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SFA Research Corner

Sitting in Limbo Waiting for the Dice to Roll: An Update on Student Loan ABS

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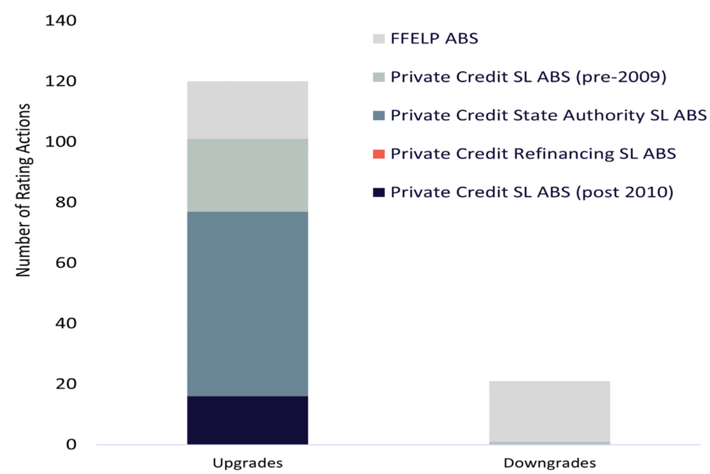
In 2022, S&P upgraded 120 student loan ABS (SL ABS) ratings, affirmed 540 and downgraded 21 as reported by the rating agency in the first edition (February 22, 2023) of their U.S. Student Loan ABS newsletter. The benign ratings performance belies three-years of turmoil and uncertainty experienced by the student loan industry because of pandemic-related policies. We discuss some of these policies below and the impact on ABS.

According to S&P's report, performance for highly rated post-2010 private credit SL ABS and private credit refinancing SL ABS has been "solid" thus far due to high-quality borrowers and the prevalence of co-signers. Although "sticky inflation and forecasts for rising unemployment" may result in "some stress" to borrowers, they expect that the adequate levels of credit enhancement on investment-grade SL ABS will "absorb deterioration and remain stable." The report also notes that the rating agency downgraded 20 FFELP ABS classes, which are backed by government guaranteed and subsidized Federal Family Education Loans.

Student Loan ABS Ratings Actions YTD 2023



Source: S&P Global Ratings: Market Insights, Sector Intelligence, Student Loan ABS (February 22, 2023)

Negative rating actions in FFELP ABS have been driven by liquidity concerns brought on by slower-than-expected borrower payments. Payments into ABS trusts slowed when borrowers took advantage of income-driven repayment plans and pandemic-related forbearance options during the 2020/2021 periods of financial stress. Liquidity concerns were temporarily addressed following the announcement of Biden's debt forgiveness plan as borrowers consolidated their FFEL loans into the federal Direct Loan program to qualify for debt relief. The prepayment surge reversed in September 2022 when the Administration made commercially held FFEL loans, such as those held in securitizations, ineligible for debt forgiveness. Commercially-held current FFEL loans are also not eligible for the ongoing federal repayment pause and interest waiver.

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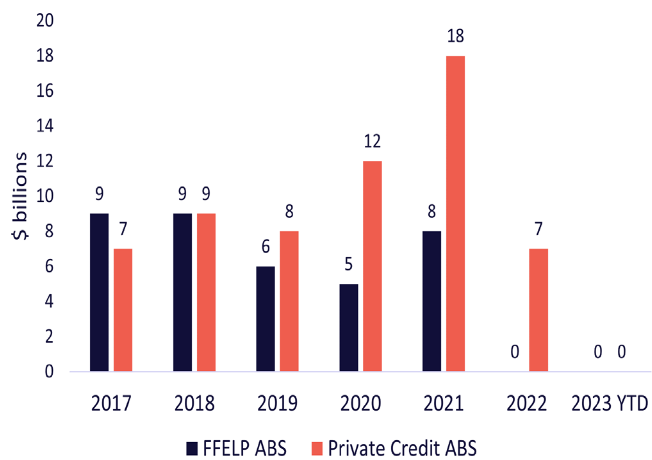
The federal debt forgiveness proposal isn't the only issue having an impact on SL ABS. In 2022, high interest rates and the ongoing federal student loan repayment pause and interest waiver has dampened private student loan refinancing activity. As refi activity has driven the issuance of private credit SL ABS supply in recent years, low refi volume has meant an anemic supply of new issue bonds. New issuance of private credit SL ABS reached $7 billion in 2022, 61% below its level one year prior. So far, no SL ABS has been issued in 2023.

Student Loan ABS Issuance Down 61% YOY in 2022



Source: J.P. Morgan Securities LLC

Market participants expect new issue activity to resume once repayments and refinancing activity resumes, although when that will occur remains unclear and is now contingent upon the resolution of litigation. In November 2022, the Biden Administration extended the federal loan repayment pause for the eighth time and asked the Supreme Court to review injunctions imposed by lower federal courts. The injunctions were in response to two legal challenges questioning the Administration's authority to implement student loan debt forgiveness and on February 28, 2023 the Supreme Court heard oral arguments for the two cases (Biden v. Nebraska and Dept. Education v. Brown). Will Black, consumer credit and structured finance professional previously with Moody's, stated in his March 11 *Consumer Credit Matters* blog, "Expect default rates to return to pre-pandemic run rates if the relief program is struck down." Repayments, which have been on hold for three years and five months since then-President Trump first paused repayments in response to the COVID-related national emergency, are expected to resume 60 days after litigation is resolved. If litigation is not resolved by June 30, then repayments will resume at the end of August 2023, as stated by the Department of Education.

The repayment pause resulted in a sharp drop in delinquencies for federal student loans, which comprises 93% of the total student loans outstanding. With the repayment pause extensions on such a large percentage of the student loans, the 30+ delinquency rate for all student loans has stayed near the pandemic-related historic low of 1%. However, when we look at private credit student loans separately, where payments are no longer paused, the delinquency rate has climbed back up to pre-pandemic levels – similar to the delinquency rates for other consumer debt. Fitch Rating's ABS Student Loan Indices shows that the 30+ delinquency rate for private student loan ABS was 4.02% in December 2022, versus 2.39% in June 2020. Before the pandemic, this metric ranged between 3.85% and 4.39%.

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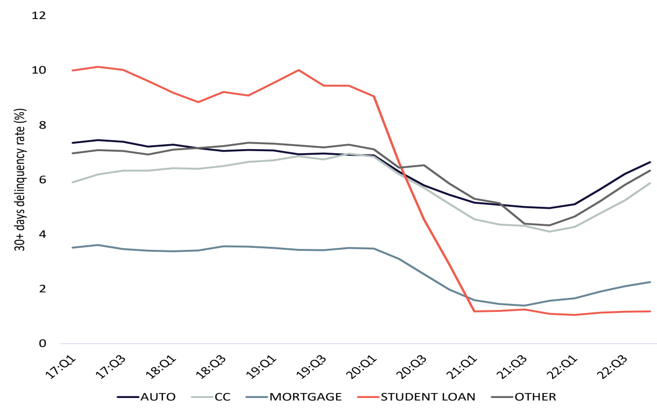
30+Day Delinquency Rates for ED-Held Federal Loans Remain at 0% with Repayment Pause…

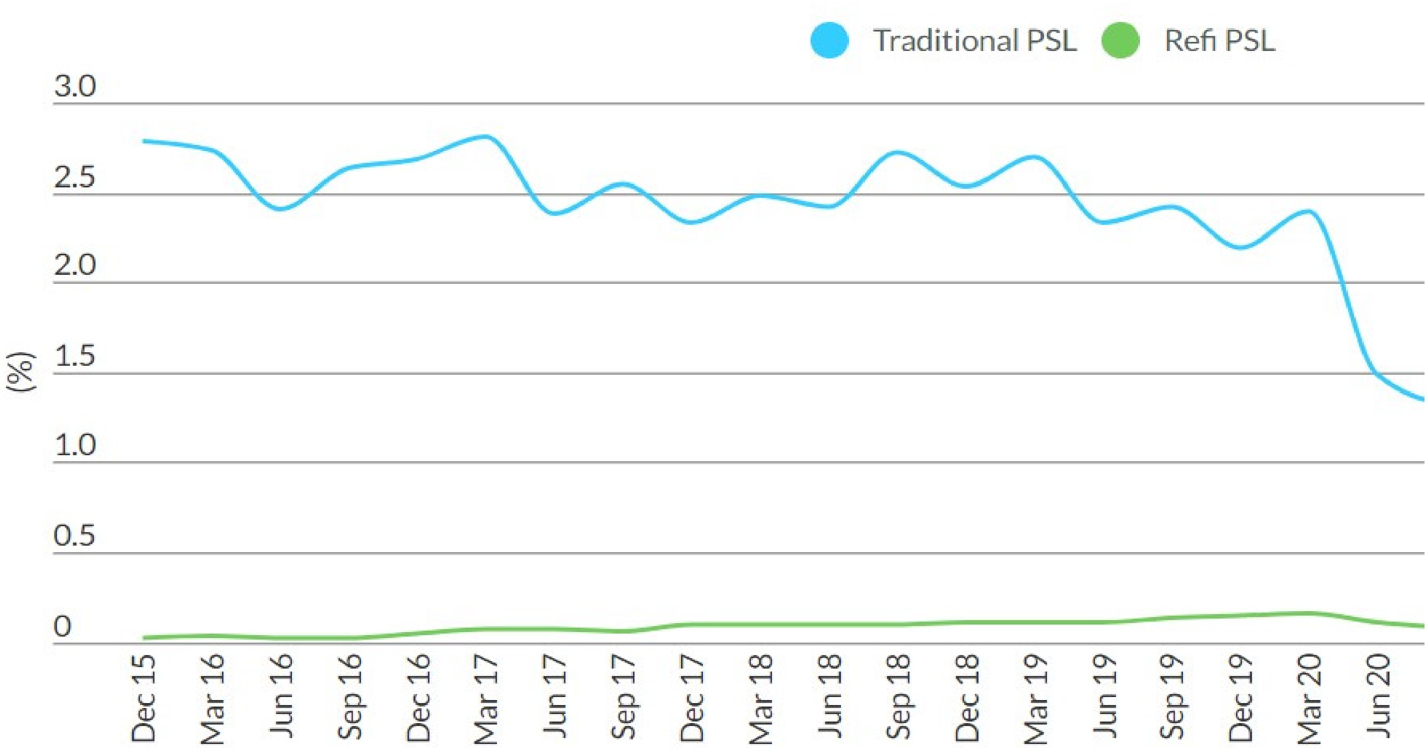
Source: National Student Loan Data System (NSLDS)

…Keeping 30+Day Delinquency Rate for All Student Loans Near Historic Lows



Source: FRBNY Consumer Credit Panel/Equifax

30+Day Delinquency Rate for Private Credit Student Loans Starts to Climb (ABS Student Loan Indices)



Source: Fitch Ratings