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Valuing a Student Loan ABS Portfolio

In our February 21, 2005, newsletter, we discussed the rudiments of student loan asset-backed security (SLABS) portfolios. As promised, DBRS will now focus on student loan portfolio valuation.

DBRS assesses a portfolio's quality based on applicant-provided pool and loan-/obligor-level data. We review credit risk and estimated overall payment speed within the context of the proposed transaction's cash flow structure and comparatively with previously issued securitizations. Particularly in the fragmented private student loan market, access to historical performance is a crucial analytical requirement.

Portfolio analysis will also include determining how factors such as borrower status (parent or child), field of study, academic institution, geographic concentration, and loan term affect portfolio performance.

Cash Flow Modeling: DBRS will analyze the proposed transaction and request ratings-driven cash flow stress scenarios, providing prepay and loss assumptions consistent with the student loan pool characteristics. Key analytical considerations will include:
- Loan default volume, severity and timing ,
- Applicable guaranty levels, historical claim rates and payment delays,
- Loan pool prepayment and extension risks, and
- Interest rate and basis risk, as well as applicable reinvestment rates.

Such analysis will take into consideration timing of both the government and alternative student loan life cycles, as discussed below.

Structural and Legal Evaluation: DBRS examines applicable legal opinions to assess the strength of a proposed transaction's bankruptcy-remote structure. As student loan-backed securities are issued by one of three types of entities (state agencies, not-for-profit organizations, and for-profit companies), the appropriate sections of the U.S. Bankruptcy Code are applied when assessing for the risk of special-purpose entity (SPE) consolidation with respect to the obligations of the student borrower, the loan seller, and the SLABS SPE.

Due Diligence: DBRS schedules meetings with the proposed transaction's originator/facilitator and its master servicer. For government guaranteed loans, the servicer's compliance with Department of Education (DOE) guaranty regulations is stressed. For alternative loans, collection procedures are key. DBRS also takes into consideration the servicer's financial strength and that of any selected alternate servicer.

Conclusion: While the credit risk of student loan pools resembles other forms of non-collateralized consumer debt, the asset class is distinctive with respect to (1) the relatively limited credit history of most borrowers, (2) the loans' irregular "stop and go" payment terms, and (3) the industry's highly specialized operational requirements. SLABS cash flow structures reflect these characteristics. Consequently, DBRS has designed analytical criteria that reflect the unique nature of this asset class and its securitization structures. As the student loan securitization market evolves, DBRS will continue to reassess its methodology in a manner that is both analytically comprehensive for investors and operationally transparent for issuers.