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Servicing Alternative Student Loan ABS – Part 1

Every asset class has unique servicing requirements and potential operational pitfalls. Within the rapidly growing and diversifying universe of student loan securitizations, these requirements are bifurcated into two very distinct collateral subsets, U.S. government reinsured loans (Federal Family Education Loan Program or FFELP) and private market (alternative) loans. This newsletter is the first of a series being published by DBRS addressing the specialized world of alternative student loan servicing. These newsletters expand upon and complement the servicing section of DBRS's report, The Core Curriculum.

Alternative vs. FFELP Servicing Requirements

The history of student loan securitization is similar to that of the oldest of securitized asset classes, residential mortgages (RMBS). Both asset classes started with U.S. government guaranteed products channeled through securitization vehicles structured by government sponsored enterprises (GSEs) to create highly creditworthy and liquid securities for institutional investors. So-called "government-sponsored" student loan securitizations were very different from their RMBS counterparts, however, in that the form of U.S. government guarantee was found at the loan-level. GSE RMBS, on the other hand, benefited (and still benefit) from security-level guarantees. This important distinction is at the root of the salient characteristic of FFELP servicing, very specific and very strict, loan-by-loan Department of Education (DOE) program compliance. Like their FFELP counterparts, alternative student loans securitizations are also driven by a loan-by-loan analytical process. For alternative loans, however, this process is driven by individual obligor collateral credit performance rather than government program compliance. Consequently, FFELP and alternative student programs must be managed differently by specialized, experienced professionals using the latest appropriate underwriting and servicing technology. SLABS originators and servicers should, therefore, be divided into three basic categories:

- FFELP specialists;
- Alternative loan specialists; and
- FFELP/alternative combination shops.

While there are many analytical, operational, and general management skill sets common to both FFELP and alternative loan specialists, proven expertise in one specialty is not, in and of itself, a qualification for the other. Key factors that should be considered in reviewing both the underwriting and servicing of alternative loans include:

- Consumer credit analytical resources and underwriting standards as applicable to both stand-alone and co-signed student loans, taking into consideration the relatively short credit history of the borrowers.
- Adaptability of FFELP-driven software programs to an alternative market (piggy-back vs. overhaul vs. new package).
- Relative uniformity and transparency of U.S. government programs vs. the potentially unlimited product diversity and statistical incompleteness of alternative programs.
- Very large number of originators vs. a relatively small number of qualified servicers.
- Applicable private lending Federal and State consumer laws.

Conference Call

DBRS will host its "Semi Annual review of the U.S. Structured Finance Markets" conference call on Thursday, June 23, at 1:00 pm (EST). Toll-free # 1-877-211-7911; Pass code: 3156327#. Toll-free replay (available for one month to July 22nd) # 1-800-408-3053; Pass code: 3156327#.