

SFA Research Corner

Learning Curve: Unpacking Shifts in Student Loan ABS

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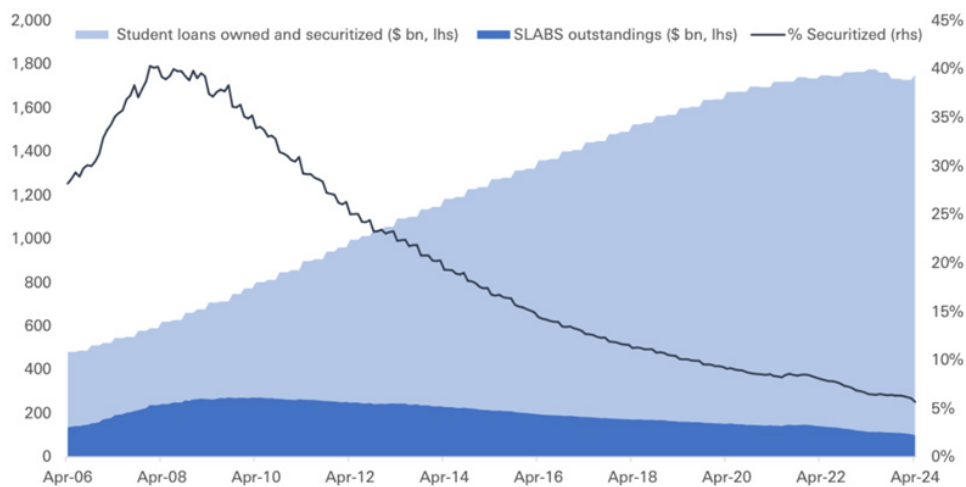


✉ [Elen Callahan](#)
Head of Research
☎ 203.512.0503

Learning Curve: Unpacking Shifts in Student Loan ABS

Student loan debt in the U.S. has reached \$1.7 trillion, carried by over 44 million borrowers, according to Q1 2024 data from the [Federal Reserve](#). Almost all of that, nearly [\\$1.6 trillion](#), is directly held by the U.S. government, primarily through the Direct Loan Program (\$1.4 trillion), with the remaining portion held between the now-defunct Federal Family Education Loan Program (FFELP with \$176 billion), and the Perkins Program (\$3.4 billion). Less than 7% of the total student loans outstanding, at \$119 billion, had been raised in the securitization market through the issuance of Student Loan Asset-Backed Securities (SL ABS). Of this amount, \$63 billion is backed by commercially held FFELP loans, while \$56 billion is supported by private unsecured loans that are not federally guaranteed. We look at the evolution of the student loan market below.

Outstandings: Total Student Loans (\$1.7 Trillion) vs Student Loan ABS (\$119 Billion)



Source: Federal Reserve Bank (FRED), Intex, Deutsche Bank

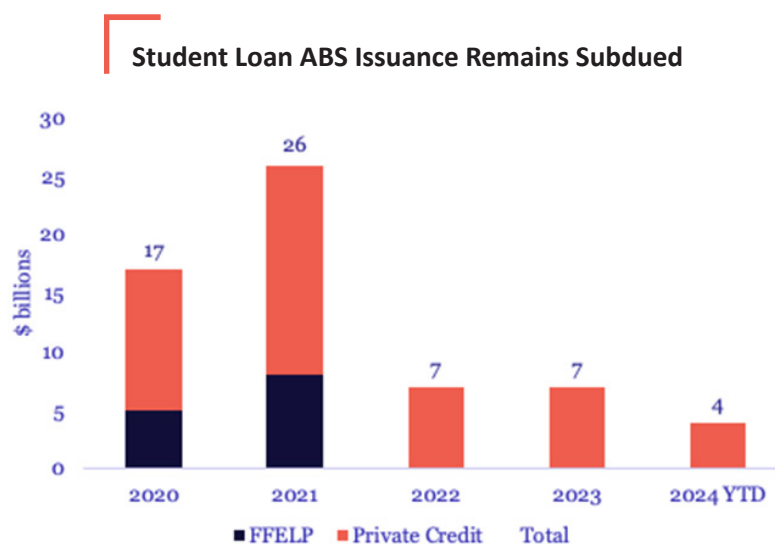
In the early 2000s, the private securitization markets played a much larger role in funding the student loan market. At its height, SL ABS primarily backed by government guaranteed FFELP loans reached \$200 billion in 2009, funding over 40% of the student loan market. Investors found these securities appealing due to their robust credit quality, backed by third-party guarantors ensuring 97% to 100% coverage against default, reinsured by the U.S. Department of Education (ED). Additionally, FFELP SL ABS trusts received subsidy payments from the ED, bolstering and stabilizing their cash flow.

However, the landscape shifted following the 2008 global financial crisis, leading to legislative changes and the eventual phasing out of the FFELP program.

The history of private-public partnership in federal student loans begins with the Higher Education Act of 1965, which established the Guaranteed Student Loan Program, which later became known as FFELP. This allowed private lenders to offer federally guaranteed loans to students. Over time, the government's role expanded, leading to the introduction of the Direct Loan Program in 1993, which allowed the government to lend directly to students. Then in 2010, in the aftermath of the financial crisis and with the objective of streamlining the lending process, the Health Care and Education Reconciliation Act ended the FFELP, transitioning all government held federal student loans to the Direct Loan Program. Today, the federal government dominates the student loan market through this program. The share of nonfederal education loans from private lenders, including banks and credit unions, has risen from [7% in 2010 to 15%](#) of the total loans available to borrowers.

The shift away from FFELP led to a decrease in FFELP-backed ABS. With no new FFELP loans issued after 2010, the issuance of new FFELP-backed SL ABS primarily focused on refinancing existing deals as they amortized. As borrowers sought lower rates and more flexible terms, they turned to private lenders to refinance their government-held FFELP loans, prompting lenders to tap into the securitization market to finance these loans. Morningstar DBRS estimates that around \$45 billion of FFELP loans have been refinanced through private student loan ABS. Pandemic-related policies and higher interest rates changed this.

However, the landscape shifted due to pandemic-related policies and higher interest rates. In 2020, measures implemented during the pandemic paused student loan repayments, diminishing the incentive for refinancing. This incentive dwindled further with the increase in interest rates in 2022, multiple extensions of the repayment pause, and a growing likelihood of loan forgiveness. Consequently, SL ABS issuance dropped to \$7 billion in 2022 and remained at that level in 2023. Year-to-date SL ABS issuance in 2024 stands at \$4 billion.



Source: SFA Market Compilation

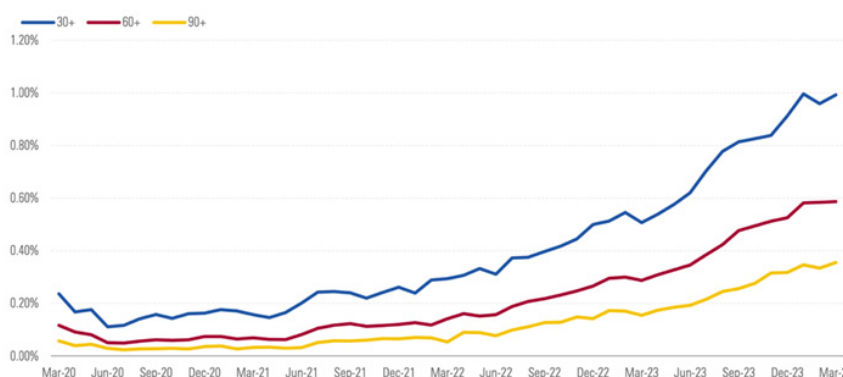
Although repayments have technically resumed, the attractiveness of refinancing in the private market, remains subdued given today's high rates. Compounding the issue are the ongoing efforts of the Biden Administration to cancel student loan debt, incentivizing borrowers to refinance their government-held FFELP loans into the Direct Loan program to meet eligibility criteria. To date, approximately \$167 billion in student loan debt has been forgiven for about 5 million borrowers.

However, when interest rates decline, private lenders could witness another surge in loan refinancing given today's high rates, as noted by Morningstar DBRS's student loan analyst, Jon Riber. The fixed interest rate on federal student loans, which is linked to the 10-year Treasury note, has recently risen to multi-year highs. This is particularly noticeable for Federal PLUS loans where interest rates have climbed to a 30-year high of 9.08%. Moreover, Federal PLUS loans, designed for parents of dependent undergraduates and graduate and professional students, come with origination fees exceeding 4%, further increasing the overall loan cost over time. Coupled with the fact that Federal PLUS loans offer fewer borrower benefits and protections compared to Direct undergraduate loans, borrowers may be further incentivized to refinance in a lower interest rate environment.

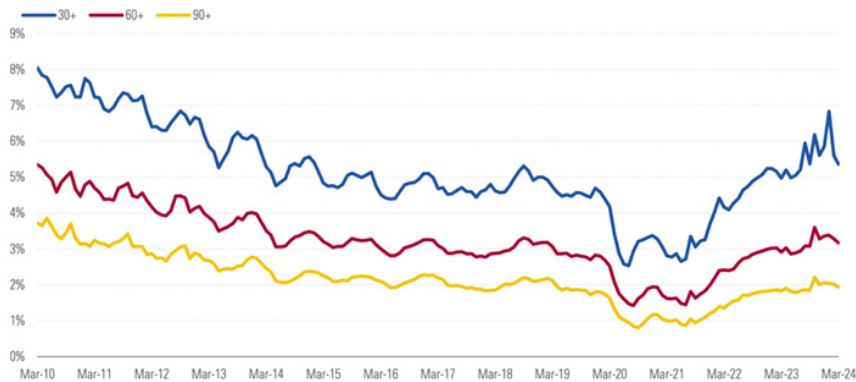
Recent insights from [Morningstar DBRS](#) provide perspective on the credit performance of private SL ABS. Since the conclusion of pandemic-related policies offering forbearance options and government stimulus, delinquencies on SL ABS have been on the rise. Financial pressures stemming from inflation and elevated interest rates, which have strained consumers' wallets, have only exacerbated these pressures. However, despite these challenges, delinquency rates on Refi SL ABS remain notably lower than those on Traditional In-school Private SL ABS. As of March 2024, the delinquency rates for Refi SL ABS stood at 0.99%, 0.59%, and 0.36% for the 30-day, 60-day, and 90+ day periods, respectively. In contrast, Traditional In-school Private SL ABS reported higher rates at 5.36%, 3.17%, and 1.94% for the same periods. The difference can be attributed to the stronger credit profile of refinance borrowers, who typically exhibit higher credit quality and greater cash flow compared to in-school or new graduate borrowers.

The landscape of the student loan market has undergone significant transformations over the years, from the prominence of government-guaranteed FFELP loans to the dominance of the Direct Loan Program. The rise and subsequent decline of SL ABS issuance reflect these shifts, influenced by factors such as legislative changes, economic crises, and pandemic-related policies. Ongoing challenges to credit and supply include rising delinquencies and the looming specter of loan forgiveness.

Refi Private SL ABS Delinquencies



Source: Morningstar DBRS Student Loan ABS Update


Traditional Private SL ABS Delinquencies


Source: Morningstar DBRS Student Loan ABS Update

A Timeline of the CFPB vs. NCSLT Legal Proceedings

- Background: The Consumer Financial Protection Bureau (CFPB) and the National Collegiate Student Loan Trusts (NCSLT) have been involved in legal proceedings related to alleged violations in student loan servicing and debt collection.
- The NCSLTs manage over \$12 billion in private student loans through 15 Delaware statutory trusts established between 2001 and 2007. These trusts were created to finance student loans by selling notes to investors in securitization transactions. Third-party servicers were engaged for loan servicing and collection.
- The 2017 Lawsuit's Legal Proceedings:
 - September 2014: CFPB initiates litigation against servicers involved in debt collection on behalf of the Trusts.
 - 2017: CFPB issues civil investigative demands to each Trust for information regarding student loan debt collection lawsuits.
 - May 31, 2020: Court denies CFPB's motion to approve a Proposed Consent Judgment.
 - March 26, 2021: Court dismisses lawsuit against the Trusts.
 - April 30, 2021: CFPB files amended complaint arguing Trusts should be considered "covered persons" under the Consumer Financial Protection Act (CFPA).
 - December 13, 2021: Court denies Trusts' motion to dismiss, ruling Trusts are "covered persons."
 - February 11, 2022: Court grants motion for interlocutory appeal to the Third Circuit.

A Timeline of the CFPB vs. NCSLT Legal Proceedings (*continued*)

- Third Circuit Decision:
 - May 17, 2023: Interim appeal argued before Third Circuit panel.
 - March 19, 2024: Third Circuit renders decision, upholding actions of CFPB Director and determining Trusts qualify as covered persons.
 - May 6, 2024: The CFPB and the Trusts requested the U.S. District Court of Delaware to extend scheduling order deadlines and delay the CFPB's motion to strike intervenors' answers to facilitate settlement discussions until May 20, 2024. Additionally, on the same day, the Trusts and an intervening party petitioned the Third Circuit Court of Appeals for a rehearing and a rehearing en banc regarding the narrow decision reached in March regarding the Trusts' classification as covered persons under the CFPA.
 - May 21, 2024: Third Circuit Court of Appeals denies the petition for rehearing.
- [Second Enforcement Action](#):
 - May 6, 2024: The CFPB filed a second enforcement action against the Trusts and PHEAA in Pennsylvania, and a related stipulated final judgment, citing mishandling of borrower inquiries and failure to follow servicing guidelines. If entered by the court, the stipulated final judgement will require PHEAA to pay \$2.89 million in consumer redress and \$1.75 million as a penalty, while the NCSLT Trusts must reserve \$2.89 million for consumer redress and pay \$400,000 as civil money penalty. Additionally, the orders would mandate "significant non-monetary relief," according to the CFPB.
 - May 24, 2024: PIMCO and another investor group files for a 28-day extension to file objections to the proposed stipulated judgment. While the Trusts and PHEAA did not take a position on this request, the CFPB did not consent to the request.

See Cadwalader's Clients & Friends Memos to read more: [here](#) and [here](#). To stay apprised of future updates to stemming from this case, please join SFA's [CFPB v NCSLT Task Force](#), by filling out this [join form](#) or by emailing Committees@StructuredFinance.org.