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Case No. 12111-VCS

**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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| IN RE NATIONAL COLLEGIATE STUDENT LOAN TRUSTS LITIGATION | ) | CONS. C.A. No. 12111-VCS |

**MOTION FOR LEAVE TO PARTICIPATE AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS**

The Structured Finance Association ("SFA"), by and through its undersigned counsel, respectfully moves for leave to participate in this action as *amicus curiae* in support of Defendants and to file the Brief of Proposed *Amicus Curiae* Structured Finance Association (the "Brief," attached hereto as Exhibit A). Through the Brief, SFA seeks to assist the Court by providing important context and background information about the securitization market, and by explaining how three particular arguments offered by Plaintiffs—that (1) they are or should be entitled to certain control rights over the securitizations by virtue of their residual equity ownership interests, (2) they have the ability to direct the trust to incur certain expenses to be paid out on a priority basis under the transaction documents, and (3) the Granting Clauses in the Indentures granted only a security interest in the securitization's underlying assets—run contrary to both the transaction terms at issue in this litigation and established securitization market practice, as well as the foundational principles that underlie securitizations as a whole. The bases of this Motion are set forth below.

## BACKGROUND

1. The present consolidated proceeding arises from disputes related to fifteen Delaware statutory trusts formed through the National Collegiate Student Loan Trusts (the "Trusts"), collectively holding approximately $15 billion in securitized student loans. Through their Motion for Judgment on the Pleadings pursuant to Delaware Court of Chancery Rule 12(c), Plaintiffs—holders of residual equity interests in the Trusts—seek declaratory relief with respect to their rights and benefits under the Trusts' governing agreements.

2. For the reasons explained in the Brief, however, Plaintiffs' requested relief and the arguments they rely upon ignore the plain terms of the Trusts' transaction terms and run contrary to settled industry understandings regarding how securitizations are fundamentally structured. If judicially endorsed, Plaintiffs' requested relief will set a precedent that threatens to disrupt the multi-trillion dollar securitization industry.

3. In order to provide the Court with the benefit of the unique perspective offered by SFA's members—over 360 members representing all sectors of the securitization industry—on a matter of important public interest for the national economy, SFA respectfully petitions the Court of Chancery for leave to file the enclosed Brief as *amicus curiae* in support of Defendants.

## ARGUMENT

4. The Court of Chancery has "no rule governing the submission of *amicus curiae* briefs . . . [but] such briefs are permitted at the Court's discretion." *La. Mun. Police Emps' Ret. Sys. v. Hershey Co.*, 2013 WL 1776668, at *1 (Del. Ch. Apr. 16, 2013); *see also Turnbull for Turnbull v. Fink*, 644 A.2d 1322, 1324 (Del. 1994) ("The privilege to be heard as an *amicus curiae*¸ as well as the manner and extent of participation, rests within the discretion of the court.") Accordingly, this Court permits participation by *amicus curiae* in appropriate circumstances. *See, e.g.*, *Jimenez v. Palacios*, 2019 WL 3526479, at *8 (Del. Ch. Aug. 2, 2019), *as revised* (Aug. 12, 2019); *Hershey Co.*, 2013 WL 1776668, at *2; *In re Trulia, Inc. Stockholder Litig*., 129 A.3d 884, 890 (Del. Ch. 2016).

5. Where, as here, all parties are represented by counsel, it is appropriate for the Court to permit submissions by *amicus curiae* in cases of "general public interest." *Giammalvo v. Sunshine Mining Co*., 644 A.2d 407, 409 (Del. 1994).

6. "When both sides are represented by counsel, the purpose of an *amicus curiae* is to (1) assist the Court by 'supplementing the efforts of counsel . . . in a case of general public interest'; or (2) draw attention to 'broader legal or policy implications that might otherwise escape its consideration in the narrow context of a specific case.'" *Hershey Co.*, 2013 WL 1776668, at *1 (quoting *Giammalvo*, 644 A.2d at 409 (Del. 1994)).

7. Here, SFA seeks to assist the Court in both respects. SFA will complement and "supplement the efforts of counsel" by providing important context and background information about the securitization market, including with respect to established securitization market practices as well as the foundational principles that form the bedrock of the securitization industry.

8. Moreover, through its participation as a prominent member-based industry advocacy group that represents all sectors of the securitization market, SFA will also 'draw attention' to the broader economic implications of this action "that might otherwise escape [the Court's] consideration in the narrow context of" a contract interpretation dispute involving fifteen Delaware statutory trusts.

9. The Court's resolution of this action will have significant implications for the multi-trillion dollar securitization market. A decision favoring Plaintiffs would not only be contrary to established market practices, but also threatens to disrupt the securitization market by undermining basic, foundational principles underlying all securitizations to the detriment of market participants and the economy as a whole.

10. Participation by *amicus curiae* is especially appropriate where, as here, the proposed *amicus curiae* possesses a "unique perspective" regarding an "important public issue before the court." SFA submits that this case presents such an "important public issue" and that its proposed *amicus* brief would assist the Court

by supplementing the efforts of counsel with a "unique perspective" on the issues in this action.

## **CONCLUSION**

For the foregoing reasons, SFA respectfully requests that the Court grant it leave to participate as *amicus curiae* in the manner set forth in the enclosed form of order.

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# EXHIBIT A

**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

| | | |
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| IN RE NATIONAL COLLEGIATE STUDENT LOAN TRUSTS LITIGATION | ) ) ) ) | CONS. C.A. No. 12111-VCS |

**BRIEF OF PROPOSED *AMICUS CURIAE* STRUCTURED FINANCE ASSOCIATION**


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## INTRODUCTION

The Structured Finance Association ("SFA") has respectfully moved for leave to file this brief as an *amicus curiae*, in order to provide the Court with background on the structure and process of securitizations and their importance to the economy generally and to students needing loans to further their educations in particular. Through this brief, SFA seeks to explain to the Court the potentially harmful and destabilizing impact on the securitization industry that would result from Plaintiffs' arguments and requested relief, which—among other things—would subvert well-established market understandings regarding the alignment of control rights and economic interests in securitizations and seek to re-write securitization contracts without the consent of the affected parties, thereby disrupting the certainty afforded to securitization contract terms that comprises a key aspect of the industry's success.

## STATEMENT OF INTEREST AS *AMICUS CURIAE*

SFA is a member-based trade industry advocacy group focused on improving and strengthening the structured finance and securitization market. With over 360 members, SFA represents all sectors of the securitization market, including investors, issuers, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. SFA was established with the core mission of supporting a robust and liquid securitization market, recognizing that securitization is an essential source of core funding for the real economy. As part of

that core mission, SFA is dedicated to furthering public understanding among members, legislators, regulators and other constituencies about structured finance, securitization, and related capital markets.

While SFA's members play diverse roles and have varying economic interests in the securitization market, SFA's members share the common goal of having securitizations administered in accordance with settled industry expectations, which includes ensuring that securitization agreements are interpreted in accordance with their terms. SFA and its members thus have a strong interest in the outcome of this action, because Plaintiffs' arguments and requested relief contradict and undermine basic, foundational principles that underlie the fundamental structure of securitizations, thereby threatening to substantially disrupt the multi-trillion dollar U.S. securitization market. SFA thus respectfully submits this brief in support of Defendants.

## SUMMARY OF ARGUMENT

Securitization, a key mechanism for facilitating liquidity in the credit markets and expanding the availability of credit and lowering its cost to consumers, small businesses and corporations, represents a critical component of the national economy. In this brief, SFA respectfully seeks to provide the Court with important context and background information about the multi-trillion dollar securitization

market, as well as to address how the arguments advanced and relief urged by Plaintiffs threaten to destabilize the entire securitization market.

*First*, SFA will explain to this Court how securitizations are structured and summarize the basic mechanics behind the securitizations at issue in this case. In addition, SFA will also discuss the importance of securitization to the national economy, including with respect to how the securitization of student loans benefits student borrowers.

*Second*, SFA will focus on three specific arguments offered by Plaintiffs, namely (i) that they are or should be entitled to certain control rights over the securitizations by virtue of their residual equity ownership interests (*see* Section II.A), (ii) that they have the ability to direct the trust to incur certain expenses to be paid out on a priority basis under the transaction documents (*see* Section II.B, below), and (iii) that the Granting Clauses in the Indentures granted only a security interest in the securitization's underlying assets (*see* Section II.C). SFA will discuss how these arguments run contrary to both the transaction terms at issue in this litigation and established securitization market practice, as well as the foundational principles that underlie securitizations as a whole. SFA also will discuss why Plaintiffs' arguments threaten to disrupt the securitization market.

# ARGUMENT

## I. SECURITIZATION IS CRITICAL TO THE HEALTH OF THE LENDING MARKETS AND, MORE BROADLY, THE NATIONAL ECONOMY

### A. The Structure of Securitizations

Broadly speaking, securitization is the pooling of various types of assets that generate regular cash flows—such as residential and commercial real estate mortgages, credit card receivables or, as in this case, student loans—into a special purpose vehicle, often a trust, which then issues securities to third party investors, the interest and principal payments of which are funded by the cash flows accruing to the assets in the trust. At a high level, structuring a securitization is a five step process. While the mechanics of a student loan securitization is described below, the process is similar for securitizations of other types of assets.

*First*, a bank, specialized lender, or with respect to FDLP loans described below, the U.S. Department of Education, makes the loan to a student borrower. In the securitization industry, this is referred to as "originating" the loan. Securitized student loans generally fall into three categories: (1) Federal Family Education Loan Program (FFELP) student loans, which are guaranteed or originated by the U.S. Department of Education, with terms and conditions authorized under the Higher

Education Act,[1] (2) loans issued by the federal government through the William D. Ford Direct Loan Program (FDLP),[2] and (3) private student loans, which are consumer loans offered to borrowers funded by banks or private lending institutions. Any student loan borrower may choose to consolidate or refinance their private and/or federal loans with a private bank or lending institution, which is referred to as a "refinancing" or "consolidation" of the loans. Certain federal student loans may also be consolidated through the U.S. Department of Education.

*Second*, a "sponsor" identifies or "designates" student loans to be included into what is often referred to as the reference portfolio, or collateral pool. Typically, the sponsor is the originating financial institution, but it also may be an originating financial institution's affiliate or another entity that has purchased the loans from the originating financial institution.

*Third*, the sponsor sells the pool of designated student loans to an entity called the "depositor," which is typically a wholly-owned but legally separate subsidiary of the sponsor. The purpose of selling the loans to the depositor before they are securitized is to separate legally (*i.e.*, isolate) the loans from the originating financial

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[1] Although FFELP loan originations ceased in 2010, the loan portfolios are still extant and new issues of asset-backed securities collateralized by FFELP loans continue to this day.

[2] FDLP loans cannot be securitized directly, but they can be consolidated or refinanced through a private lender.

institution, as securitization investors are looking to take on the risk and reward of the performance of the specific securitized loans, but not the credit risk of the originating financial institution or sponsor. This legal separation ensures that investors in the securitization are protected from the risk of the sponsor's potential insolvency, but it also means that investors can only look to the securitized loans for repayment of their investment in the securitization. Because of this, the depositor is typically a single purpose entity (or "SPE"), also referred to as a special purpose vehicle (or "SPV"), that has no assets other than the designated loans and no liabilities, employees or operations. The depositor is formed for the sole purpose of acting as a conduit for transferring such student loans to the "issuer."

*Fourth*, the depositor sells the student loans to an "issuer," typically a trust. While the issuer is also an SPE, unlike the depositor, it may not be an affiliate of the sponsor or depositor. Through an investment bank underwriter, the issuer then sells interest-bearing securities—usually in the form of notes—to third party investors. In this transaction, payments on the investors' securities are paid by—or "backed" by—payments made on the underlying loans, which is why the securities are referred to as "asset-backed securities." Put another way, once student loans are sold to an issuer SPE and designated for a securitization, the funds from the student borrowers' payment of principal, interest, and fees on their loans are used to pay the principal, interest and other amounts owed to the investors who own the securities. A portion

of the proceeds received from the sale of those securities to investors is collected by the issuer and paid to the depositor in exchange for the securitized loans, who in turn pays the sponsor for these loans.

*Fifth*, the sponsor often will use the cash proceeds generated from the sale of such securities, directly or indirectly, to make new loans to student borrowers (for example, if the sponsor is the originating financial institution) or to buy new loans from other originating financial institutions.

Upon the closing of a securitization transaction, oversight, administration and management of the issuer (here, a trust for illustrative purposes) and the trust assets typically are performed by various parties, including trustees, servicers, and administrators, respectively. Depending on the structure of the transaction, the indenture trustee (acting on behalf of the investors or "Noteholders" in the securitization) typically performs limited administrative duties relating to the securities (such as those of the securities registrar and paying agent) and, subject to the terms and conditions of the trusts, enforces certain rights and remedies on behalf of the trust and the investors, all as specifically enumerated in the relevant trust agreements and indentures. Servicers interact and communicate with borrowers and manage their accounts, collect and process payments on the underlying assets, and handle delinquent and defaulted assets. Servicers also remit the payments they collect to the trustee for distribution to investors pursuant to a predetermined

payment schedule—colloquially referred to as a 'waterfall'—that prioritizes the sequence in which investors and other transaction parties are paid, as outlined in the transaction documents.

A key feature of securitization transactions is that the issued securities are typically divided into tranches or classes, each with its own prescribed payment terms as well as a specified ranking as to the priority in which each tranche will receive principal and interest payments, or be allocated losses on the underlying assets. In a typical structure, tranches are divided into senior, mezzanine, and junior classes or tranches. Holders of interests in the securities—*i.e.*, Noteholders in the case at hand—in the various tranches are paid according to their position in the waterfall, with payments cascading from the senior tranches, to the mezzanine tranches, and finally, to the junior tranches in a fixed order. Generally, the most senior tranches have first priority to receive distributions of the cash flows generated by the asset pool after pre-determined expenses of the issuer have been paid (*i.e.*, payment obligations to securitization servicers, trustees and any other administrative agents), while the more junior tranches start receiving distributions only after the payment obligations to investors in the senior and mezzanine tranches and subordinated issuer expenses have been fulfilled. Losses on the assets backing the tranches are typically allocated in reverse order of priority, with losses allocated to the most junior tranche first, and the most senior tranche last. In other words, if

amounts received from the assets in the securitization pool are insufficient to make payments on the securities—for example, when the securitization's underlying student loans experience a rate of default above an anticipated level—the most junior tranche absorbs losses first, followed by the next most junior tranche, each protecting the senior classes or tranches above it until the losses exceed the entire amount of the subordinated tranches. Due to the lower risk profile for the more senior tranches, the expected investment yield for such senior tranches usually is lower than for junior, higher risk tranches.

The most junior tranche in a securitization structure is typically referred to as the residual, equity, or ownership interest.[3] While there are different kinds of residual interests depending on the type of securitization, these interest holders are generally paid last in the waterfall, and receive the residual remaining cash flow (if any) from the securitized assets only after all of the other more senior classes or tranches are paid in full and all expenses of the trust have also been paid in full. Residual interest holders are also the first in line to absorb losses on the underlying trust assets—often referred to as the "first loss position"—and thus are most exposed to default risk. By absorbing losses before more senior tranches, residual interests

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[3] *See, e.g.*, Jason H.P. Kravitt & Christine Vincent, *Securitization of Financial Assets* § 2.01 (3rd ed. 2020) (defining "residual interest" as "the most subordinated claim on a pool of securitized assets").

provide credit enhancement[4] to such senior tranches, reducing the volatility of distributions and risk associated with the more senior tranches.

A summary of the parties to a securitization transaction is set forth in the following table:

| ***Party*** | ***Role in Securitization*** |
|---|---|
| Originator / Originating financial institution | Originators generate the assets to be securitized (*e.g.*, by making loans to borrowers). |
| Sponsor | The sponsor—often the same entity as the originator—identifies and pools the assets to be securitized before selling them to the depositor. |
| Depositor | The depositor is typically a legally separate subsidiary of the sponsor that is created solely to legally separate assets from the originator and transfer assets to the issuer.[5] |
| Issuer | The issuer—usually a trust—purchases the assets, then sells securities backed by the assets to third party investors. These securities are typically separated into different classes or tranches. |
| Underwriter | The underwriter organizes and markets the securitization's securities for sale to third party investors, and often sells the securities as well. |
| Investor | Investors purchase the securities and are therefore entitled to receive principal repayments and interest based on cash flows generated by the student loan assets in the securitization pool.<br><br>How and when investors are paid, or are allocated losses resulting from the performance of the asset pool, depends on |

[4] Credit enhancement is a risk-reduction method that provides protection, in the form of financial support, to help cover losses on securitized assets.

[5] The role of the depositor is sometimes, though not always, present in securitization transactions in which case the loans are sold directly to the issuer.

| *Party* | *Role in Securitization* |
|---|---|
| | which tranche or class of securities have been purchased by the investor. |
| Trustee | Trustees are banks appointed by the issuer (usually a trust) to perform limited administrative duties relating to the securities and to enforce certain provisions of the securitization agreements. Trustees generally oversee the disbursement of cash flow to investors pursuant to the securitization waterfall. |
| Indenture Trustee | Indenture Trustees administer the trust that issues the classes or tranches of notes that are sold to investors, pursuant to an indenture, and, under specified conditions, act on behalf of the noteholders (*i.e.*, parties that purchase the notes). |
| Owner Trustee | Owner Trustees administer the trust that issues certificates representing beneficial ownership interests in the issuer's equity, and, under specified conditions, act on behalf of the certificateholders/residual interest holders (*i.e.*, parties that purchase or retain the certificates). |
| Servicer | Servicers provide payment collections services and remit payments they collect to the trustee. |
| Administrator | Administrators typically consist of a trustee or affiliate of the sponsor that handles certain administrative functions and corporate management services on behalf of the issuer. |
| Residual interest holders | Residual interest holders, who hold certificates representing beneficial ownership interests in the issuer, typically occupy the most junior position in the securitization waterfall, and as such, are generally first to absorb losses and are paid only the "residual" cash flow (if any) after all other classes or tranches have been paid in full. |

### B. The Securitizations at Issue

The securitizations at issue in this case were fifteen Delaware statutory trusts formed through the National Collegiate Student Loan Trusts (the "Trusts"), collectively holding approximately $15 billion in student loans. Each of the Trusts

is governed by a Trust Agreement, an Indenture, and an Administration Agreement.[6] The Trusts are administered, as specified by their governing documents, by the Owner Trustee (Wilmington Trust Company), the Indenture Trustee (U.S. Bank National Association), and the Administrator (GSS Data Services, Inc.).

Under the terms of the Trust Agreements, the Owner Trustee executed the Indentures with the Indenture Trustee on behalf of the Trusts. The Trusts then issued debt securities in the form of notes (the "Notes") pursuant to the Indentures in order to finance the purchase of the student loan collateral. Purchasers of these Notes (the "Noteholders") are entitled to receive principal repayments and interest from amounts collected from the student loans' borrowers. To secure repayment of the Notes, the Trusts granted their right, title, and interest in and to the student loans and assigned all of their rights under the documents underlying the securitizations (including the Trust Agreements and the agreements related to the underlying student loans) to the Indenture Trustee pursuant to provisions in each of the Indentures (the "Granting Clauses") for the benefit of the Noteholders and, with respect to three of the fifteen Trusts, the Note Insurer. The resulting two-trust structure—as represented by the Indenture Trustee and Owner Trustee with their

[6] Because Ambac Assurance Corporation (the "Note Insurer") issued policies guaranteeing payments on certain notes for three of the Trusts, these three trusts are also governed by an Insurance Agreement.

respective trusts—is specifically contemplated to provide the Noteholders with more rights and protections by giving governing rights over the securitization to the Indenture Trustee until the Indenture is discharged.

The fifteen Trusts at issue in this action are thus distinguishable from typical non-securitization Delaware statutory trusts that are solely governed by their trust agreements. Instead, by executing the Indentures as part of the process of securitizing the student loans, the Trusts are accordingly subject to contractual obligations and covenants that are designed to (among other things) protect the priority position of the Noteholders (and where applicable, the Note Insurers) in the securitization's structure. These obligations and covenants limit the rights and authority held by the Owner Trustee for the benefit of the residual interest holders (because of the junior position of the residual interest holders in the securitization's structure) and remain in place until the Indenture is discharged and the Notes are fully repaid.

### C. Securitizations Provide Investment Opportunities for Investors While Reducing Costs for Borrowers

Securitization as a financial practice dates back to the 1970s, beginning with the third party financing of pools of mortgages.[7] Prior to this, banks issuing loans

[7] Office of the Comptroller of the Currency, *Asset Securitization: Comptroller's Handbook* 2 (Nov. 1997) [hereinafter *Comptroller's Handbook*],

would typically engage in portfolio lending—*i.e.*, holding loans until they matured or were paid off. However, the portfolio lending model suffered from a number of disadvantages. For example, under the portfolio lending model, a bank's funds available for loans were limited by the financial institution's deposits and debt, which created a necessary limitation on the number and amount of loans offered and therefore how competitive loan terms would likely be. The portfolio lending model also potentially exposed lenders to high levels of risk, as financial institutions that issued loans to various segments of borrowers in different markets and geographic areas would necessarily be exposed to significant financial risk if those particular segments of borrowers, markets or geographic areas experienced an economic downturn. The development of securitization as a financial practice mitigated these risks for banks, and also allowed banks to transfer credit risks from customer lending to the broader financial system by expanding the investor base for such loans.[8] Securitization also provides many additional benefits to the national economy,

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https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/asset-securitization/pub-ch-asset-securitization.pdf.

[8] U.S. Dep't of the Treasury, *A Financial System That Creates Economic Opportunities: Capital Markets* 18 (Oct. 2017) [hereinafter *Treasury Report*], https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

including facilitating efficient access to capital markets, minimizing issuer-specific limitations on the ability to raise capital, and monetizing illiquid assets.

In particular, securitization benefits investors by permitting investment in different types of assets—in this particular case, student loans—without exposure to the credit risk of the sponsor. While securitizations present an appealing investment opportunity to a broad range of investors, the "diversification benefits, liquidity, and yield" of these investments are particularly attractive to institutional investors such as insurance companies, pension funds, and other investment funds.[9] Moreover, securitizations also have the added benefit of providing investors with a high measure of flexibility, because payment streams and credit enhancements can be structured to meet investors' differing asset diversification, risk, and duration requirements.[10]

With respect to the securitization of student loans specifically, securitization provides significant benefits for student borrowers. For the 2019-2020 academic year, the average cost of one year at a four-year private college was $49,870.[11] Likewise, the average annual costs for an in-state and out-of-state student at a public

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[9] *Id.*

[10] *Comptroller's Handbook*, *supra* note 7, at 4.

[11] College Bd., *Published Charges by Sector and by Carnegie Classification, 2019-20* 1 (2019), https://research.collegeboard.org/pdf/2019-trendsincp-table-1.pdf. This figure is inclusive of tuition, fees, and room and board.

university were $21,950 and $38,330, respectively.[12] Due to the high cost of post-secondary education, 54% of students who went to college took on some debt for their education in 2019, with outstanding student debt in the United States amounting to approximately $1.5 trillion in total.[13] Federal student loans are limited to a certain dollar amount, an amount dependent upon factors such as the school and type of borrower. Often times, private student loans serve to cover tuition costs above federal loan limits.[14] The private student loan market accounts for approximately $125 billion of the total outstanding student debt, a market which commonly relies on funding from securitization.[15] Student loans, however, present a number of unique challenges and risks for lenders that distinguish them from other

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[12] *Id.*

[13] Bd. of Governors of the Fed. Reserve Sys., *Report on the Economic Well-Being of U.S. Households in 2018 – May 2019 - Student Loans and Other Education Debt* (Jan. 30, 2020), https://www.federalreserve.gov/publications/2019-economic-well-being-of-us-households-in-2018-student-loans-and-other-education-debt.htm; Fed. Reserve Bank of N.Y., *Quarterly Report on Household Debt and Credit, 2019: Q2* 1 (Aug. 2019), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/hhdc_2019q2.pdf.

[14] *See* U.S. Dep't of Education Fed. Student Aid Office, *The US Department of Education offers low-interest loans to eligible students to help cover the cost of college or career school* (last visited June 30, 2020), https://studentaid.gov/understand-aid/types/loans/subsidized-unsubsidized#how-much.

[15] *See* Elan Amir, Jared Teslow & Christopher Borders, *The MeasureOne Private Student Loan Report* 7, MeasureOne (December 11, 2019), https://www.measureone.com/industry-report.

forms of consumer debt, including the significant time lag between loan advances and repayment, the counter-cyclical nature of student borrowing, and the student borrowers' lack of certainty in finding a stable, reliable source of funds to repay loans after graduation.[16] Through the process of securitization—pooling student loan debt, then selling interests in them to investors as securities—lenders can partly offset these risks by spreading the risks to third parties, thus allowing lenders to provide student borrowers with access to more loans as well as loans at lower interest rates.

### D. Securitization's Key Role in the National Economy

Securitization has become a fundamental source of capital to support the national economy. As of the end of the third quarter of 2019, there were approximately $12.1 trillion in total outstanding mortgage-backed securities and asset-backed securities.[17] With respect to student loans specifically, approximately $173 billion of student loan debt is currently securitized into student loan asset-

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[16] Office of the Comptroller of the Currency, *Comptroller's Handbook: Student Lending* 5 (May 2016), https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/student-lending/pub-ch-student-lending.pdf.

[17] Sec. Indus. & Fin. Mkts. Ass'n, *US MBS Issuance and Outstanding* (June 8, 2020), https://www.sifma.org/resources/research/us-mbs-issuance-and-outstanding/; Sec. Indus. & Fin. Mkts. Ass'n, *US ABS Issuance and Outstanding* (June 8, 2020), https://www.sifma.org/resources/research/us-abs-issuance-and-outstanding/.

backed securities as of the third quarter of 2019.[18] The volume of securities issuances also provides another means of demonstrating the prevalence of securitization in the economy. In 2019, there were over $3 trillion in new mortgaged-backed securities and asset-backed securities issuances, of which over $15 billion were new issues of student loan securitizations.[19]

The high level of securitization in the economy has allowed for significant investment into lending markets. As of the third quarter of 2019, outstanding student debt totaled $1.5 trillion.[20] The fact that $173 billion of student loan debt is currently financed by securitization represents billions of dollars in loans that might not have otherwise been made available to student borrowers without the access to funding provided by securitization.

The benefits generated by securitizations to market participants and the overall economy should not be underestimated. The U.S. government has expressly

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[18] Sec. Indus. & Fin. Mkts. Ass'n, *US ABS Issuance and Outstanding* (June 8, 2020), https://www.sifma.org/resources/research/us-abs-issuance-and-outstanding/.

[19] Sec. Indus. & Fin. Mkts. Ass'n, *US MBS Issuance and Outstanding* (June 8, 2020), https://www.sifma.org/resources/research/us-mbs-issuance-and-outstanding/; Sec. Indus. & Fin. Mkts. Ass'n, *US ABS Issuance and Outstanding* (June 8, 2020), https://www.sifma.org/resources/research/us-abs-issuance-and-outstanding/.

[20] Fed. Reserve Bank of N.Y., *Household Debt Continues to Climb in Third Quarter as Mortgage and Auto Loan Originations Grow* (Nov. 13, 2019), https://www.newyorkfed.org/newsevents/news/research/2019/20191113.

described securitization as “a vital financial tool to facilitate growth in our domestic economy,” and has stated that securitization should be viewed “as a byproduct of, and safeguard to, America’s global financial leadership.”[21]

## II. THE ARGUMENTS OFFERED BY THE RESIDUAL OWNERS ARE CONTRARY TO ESTABLISHED MARKET PRACTICE AND MAY LEAD TO MARKET DISRUPTION

### A. Securitization Governance and Control Aligns With Priority Economic Interests

It is well-established in the securitization industry that securitizations operate as investment vehicles affording priority economic rights to protect the interests of the noteholders according to their position in the cashflow waterfall and the economic value of those provisions. For example, substantial steps are taken in the securitization process to protect noteholders economically in accordance with the seniority of their notes, which include credit enhancement measures such as subordinating tranches of securitization debt and the formation of cash reserve accounts that are typically payable to the most senior tranches of securities.

[21] *Treasury Report*, *supra* note 8, at 91.

Securitization transactions are also contractually structured to align control rights[22] with economic interests in order to attract third party investors.

Alignment of control rights with economic interests is illustrated by the structure of a typical securitization transaction, where the indenture grants to the noteholders the power to undertake or approve significant amendments by the trust. In the indenture and the trust agreement, the residual interest holders typically are proscribed from undertaking such actions until all notes are paid in full. Other such significant trust actions include the authority to waive events of default under the securitization documents, accelerate the maturity date of the notes after the occurrence of an event of default, and institute legal proceedings against the trust.

Furthermore, the offering documents upon which potential investors in both the notes and residual interests base their decisions typically include explicit disclosures notifying potential investors in the residual certificates that residual interest holders will have limited legal remedies and voting rights until all notes are paid in full. Investors in both notes and residual certificates receive this disclosure prior to investing in either the notes or residual certificates, and the notes—and in

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[22] In the securitization context, "control rights" generally refer to the power to control the trusts as well as the securitized assets. Control rights include the right to amend the securitization documents as well as the right to direct the trusts to undertake certain actions, including selling, transferring and/or disposing the trusts' assets.

some instances, the residual certificates—have an agreed-upon yield[23] based upon this information. For instance, the prospectus for one of the securitizations at issue in this action expressly discloses, with respect to the residual or owner certificates:

> On the closing date, the trust will issue privately a single class of owner trust certificates to the depositor and TERI. The owner trust certificates will represent the beneficial ownership interests in the trust's assets. *The owner trust certificates will not have a principal balance and will not bear interest. On each distribution date, the owner trust certificates will not be entitled to any distributions with respect to the Available Funds until all amounts owed to the noteholders have been paid.* Once a distribution has been made in respect of the owner trust certificates, it will not be available to pay any of the noteholders.[24]

Thus, residual interest holders—whose economic interests in a securitization, like the ones in question, are subordinate to those of the noteholders—generally have little to no rights to direct a securitization trust until *after* all the notes have been paid in full and the related indenture has been discharged. As a consequence, securitizations are managed for the benefit of all interest holders, taking into account the relative economic priorities of such interest holders. In this regard, a securitization is markedly distinguishable from a corporation, where the corporate entity is managed for the benefit of its equity shareholders. *See, e.g.*, *Bandera*

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[23] In many cases residual certificates are not structured to receive payments of interest.

[24] National Collegiate Student Loan Tr. 2007-4, Prospectus Supplement, at S-81 (Sept. 19, 2007) (emphasis added).

*Master Fund LP v. Boardwalk Pipeline Partners, LP*, 2019 WL 4927053, at *14 (Del. Ch. Oct. 7, 2019) (corporate directors "must seek 'to promote the value of the corporation for the benefit of its stockholders'"). Securitizations are distinguishable from corporations for the further reason that securitizations and corporations are structured in diametrically opposing ways: while corporations are usually organized to exist indefinitely with unlimited returns to stockholders over time, securitizations are typically structured with a scheduled termination date and capped returns to investors. Hence the reason why securitizations are structured and managed in a way that reflects the relative economic priorities of interest holders—the capped nature of securitization returns makes it essential that the senior interest holders who purchase the least risky investments in the securitization's assets are protected.

Moreover, as noted above in Section I.A, residual interest holders typically occupy the most junior position in the securitization waterfall, and are entitled to periodic distributions (any remaining residual cash flows) in accordance with the securitization documents and <u>only</u> after all other, more senior tranches and all expenses have been paid in accordance with the transaction waterfall. Indeed, residual certificates issued in connection with a securitization are typically maintained and retained by the sponsor "for tax reasons or to provide credit

enhancement to the third party investors in the trust by subordinating such retained interest."[25]

The Residual Owners' claims that they are entitled to control the Trusts and the Trusts' assets by virtue of their position as residual interest holders is contrary to the foundational understandings in the securitization market regarding the alignment of control rights and economic interests, described above. The crux of many of the Residual Owners' requested declarations is the argument that securitizations are designed so that the Residual Owners have control rights throughout the life of the securitization because, as they are entitled to only residual distributions, they have an interest in preserving the corpus of the trusts.[26] For instance, the Residual Owners claim that "the Trusts exist[] for the benefit of the Owners, not the Noteholders," that "the Owners have the right to direct the Owner Trustee with respect to nonministerial matters concerning the Trust," and seek judicial declarations to that effect from the Court. (Plaintiffs' Br. at 59, 38.) However, because the Residual Owners occupy the bottom of the Indentures' waterfalls, accepting the Residual Owners' claims would mean that investors with the most subordinated tranche in the

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[25] Jason H.P. Kravitt & Christine Vincent, *Securitization of Financial Assets* § 4.02(B) (3rd ed. 2020).

[26] *See, e.g.*, Plaintiffs' Opening Brief in Support of their Motion for Judgment on the Pleadings ("Plaintiffs' Br."), Doc. ID 64846623, Declarations E, F, G, H, I, J, K, L, M.

transaction—which is intended to absorb losses and provide credit enhancement for the senior tranches in the securitization waterfall— would now have the ability to exercise control over the securitization in a way that inverts the waterfall's priority of payments. The Residual Owners would effectively be able to divert distributions away from the intended recipients to provide themselves and their high-risk investments with distributions to which they are not entitled under the terms of the securitization documents, all at the expense of investors with more senior tranches that were originally structured to provide those investors with a low-risk investment in the Trust's assets. This undermines, and indeed, directly contradicts, the foundational alignment of control rights with economic rights that undergirds the structure of a tranched securitization.

A judicial endorsement of these arguments will thoroughly disrupt the reasonable and contractually documented expectations of market participants, not least of all investors. Investors participate in hundreds of billions of dollars-worth of securitizations each year based in part on the expectation that market participants and parties to transactions will adhere to the securitization's basic, foundational principles. Allowing the Residual Owners to exercise essentially unfettered control over the Trusts and the Trusts' assets before the Notes are discharged, as they are attempting to do through their requested declarations, would have a significant

chilling effect on investments in securitizations and be highly destructive to the securitization market as a whole.

### B. The Reassignment of Expenses Related to Management of Securitization Is Contrary to Established Industry Practice

In general, the waterfall provisions that govern cash flow allocation in securitizations pay the administrative fees and expenses incurred by the securitization's servicers and agents (including trustees) in managing the securitization's trusts and underlying assets *prior* to distributing the cash flow to noteholders in order of seniority. In other words, administrative fees and expenses are usually paid out at the top of the securitization's waterfall. With respect to expenses, securitization transactions—including the ones at issue in this litigation—typically limit the amount of Owner Trustee and Indenture Trustee (as well as other parties') expenses that can be paid by the trust prior to payments being made to noteholders. These "expense caps" are critical to modeling cash flows to be paid to noteholders, which is an essential component of the rating agency analysis conducted in connection with assigning credit ratings to the various classes of notes. As described in credit rating criteria for private student loan asset-backed securities, one of the many factors considered by the ratings agencies is "the priority of payments in the transaction documents to identify the relative seniority of each class

of notes and the transaction's other obligations."[27] Additionally, with respect to capping expenses within a transaction, "[u]ncapped senior fees and expenses might pose a risk to timely payment of interest to the noteholders, because an unexpected spike in uncapped fees in any given month at the top of the payment waterfall could exhaust all available cash flow for the month"—as noted in S&P's rating methodology for global structured finance.[28]

In this action, the Residual Owners request a number of judicial declarations related to expenses—specifically, the Residual Owners argue that they may direct the Owner Trustee to categorize certain expenses, including expenses incurred by professionals retained at the Residual Owners' direction and without the knowledge or consent of the Owner Trustee, as Owner Trustee expenses that are paid at the top of the securitizations' waterfalls.[29] The Residual Owners' expenses-related requests, however, run contrary to established industry practice and norms. In particular, the Residual Owners' argument that they have the ability to reassign the relevant

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[27] Fitch Ratings, Inc., *U.S. Private Student Loan ABS Rating Criteria* 7 (June 12, 2020), https://www.fitchratings.com/research/structured-finance/us-private-student-loan-abs-rating-criteria-12-06-2020.

[28] Standard & Poor's Fin. Servs., LLC, *Criteria | Structured Finance | General: Global Framework for Cash Flow Analysis of Structured Finance Securities* 6 (Oct. 9, 2014), https://www.standardandpoors.com/en_US/web/guest/ratings/ratings-criteria/-/articles/criteria/structured-finance/filter/general.

[29] *See, e.g.*, Plaintiffs' Br., Declarations W, X, O, P, Q, R, S, T.

expenses as Owner Trustee expenses subverts the foundational alignment between investment risk and a securitization waterfall's priority of payments at the crux of the securitization process. Indeed, allowing the Residual Owners to cause their own expenses to be categorized in a way that would allow them to be covered by Trust assets on a priority basis at the *top* of the waterfall is fundamentally at odds with the Residual Owners' economic stake in the Trusts as the holders of the most volatile, high-risk interests that are only entitled to residual cashflow (if any) to be paid at the *bottom* of the waterfall after all of the other obligations of the Trust have been satisfied.

Moreover, the Residual Owners' requested judicial relief with respect to expenses also is atypical because such relief would undermine the Owner Trustee's ability, pursuant to the Trust Agreements, to avoid acting in violation of the other transaction documents.

### C. The Residual Owners are Fundamentally Misinterpreting the Underlying Documents With Respect to the Indentures' Granting Clauses

In a securitization transaction, the rights, obligations, and roles of all the parties involved are governed by various interlocking contracts between the participants in the transaction, including (depending on the nature of the underlying securities) the trust agreements, the indentures, the administration agreements, servicing agreements, and/or pooling and servicing agreements. The securitization

industry has operated for decades on the premise that these carefully-negotiated contracts reflect the understandings and expectations of all participants in the securitization, as well as their agreement on how rights, responsibilities, and risk will be allocated.[30] Because the certainty afforded to contract terms comprises a key aspect of the structured finance industry's long-established market norms, disrupting that certainty by re-writing contracts without the consent of the affected parties would not only violate the settled expectations of the relevant parties, but also set a precedent that would disrupt the broader securitization market.

The interpretation of the Granting Clause urged by the Residual Owners, however, runs contrary to settled industry understanding regarding the primacy of bargained-for contractual terms and essentially amounts to re-writing the securitization contracts without the consent of the parties. Specifically, the Residual Owners argue that the Indentures' Granting Clauses granted only a security interest in the Trusts' assets and "did not assign or pledge the power to assert all claims on

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[30] In this respect, contrary to what the Residual Owners claim, the dispute at issue over the scope of the Granting Clauses is not analogous to a bankruptcy priority dispute, where the court does not adjudicate the intent of the parties but instead relies upon independent standards to determine on an equitable basis, for example, whether a transaction constitutes a true assignment or a sale. *See* Plaintiffs' Single Combined Answering Brief in Response to Rule 12(c) Opening Briefs Filed by Wilmington Trust, U.S. Bank, the Minority Noteholders, and Ambac, Doc. ID 65598761 at 14-18. Here, in the securitization context, the rights and obligations of the parties turn on the bargained-for terms of the securitization agreements.

behalf of the Trusts" relating to the rights encompassed by the Grant. (Plaintiffs' Br. at 17.) To this end, the Residual Owners argue that with respect to interpreting the scope of the Granting Clauses, "the plain language in this context does not control."[31]

Given the importance placed on bargained-for contractual terms in the securitization context as well as by the Delaware Statutory Trust Act, which "give[s] maximum effect to the principle of freedom of contract and to the enforceability of governing instruments,"[32] however, it is precisely the plain language of the Granting Clauses that reflects the parties' intent regarding the scope of its grant. Here, the plain terms of the Granting Clauses clearly indicate that the Granting Clauses effect a broad and complete assignment of "*all* present and future *claims*" stemming from "*all* . . . right, title, and interest" the Trusts have with respect to the assets and contracts specified in the Granting Clauses, which include the student loans of the

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[31] *In re Nat'l Collegiate Student Loans Tr. Litig.*, Cons. C.A. No. 12111-VCS, at 14 (Del. Ch. May 15, 2020) (TRANSCRIPT).

[32] 12 Del. C. § 3825(b); *also PHL Variable Ins. Co. v. Price Dawe 2006 Ins. Tr., ex rel. Christiana Bank & Tr. Co.*, 28 A.3d 1059, 1077 (Del. 2011) ("[T]he policy of the Delaware Statutory Trust Act is to give maximum effect to freedom of contract and the enforceability of governing instruments."); *Cargill, Inc. v. JWH Special Circumstance LLC*, 959 A.2d 1096, 1111–12 (Del. Ch. 2008) ("Delaware statutory trusts were designed with flexibility in mind . . . Consistent with this emphasis on freedom of contract, the Act enables the parties to bargain for modifications to the traditional default duties and standards of liability applicable to fiduciaries.").

Trusts and payments on those loans as well as the Indentures and Trust Agreements.[33]

Moreover, the public policy imperative that issuers adhere to their obligations under the indentures under which they issue debt securities to the public is a vital one that has been expressly reflected in the Trust Indenture Act of 1939. Indeed, issuer adherence to the indentures is of critical importance to market participants. If issuers could discard indenture provisions they find inconvenient, investors would cease to invest in the securities due to the now-unreliable nature of the securitization documentation and the capital markets would not be able to function, thereby jeopardizing the national economy. With their novel interpretation of the Granting Clauses' scope, the Residual Owners clearly propose to jettison a foundational component of the securitizations at issue. The Granting Clauses form a critical part of the Indentures by effecting a comprehensive assignment and pledge of *all* the Trusts' rights in the underlying assets to the Indenture Trustee as security for the Trusts' obligations to the Noteholders, until the Notes have been repaid in full and

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[33] Joint Answering Brief in Opposition to Plaintiffs' Motion for Judgment on the Pleadings, Doc. ID 65599430, at 37 (emphasis added).

the Indentures are discharged. It is thus of utmost importance that the plain terms of the Granting Clauses are adhered to by the Issuer.

Finally, the Residual Owners' interpretation of the Granting Clauses is contrary to industry understanding for the further reason that it contradicts the fundamental principle that tranched securitizations are investment vehicles designed to provide protections primarily for investors in the senior positions of the securitization waterfall. (*See* Section II.A, above.) Participants in a securitization thus agree to convey all rights in the securitization trusts' assets to the indenture trustee for the benefit of the noteholders (and the note insurer, where applicable) in furtherance of this principle. The Residual Owners' argument that the Granting Clauses merely grant a security interest in the Trusts' assets represents yet another attempt to contradict this fundamental principle underlying securitization to the detriment of market participants and the economy as a whole.

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Case No. 12111-VCS

**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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| IN RE NATIONAL COLLEGIATE STUDENT LOAN TRUSTS LITIGATION | ) ) ) ) | CONS. C.A. No. 12111-VCS |

**[PROPOSED] ORDER GRANTING MOTION FOR LEAVE TO PARTICIPATE AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS**

The Structured Finance Association ("SFA") having moved this Court for an Order granting their motion for leave to participate in this action as *amicus curiae*, and the Court having considered the matter,

IT IS HEREBY ORDERED this _______ day of June, 2020, that:

1. SFA's motion for leave to participate as *amicus curiae* is GRANTED.

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Vice Chancellor Slights