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SFA Research Corner

Student Loan Forgiveness and ABS

February 23, 2021

WHAT WE'RE WATCHING

President Biden announced on February 16 that he was "prepared" to forgive "$10,000, but not $50,000" of federal student loan debt. Timing and execution remain uncertain; however, President Biden has noted preference for legislative action over an executive order. While all borrowers of federal student loans would benefit to some degree, a blanket forgiveness of $10,000 would completely eliminate debt for over 15 million borrowers. In particular, borrowers 24 years or younger would reap the most benefit as over half of the borrowers in this cohort hold loans with balances of $10,000 or below.

Forgiveness of federal student loan debt is not a new topic; however, it is one that the Biden administration is very focused on. Over 43 million borrowers hold $1.56 trillion of student loan debt originated through three federal programs – Direct Loan, Federal Family Education Loan, and Perkins. Direct Loans represent 84%, or $1.3 trillion, of the total. These are directly issued and held by the U.S. Department of Education (ED). Needs-based Perkins Loans contribute another $5.2 billion to 1.7 million borrowers. The remaining $246 billion, or 16% of the total, was made to 11 million borrowers through the now-discontinued Federal Family Education Loan Program (FFELP).

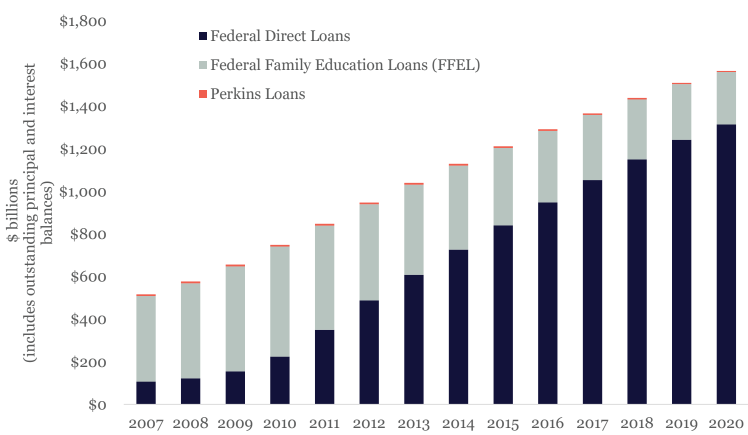
FFELP loans were originated by private lenders and funded by the securitization markets. The loans are guaranteed against default by a third-party guarantor for 97% to 100% of principal and accrued interest, and reinsured by ED. The last FFELP loan was offered in 2010. ABS backed by student loans had been dominated by FFELP collateral before 2010, peaking at $65 billion in 2006. Despite no new FFELP loan originations, FFELP loan securitizations still accounted for 50-80% of the annual new-issue volume in student loans. As the outstanding FFELP portfolio loan winds down, new-issue supply has been increasingly backed by private sector student loans, which are either new loans or refinancings of existing private sector loans. FFELP ABS comprises 66%, or $105 billion, of the total student loan ABS outstanding.

The impact on ABS backed by FFELP loans will depend on the scope of loan forgiveness. If forgiveness were extended to privately held FFELP loans or if legislation allowed FFELP borrowers to consolidate their privately held FFELP loan debt into Direct loans from the ED, then FFELP ABS trusts could see an increase in prepayments and improvements to overall credit quality.

When it comes to overall credit quality, "historical data has shown that FFELP loans with balances of less than $10,000 tend to default more than those with larger balances," explains Jonathan Riber, Senior Vice President at DBRS Morningstar. "This can partially be attributed to student borrowers that took out a student loan but never completed school. College dropouts carry the burden of student loans debt, but do not have the college degree that can help them pay off the debt." Riber continues, "because undergraduate degree loan balances are capped, their balances tend to be much lower than loans for graduate degrees which are uncapped. Therefore, as a result of loan forgiveness, remaining FFELP ABS pools will likely have a significantly higher percentage of graduate degrees which tend to perform much better than undergraduate degrees.

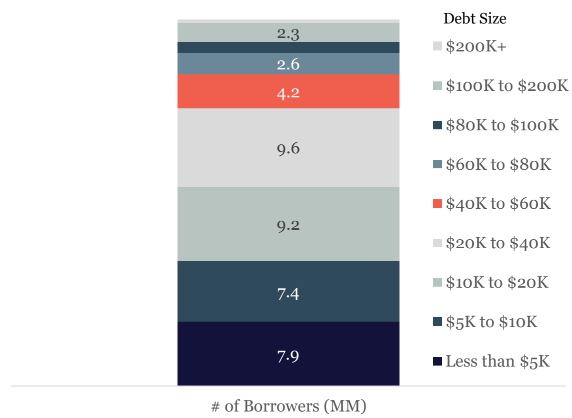
In terms of prepayments, an increase would be a positive development for FFELP ABS. Income-based repayment (IBR) plans, which are available to borrowers facing financial hardship, and pandemic-related lender accommodation programs have resulted in cash flow delays for FFELP-backed ABS. This has led to liquidity and maturity risk, resulting in some negative rating actions. In June, Moody's took negative rating actions on 45 tranches of FFELP ABS reflecting the increased use of forbearance and IBR use. Most recently, S&P Global Ratings lowered its ratings on many FFELP ABS classes maturing in the next three years to speculative grade ('BB+' and lower) citing liquidity issues.

Federal Student Loan Portfolio – $1.56 trillion held by 43 million borrowers



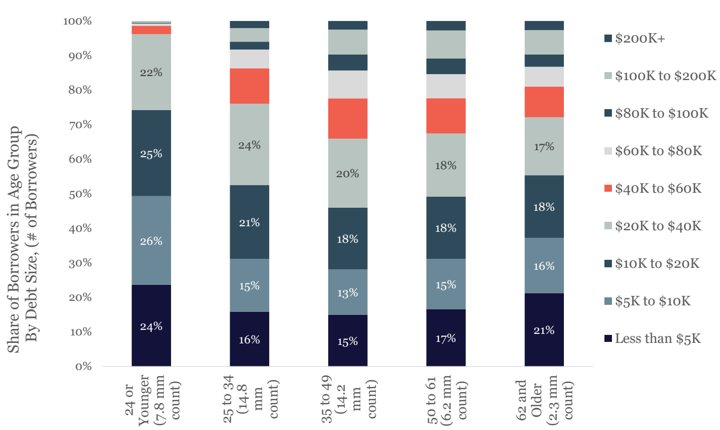
Source: Department of Education

15.3 Million, or 35%, of All Borrowers Hold Balances Below $10K



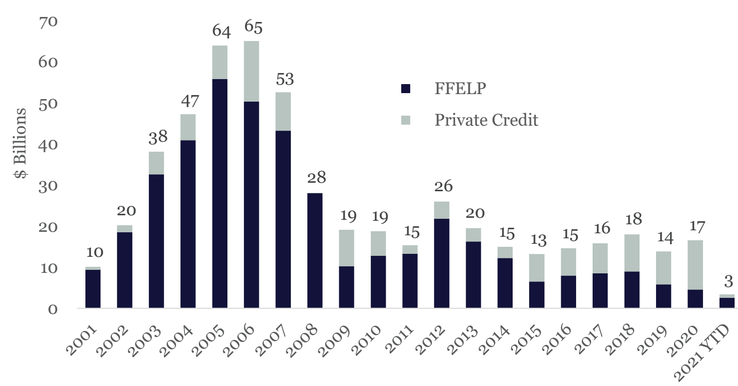
Source: Department of Education

Student Loan Debt Held by Age



Source: Department of Education

Student Loan ABS Issuance by Loan Type 2001 to Today



Source: JP Morgan

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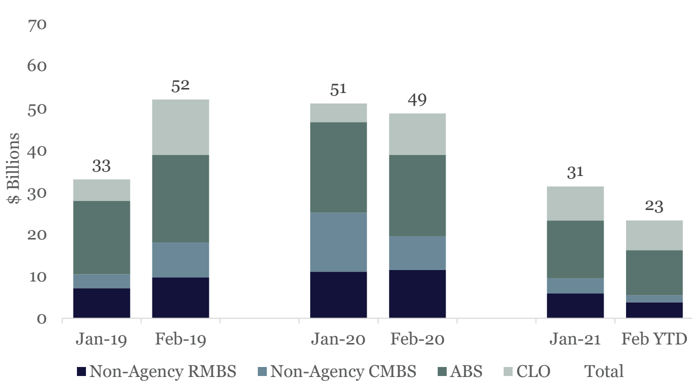
MARKET SUMMARY

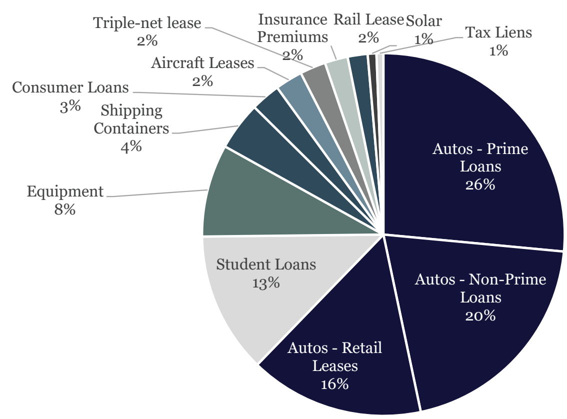
Over the past week, nearly $8 billion of structured products backed by non-agency RMBS and CMBS, ABS and CLOs came to market. Total year-to-date issuance now stands at $54 billion. Offerings in the ABS space included a $1.9 billion deal backed by non-prime auto loans from Santander Drive Auto Receivables Trust, the largest ABS deal so far in 2021. Steady demand kept prices in the secondary market firm, keeping bid-ask spreads unchanged for the most liquid, benchmark products.

Issuance for Non-Agency RMBS and CMBS, ABS, and CLO 2021 YTD ($54 Billion) Versus 2019, 2020



Source: Market Compilation

ABS Only
2021 YTD ($24.3 billion)



Source: Market Compilation

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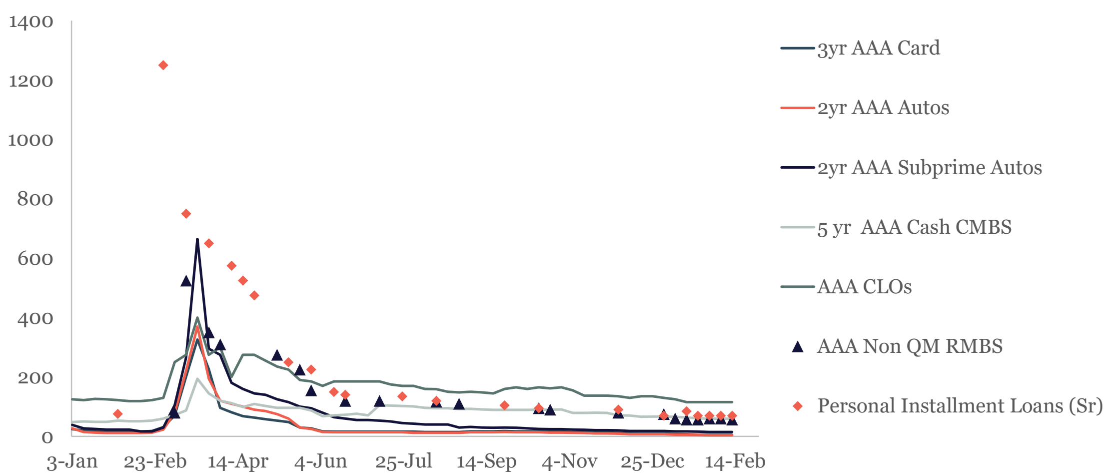
Secondary Market Bid-Ask Spreads (BP)



Source: Market Compilation

Secondary Market Bid-Ask Spreads		
(bps)	12-Feb	5-Feb
3yr AAA Card	5	5
2yr AAA Prime Autos	4	4
2yr AAA Subprime Autos	15	15
5yr AAA Cash CMBS	59	60
AAA CLOs	115	115