requiring, among other things, confidentiality of trade secrets, assignment of inventions, and non-solicitation of other employees post-termination. Consultants, suppliers, and other business partners are also required to sign nondisclosure agreements to protect the Company's proprietary rights.

## Employees

As of December 31, 2012, the Company had approximately 2,500 employees. None of the Company's employees are covered by collective bargaining agreements. The Company is not involved in any material disputes with any of its employees, and the Company believes that relations with its employees are good.

## Available Information

Copies of the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports are available on the Company's Web site free of charge as soon as reasonably practicable after such reports are filed with or furnished to the United States Securities and Exchange Commission. Investors and other interested parties can access these reports and the Company's proxy statements at <http://www.nelnet.com>. The Company routinely posts important information for investors on its Web site. The SEC maintains an Internet site (<http://www.sec.gov>) that contains periodic and other reports such as annual, quarterly, and current reports on Forms 10-K, 10-Q, and 8-K, respectively, as well as proxy and information statements regarding the Company and other companies that file electronically with the SEC.

The Company has adopted a Code of Conduct that applies to directors, officers, and employees, including the Company's principal executive officer and its principal financial and accounting officer, and has posted such Code of Conduct on its Web site. Amendments to and waivers granted with respect to the Company's Code of Conduct relating to its executive officers and directors which are required to be disclosed pursuant to applicable securities laws and stock exchange rules and regulations will also be posted on its Web site. The Company's Corporate Governance Guidelines, Audit Committee Charter, Compensation Committee Charter, Nominating and Corporate Governance Committee Charter, and the Risk and Finance Committee Charter are also posted on its Web site.

Information on the Company's Web site is not incorporated by reference into this report and should not be considered part of this report.

## ITEM 1A. RISK FACTORS

We operate our business in a highly competitive and regulated environment. We are subject to risks including, but not limited to, market, liquidity, credit, regulatory, technology, operational, security, and other business risks such as reputation damage related to negative publicity and dependencies on key personnel, customers, vendors, and systems. This section highlights specific risks that could affect us. Although this section attempts to highlight key risk factors, other risks may emerge at any time and we cannot predict all risks or estimate the extent to which they may affect our financial performance. These risk factors should be read in conjunction with the other information included in this report.

### Student Loan Portfolio

Our student loan portfolio is subject to certain risks related to interest rates, our ability to manage the risks related to interest rates, prepayment, and credit risk, each of which could reduce the expected cash flows and earnings on our portfolio.

#### Interest rate risk - basis and repricing risk

We are exposed to interest rate risk in the form of basis risk and repricing risk because the interest rate characteristics of our student loan assets do not match the interest rate characteristics of the funding for those assets.

We fund the majority of our student loan assets with one-month or three-month LIBOR indexed floating rate securities. In addition, the interest rates on some of our debt are set via a “dutch auction” or through a periodic remarketing. Meanwhile, the interest earned on our student loan assets is indexed to one-month LIBOR and Treasury bill rates. The different interest rate characteristics of our loan assets and our liabilities funding these assets results in basis risk. We also face repricing risk due to the timing of the interest rate resets on our liabilities, which may occur as infrequently as once a quarter, in contrast to the timing of the interest rate resets on our assets, which generally occur daily. In a declining interest rate environment, this may cause our student loan spread to compress, while in a rising interest rate environment, it may cause the spread to increase.

As of December 31, 2012, we had \$23.9 billion and \$1.1 billion of FFELP loans indexed to the one-month LIBOR and the three-month Treasury bill rate, respectively, both of which reset daily, and \$16.5 billion of debt indexed to three-month LIBOR, which resets quarterly, and \$5.0 billion of debt indexed to one-month LIBOR, which resets monthly. While these indices are all short term in nature with rate movements that are highly correlated over a longer period of time, there have been points in recent history related to the U.S. and European debt crisis that have caused volatility to be high and correlation to be reduced. There can be no

assurance that the indices' historically high level of correlation will not be disrupted in the future due to capital market dislocations or other factors not within our control. In such circumstances, our earnings could be adversely affected, possibly to a material extent.

We have entered into basis swaps to hedge our basis and repricing risk. For these derivatives, we receive three-month LIBOR set discretely in advance and pay one-month LIBOR plus or minus a spread as defined in the agreements (the 1:3 Basis Swaps).

#### Interest rate risk - loss of floor income

We are exposed to interest rate risk because of the interest rate characteristics of certain of our student loan assets and the interest rate characteristics of the related funding of those assets.

FFELP loans originated prior to April 1, 2006 generally earn interest at the higher of a floating rate based on the Special Allowance Payment ("SAP") formula set by the Department and the borrower rate, which is fixed over a period of time. The SAP formula is based on an applicable indice plus a fixed spread that is dependent upon when the loan was originated, the loan's repayment status, and funding sources for the loan. We generally finance our student loan portfolio with variable rate debt. In low and/or declining interest rate environments, when the fixed borrower rate is higher than the rate produced by the SAP formula, our student loans earn at a fixed rate while the interest on the variable rate debt typically continues to decline. In these interest rate environments, we may earn additional spread income that we refer to as floor income.

Depending on the type of loan and when it was originated, the borrower rate is either fixed to term or is reset to an annual rate each July 1. As a result, for loans where the borrower rate is fixed to term, we may earn floor income for an extended period of time, which we refer to as fixed rate floor income, and for those loans where the borrower rate is reset annually on July 1, we may earn floor income to the next reset date, which we refer to as variable rate floor income. Lenders are required to rebate fixed rate floor income and variable rate floor income to the Department for all new FFELP loans originated on or after April 1, 2006.

For the year ended December 31, 2012, we earned \$145.3 million of fixed rate floor income, net of \$19.3 million of settlements paid related to derivatives used to hedge loans earning fixed rate floor income. Absent the use of derivative instruments, a rise in interest rates will reduce the amount of floor income received and this will have an impact on earnings due to interest margin compression caused by increased financing costs until such time as the federally insured loans earn interest at a variable rate in accordance with their SAP formulas. In higher interest rate environments, where the interest rate rises above the borrower rate and fixed rate loans effectively convert to variable rate loans, the impact of the rate fluctuations is reduced.

#### Interest rate risk - use of derivatives

We utilize derivative instruments to manage interest rate sensitivity. Our derivative instruments are intended as economic hedges but do not qualify for hedge accounting; consequently, the change in fair value, called the "mark-to-market," of these derivative instruments is included in our operating results. Changes or shifts in the forward yield curve can and have significantly impacted the valuation of our derivatives. Accordingly, changes or shifts in the forward yield curve will impact our financial position and results of operations.

Developing an effective strategy for dealing with movements in interest rates is complex, and no strategy can completely insulate us from risks associated with such fluctuations. Although we believe our derivative instruments are highly effective, because many of our derivatives are not balance guaranteed to a particular pool of student loans, we are subject to prepayment risk that could result in being under or over hedged, which could result in material

losses. In addition, our interest rate risk management activities could expose us to substantial mark-to-market losses if interest rates move in a materially different way than was expected based on the environment when the derivatives were entered into. As a result, we cannot offer any assurance that our economic hedging activities will effectively manage our interest rate sensitivity or have the desired beneficial impact on our results of operations or financial condition.

By using derivative instruments, we are exposed to credit and market risk.

We attempt to manage credit and market risks associated with interest rates by establishing and monitoring limits as to the types and degree of risk that may be undertaken and by entering into transactions with high-quality counterparties that are reviewed periodically by our risk committee. As of December 31, 2012, all of our derivative counterparties had investment grade credit ratings. We also have a policy of requiring that all derivative contracts be governed by an International Swaps and Derivatives Association, Inc. Master Agreement.



When the fair value of a derivative contract is positive (an asset on our balance sheet), this generally indicates that the counterparty owes us if the derivative was settled. If the counterparty fails to perform, credit risk with such counterparty is equal to the extent of the fair value gain in the derivative less any collateral held by us. If we were unable to collect from a counterparty, we would have a loss equal to the amount the derivative is recorded on the consolidated balance sheet. As of December 31, 2012, the fair value of our derivatives, which had a positive fair value in our favor (an asset on our balance sheet), was \$97.4 million, of which \$82.8 million related to the fair value of our cross-currency interest rate swaps. As of December 31, 2012, our trustee held \$20.0 million of collateral from the counterparty on the cross-currency interest rate swaps.

When the fair value of a derivative instrument is negative (a liability on our balance sheet), we would owe the counterparty if the derivative was settled and, therefore, have no immediate credit risk. If the negative fair value of derivatives with a counterparty exceeds a specified threshold, we may have to make a collateral deposit with the counterparty. The threshold at which we may be required to post collateral is dependent upon our unsecured credit rating. Based on our current unsecured credit ratings (Standard & Poor's: BBB- (stable outlook) and Moody's: Ba1 (stable outlook)), we have substantially collateralized our corporate derivative liability position with our counterparties. As such, any downgrades from the current ratings would not result in additional collateral requirements of a material nature. In addition, no counterparty has the right to terminate its contracts in the event of downgrades from the current ratings. However, some long dated derivative contracts have mutual optional termination provisions that can be exercised in 2016, 2017, 2021, and 2022. As of December 31, 2012, the fair value of derivatives with early termination provisions was a positive \$1.4 million (an asset on our balance sheet).

Interest rate movements have an impact on the amount of collateral we are required to deposit with our derivative instrument counterparties. Based on the interest rate swaps outstanding as of December 31, 2012 (for both the floor income and hybrid debt hedges), if the forward interest rate curve was one basis point lower for the remaining duration of these derivatives, we would have been required to post \$1.4 million in additional collateral. In addition, if the forward basis curve between 1-month and 3-month LIBOR experienced a one basis point reduction in spread for the remaining duration of our 1:3 Basis Swap derivatives (in which we pay 1-month LIBOR and receive 3-month LIBOR), we would have been required to post \$8.2 million in additional collateral.

With our current derivative portfolio, we do not currently anticipate a near term movement in interest rates having a material impact on our capital or liquidity profile, nor expect future movements in interest rates to have a material impact on our ability to meet potential collateral deposit requirements with our counterparties. Due to the existing low interest rate environment, our exposure to downward movements in interest rates on our interest rate swaps is limited. In addition, the historical high correlation between 1-month and 3-month LIBOR limits our exposure to interest rate movements on the 1:3 Basis Swaps.

However, if interest rates move materially and negatively impact the fair value of our derivative portfolio or if we enter into additional derivatives in which the fair value of such derivatives become negative, we could be required to deposit a significant amount of collateral with our derivative instrument counterparties. The collateral deposits, if significant, could negatively impact our liquidity and capital resources. As of December 31, 2012, the fair value of our derivatives, which had a negative fair value (a liability on our balance sheet), was \$70.9 million and we had \$63.1 million posted as collateral with derivative counterparties.

Our cross-currency interest rate swaps are derivatives entered into as a result of certain asset-backed security financings. These derivatives are entered into at the trust level with the counterparty. Trust related derivatives do not contain credit contingent features related to our or our trust's credit ratings. As such, there are no collateral requirements and as a result the impact of changes to foreign currency rates has no impact on the amount of collateral we would be required to deposit with the counterparty on these derivatives.

Prepayment risk

Higher rates of prepayments of student loans, including consolidation by the Department through the Federal Direct Loan Program, would reduce our interest income.

Pursuant to the Higher Education Act, borrowers may prepay loans made under the FFEL Program at any time without penalty. Prepayments may result from consolidation of student loans by the Department as part of the Federal Direct Loan Program, which historically tends to occur more frequently in low interest rate environments, from borrower defaults, which will result in the receipt of a guaranty payment, and from voluntary full or partial prepayments, among other things.

On October 25, 2011, the White House issued an Executive Order allowing a short-term consolidation initiative to eligible student loan borrowers beginning in January 2012 and ending June 30, 2012. This initiative allowed student loan borrowers with at least one FFELP loan and at least one federal student loan owned by the Department to convert the FFELP loans to the Federal Direct Loan Program, at which time all of the converted loans, as well as the borrower's existing Direct Loans, would be considered a

Special Direct Consolidation Loan. During 2012, we lost \$936.4 million of FFELP loans as a result of this initiative. If this short-term initiative is deemed to be beneficial to the Federal Government and the Department, a similar consolidation program could be initiated that could further increase prepayments and reduce interest income.

The rate of prepayments of student loans may be influenced by a variety of economic, social, political, and other factors affecting borrowers, including interest rates, federal budgetary pressures, and the availability of alternative financing. Our profits could be adversely affected by higher prepayments, which reduce the balance of loans outstanding and, therefore, the amount of interest income we receive.

#### Credit risk

Future losses due to defaults on loans held by us, or loans sold to unaffiliated third parties which we are obligated to repurchase in the event of certain delinquencies, present credit risk which could adversely affect our earnings.

The vast majority (99.9 percent) of our student loan portfolio is federally guaranteed. The allowance for loan losses from the federally insured loan portfolio is based on periodic evaluations of our loan portfolios, considering loans in repayment versus those in nonpaying status, delinquency status, trends in defaults in the portfolio based on Company and industry data, past experience, trends in student loan claims rejected for payment by guarantors, changes to federal student loan programs, current economic conditions, and other relevant factors. The federal government currently guarantees 97 percent of the principal and interest on federally insured student loans disbursed on and after July 1, 2006 (and 98 percent for those loans disbursed prior to July 1, 2006), which limits our loss exposure on the outstanding balance of our federally insured portfolio. Student loans disbursed prior to October 1, 1993 are fully insured for both principal and interest.

Our non-federally insured loans are unsecured, with neither a government nor a private insurance guarantee. Accordingly, we bear the full risk of loss on these loans if the borrower and co-borrower, if applicable, default. In determining the adequacy of the allowance for loan losses on the non-federally insured loans, we consider several factors, including: loans in repayment versus those in a nonpaying status, delinquency status, type of program, trends in defaults in the portfolio based on Company and industry data, past experience, current economic conditions, and other relevant factors. We place a non-federally insured loan on nonaccrual status when the collection of principal and interest is 30 days past due, and charge off the loan when the collection of principal and interest is 120 days past due.

The evaluation of the allowance for loan losses is inherently subjective, as it requires material estimates that may be subject to significant changes. As of December 31, 2012, our allowance for loan losses was \$51.9 million. During the year ended December 31, 2012, we recognized a provision for loan losses of \$21.5 million. The provision for loan losses reflects the activity for the applicable period and provides an allowance at a level that management believes is appropriate to cover probable losses inherent in the loan portfolio. However, future defaults can be higher than anticipated due to a variety of factors, such as downturns in the economy, regulatory or operational changes, and other unforeseen future trends. Recent general economic and employment conditions have led to higher rates of student loan defaults. If actual performance is worse than currently estimated, it would materially affect our estimate of the allowance for loan losses and the related provision for loan losses in our statements of income.

We have participated interests in non-federally insured loans to unaffiliated third parties. As of December 31, 2012, we had \$107.7 million (par value) of loans participated under these agreements that have been accounted for as loan sales. Accordingly, the participation interests sold are not included on our consolidated balance sheet. Under the terms of the servicing agreements, our servicing operations are obligated to repurchase loans subject to the participation interests when such loans become 60 or 90 days delinquent. In addition, we have sold a portfolio of non-federally insured loans in which we have retained the credit risk and will pay cash to purchase back any loans which become 60 days delinquent. As of December 31, 2012, the outstanding balance of loans related to this loan sale was \$72.8 million

(par value). As of December 31, 2012, we had a reserve related to these servicing and credit risk obligations of \$16.1 million included in other liabilities on the consolidated balance sheet. The evaluation of the reserve related to these loans is inherently subjective, as it requires estimates that may be subject to changes. If actual performance is worse than estimated, it would negatively affect our results of operations.

#### Liquidity and Funding

We fund student loans in FFELP warehouse facilities. The current maturities of these facilities do not match the maturity of the related funded assets. Therefore, we will need to modify and/or find alternative funding related to the student loan collateral in these facilities prior to their expiration. If we cannot find any funding alternatives, we would lose our collateral, including the student loan assets and cash advances, related to these facilities.

The majority of our portfolio of student loans is funded with asset-backed securitizations that are structured to substantially match the maturity of the funded assets, and there are minimal liquidity issues related to these facilities. We also have student loans funded in FFELP warehouse facilities. The current maturities of these facilities do not match the maturity of the related funded assets. Therefore, we will need to modify and/or find alternative funding related to the student loan collateral in these facilities prior to their expiration.

As of December 31, 2012, we maintained three FFELP warehouse facilities as described in note 4 of the notes to the consolidated financial statements included in this report. In addition, the Company entered into a fourth warehouse facility on January 16, 2013. These facilities have revolving financing structures supported by 364-day liquidity provisions, which expire in 2013 and 2014. In the event we are unable to renew the liquidity provisions, the facilities would become a term facility at a stepped-up cost, with no additional student loans being eligible for financing, and we would be required to refinance the existing loans in the facilities by their final maturity dates in 2015 and 2016. The FFELP warehouse facilities also contain financial covenants relating to levels of our consolidated net worth, ratio of adjusted EBITDA to corporate debt interest, and unencumbered cash. Any noncompliance with these covenants could result in a requirement for the immediate repayment of any outstanding borrowings under the facilities. As of December 31, 2012, \$1.6 billion was outstanding under the warehouse facilities and \$126.3 million was advanced as equity support.

If we are unable to obtain cost-effective funding alternatives for the loans in the FFELP warehouse facilities prior to the facilities' maturities, our cost of funds could increase, adversely affecting our results of operations. If we cannot find any funding alternatives, we would lose our collateral, including the student loan assets and cash advances, related to these facilities.

We are exposed to mark-to-formula collateral support risk on our FFELP warehouse facilities.

Some of our warehouse facilities provide formula based advance rates based on market conditions, which require equity support to be posted to the facilities. Other warehouse facilities have static advance rates that require initial equity for loan funding, but do not require increased equity based on market movements. As of December 31, 2012, \$126.3 million was advanced as equity support under these facilities. Should a significant change in the valuation of loans result in additional required equity funding support for the warehouse facilities greater than what we can provide, the warehouse facilities could be subject to an event of default resulting in termination of the facilities and an acceleration of the repayment provisions. If we cannot find any funding alternatives, we would lose our collateral, including the student loan assets and cash advances, related to these facilities. A default on the FFELP warehouse facilities would result in an event of default on our \$250.0 million unsecured line of credit that would result in the outstanding balance on the line of credit becoming immediately due and payable.

## Operations

Risks associated with our operations, as further discussed below, include those related to our information technology systems and security and privacy breaches, our ability to manage performance related to regulatory requirements, and the importance of maintaining scale by retaining existing customers and attracting new business opportunities.

A failure in or breach of one of our operational or information systems or infrastructure, or those of our third-party vendors could disrupt our businesses. These types of failures or breaches, including but not limited to cyber attacks, could result in the disclosure or misuse of confidential or proprietary information which could damage our reputation, increase costs, and jeopardize existing business contracts or result in regulatory penalties.

As a loan servicer, hosted loan servicing software provider, and payment processor for the federal government, financial institutions, and the education industry that serves millions of customers through the Internet and other

distribution channels across the U.S., we depend on our ability to process, secure, record, and monitor a large number of customer transactions and confidential information on a continuous basis.

Information security risks have significantly increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to support and process customer transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. Our operations rely on the secure processing, transmission, and storage of confidential information in our computer systems and networks. Our business segments rely on our digital technologies, computer and email systems, software, and networks to conduct their operations. In addition, to access our products and services, our customers may use personal smartphones, tablet PC's, and other mobile devices that are beyond our control systems. Although we believe we have robust information security procedures and controls, our technologies, systems, networks, and our customers' devices may become the target of cyber attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss, or destruction of Company or customer confidential, proprietary, and other information, or otherwise disrupt the Company's or our customers' business operations. A

cyber attack or information security breach of this nature could significantly affect our ability to retain strategic business customers, which could lead to increased costs to retain customers or result in regulatory penalties or a material loss of future revenue.

Third parties with which we do business or that facilitate our business activities, including financial intermediaries, data centers, data storage locations, collection services, distribution centers, or other vendors that provide services or security solutions for our operations, could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints.

Although to date we have not experienced a material loss relating to cyber attacks or other information security breaches, there can be no assurance that we will not suffer such losses in the future or a current threat remains undetected at this time. Our risk and exposure to these matters remains heightened because of, among other things, the evolving nature of these threats, the size and scale of our servicing contracts and our contract with the federal government.

As a result, cyber security and the continued development and enhancement of our training, controls, processes, and practices designed to protect and monitor our systems, computers, software, data, and networks from attack, damage, or unauthorized access remain a priority for the Company and each of our business segments. Additionally, we maintain technology and telecommunication, professional services, media, network security, privacy, injury, and liability insurance coverage to offset costs that may be incurred as a result of a cyber attack or information security breach.

As cyber threats continue to evolve, we may be required to expend significant additional resources to continue to modify or enhance our protective measures or to investigate and remediate any information security vulnerabilities.

Additionally, we must continually and cost-effectively maintain and improve our information technology systems and infrastructure in order to successfully deliver competitive products and services to our customers. The widespread adoption of new technologies and market demands could require substantial expenditures to enhance system infrastructure and existing products and services. If we fail to enhance and scale our systems and operational infrastructure or products and services, our operating segments may lose their competitive advantage and this could adversely affect financial and operating results.

We also face the risk of business disruption if system outages occur as a result of changes in infrastructure, introduction of new software or software enhancements, relocation of infrastructure, or failure to perform required services, which could have a material impact upon our reputation and our ability to retain customers. Although we have business continuity management plans, a major physical disaster or other calamity that causes significant damage to or the loss of our information systems or business operations for a sustained period of time could adversely affect our business, cash flows, and ability to retain customers.

We must satisfy certain requirements necessary to maintain the federal guarantees of our federally insured loans, and we may incur penalties or lose our guarantees if we fail to meet these requirements.

As of December 31, 2012 we serviced \$26.6 billion of FFELP loans that maintained a federal guarantee, of which \$21.2 billion and \$5.4 billion were owned by the Company and third-party entities, respectively.

We must meet various requirements in order to maintain the federal guarantee on our federally insured loans. The federal guarantee on our federally insured loans is conditional based on our compliance with origination, servicing, and collection policies set by the Department and guaranty agencies. Federally insured loans that are not originated, disbursed, or serviced in accordance with the Department's and guaranty agency regulations may risk partial or complete loss of the guarantee. If we experience a high rate of servicing deficiencies (including any deficiencies

resulting from the conversion of loans from one servicing platform to another, errors in the loan origination process, establishment of the borrower's repayment status, and due diligence or claim filing processes), it could result in the loan guarantee being revoked or denied. In most cases we have the opportunity to cure these deficiencies by following a prescribed cure process which usually involves obtaining the borrower's reaffirmation of the debt. However, not all deficiencies can be cured.

We are allowed three years from the date of the loan rejection to cure most loan rejections. If a cure cannot be achieved during this three year period, insurance is permanently revoked, although we maintain our right to collect the loan proceeds from the borrower. In cases where we purchase loans that were serviced previously by another servicing institution and we identify a serving deficiency by the prior servicer, we may, based on the terms of the purchase agreement, have the ability to recourse the rejected loans back to the previous lender.



A guaranty agency may also assess an interest penalty upon claim payment if the deficiency does not result in a loan rejection. These interest penalties are not subject to cure provisions and are typically related to isolated instances of due diligence deficiencies. Additionally, we may become ineligible for special allowance interest benefits from the time of the first deficiency leading to the loan rejection through the date that the loan is cured.

Failure to comply with federal and guarantor regulations may result in penalties, a loss of special allowance interest benefits, or a loss of the federal guarantee.

Our largest fee-based customer, the Department of Education, allocates Federal Direct Loan Program servicing volume based on our and our competitors' performance metrics. Failure to be ranked above our competitors will lead to lower loan volume allocations and could lower our ability to renew the Department contract in 2014 and retain hosted servicing software clients who also service Federal Direct Loan Program loans.

In June 2009, we were one of four private sector companies awarded a student loan servicing contract by the Department of Education to provide additional servicing capacity for loans owned by the Department. The contract spans five years (through June 2014), with one five-year renewal at the option of the Department. In September 2009, the Department began assigning purchased FFELP loans to the four servicers. Beginning with the second year of servicing in June 2010, the Department began allocating new loan volume originated under the Federal Direct Loan Program among the four servicers based on five performance metrics.

Three metrics measure the satisfaction among separate customer groups, including borrowers, financial aid personnel at postsecondary schools participating in the federal student loan program, and Federal Student Aid and other federal agency personnel or contractors who work with the servicers.

Two performance metrics measure the success of default prevention efforts as reflected by the percentage of borrowers and percentage of dollars in each servicer's portfolio that go into default.

Based on the most recent survey results, the Company was ranked first out of the four private sector companies and will be allocated 30 percent of new loan volume originated by the Department during the period from August 15, 2012 through August 14, 2013 (the fourth year of the servicing contract). The Department projects it will originate new loans for 3.6 million borrowers in total during the fourth year of this contract, which is currently being allocated to the four servicers.

As of December 31, 2012, the Company was servicing \$68.8 billion of loans for 3.9 million borrowers under this contract. During 2012, the Company earned \$69.5 million in revenue under this contract.

Although the Company currently anticipates the Department will exercise its option to renew the servicing contract for five years at the end of the current term in 2014, there can be no assurance of such renewal or the terms of such renewal. Upon the expiration of the Department contract, any renewal to provide loan servicing to the Department could be subject to a bidding process in which we may not be successful. Not obtaining a renewal of a loan servicing contract upon its expiration would result in a significant reduction in revenue and we would have to make significant changes to our operations, which may result in the recording of special charges, such as workforce reduction costs, charges relating to consolidating excess facilities, and impairments of assets.

Additionally, the Company offers a hosted servicing solution that can be used by third-party clients to service various types of student loans, including Federal Direct Loan Program loans. As of December 31, 2012, the Company licenses its hosted servicing software to four non-profit organizations. Not obtaining a renewal of the Department's loan servicing contract could put at risk the long-term viability of the hosted servicing software solution agreements.

Management believes it is important to provide exceptional customer service at a reasonable price in order to increase the Company's servicing volume and renew the Department contract; therefore, the Company has focused and will continue to focus heavily on customer service-related projects, efficiencies, security, and technology development to maintain its first place ranking in future years of the contract.

Our ability to continue to grow and maintain our contracts with commercial businesses and government agencies is partly dependent on our ability to maintain compliance with various laws, regulations, and industry standards applicable to those contracts.

We are subject to various laws, regulations, and industry standards related to our commercial and government contracts. In most cases, these contracts are subject to termination rights, audits, and investigations. If we are found in noncompliance with the contract provisions or applicable laws, regulations, or standards, or the contracted party exercises its termination or other rights

for that or other reasons, our reputation could be negatively affected, and our ability to compete for new contracts or maintain existing contracts could diminish. If this were to occur, our results of operations from existing contracts and future opportunities for new contracts could be negatively affected.

#### Regulatory and Legal

Federal and state laws and regulations can restrict our business, and noncompliance with these laws and regulations could result in penalties, litigation, reputation damage, and a loss of customers.

Our operating segments and customers are heavily regulated by federal and state government regulatory agencies. The laws and regulations enforced by these agencies are proposed or enacted to protect consumers and the financial industry as a whole, not necessarily the Company, our operating segments, or our shareholders. We have procedures and controls in place to monitor compliance with numerous federal and state laws and regulations and believe we are in compliance with such laws and regulations. However, because these laws and regulations are complex, differ between jurisdictions and are often subject to interpretation, or because of a result of unintended errors, we may, from time to time, inadvertently violate these laws and regulations. Compliance with these laws and regulations is expensive and requires the time and attention of management. These costs divert capital and focus away from efforts intended to grow our business. If we do not successfully comply with laws, regulations, or policies, we could incur fines or penalties, lose existing or new customer contracts, or suffer damage to our reputation. Changes in these laws and regulations can significantly alter our business environment, limit business operations, and increase costs of doing business, and we cannot predict the impact such changes would have on our profitability. The use of Executive Order provisions from the Executive Branch of the Federal Government has created new regulations that have impacted our Company. The use of Executive Order provisions to define regulations creates additional uncertainty and risks within the education and student loan industry.

Our Student Loan and Guaranty Servicing and Asset Generation and Management operating segments are subject to the Higher Education Act and various consumer protection and privacy regulations. These operating segments take necessary steps to evaluate, monitor, and comply with these regulations. However, the Department or other regulating agencies could, based on regulatory interpretation, determine we are not compliant. Failure to comply with these regulations could lead to a loss of the guarantee on our federally insured loans, increased servicing costs to cure such loans, or suspension or termination of our rights to participate as a servicer.

Certain provisions of the Higher Education Act that became effective July 1, 2011 have impacted our Enrollment Services operating segment in connection with services it provides to for-profit schools. To be eligible to participate in federal student aid programs, the Higher Education Act requires educational institutions, including for-profit schools, to enter into a program participation agreement with the Department. This agreement includes a number of requirements with which an institution must comply to be granted initial and continuing eligibility to participate in the federal student aid program. The regulations impose strict liability on educational institutions for misrepresentations made by entities, like us, who contract with these institutions to provide marketing services. As a result, our school customers have demanded and, in limited circumstances, we have acquiesced to be subject to increased limitations of liability in our contracts and, in some cases, to indemnify our customers for actions by our third-party inquiry generation vendors. Significantly all inquiry generation and management revenue (which makes up approximately 80 percent of total revenue included in the Enrollment Services operating segment) is generated from for-profit schools. The regulations discussed above may subject us to greater risk of liability and may increase our cost of compliance with these regulations or limit our ability to serve for-profit schools. In addition, the regulations could negatively impact enrollment at for-profit schools, which could adversely affect revenue.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) represents a comprehensive overhaul of the financial services industry within the United States, and established the Consumer Financial Protection

Bureau (the “CFPB”). The CFPB has broad authority with respect to the businesses in which we engage. It has authority to write regulations under federal consumer financial protection laws, and enforce those laws. The CFPB is authorized to prevent “unfair, deceptive, or abusive acts or practices” through its supervisory enforcement and regulatory authority. It is authorized to collect fines and provide consumer restitution in the event of violations, engage in consumer financial education, request data, and promote the availability of financial services to underserved consumers and communities. In addition, the CFPB maintains an online complaint system that allows consumers to log complaints with respect to the products we offer. The system could inform future agency decisions with respect to regulatory, enforcement, or examination focus. There continues to be uncertainty as to how the CFPB's strategies and priorities will impact our businesses and our results of operations going forward. Actions by the CFPB could result in requirements to alter our services causing them to be less attractive or effective and impair our ability to offer them profitably. Should the CFPB change regulations adopted in the past by other regulators, or modify past regulatory guidance, our compliance costs and litigation exposure could increase. Our litigation exposure could also increase if the CFPB exercises its authority to limit or ban pre-dispute arbitration clauses. Recent reports released by the CFPB have clearly communicated their focus to protect student loan borrowers. This additional focus and regulatory oversight will most likely increase operating costs and could limit revenue opportunities.

The Dodd-Frank Act also provides the Commodity Futures Trading Commission (the "CFTC") and the SEC with substantial authority to regulate over-the-counter derivatives transactions, and includes provisions that require derivatives transactions to be executed through an exchange or central clearinghouse. The Dodd-Frank Act could also affect future student loan portfolio asset-backed securities transactions. The regulations require issuers of asset-backed securities or persons who organize and initiate asset-backed securities transactions to retain a portion of the underlying assets' credit risk, disclose and report requirements for each tranche of asset-backed securities, including new loan-level data requirements, and disclose requirements relating to the representations, warranties, and enforcement mechanisms available to investors. Although we cannot predict the ultimate outcome of these processes and regulations, they may increase our costs and cash collateral margin requirements and affect the terms of future asset-backed securities transactions and derivatives used to manage financial risks related to interest rate and foreign currency exchange rate volatility.

The Reconciliation Act of 2010 prohibits new loan originations under the FFEL Program and requires all new federal loan originations be made through the Federal Direct Loan Program. As a result of this legislation, interest income on our existing FFELP loan portfolio, as well as fee-based revenue from guaranty and third-party FFELP servicing and FFELP loan servicing software licensing and consulting fees will decline over time as our and our third-party lender clients' FFELP loan portfolios are paid down.

The Reconciliation Act of 2010 prohibits new loan originations under the FFEL Program and requires that all new federal loan originations be made through the Federal Direct Loan Program. The law did not alter or affect the terms and conditions of existing FFELP loans.

As a result of the Reconciliation Act of 2010, interest income on our existing FFELP loan portfolio, as well as fee-based revenue from guaranty and third-party FFELP servicing and FFELP loan servicing software licensing and consulting fees related to the FFEL Program, will decline over time as our and our third-party lender clients' FFELP loan portfolios are paid down. During the years ended December 31, 2012, 2011, and 2010 we recognized approximately \$344 million, \$367 million, and \$377 million, respectively, of interest income on our FFELP loan portfolio, approximately \$96 million, \$91 million, and \$101 million, respectively, in guaranty and third-party FFELP servicing revenue, and approximately \$6 million, \$7 million, and \$8 million, respectively, in FFELP loan servicing software licensing and consulting fees related to the FFEL Program.

If the Company is unable to grow or develop new revenue streams, the Company's consolidated revenue and operating margin will decrease as a result of the decline in FFELP loan volume outstanding.

Exposure related to certain tax issues could decrease our net income.

We are subject to federal and state income tax laws and regulations. Income tax regulations are often complex and require interpretation. The nexus standards and the sourcing of receipts from intangible personal property and services have been the subject of state audits and litigation with state taxing authorities and tax policy debates by various state legislatures. As the U.S. Congress and U.S. Supreme Court have not provided clear guidance in this regard, conflicting state laws and court decisions create tremendous uncertainty and expense for taxpayers conducting interstate commerce. Changes in income tax regulations could negatively impact our results of operations. If states enact legislation, alter apportionment methodologies, or aggressively apply the income tax nexus standards, we may become subject to additional state taxes.

From time to time, we engage in transactions in which the tax consequences may be subject to uncertainty. Examples of such transactions include asset and business acquisitions and dispositions, financing transactions, apportionment, nexus standards, and income recognition. Significant judgment is required in assessing and estimating the tax

consequences of these transactions. We prepare and file tax returns based on the interpretation of tax laws and regulations. In the normal course of business, our tax returns are subject to examination by various taxing authorities. Such examinations may result in future tax and interest assessments by these taxing authorities. In accordance with authoritative accounting guidance, we establish reserves for tax contingencies related to deductions and credits that we may be unable to sustain. Differences between the reserves for tax contingencies and the amounts ultimately owed are recorded in the period they become known. Adjustments to our reserves could have a material effect on our financial statements.

The costs and effects of litigation, investigations, or similar matters, or adverse facts and developments related thereto, could materially affect our financial position, results of operations, and cash flows.

We may be involved from time to time in a variety of lawsuits, investigations, or similar matters arising out of our business operations. Our insurance may not cover all claims that may be asserted against us, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation. If the ultimate judgments or settlements in any litigation or investigation

significantly exceed our insurance coverage, they could have a material adverse effect on our financial position, results of operations, and cash flows for any particular period.

#### Principal Shareholder and Related Party Transactions

Our Chairman and Chief Executive Officer beneficially owns 67.7 percent of the voting rights of our shareholders and has day to day control over all matters at our Company.

Michael S. Dunlap, our Chairman, Chief Executive Officer, and a principal shareholder, beneficially owns 67.7 percent of the voting rights of our shareholders. In addition, Mr. Dunlap, Stephen F. Butterfield, our Vice Chairman, and Angela L. Muhleisen, Mr. Dunlap's sister, beneficially own stock that in the aggregate has 82.8 percent of the voting rights of our shareholders. Accordingly, each member of the Board of Directors and each member of management has been elected or effectively appointed by Mr. Dunlap and can be removed by Mr. Dunlap. As a result, Mr. Dunlap, as Chairman, Chief Executive Officer, and controlling shareholder, has day to day control over all matters at our Company and has the ability to take actions that benefit him and Ms. Muhleisen but may not benefit other minority shareholders, and may otherwise exercise his control in a manner with which other minority shareholders may not agree or which they may not consider to be in their best interests.

We have entered into contractual arrangements with Union Bank & Trust Company ("Union Bank"). Union Bank and the Company have common ownership. The transactions with Union Bank present conflicts of interest and pose risks to our shareholders that the terms may not be as favorable to us as we could receive from unrelated third parties.

Union Bank is controlled by Farmers & Merchants Investment Inc. ("F&M"), which owns 81.4 percent of Union Bank's common stock and 15.4 percent of Union Bank's non-voting preferred stock. Michael S. Dunlap, a significant shareholder, as well as our Chief Executive Officer, Chairman, and a member of our Board of Directors, along with his spouse and children, owns or controls a total of 40.2 percent of the stock of F&M, and Mr. Dunlap's sister, Angela L. Muhleisen, along with her husband and children, owns or controls 38.6 percent of F&M stock. Mr. Dunlap serves as a Director and Chairman of F&M. Ms. Muhleisen serves as Director and President of F&M and as a Director, Chairperson, President, and Chief Executive Officer of Union Bank. Union Bank is deemed to have beneficial ownership of various shares of Nelnet it holds because it serves in a capacity of trustee or account manager and may share voting and/or investment power with respect to such shares. As of December 31, 2012, Union Bank was deemed to beneficially own 11.7 percent of the voting rights of our common stock. As of December 31, 2012, Mr. Dunlap and Ms. Muhleisen beneficially owned 67.7 percent and 12.8 percent, respectively, of the voting rights of our outstanding common stock.

We have entered into certain contractual arrangements with Union Bank, including loan purchases, loan servicing, loan participations, banking services, 529 Plan Administration services, lease arrangements, and various other investment and advisory services. The net aggregate impact on our consolidated statements of income for the years ended December 31, 2012, 2011, and 2010 related to the transactions with Union Bank was income of \$11.9 million, \$9.4 million, and \$8.2 million, respectively. See note 19 of the notes to the consolidated financial statements included in this report for additional information related to the transactions between us and Union Bank.

Transactions between Union Bank and us are generally based on available market information for comparable assets, products, and services and are extensively negotiated. In addition, all related party transactions between Union Bank and us are approved by both the Union Bank Board of Directors and our Board of Directors. Furthermore, Union Bank is subject to regulatory oversight and review by the FDIC, the Federal Reserve, and the State of Nebraska Department of Banking and Finance. The FDIC and the State of Nebraska Department of Banking and Finance regularly review Union Bank's transactions with affiliates. The regulatory standard applied to the bank falls under Regulation W, which places restrictions on certain "covered" transactions with affiliates.

We intend to maintain our relationship with Union Bank, which our management believes provides certain benefits to us. Those benefits include Union Bank's knowledge of and experience in the FFELP industry, its willingness to provide services, and at times liquidity and capital resources, on an expedient basis, and the proximity of Union Bank to our corporate headquarters located in Lincoln, Nebraska.

The majority of the transactions and arrangements with Union Bank are not offered to unrelated third parties or subject to competitive bids. Accordingly, these transactions and arrangements not only present conflicts of interest, but also pose the risk to our shareholders that the terms of such transactions and arrangements may not be as favorable to us as we could receive from unrelated third parties. Moreover, we may have and/or may enter into contracts and business transactions with related parties that benefit Mr. Dunlap and his sister, as well as other related parties, that may not benefit us and/or our minority shareholders.



## ITEM 1B. UNRESOLVED STAFF COMMENTS

The Company has no unresolved comments from the staff of the Securities and Exchange Commission regarding its periodic or current reports under the Securities Exchange Act of 1934.

## ITEM 2. PROPERTIES

The following table lists the principal facilities for office space owned or leased by the Company as of December 31, 2012. The Company owns the building in Lincoln, Nebraska where its principal office is located. The building is subject to a lien securing the outstanding mortgage debt on the property.

Location	Primary Function or Segment	Approximate square feet	Lease expiration date
Lincoln, NE	Corporate Headquarters, Asset Generation and Management, Student Loan and Guaranty Servicing, Tuition Payment Processing and Campus Commerce, Enrollment Services	187,000	–
Lincoln, NE	Student Loan and Guaranty Servicing	70,000	December 2015
Aurora, CO	Student Loan and Guaranty Servicing	96,000	February 2015
Highlands Ranch, CO	Student Loan and Guaranty Servicing	67,000	March 2017
Paramus, NJ	Enrollment Services	23,000	December 2015

The square footage amounts above exclude a total of approximately 27,000 square feet of owned office space in Lincoln, Nebraska, and 17,000 square feet of leased office space in Highlands Ranch, Colorado, that the Company leases to third parties. Also excluded from the table above is 62,000 square feet of leased office space in Indianapolis, Indiana where Student Loan and Guaranty Servicing operations were previously conducted. On December 31, 2012, the Company entered into a lease termination agreement with the landlord of the property in Indiana, which terminated the lease effective January 31, 2013. Also excluded from the table above is approximately 18,000 square feet of space leased in Jacksonville, Florida where a data center was previously housed; the lease will expire in September 2013. The Company leases other office facilities located throughout the United States. These properties are leased on terms and for durations that are reflective of commercial standards in the communities where these properties are located. The Company believes that its respective properties are generally adequate to meet its long term business goals. The Company's principal office is located at 121 South 13<sup>th</sup> Street, Lincoln, Nebraska 68508.

## ITEM 3. LEGAL PROCEEDINGS

## General

The Company is subject to various claims, lawsuits, and proceedings that arise in the normal course of business. These matters principally consist of claims by student loan borrowers disputing the manner in which their student loans have been processed and disputes with other business entities. In addition, from time to time, the Company receives information and document requests from state or federal regulators concerning its business practices. The Company

cooperates with these inquiries and responds to the requests. While the Company cannot predict the ultimate outcome of any inquiry or investigation, the Company believes its activities have materially complied with applicable law, including the Higher Education Act, the rules and regulations adopted by the Department of Education thereunder, and the Department's guidance regarding those rules and regulations. Other than as specifically discussed below, on the basis of present information, anticipated insurance coverage, and advice received from counsel, it is the opinion of the Company's management that the disposition or ultimate determination of these claims, lawsuits, and proceedings will not have a material adverse effect on the Company's business, financial position, or results of operations.

**Bais Yaakov of Spring Valley v. Peterson's Nelnet, LLC**

On January 4, 2011, a complaint against Peterson's Nelnet, LLC ("Peterson's"), a subsidiary of the Company, was filed in the U.S. federal District Court for the District of New Jersey (the "District Court"). The complaint alleges that Peterson's sent six advertising faxes to the named plaintiff in 2008-2009 that were not the result of express invitation or permission granted by the plaintiff and did not include certain opt out language. The complaint also alleges that such faxes violated the federal Telephone Consumer Protection Act (the "TCPA"), purportedly entitling the plaintiff to \$500 per violation, trebled for willful violations for each of the six faxes. The complaint further alleges that Peterson's had sent putative class members more than 10,000 faxes that violated the

TCPA, amounting to more than \$5 million in statutory penalty damages and more than \$15 million if trebled for willful violations. The complaint seeks to establish a class action. As of the filing date of this report, the District Court has not established or recognized any class.

On April 14, 2012, the U.S. Court of Appeals for the Third Circuit, which has jurisdiction over the District Court, issued an order in an unrelated TCPA case which remanded that case to the District Court to determine whether the statutory provisions of the TCPA limit whether or to what extent a TCPA claim can be heard as a class action in federal court where applicable state law would impose limitations on a class action if the claim were brought in state court. The resolution of this issue may affect whether the claim against Peterson's can be pursued as a class action, and in light of the ruling, Peterson's requested and received the District Court's permission to file a renewed motion to dismiss the complaint. Peterson's filed that motion on May 29, 2012, and on October 17, 2012, the District Court denied the motion. On November 7, 2012, Peterson's filed a motion for reconsideration of the District Court's order, or in the alternative, to certify the District Court's order for interlocutory appeal. On February 21, 2013, the District Court denied Peterson's motion for reconsideration, but granted the motion to certify its order for interlocutory appeal. Accordingly, Peterson's intends to submit a Petition for Permission to Appeal with the 3rd Circuit Court of Appeals, and intends to continue to contest the suit vigorously.

Due to the preliminary stage of this matter and the uncertainty and risks inherent in class determination and the overall litigation process, the Company believes that a meaningful estimate of a reasonably possible loss, if any, or range of reasonably possible losses, if any, cannot currently be made.

#### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

#### PART II.

#### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's Class A common stock is listed and traded on the New York Stock Exchange under the symbol "NNI," while its Class B common stock is not publicly traded. As of January 31, 2013, there were 35,032,426 and 11,495,377 shares of Class A common stock and Class B common stock outstanding, respectively. The number of holders of record of the Company's Class A common stock and Class B common stock as of January 31, 2013 was 893 and 22, respectively. The record holders of the Class B common stock are Michael S. Dunlap and Stephen F. Butterfield, an entity controlled by them, various members of their families, and various estate planning trusts established by them. Because many shares of the Company's Class A common stock are held by brokers and other institutions on behalf of shareholders, the Company is unable to estimate the total number of beneficial owners represented by these record holders. The following table sets forth the high and low intraday sales prices for the Company's Class A common stock for each full quarterly period in 2012 and 2011. The 2011 prices have been revised to conform to the current year presentation of high and low intraday (not closing) sales prices.

2012				2011			
1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
High \$27.20	\$26.64	\$24.99	\$29.98	\$24.28	\$23.35	\$22.85	\$24.75
Low 23.72	21.49	22.16	23.17	20.36	19.52	16.50	17.57

Dividends of \$0.07, \$0.10, \$0.10, and \$0.10 per share on the Company's Class A and Class B common stock were paid on March 15, 2011, June 15, 2011, September 15, 2011, and December 15, 2011, respectively, to all holders of record as of March 1, 2011, June 1, 2011, September 1, 2011, and December 1, 2011, respectively.

Dividends of \$0.10 per share on the Company's Class A and Class B common stock were paid on March 15, 2012, June 15, 2012, and September 15, 2012, to all holders of record as of March 1, 2012, June 1, 2012, and September 1, 2012, respectively. A dividend of \$1.10 per share on the Company's Class A and Class B common stock was paid on November 27, 2012 to all holders of record as of November 19, 2012. This dividend consisted of a regular quarterly dividend of \$0.10 per share and a special cash dividend of \$1.00 per share.

The Company currently plans to continue making regular quarterly dividend payments, subject to future earnings, capital requirements, financial condition, and other factors. In addition, the payment of dividends is subject to the terms of the Company's outstanding junior subordinated hybrid securities, which generally provide that if the Company defers interest payments on those securities it cannot pay dividends on its capital stock.

#### Performance Graph

The following graph compares the change in the cumulative total shareholder return on the Company's Class A common stock to that of the cumulative return of the S&P 500 Index and the S&P Financials Index. The graph assumes that the value of an investment in the Company's Class A common stock and each index was \$100 on December 31, 2007 and that all dividends, if applicable, were reinvested. The performance shown in the graph represents past performance and should not be considered an indication of future performance.

Company/Index	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012
Nelnet, Inc.	\$100.00	\$113.44	\$136.97	\$194.69	\$204.70	\$263.14
S&P 500	100.00	63.00	79.67	91.67	93.61	108.59
S&P Financials	100.00	44.68	52.38	58.73	48.71	62.75

The preceding information under the caption "Performance Graph" shall be deemed to be "furnished" but not "filed" with the Securities and Exchange Commission.

## Stock Repurchases

The following table summarizes the repurchases of Class A common stock during the fourth quarter of 2012 by the Company or any “affiliated purchaser” of the Company, as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934.

Period	Total number of shares purchased (a)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (b)	Maximum number of shares that may yet be purchased under the plans or programs (b)
October 1 - October 31, 2012	1,385	\$24.00	480	4,990,760
November 1 - November 30, 2012	195,567	27.12	195,253	4,795,507
December 1 - December 31, 2012	549,507	29.04	548,928	4,246,579
Total	746,459	\$28.53	744,661	

The total number of shares includes: (i) shares purchased pursuant to the stock repurchase program discussed in footnote (b) below; and (ii) shares owned and tendered by employees to satisfy tax withholding obligations upon the vesting of restricted shares. Shares of Class A common stock purchased pursuant to the stock repurchase program included 480 shares, 1,351 shares, and 10,212 shares in October, November, and December 2012, respectively, that had been issued to the Company’s 401(k) plan and allocated to employee participant accounts (a) pursuant to the plan’s provisions for Company matching contributions in shares of Company stock, and were purchased by the Company from the plan pursuant to employee participant instructions to dispose of such shares. Shares of Class A common stock tendered by employees to satisfy tax withholding obligations included 905 shares, 314 shares, and 579 shares in October, November, and December 2012, respectively. Unless otherwise indicated, shares owned and tendered by employees to satisfy tax withholding obligations were purchased at the closing price of the Company’s shares on the date of vesting.

(b) On May 9, 2012, the Company announced that its Board of Directors had authorized a stock repurchase program to repurchase up to a total of five million shares of the Company's Class A common stock during the three-year period ending May 24, 2015. Certain share repurchases included in the table above were made pursuant to a trading plan adopted by the Company in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934.

## Equity Compensation Plans

For information regarding the securities authorized for issuance under the Company's equity compensation plans, see Part III, Item 12 of this report.

## ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial and other operating information of the Company. The selected financial data in the table is derived from the consolidated financial statements of the Company. The following selected financial data should be read in conjunction with the consolidated financial statements, the related notes, and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in this report.

	Year ended December 31,					
	2012	2011	2010	2009	2008	
	(Dollars in thousands, except share data)					
<b>Operating Data:</b>						
Net interest income	\$345,287	364,565	371,071	235,345	187,892	
Loan and guaranty servicing revenue	209,748	175,657	158,584	129,911	124,057	
Tuition payment processing and campus commerce revenue	74,410	67,797	59,824	53,894	48,155	
Enrollment services revenue	117,925	130,470	139,897	119,397	112,405	
Other income	39,476	29,513	31,310	26,469	22,775	
Gain (loss) on sale of loans and debt repurchases, net	4,139	8,340	78,631	76,831	(51,414 )	
Income attributable to Nelnet, Inc. - continuing operations	\$177,997	204,335	189,034	139,125	26,844	
Income attributable to Nelnet, Inc. - discontinued operations	—	—	—	—	1,818	
Net income attributable to Nelnet, Inc.	\$177,997	204,335	189,034	139,125	28,662	
<b>Earnings per common share (attributable to Nelnet, Inc. shareholders)</b>						
<b>Basic:</b>						
Continuing operations	\$3.76	4.24	3.82	2.79	0.54	
Discontinued operations	—	—	—	—	0.04	
Net earnings	\$3.76	4.24	3.82	2.79	0.58	
<b>Diluted:</b>						
Continuing operations	\$3.74	4.23	3.81	2.78	0.54	
Discontinued operations	—	—	—	—	0.04	
Net earnings	\$3.74	4.23	3.81	2.78	0.58	
Dividends per common share	\$1.40	0.37	0.70	0.07	0.07	
<b>Other Data:</b>						
Fixed rate floor income, net of derivative settlements	\$145,345	144,454	132,243	145,098	37,457	
Core student loan spread	1.44	% 1.52	% 1.48	% 1.18	% 0.99	%
Origination and acquisition of student loans (par value)	\$3,885,138	2,841,334	4,202,164	2,779,873	2,809,082	
Student loans serviced (at end of period)	97,492,053	76,119,717	61,477,651	37,549,563	35,888,693	

	As of December 31,					
	2012	2011	2010	2009	2008	
	(Dollars in thousands, except share data)					
<b>Balance Sheet Data:</b>						
Cash and cash equivalents	\$66,031	42,570	283,801	338,181	189,847	
Student loans receivables, net	24,830,621	24,297,876	24,033,001	23,926,957	25,413,008	
Goodwill and intangible assets	126,511	145,492	155,830	197,255	252,232	
Total assets	26,607,895	25,852,217	25,893,892	25,876,427	27,854,897	
Bonds and notes payable	25,098,835	24,434,540	24,672,472	24,805,289	26,787,959	
Nelnet, Inc. shareholders' equity	1,165,208	1,066,205	906,633	784,563	643,226	
Tangible Nelnet, Inc. shareholders' equity (a)	1,038,697	920,713	750,803	587,308	390,994	
Book value per common share	25.00	22.62	18.75	15.73	13.05	
Tangible book value per common share (a)	22.28	19.53	15.53	11.77	7.93	
<b>Ratios:</b>						
Shareholders' equity to total assets	4.38	% 4.12	% 3.50	% 3.03	% 2.31	%

(a) Tangible Nelnet, Inc. shareholders' equity, a non-GAAP measure, equals "Nelnet, Inc. shareholders' equity" less "goodwill" and "intangible assets, net." Management believes presenting tangible equity and tangible book value per common share are useful measures of evaluating the strength of the Company's capital position. These measures may be calculated differently by other companies.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Management's Discussion and Analysis of Financial Condition and Results of Operations is for the years ended December 31, 2012, 2011, and 2010. All dollars are in thousands, except per share amounts, unless otherwise noted.)

The following discussion and analysis provides information that the Company's management believes is relevant to an assessment and understanding of the consolidated results of operations and financial condition of the Company. The discussion and analysis should be read in conjunction with the Company's consolidated financial statements and related notes included in this report. This discussion and analysis also contains forward-looking statements and should also be read in conjunction with the disclosures and information contained in "Forward-Looking and Cautionary Statements" and Item 1A "Risk Factors" included in this report.



## OVERVIEW

The Company is an education services company focused primarily on providing fee-based processing services and quality education-related products and services in four core areas: asset management and finance, loan servicing, payment processing, and enrollment services (education planning). These products and services help students and families plan, prepare, and pay for their education and make the administrative and financial processes more efficient for schools and financial organizations. In addition, the Company earns interest income on a portfolio of federally insured student loans.

A summary of consolidated results and financial and operational highlights is provided below.

Continued strong earnings. For the year ended December 31, 2012, the Company's net income, excluding derivative market value and foreign currency adjustments, was \$207.4 million, or \$4.38 per share, compared to \$215.4 million, or \$4.47 per share, for 2011. GAAP net income for the year ended December 31, 2012 was \$178.0 million, or \$3.76 per share, compared with GAAP net income for 2011, which was \$204.3 million, or \$4.24 per share. Derivative market value and foreign currency adjustments were an expense of \$29.4 million after tax, or \$0.62 per share, during 2012, compared with an expense of \$11.1 million after tax, or \$0.23 per share, for 2011. (a)

The decrease in net income in 2012 compared to 2011 was expected as the Company's student loan portfolio runs off due to Congress' elimination of new loan originations under the FFEL Program in 2010. The decrease was partially offset by the growth of the Company's fee-based businesses.

An increase in revenue from fee-based businesses (excluding intersegment servicing revenue) to \$402.1 million, or 7.5%, for 2012 as compared to \$373.9 million in 2011.

Purchased \$3.9 billion (par value) of student loans from third parties during 2012, including \$3.0 billion during the fourth quarter.

Repurchased 806,023 shares of Class A common stock for \$22.8 million (\$28.30 per share) during 2012, including 746,459 shares repurchased in the fourth quarter of 2012.

Repurchased \$136.1 million of debt for a gain totaling \$4.0 million during 2012, including \$114.4 million of debt repurchased during the fourth quarter for a gain of \$3.0 million.

Paid cash dividends totaling \$1.40 per share in 2012, which includes a special fourth quarter 2012 cash dividend of \$1.00 per share.

An increase in book value per share to \$25.00, or 10.5%, from December 31, 2011.

Strong liquidity represented by \$149.3 million of cash and investments as of December 31, 2012 and \$299.3 million of net cash provided by operating activities during 2012.

The Company provides non-GAAP information that reflects specific items management believes to be important in the evaluation of its financial position and performance. "Derivative market value and foreign currency adjustments" include (i) the unrealized gains and losses that are caused by changes in fair values of derivatives (a) which do not qualify for "hedge treatment" under GAAP; and (ii) the foreign currency transaction gains or losses caused by the re-measurement of the Company's Euro-denominated bonds to U.S. dollars. The Company believes these point-in-time estimates of asset and liability values related to these financial instruments that are subject to interest and currency rate fluctuations affect the period-to-period comparability of the results of operations.



The Company earns fee-based revenue through the following operating segments:

- Student Loan and Guaranty Servicing ("LGS") - referred to as Nelnet Diversified Solutions ("NDS")
- Tuition Payment Processing and Campus Commerce ("TPP&CC") - referred to as Nelnet Business Solutions ("NBS")
- Enrollment Services - commonly called Nelnet Enrollment Solutions ("NES")

In addition, the Company earns net interest income on its FFELP student loan portfolio in its Asset Generation and Management ("AGM") operating segment. This segment is expected to generate a stable net interest margin and significant amounts of cash as the FFELP portfolio amortizes. As of December 31, 2012, the Company had a \$24.8 billion student loan portfolio that will amortize over the next approximately 20 years. The Company actively seeks to acquire FFELP loan portfolios to leverage its servicing scale and expertise to generate incremental earnings and cash flow.

The information below provides the operating results for each reportable operating segment for the years ended December 31, 2012, 2011, and 2010 (dollars in millions).

Total revenue includes "net interest income after provision for loan losses" and "total other income" from the Company's segment statements of income, excluding the impact from changes in fair values of derivatives and foreign currency transaction adjustments, which was an expense of \$51.8 million, income of \$7.6 million, and (a) income of \$3.0 million for the years ended December 31, 2012, 2011, and 2010, respectively. Net income excludes changes in fair values of derivatives and foreign currency transaction adjustments, net of tax, which was an expense of \$32.1 million, income of \$4.7 million, and income of \$1.9 million for the years ended December 31, 2012, 2011, and 2010, respectively.

(b) Computed as income before income taxes, excluding restructuring and impairment charges, divided by total revenue.

A summary of the results and financial highlights for each reportable operating segment for the year ended December 31, 2012 and a summary of the Company's liquidity and capital resources follows. See "Results of Operations" for each reportable operating segment and "Liquidity and Capital Resources" under this Item 7 for additional detail.

#### Student Loan and Guaranty Servicing

• An increase in government servicing revenue due to increased volume from the Department.

• An increase in guaranty collection revenue due to an increase in defaulted loan volume.

• An increase in software services revenue as a result of the Company beginning to provide hosted student loan servicing to a significant customer in October 2011.

• An increase in operating expenses due to incurring additional costs related to the government servicing contract and the hosted servicing software product.

Achieved the first place ranking in the most recent annual survey results related to the servicing contract with the Department, which led to a larger allocation of loan volume to the Company for the fourth year of this contract (the period from August 15, 2012 through August 14, 2013). The Company is allocated 30 percent of new loan volume originated by the Department, up from 16 percent the prior two years.

#### Tuition Payment Processing and Campus Commerce

• An increase in revenue as a result of an increase in the number of managed tuition payment plans and campus commerce customers.

• A compression in margin due to an increase in amortization of intangible assets and continued investment in new products and services to meet customer needs and expand product and service offerings.

#### Enrollment Services

Continued decrease in inquiry generation and inquiry management (agency) revenue due to the effects from regulatory uncertainty regarding recruiting and marketing to potential students in the for-profit college industry, which has caused schools to decrease spending on marketing efforts.

• Recorded a charge of \$2.8 million related to the impairment of student list costs.

#### Asset Generation and Management

• The acquisition of \$3.9 billion (par value) of FFELP student loans during 2012.

• The loss of \$936.4 million of FFELP student loans during 2012 as a result of the Department's special direct consolidation loan initiative, the student loan borrower application period for which expired June 30, 2012.

• Continued recognition of significant fixed rate floor income due to historically low interest rates.

#### Liquidity and Capital Resources

• As of December 31, 2012, the Company had \$149.3 million of cash and investments.

• For the year ended December 31, 2012, the Company generated \$299.3 million in net cash provided by operating activities.

- Forecasted future undiscounted cash flows from the Company's FFELP student loan portfolio remain strong and are estimated to be approximately \$1.97 billion as of December 31, 2012.

On February 17, 2012, the Company entered into a new \$250.0 million unsecured line of credit that has a maturity date of February 17, 2016. As of December 31, 2012, \$195.0 million was available for borrowing under this line of credit.

The Company will continue to use its strong liquidity position to capitalize on market opportunities, including FFELP student loan acquisitions; strategic acquisitions and investments, including ongoing investments in its core business areas of asset management and finance, loan servicing, payment processing, and enrollment services (education planning); and capital management initiatives, including stock repurchases, debt repurchases, and dividend distributions.

## Income Taxes

The Company's effective tax rate was 35.0 percent for the year ended December 31, 2012, compared to 36.5 percent in 2011. During 2012, state tax laws were enacted that reduced the Company's income tax expense by \$3.4 million. The Company currently expects the effective tax rate in 2013 will be 36.0 percent to 38.0 percent.

## CONSOLIDATED RESULTS OF OPERATIONS

The components of the Company's consolidated financial statements are summarized below.

The Company's operating results are primarily driven by the performance of its existing portfolio and the revenues generated by its fee-based businesses and the costs to provide such services. The performance of the Company's portfolio is driven by net interest income (which includes financing costs) and losses related to credit quality of the assets, along with the cost to administer and service the assets and related debt.

The Company operates as four distinct operating segments. The Company's operating segments include:

- § Student Loan and Guaranty Servicing
- ¶ Tuition Payment Processing and Campus Commerce
- £ Enrollment Services
- ▲ Asset Generation and Management

See Item 1, "Business - Overview" for further discussion on the components of each segment. In addition, the operating results of each of the Company's reportable operating segments, including a reconciliation of the segment operating results to the consolidated results of operations, are included in note 14 of the notes to the consolidated financial statements included in this report. Since the Company monitors and assesses its operations and results based on these segments, the discussion following the consolidated results of operations is presented on a segment basis. As further discussed in the notes to the consolidated financial statements, in 2012 the Company changed its operating segment income measurement from "base net income" to GAAP net income. Prior period segment operating results have been restated to conform to the current period presentation.

## Consolidated Net Interest Income after Provision for Loan Losses (net of settlements on derivatives)

	Year ended December 31,			December 31, 2012 vs. 2011		December 31, 2011 vs. 2010	
	2012	2011	2010	Increase(Decrease) \$	%	Increase(Decrease) \$	%
Interest income:							
Loan interest	\$609,237	589,686	598,675	19,551	3.3	(8,989)	(1.5)
Investment interest	4,616	3,168	5,256	1,448	45.7	(2,088)	(39.7)
Total interest income	613,853	592,854	603,931	20,999	3.5	(11,077)	(1.8)
Interest expense:							
Interest on bonds and notes payable	268,566	228,289	232,860	40,277	17.6	(4,571)	(2.0)
Net interest income	345,287	364,565	371,071	(19,278)	(5.3)	(6,506)	(1.8)
Provision for loan losses	21,500	21,250	22,700	250	1.2	(1,450)	(6.4)
Net interest income after provision for loan losses	323,787	343,315	348,371	(19,528)	(5.7)	(5,056)	(1.5)
Derivative settlements, net (a)	(14,022)	(7,840)	(14,264)	(6,182)	(78.9)	6,424	(45.0)
	\$309,765	335,475	334,107	(25,710)	(7.7)	1,368	0.4

Net interest income after provision for  
loan losses (net of settlements on  
derivatives)

The Company maintains an overall risk management strategy that incorporates the use of derivative instruments to reduce the economic effect of interest rate volatility. Management has structured the majority of the Company's (a) derivative transactions with the intent that each is economically effective; however, the Company's derivative instruments do not qualify for hedge accounting. Derivative settlements for each applicable period should be evaluated with the Company's net interest income.

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Net interest income after provision for loan losses, net of settlements on derivatives, includes the following items:

	Year ended December 31,			December 31, 2012 vs. 2011		December 31, 2011 vs. 2010	
	2012	2011	2010	Increase(Decrease) \$	%	Increase(Decrease) \$	%
Variable net interest income, net of settlements on derivatives (a)	\$ 192,021	219,363	242,127	(27,342 )	(12.5 )%	(22,764 )	(9.4 )%
Fixed rate floor income, net of settlements on derivatives (b)	145,345	144,454	132,243	891	0.6	12,211	9.2
Investment interest (c)	4,616	3,168	5,256	1,448	45.7	(2,088 )	(39.7 )
Non-portfolio related derivative settlements	(2,232 )	(611 )	(928 )	(1,621 )	(265.3 )	317	34.2
Corporate debt interest expense (d)	(8,485 )	(9,649 )	(21,891 )	1,164	12.1	12,242	55.9
Provision for loan losses (e)	(21,500 )	(21,250 )	(22,700 )	(250 )	(1.2 )	1,450	6.4
Net interest income after provision for loan losses (net of settlements on derivatives)	\$ 309,765	335,475	334,107	(25,710 )	(7.7 )%	1,368	0.4 %

The Company generates a significant portion of its earnings from the spread, referred to as its student loan spread, between the yield the Company receives on its student loan portfolio and the cost of funding these loans. Because the Company generates a significant portion of its earnings from its student loan spread, the interest rate sensitivity of the Company's balance sheet is important to its operations. The current and future interest rate environment can and will affect the Company's net interest income. The effects of changing interest rate environments are further outlined in Item 7A, "Quantitative and Qualitative Disclosures about Market Risk — Interest Rate Risk."

Variable student loan spread is also impacted by the amortization/accretion of loan premiums and discounts, including capitalized costs of origination, the 1.05% per year consolidation loan rebate fee paid to the Department, and yield adjustments from borrower benefit programs. See "Asset Generation and Management Operating Segment - Results of Operations" in this Item 7 below for additional information.

The Company has a portfolio of student loans that are earning interest at a fixed borrower rate which exceeds the statutorily defined variable lender rate, generating fixed rate floor income. See Item 7A, "Quantitative and Qualitative Disclosures about Market Risk – Interest Rate Risk" for additional information.

Investment interest income includes income from unrestricted interest-earning deposits and investments and funds in the Company's special purpose entities which are utilized for its asset-backed securitizations. Investment interest increased in 2012 compared to 2011 due to an increase in the average investment balance, and decreased in 2011 compared to 2010 due to lower interest rates and a decrease in average cash held.

Corporate debt interest expense includes interest expense incurred on the Company's 5.125% Senior Notes, which matured in 2010 (the "Senior Notes"), Junior Subordinated Hybrid Securities, and its unsecured and secured lines of credit. The decrease in corporate debt interest expense is due to the Company using cash generated by operations and proceeds from securitization transactions to pay down corporate debt. The average outstanding corporate debt during 2010, 2011, and 2012 was approximately \$881.8 million, \$249.5 million, and \$183.5 million, respectively.

The provision for loan losses represents the periodic expense of maintaining an allowance sufficient to absorb losses inherent in the Company's portfolio of loans. See "Asset Generation and Management Operating Segment - Summary and Comparison of Operating Results" in this Item 7 below for additional information.





## Consolidated Other Income

The Company also earns fees and generates revenue from other sources as summarized below.

	Year ended December 31,			December 31, 2012 vs. 2011		December 31, 2011 vs. 2010			
	2012	2011	2010	Increase(Decrease)		Increase(Decrease)			
				\$	%	\$	%		
Loan and guaranty servicing revenue (a)	\$209,748	175,657	158,584	34,091	19.4	%	17,073	10.8	%
Tuition payment processing and campus commerce revenue (b)	74,410	67,797	59,824	6,613	9.8		7,973	13.3	
Enrollment services revenue (c)	117,925	130,470	139,897	(12,545)	(9.6)	)	(9,427)	(6.7)	)
Other income (d)	39,476	29,513	31,310	9,963	33.8		(1,797)	(5.7)	)
Gain on sale of loans and debt repurchases (e)	4,139	8,340	78,631	(4,201)	(50.4)	)	(70,291)	(89.4)	)
Derivative market value and foreign currency adjustments (f)	(47,394)	(17,807)	3,587	(29,587)	(166.2)	)	(21,394)	(596.4)	)
Derivative settlements, net (g)	(14,022)	(7,840)	(14,264)	(6,182)	(78.9)	)	6,424	45.0	
Total other income	\$384,282	386,130	457,569	(1,848)	(0.5)	)%	(71,439)	(15.6)	)%

Student loan and guaranty servicing revenue consists of revenue generated by the Student Loan and Guaranty (a) Servicing operating segment. See "Student Loan and Guaranty Servicing Operating Segment – Results of Operations" in this Item 7 below for additional information.

Tuition payment processing and campus commerce revenue consists of revenue generated by the Company's (b) Tuition Payment Processing and Campus Commerce operating segment. See "Tuition Payment Processing and Campus Commerce – Results of Operations" in this Item 7 below for additional information.

Enrollment services revenue consists of revenue generated by the Company's Enrollment Services operating (c) segment. See "Enrollment Services Operating Segment - Results of Operations" in this Item 7 below for additional information.

(d) The following table summarizes the components of "other income."

	Year ended December 31,		
	2012	2011	2010
Borrower late fee income (1)	\$13,876	12,647	12,390
Investment advisory fees (2)	8,727	5,062	—
Investments - realized and unrealized gains/(losses), net	7,511	3,183	1,103
529 Plan administration fees	1,741	2,275	5,744
Other	7,621	6,346	12,073
Other income	\$39,476	29,513	31,310

(1) Borrower late fee income is earned by the education lending subsidiaries (in the Asset Generation and Management operating segment) and is recognized when payments are collected from the borrower.

(2) During 2011, the Company began to provide investment advisory services under various arrangements and earns annual fees of 25 basis points on the outstanding balance of investments and up to 50 percent of the gains from the sale of securities for which it provides advisory services. As of December 31, 2012 and December 31, 2011, the

outstanding balance of investments subject to these arrangements was \$669.3 million and \$394.2 million, respectively.

(e) The Company periodically engages in selling loans and repurchasing its debt. Depending on market conditions, the Company generally realizes gains on such transactions. "Gain on sale of loans and debt repurchases" includes the following:

	Year ended December 31, 2012			Year ended December 31, 2011			Year ended December 31, 2010		
	Notional amount	Purchase price	Gain	Notional amount	Purchase price	Gain	Notional amount	Purchase price	Gain
Gains on debt repurchases:									
Junior Subordinated Hybrid Securities	\$ 1,465	1,140	325	62,558	55,651	6,907	34,995	30,073	4,922
Asset-backed securities	134,667	130,969	3,698	12,254	12,199	55	690,750	650,789	39,961
	\$ 136,132	132,109	4,023	74,812	67,850	6,962	725,745	680,862	44,883
Gain on sale of loans			116			1,378			33,748
Gain on sale of loans and debt repurchases			\$4,139			8,340			78,631

The change in "derivative market value and foreign currency adjustments" is the result of the change in the fair value of the Company's derivative portfolio and transaction gains/losses resulting from the re-measurement of the Company's Euro-denominated bonds to U.S. dollars. These changes are summarized below. Valuations of (f) derivative instruments vary based upon many factors, including changes in interest rates, credit risk, foreign currency fluctuations, and other market factors. As a result, net gains and losses on derivatives and hedging activities may vary significantly from period to period.

	Year ended December 31,		
	2012	2011	2010
Change in fair value of derivatives - income (expense)	\$(27,833	) (50,513	) (77,134
Foreign currency transaction adjustment - income (expense)	(19,561	) 32,706	80,721
Derivative market value and foreign currency adjustments - income (expense)	\$(47,394	) (17,807	) 3,587

As discussed in footnote (a) to the "Consolidated Net Interest Income after Provision for Loan Losses (net of (g) settlements on derivatives)" table above, derivative settlements should be evaluated with the Company's net interest income.

### Consolidated Operating Expenses

Operating expenses includes indirect costs incurred to acquire student loans; costs incurred to manage and administer the Company's student loan portfolio and its financing transactions; costs incurred to service the Company's student loan portfolio and the portfolios of third parties; collection costs related to rehabilitation revenue; the cost to provide enrollment services; costs incurred to provide tuition payment processing and campus commerce products and services to third parties; the depreciation and amortization of capital assets and intangible assets; investments in products, services, and technology to meet customer needs and support continued revenue growth; and other general and administrative expenses. Operating expenses also includes impairment charges related to the impairment of goodwill and certain intangible assets. Operating expenses in 2010 includes employee termination benefits and lease termination costs related to restructuring activities and a litigation settlement charge.



As shown below, operating expenses, excluding direct costs to provide enrollment services, depreciation and amortization, impairment charges, restructuring charges, a litigation settlement, and collection costs related to loan rehabilitation revenue increased \$24.1 million (8.8%) for the year ended December 31, 2012 compared to 2011, and increased \$7.8 million (2.9%) for the year ended December 31, 2011 compared to 2010.

	Year ended December 31,			December 31, 2012 vs. 2011		December 31, 2011 vs. 2010		
	2012	2011	2010	Increase(Decrease)		Increase(Decrease)		
				\$	%	\$	%	
Salaries and benefits	\$192,826	177,951	166,011	14,875	8.4	% 11,940	7.2 %	
Other expenses	105,489	96,300	100,424	9,189	9.5	(4,124 )	(4.1 )	
Operating expenses, excluding cost to provide enrollment services, depreciation and amortization, impairment charges, restructuring charges, litigation settlement, and collection costs related to loan rehabilitation revenue	298,315	274,251	266,435	24,064	8.8	% 7,816	2.9 %	
Cost to provide enrollment services	78,375	86,548	91,647					
Depreciation and amortization	33,625	29,744	38,444					
Impairment expense (a)	2,767	—	26,599					
Restructure expense	—	—	6,020					
Litigation settlement (b)	—	—	55,000					
Collection costs related to loan rehabilitation revenue (c)	20,482	17,115	19,341					
Total operating expenses	\$433,564	407,658	503,486					

(a) The Company incurred impairments of certain intangible assets (2012 and 2010) and goodwill (2010) recorded at the Enrollment Services operating segment.

(b) The Company entered into a settlement agreement during 2010 to settle all claims associated with the "qui tam" action brought by Jon H. Oberg. As a result of the settlement, the Company recorded a \$55.0 million pre-tax charge.

(c) The Company incurred collection costs directly related to revenue earned from rehabilitation loans. These costs are included in "other" under the operating expense section of the consolidated statements of income and are shown separately in the above table for comparability purposes for the periods shown.

The increase in operating expenses over the last two years was due to the addition of resources and incurring other expenses to (i) support the growth in loan and guaranty servicing revenue and improve survey results related to the government servicing contract; (ii) support the hosted servicing software product; (iii) implement and comply with the Department's special direct consolidation loan initiative; and (iv) support the increase in the number of managed tuition payment plans and campus commerce customers.

#### Consolidated Income Taxes

The Company's effective tax rate was 35.0 percent and 36.5 percent for the years ended December 31, 2012 and 2011, respectively. The effective tax rate during 2012 decreased compared to 2011 due to various state changes and changes in the Company's gross unrecognized tax benefits liability. During 2012, state tax laws were enacted that reduced the Company's income tax expense by \$3.4 million. The Company currently expects the effective tax rate in 2013 will be 36 percent to 38 percent.

The Company's effective tax rate was 36.5 percent and 37.5 percent for the years ended December 31, 2011 and 2010, respectively. The effective tax rate during 2011 decreased compared to 2010 due to a decrease in the Company's valuation allowance, state incentive tax credits, and an overall reduction of the Company's state effective tax rate.

STUDENT LOAN AND GUARANTY SERVICING OPERATING SEGMENT – RESULTS OF OPERATIONS

Student Loan Servicing Volumes (dollars in millions)

Company owned	\$23,139	\$23,727	\$23,249	\$22,757	\$22,503	\$22,650	\$22,277	\$21,926	\$21,504
% of total	61.6%	38.6%	34.2%	33.0%	30.2%	29.8%	27.1%	25.6%	23.2%
Number of servicing borrowers:									
Government servicing:	441,913	2,804,502	2,814,142	2,666,183	2,966,706	3,036,534	3,096,026	3,137,583	3,588,412
FFELP servicing:	2,311,558	1,912,748	1,870,538	1,837,272	1,812,582	1,799,484	1,779,245	1,724,087	1,659,020
Private servicing:	152,200	155,947	154,106	151,734	162,950	164,554	163,135	161,763	175,070
Total:	2,905,671	4,873,197	4,838,786	4,655,189	4,942,238	4,717,250	5,000,572	5,038,406	5,023,433
Number of remote hosted borrowers									
	684,996	545,456	529,682	514,538	579,600	9,566,296	8,645,463	7,909,300	7,505,693



## Summary and Comparison of Operating Results

	Year ended December 31,			December 31, 2012 vs. 2011 Increase (Decrease)		December 31, 2011 vs. 2010 Increase (Decrease)	
	2012	2011	2010	\$	%	\$	%
Net interest income	\$53	58	62	(5 )	(8.6 )%	(4 )	(6.5 )%
Loan and guaranty servicing revenue	209,748	175,657	158,838	34,091	19.4	16,819	10.6
Intersegment servicing revenue	65,376	69,037	85,342	(3,661 )	(5.3 )	(16,305 )	(19.1 )
Other income	—	—	519	—	—	(519 )	(100.0 )
Total other income	275,124	244,694	244,699	30,430	12.4	(5 )	—
Salaries and benefits	115,126	102,878	95,293	12,248	11.9	7,585	8.0
Depreciation and amortization	18,415	15,313	13,755	3,102	20.3	1,558	11.3
Restructure expense	—	—	6,040	—	—	(6,040 )	(100.0 )
Other expenses	70,505	60,442	60,211	10,063	16.6	231	0.4
Intersegment expenses, net	5,280	4,776	5,074	504	10.6	(298 )	(5.9 )
Total operating expenses	209,326	183,409	180,373	25,917	14.1	3,036	1.7
Income before income taxes and corporate overhead allocation	65,851	61,343	64,388	4,508	7.3	(3,045 )	(4.7 )
Corporate overhead allocation	(5,904 )	(4,138 )	(5,856 )	(1,766 )	(42.7 )	1,718	29.3
Income before income taxes	59,947	57,205	58,532	2,742	4.8	(1,327 )	(2.3 )
Income tax expense	(22,780 )	(21,736 )	(22,243 )	(1,044 )	(4.8 )	507	2.3
Net income	\$37,167	35,469	36,289	1,698	4.8 %	(820 )	(2.3 )%
Before tax operating margin, excluding restructure expense	21.8 %	23.4 %	23.9 %				

## Loan and guaranty servicing revenue

	Year ended December 31,			December 31, 2012 vs. 2011 Increase (Decrease)		December 31, 2011 vs. 2010 Increase (Decrease)	
	2012	2011	2010	\$	%	\$	%
FFELP servicing (a)	\$24,255	26,653	37,013	(2,398 )	(9.0 )%	(10,360 )	(28.0 )%
Private servicing	9,201	9,911	9,304	(710 )	(7.2 )	607	6.5
Government servicing (b)	69,493	50,978	29,947	18,515	36.3	21,031	70.2
FFELP guaranty collection (c)	58,926	47,801	45,123	11,125	23.3	2,678	5.9
FFELP guaranty servicing (d)	13,183	16,249	18,503	(3,066 )	(18.9 )	(2,254 )	(12.2 )
Software services (e)	33,512	23,443	18,948	10,069	43.0	4,495	23.7
Other	1,178	622	—	556	89.4	622	100.0
Loan and guaranty servicing revenue	\$209,748	175,657	158,838	34,091	19.4 %	16,819	10.6 %

(a) FFELP servicing revenue decreased due to third-party customers' FFELP portfolios decreasing in size due to run off.

(b) Government servicing revenue increased due to the increase in the number of borrowers serviced.

(c) The Company earns revenue from rehabilitating defaulted FFELP loan assets on behalf of FFELP guaranty agencies. This revenue has increased based on an increase in defaulted loan volume. However, over time, this FFELP-related revenue source will decrease as FFELP portfolios continue to run off.

(d)

FFELP guaranty servicing revenue will continue to decrease as FFELP portfolios run off and guaranty volume decreases.

In October 2011, the Company began providing hosted student loan servicing to a significant customer, which resulted in an increase in software services revenue. The contract with this customer expires in December 2013, at (e) which time the Company expects the number of remote hosted borrowers and related revenue to significantly decrease. However, a portion of these borrowers will transfer to a full-service borrower under the Department's servicing contract. During 2012, \$14.7 million in software services revenue was earned from this customer.

The increase in remote hosted servicing revenue compared to prior periods was offset by a reduction in other software services revenue due to a decrease in the number of other products and services provided to external customers as a result of legislative changes in the student loan industry.

Intersegment servicing revenue. Intersegment servicing revenue includes servicing revenue earned for the Student Loan and Guaranty Servicing operating segment as a result of servicing loans for the Asset Generation and Management operating segment.

Operating expenses. Excluding restructure expense and collection costs related to guaranty collection revenue, 2012 operating expenses increased \$22.5 million (13.6%) in 2012 compared with 2011 and increased \$11.3 million (7.3%) in 2011 compared to 2010. These increases were due to incurring additional costs related to:

- Supporting the increase in government servicing volume.

- Supporting initiatives to improve performance metrics under the government servicing contract.

- Preparing for and supporting additional volume that was added to the Company's servicing platforms related to the hosted servicing software solution.

There is potential for continued compression of operating margin in this operating segment as a result of the government servicing portfolio growing as a percentage of the Company's total servicing portfolio.

## TUITION PAYMENT PROCESSING AND CAMPUS COMMERCE OPERATING SEGMENT – RESULTS OF OPERATIONS

This segment of the Company's business is subject to seasonal fluctuations which correspond, or are related to, the traditional school year. Tuition management revenue is recognized over the course of the academic term, but the peak operational activities take place in summer and early fall. Revenue associated with providing electronic commerce subscription services is recognized over the service period, with the highest revenue months being July through September and December and January. The Company's operating expenses do not follow the seasonality of the revenues. This is primarily due to generally fixed year-round personnel costs and seasonal marketing costs. Based on the timing of revenue recognition and when expenses are incurred, revenue and pre-tax operating margin are higher in the first quarter and lower in the second quarter.

### Summary and Comparison of Operating Results

	Year ended December 31,			December 31, 2012 vs. 2011 Increase (Decrease)		December 31, 2011 vs. 2010 Increase (Decrease)			
	2012	2011	2010	\$	%	\$	%		
Net interest income	\$8	21	32	(13	) (61.9	)%	(11	) (34.4	)%
Tuition payment processing and campus commerce revenue	74,410	67,797	59,824	6,613	9.8	7,973	13.3		
Salaries and benefits	34,314	30,070	27,180	4,244	14.1	2,890	10.6		
Depreciation and amortization	7,240	6,179	7,089	1,061	17.2	(910	) (12.8	)	
Other expenses	10,439	10,192	9,379	247	2.4	813	8.7		
Intersegment expenses, net	5,383	4,714	3,730	669	14.2	984	26.4		
Total operating expenses	57,376	51,155	47,378	6,221	12.2	3,777	8.0		
Income before income taxes and corporate overhead allocation	17,042	16,663	12,478	379	2.3	4,185	33.5		
Corporate overhead allocation	(1,968	) (1,379	) (1,952	) (589	) (42.7	)	573	29.4	
Income before income taxes	15,074	15,284	10,526	(210	) (1.4	)	4,758	45.2	
Income tax expense	(5,728	) (5,807	) (4,000	) 79	1.4	(1,807	) (45.2	)	
Net income	\$9,346	9,477	6,526	(131	) (1.4	)%	2,951	45.2	%
Before tax operating margin	20.3	% 22.5	% 17.6	%					

Tuition payment processing and campus commerce revenue. Tuition payment processing and campus commerce revenue has been increasing year over year as a result of an increase in the number of managed tuition payment plans as well as an increase in campus commerce customers.

Operating expenses. Operating expenses increased year over year as a result of incurring additional costs to support the increase in the number of managed tuition payment plans and campus commerce customers. In addition, the Company continues to invest in new products and services to meet customer needs and expand product and service offerings. The amount and types of investments made by the Company impacts operating expenses and operating margin from period to period. The operating expenses for the years ended December 31, 2012, 2011, and 2010 includes \$6.3 million, \$5.0 million, and \$5.8 million, respectively, of amortization expense related to intangible assets. Excluding amortization expense of intangible assets, the before tax operating margin for the years ended December 31, 2012, 2011, and 2010 was 28.7%, 29.9%, and 27.2%, respectively.

## ENROLLMENT SERVICES OPERATING SEGMENT – RESULTS OF OPERATIONS

## Summary and Comparison of Operating Results

	Year ended December 31,			December 31, 2012 vs. 2011 Increase (Decrease)		December 31, 2011 vs. 2010 Increase (Decrease)	
	2012	2011	2010	\$	%	\$	%
Enrollment services revenue	\$ 117,925	130,470	139,897	(12,545 )	(9.6 )%	(9,427 )	(6.7 )%
Salaries and benefits	22,816	25,155	24,827	(2,339 )	(9.3 )	328	1.3
Cost to provide enrollment services	78,375	86,548	91,647	(8,173 )	(9.4 )	(5,099 )	(5.6 )
Depreciation and amortization	6,491	6,854	15,771	(363 )	(5.3 )	(8,917 )	(56.5 )
Impairment expense	2,767	—	26,599	2,767	100.0	(26,599 )	(100.0 )
Other expenses	7,649	9,425	10,683	(1,776 )	(18.8 )	(1,258 )	(11.8 )
Intersegment expenses, net	3,768	3,521	2,467	247	7.0	1,054	42.7
Total operating expenses	121,866	131,503	171,994	(9,637 )	(7.3 )	(40,491 )	(23.5 )
Income (loss) before income taxes and corporate overhead allocation	(3,941 )	(1,033 )	(32,097 )	(2,908 )	(281.5 )	31,064	96.8
Corporate overhead allocation	(1,968 )	(1,379 )	(1,952 )	(589 )	(42.7 )	573	29.4
Income (loss) before income taxes	(5,909 )	(2,412 )	(34,049 )	(3,497 )	(145.0 )	31,637	92.9
Income tax (expense) benefit	2,244	917	12,935	1,327	144.7	(12,018 )	(92.9 )
Net income (loss)	\$(3,665 )	(1,495 )	(21,114 )	(2,170 )	(145.2 )%	19,619	92.9 %
Before tax operating margin, excluding impairment expense	(2.7 )%	(1.8 )%	(5.3 )%				

## Enrollment services revenue, cost to provide enrollment services, and gross profit

Year ended December 31, 2012

	Inquiry Generation (a)	Inquiry Management (Agency) (a)	Inquiry Management (Software) (b)	Digital Marketing (c)	Content Solutions (d)	Total
Enrollment services revenue	\$ 17,650	72,930	3,620	4,850	18,875	117,925
Cost to provide enrollment services	10,717	64,705	—	268	2,685	78,375
Gross profit	\$ 6,933	8,225	3,620	4,582	16,190	39,550
Gross profit %	39.3%	11.3%				

Year ended December 31, 2011

	Inquiry Generation (a)	Inquiry Management (Agency) (a)	Inquiry Management (Software) (b)	Digital Marketing (c)	Content Solutions (d)	Total
Enrollment services revenue	\$ 24,556	78,804	2,690	4,455	19,965	130,470
Cost to provide enrollment services	14,552	69,533	—	317	2,146	86,548
Gross profit	\$ 10,004	9,271	2,690	4,138	17,819	43,922
Gross profit %	40.7%	11.8%				

Year ended December 31, 2010

	Inquiry Generation (a)	Inquiry Management (Agency) (a)	Inquiry Management (Software) (b)	Digital Marketing (c)	Content Solutions (d)	Total
Enrollment services revenue	\$ 27,228	84,148	1,659	4,848	22,014	139,897
Cost to provide enrollment services	15,266	73,243	—	403	2,735	91,647
Gross profit	\$ 11,962	10,905	1,659	4,445	19,279	48,250
Gross profit %	43.9%	13.0%				

Inquiry generation revenue decreased \$6.9 million (28.1%) and \$2.7 million (9.8%) and inquiry management (a)(agency) revenue decreased \$5.9 million (7.5%) and \$5.3 million (6.4%) for the years ended December 31, 2012 and 2011, respectively, compared to 2011 and 2010, respectively, due to a decrease in client activity.

Revenues from these services have been affected by the ongoing regulatory uncertainty regarding recruiting and marketing to potential students in the for-profit college industry, which has caused schools to decrease spending on marketing efforts. The Company is focused on increasing revenue and gross margin from 2012 operating results by increasing quality inquiries and volume.

Inquiry management (software) revenue increased \$0.9 million (34.6%) and \$1.0 million (62.1%) for the years ended December 31, 2012 and 2011, respectively, compared to 2011 and 2010, respectively, due to an increase in (b)client activity and the number of clients. The Company believes it will continue to see continued growth in software revenue as existing customers expand their use of the software and new customers and service offerings are added.

Digital marketing revenue increased \$0.4 million (8.9%) and decreased \$0.4 million (8.1%) for the years ended December 31, 2012 and 2011, respectively, compared to 2011 and 2010, respectively. Revenue increased in 2012 due to the Company's investment in on-line college and university product offerings and decreased in 2011 due to decreased sales of essay editing services.

Content solutions revenue decreased \$1.1 million (5.5%) and \$2.0 million (9.3%) for the years ended December 31, 2012 and 2011, respectively, compared to 2011 and 2010, respectively, as a result of a decrease in list marketing services and a decrease in the size of a contract with a significant government customer. The Company expects continued decreases in content solutions revenue as list marketing revenue continues to decrease.

Depreciation and amortization. Depreciation and amortization for the years ended December 31, 2012, 2011, and 2010, includes \$1.7 million, \$2.7 million, and \$6.6 million, respectively, of amortization expense related to student list costs and \$4.1 million, \$3.7 million, and \$8.4 million, respectively, of amortization expense of intangible assets. In 2010, the Company accelerated the amortization of student list costs to better reflect the pattern in which the economic benefit of this asset is used to generate revenue. As of December 31, 2012, all Enrollment Services' intangible assets are fully amortized.

Impairment expense. In 2012, the Company recognized an impairment charge of \$2.8 million related to student list costs. In addition, in 2010, as a result of the annual goodwill impairment test, the Company recorded impairment charges at two reporting units included in the Enrollment Services operating segment. These charges consisted of \$23.9 million related to its inquiry generation and management business and \$2.7 million related to its list marketing business.

Operating expenses. Excluding the cost to provide enrollment services, depreciation and amortization, and impairment expense, operating expenses for the years ended December 31, 2012 and 2011 decreased \$3.9 million (10.2%) and increased \$0.1 million, respectively, compared to 2011 and 2010, respectively. The decrease in operating expenses in 2012 was due to cost saving measures made by the Company in reaction to the ongoing decline in revenue in this segment. Operating expenses in 2011 were flat compared to 2010 due to a reduction in facilities costs, offset by investment in new products and services to meet customer needs and expand service offerings.

#### ASSET GENERATION AND MANAGEMENT OPERATING SEGMENT – RESULTS OF OPERATIONS

##### Student Loan Portfolio

As of December 31, 2012, the Company has a \$24.8 billion student loan portfolio that will amortize over the next approximately 20 years. For a summary of the Company's student loan portfolio as of December 31, 2012 and December 31, 2011, see note 3 of the notes to the consolidated financial statements included in this report.

##### Loan Activity

The following table sets forth the activity of loans classified as “held for investment”:

	Year ended December 31,		
	2012	2011	2010
Beginning balance (loans held for investment)	\$24,359,625	23,784,069	23,635,874
Loan originations	—	—	831,048
Loan acquisitions	3,885,138	2,841,334	3,371,116
Total originations and acquisitions (a)	3,885,138	2,841,334	4,202,164
Repayments, claims, capitalized interest, participations, and other	(1,807,144 )	(1,650,489 )	(1,221,662 )
Consolidation loans lost to external parties (b)	(1,331,163 )	(585,230 )	(599,927 )
Loans sold (c)	(110,576 )	(30,059 )	(2,141,124 )
Loans reclassified to held for sale	—	—	(91,256 )
Ending balance (loans held for investment)	\$24,995,880	24,359,625	23,784,069

As a result of legislation effective July 1, 2010, all new federal loan originations are made by the Department of Education through the Federal Direct Loan Program and the Company no longer originates FFELP loans.

(a) However, the Company believes there will continue to be opportunities to purchase FFELP loan portfolios from current FFELP participants looking to adjust their FFELP businesses.

(b)



On October 25, 2011, the White House and the Department announced a short-term special direct consolidation loan initiative to eligible student loan borrowers, with a borrower application period beginning in January 2012 and ending June 30, 2012. The Department's initiative allowed student loan borrowers with at least one FFELP loan and at least one federal student loan owned by the Department to convert the FFELP loans to the Federal Direct Loan Program. As a result of this initiative, the amount of loans lost to external parties has increased compared to prior periods. For the year ended December 31, 2012, the Company lost FFELP loans of \$936.4 million as a result of this initiative.

During 2010, the Company sold \$2.1 billion of student loans to the Department under a program that provided (c)liquidity to student loan lenders. Loans sold during 2012 and 2011 related to delinquent loans funded in the Department's conduit program and were sold as required by the provisions of that facility.

#### Allowance for Loan Losses, Loan Repurchase Obligations, and Loan Delinquencies

The provision for loan losses represents the periodic expense of maintaining an allowance sufficient to absorb losses, net of recoveries, inherent in the portfolio of student loans.

In addition, the Company's servicing operations are obligated to repurchase certain non-federally insured loans subject to participation interests in the event such loans become 60 or 90 days delinquent, and the Company has also retained credit risk related to certain non-federally insured loans sold and will pay cash to purchase back any of these loans which become 60 days delinquent. The Company's estimate related to its obligation to repurchase these loans is included in "other liabilities" in the Company's consolidated balance sheets.

Delinquencies have the potential to adversely impact the Company's earnings through increased servicing and collection costs and account charge-offs.

For a summary of the activity in the allowance for loan losses and accrual related to the Company's loan repurchase obligations for the years ended December 31, 2012, 2011, and 2010, and a summary of the Company's federally insured student loan delinquency amounts as of December 31, 2012, 2011, and 2010, see note 3 of the notes to the consolidated financial statements included in this report.

The delinquency trends in the Company's portfolio of federally insured loans were higher in 2012 as compared to 2011 and 2010, due to the sustained downturn in the economy and delinquent loans that were acquired in 2012. The increased delinquencies resulted in an increase in the provision for loan losses on federally insured loans.

The Company's non-federally insured loan portfolio has decreased since 2008 as a result of loan sales, runoff, and the Company no longer originating non-federally insured loans. The amortization of the non-federally insured student loan portfolio has resulted in provision expense being less than charge-offs during the years ended December 31, 2012, 2011, and 2010.

#### Student Loan Spread Analysis

The following table analyzes the student loan spread on the Company's portfolio of student loans, which represents the spread between the yield earned on student loan assets and the costs of the liabilities and derivative instruments used to fund the assets.

	Year ended December 31,					
	2012		2011		2010	
Variable student loan yield, gross	2.63	%	2.58	%	2.64	%
Consolidation rebate fees	(0.75)	)	(0.72)	)	(0.68)	)
Premium and deferred origination costs amortization, net of discount accretion	—		(0.09)	)	(0.20)	)
Variable student loan yield, net	1.88		1.77		1.76	
Student loan cost of funds - interest expense	(0.98)	)	(0.84)	)	(0.83)	)
Student loan cost of funds - bonds and notes payable discount accretion	(0.11)	)	(0.06)	)	—	
Student loan cost of funds - derivative settlements	0.03		0.05		0.03	

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Variable student loan spread	0.82		0.92		0.96	
Fixed rate floor income, net of settlements on derivatives	0.62		0.60		0.52	
Core student loan spread	1.44	%	1.52	%	1.48	%
Average balance of student loans	\$23,694,388		24,045,003		25,212,190	
Average balance of debt outstanding	23,932,304		24,237,459		25,327,210	

A trend analysis of the Company's core and variable student loan spreads is summarized below.

Prior to April 1, 2012, the interest earned on the majority of the Company's FFELP student loan assets was indexed to the three-month commercial paper rate. As allowed by legislation, effective April 1, 2012, the Company elected to change the index on which the Special Allowance Payments are calculated for FFELP loans from the commercial paper rate to the one-month LIBOR rate. The Company funds the majority of its assets with (a) three-month LIBOR indexed floating rate securities. The relationship between the indices in which the Company earns interest on its loans and funds such loans has a significant impact on student loan spread. This table (the right axis) shows the difference between the Company's liability base rate and the one-month LIBOR (Q2 2012 - Q4 2012) or commercial paper rate indices (Q1 2010 - Q1 2012) by quarter.

Variable student loan spread decreased during the year ended December 31, 2012 as compared to the prior years as a result of the widening of the Asset/Liability Base Rate spread as reflected in the previous table.

The primary difference between variable student loan spread and core student loan spread is fixed rate floor income, net of settlements on derivatives. A summary of fixed rate floor income and its contribution to core student loan spread follows:

	Year ended December 31,				
	2012	2011	2010		
Fixed rate floor income, gross	\$164,615	164,700	151,861		
Derivative settlements (a)	(19,270 )	(20,246 )	(19,618 )		
Fixed rate floor income, net	\$145,345	144,454	132,243		
Fixed rate floor income contribution to spread, net	0.62	% 0.60	% 0.52		%

(a) Includes settlement payments on derivatives used to hedge student loans earning fixed rate floor income.

The high levels of fixed rate floor income earned during 2012, 2011, and 2010 are due to historically low interest rates. If interest rates remain low, the Company anticipates continuing to earn significant fixed rate floor income in future periods. See Item 7A, "Quantitative and Qualitative Disclosures about Market Risk - Interest Rate Risk," which provides additional detail on the Company's portfolio earning fixed rate floor income and the derivatives used by the Company to hedge these loans.

## Summary and Comparison of Operating Results

	Year ended December 31,			December 31, 2012 vs. 2011 Increase (Decrease)		December 31, 2011 vs. 2010 Increase (Decrease)	
	2012	2011	2010	\$	%	\$	%
	Net interest income after provision for loan losses	\$324,906	347,811	362,059	(22,905)	(6.6)%	(14,248)
Other income	18,219	15,416	18,639	2,803	18.2	(3,223)	(17.3)
Gain on sale of loans and debt repurchases	3,814	1,433	73,709	2,381	166.2	(72,276)	(98.1)
Derivative market value and foreign currency adjustments, net	(51,809)	7,571	3,046	(59,380)	(784.3)	4,525	148.6
Derivative settlements, net	(11,792)	(7,228)	(13,336)	(4,564)	(63.1)	6,108	45.8
Total other income	(41,568)	17,192	82,058	(58,760)	(341.8)	(64,866)	(79.0)
Salaries and benefits	2,252	2,791	4,524	(539)	(19.3)	(1,733)	(38.3)
Other expenses	16,435	13,381	12,759	3,054	22.8	622	4.9
Intersegment expenses, net	66,215	70,018	85,268	(3,803)	(5.4)	(15,250)	(17.9)
Total operating expenses	84,902	86,190	102,551	(1,288)	(1.5)	(16,361)	(16.0)
Income before income taxes and corporate overhead allocation	198,436	278,813	341,566	(80,377)	(28.8)	(62,753)	(18.4)
Corporate overhead allocation	(5,306)	(6,896)	(9,759)	1,590	23.1	2,863	29.3
Income before income taxes	193,130	271,917	331,807	(78,787)	(29.0)	(59,890)	(18.0)
Income tax expense	(73,387)	(103,327)	(126,086)	29,940	29.0	22,759	18.1
Net income	\$119,743	168,590	205,721	(48,847)	(29.0)%	(37,131)	(18.0)%
Additional information:							
Net income	\$119,743	168,590	205,721	(48,847)	(29.0)%	(37,131)	(18.0)%
Derivative market value and foreign currency adjustments, net	51,809	(7,571)	(3,046)	59,380	784.3	(4,525)	(148.6)
Tax effect	(19,687)	2,877	1,157	(22,564)	(784.3)	1,720	148.7
Net income, excluding derivative market value and foreign currency adjustments	\$151,865	163,896	203,832	(12,031)	(7.3)%	(39,936)	(19.6)%

## Net interest income after provision for loan losses (net of settlements on derivatives).

	Year ended December 31,			December 31, 2012 vs. 2011 Increase (Decrease)		December 31, 2011 vs. 2010 Increase (Decrease)	
	2012	2011	2010	\$	%	\$	%
	Variable interest income, net of settlements on derivatives (a)	\$630,267	633,486	674,826	(3,219)	(0.5)%	(41,340)
Consolidation rebate fees (b)	(178,211)	(174,387)	(170,998)	(3,824)	(2.2)	(3,389)	(2.0)
Premium and deferred origination costs amortization, net of discount accretion (c)	47	(21,095)	(50,731)	21,142	100.2	29,636	58.4
Interest on bonds and notes payable (d)	(233,714)	(204,946)	(210,968)	(28,768)	(14.0)	6,022	2.9

Bonds and notes payable discount accretion (e)	(26,368)
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