

# U.S. Structured Finance Newsletter

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**Claire J. Mezzanotte**  
Managing Director,  
ABS/RMBS/Covered Bonds  
Structured Finance,  
+1 212 806 3272  
[cmezzanotte@dbrs.com](mailto:cmezzanotte@dbrs.com)

**Jan Buckler**  
Senior Vice President,  
Research and Modeling  
Structured Finance  
+1 212 806 3250  
[jbuckler@dbrs.com](mailto:jbuckler@dbrs.com)

**Rosemary Kelley**  
Senior Vice President, ABS  
Structured Finance  
+1 212 806 3250  
[rkelley@dbrs.com](mailto:rkelley@dbrs.com)

**Chris O'Connell**  
Senior Vice President, ABS  
Structured Finance  
+1 212 806 3253  
[coconnell@dbrs.com](mailto:coconnell@dbrs.com)

**Quincy Tang**  
Senior Vice President, RMBS  
Structured Finance  
+1 212 806 3256  
[qtang@dbrs.com](mailto:qtang@dbrs.com)

**Kathleen Tillwitz**  
Senior Vice President,  
Operational Risk, ABS/RMBS  
Structured Finance  
+1 212 806 3265  
[ktillwitz@dbrs.com](mailto:ktillwitz@dbrs.com)

**Chuck Weillmann**  
Senior Vice President, ABS  
Structured Finance  
+1 212 806 3226  
[cweillmann@dbrs.com](mailto:cweillmann@dbrs.com)

**New York**  
140 Broadway, 35th Floor  
New York, NY 10005  
+1 212 806 3277

**Chicago**  
101 North Wacker Drive  
Suite 100  
Chicago, IL 60606  
+1 312 332 3429

**Toronto**  
DBRS Tower  
181 University Avenue  
Suite 700  
Toronto, ON M5H 3M7  
+1 416 593 5577

## FINANCIAL REFORM IMPACT ON STUDENT LOAN INDUSTRY

On July 15, 2010, Congress passed the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (H.R. 4173) which will have a significant impact on student loan ABS. This financial reform bill is over 2,300 pages long and is now being sent to President Obama for his signature this week. This legislation will impact the student loan industry on many fronts including the following:

- **Bureau of Consumer Financial Protection** – There will be a newly created Bureau of Consumer Financial Protection (Bureau) which will be a new "independent" federal agency housed within the Federal Reserve. The Bureau will be responsible for regulation of consumer financial service products provided by banks and non-banks including private student loans. The Bureau will have the authority to determine underwriting and marketing standards for private student loans and the disclosure requirements for prospective borrowers. The Bureau will also have supervision authority over loans made by all non-banks and banks with more than \$10 billion in assets. Banks with below \$10 billion in assets will still need to comply with the regulations set by the Bureau; however, the enforcement of the regulations will remain with current regulators.
- **Private student loan ombudsman** – The Bureau will include a private student loan ombudsman who will be responsible for assisting borrowers who have disputes on their private student loans. The ombudsman will work closely with the federal student loan ombudsman at the U.S. Department of Education who is responsible for disputes related to federal student loans. In connection with the review of complaints, the private loan ombudsman will be tasked with looking for patterns of abuse by lenders and will make policy recommendations to Congress and in an annual report to the Secretaries of Education and the Treasury.
- **Credit risk retention** – The bill requires issuers to retain a 5% risk retention in asset backed securities. The regulation allows for a total or partial exemption for municipal and 150(d) issuers as long as the exemption is in the public interest and for the protection of investors.

There were also two particular provisions that were proposed but dropped from consideration. These included discharging private student loans when an obligor enters bankruptcy and the requirement of school certification of private loans before a student could receive them. This provision would have enabled college financial aid offices to counsel students regarding their borrowing options in order to suggest that students use federal borrowing and other options ahead of private student loans.

While the regulations address the topics broadly, the ultimate impact of this legislation on the student loan industry will be realized over time as the specific regulations are enacted. In combination with the Student Aid and Fiscal Responsibility Act (SAFRA), which eliminated the Federal Family Education Loan Program, DBRS expects continued consolidation of student loan lenders, many of whom offered both FFELP and private student loan products. We also expect a concomitant reduction in the number and types of loan products offered to students and their parents. As a result of the Bureau's oversight of lending standards and marketing, DBRS expects loan underwriting criteria to become more standardized across lenders and more transparent to investors in private student loan securities. The impact on student loan financings with regards to the credit risk retention provision will depend on the final set of rules that are promulgated. As risk retention could be in the form of a portion of each security or a first loss piece, that is structured to absorb student loan net losses, the economics of private student loan securities will vary considerably. The provision may lead some issuers to find alternative sources.

DBRS will closely monitor the development of this regulation and its potential impact on the performance of student loan issuers/servicers and student loan transactions.

For questions or comments, please contact Rosemary Kelley at [rkelley@dbrs.com](mailto:rkelley@dbrs.com).