

Structured Finance Newsletter

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DIRECT STUDENT LOAN LENDER – THE U.S. GOVERNMENT

On Tuesday, March 30, 2010, President Barack Obama signed into law, the Healthcare and Education Reconciliation of 2010, a law that includes provisions which significantly alter the student-loan marketplace and that has industry participants scrambling to accommodate the July 1st deadline for compliance by universities and colleges. Under the new law student loans will be originated directly by the Department of Education (“DOE”) under the William D. Ford Direct Student Loan Program (the “Program”). The new law ends the ability of private banks to originate student loans backed by the U.S. government and discontinues the Federal Family Education Lending Program (“FFELP”) which provided insurance to student loan lenders. Private lenders can still make student loans that are not supported by the U.S. government.

The government takeover of the student loan lending business is designed to subsidize costs related to funding additional grants and loans for students, in addition to the more widely publicized funding of healthcare costs. The Program has also been advertised as a tool for providing greater funding to community colleges and schools with a predominantly minority populations. It has been estimated by the Congressional Budget Office that the Program will result in a savings to taxpayers of \$61 billion over the next 10 years. Of this amount, over \$40 billion has been allocated for student loan programs including grants to low and moderate income families and an increase in available amounts under the Pell Grant program (which assisted over 6 million students in 2009).

Interestingly, one of the stated goals of the government’s new involvement is not to bring down the cost of financing an education for students. President Obama acknowledges this fact and rather calls upon universities and colleges to be responsible and to “do their part” to keep costs down. Interest rates will be set by Congress for the Program, with the initial undergraduate Stafford Loan limit set at 6.8%. Students will benefit from the new repayment caps that include a limit of 10% of discretionary income for loans made after July 1, 2014. In addition, members of certain professions including teaching, nursing, police and military, will be eligible for debt forgiveness after 10 years of service.

The DOE is evaluating its servicing needs and is expected to contract with outside parties for assistance with administration and servicing of the student loans. Sallie Mae and other established servicers are expected to have roles as servicers of the DOE originated loan portfolios. Servicing may also be provided by state agencies and offices that have increased their presence in the student loan marketplace following the development of the credit crisis and seizure of the financial markets. However, even with these servicing roles many industry participants are expecting dramatic changes in operations. Sallie Mae, an employer of over 8,000, has stated that it may need to reduce workforce by up to one third to appropriately size its organization.

The changes will also dramatically affect the student loan structured finance market with only non-government supported loans likely to be available as collateral for future capital markets transactions. Given the specificity and complexity of the underlying loans themselves and overall transaction structures, the longevity of the asset class is seriously in question. Even in the periods leading up to this change student loan issuance has been largely absent from the recovering capital markets with only two deals completed in the first quarter of 2010 for approximately \$1.8 billion, according to Asset-Backed Alert. DBRS will continue to monitor the impact of this new law on student loan lending and the capital markets.

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