



## U.S. STRUCTURED FINANCE NEWSLETTER

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### Northern Exposure: SLABS Arrive in the Maple Market

On September 14, 2006, the GCO Education Loan Funding Master Trust-II, Series 2006-2 (GCO ELF 2006-2) priced. This transaction, backed entirely by Federal Family Education Loan Program (FFELP) Consolidation loans, includes the first Canadian dollar-denominated (CAD) student loan asset-backed securities (SLABS). The CAD notes, Class A-1 RRNs, are structured as reset-rate notes with the initial reset date occurring seven years after closing and have a weighted-average life of seven years. The Class A-1RRNs have a DBRS provisional rating of AAA (see the [GCO Presale Report](#), issued September 8, 2006) and are priced at a spread of 6 basis points to 1-month Canadian Deposit Offering Rate (CDOR).<sup>1</sup>

The Canadian investor base for CAD SLABS includes pension funds, structured investment vehicles and other institutional investors. Like other reset-rate SLABS backed by FFELP Consolidation loans, the CAD SLABS are attractive to investors due to the: (1) high quality nature of the collateral backing the notes (reinsured by the U.S. government to at least 97% of defaulted loan principal and accrued interest), (2) stable collateral cash flows given the limited prepayment risk inherent in Consolidation loans<sup>2</sup> and (3) the soft bullet maturity feature of the notes combined with their limited extension risk.

Although attractive to Canadian investors for their collateral and structural quality, reset-rate CAD SLABS carry foreign exchange risk. This risk stems from the currency mismatch between the U.S. dollar-denominated collateral and the CAD liabilities. To hedge this risk and to better manage excess spread, a SLABS trust issuing CAD notes can enter into a currency swap which effectively converts the Canadian-dollar tranche to a synthetic U.S. dollar-denominated bond.

DBRS expects to see more CAD notes in future SLABS transactions. Including CAD notes in the capital structure allows SLABS issuers to diversify their investor base and may enhance transaction execution. Additionally, the increase in FFELP Consolidation loan volume in the second and third quarters of 2006<sup>3</sup> should ensure an ample supply of collateral for FFELP Consolidation SLABS in the months ahead.

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<sup>1</sup> CDOR is the average of all Bankers' Acceptances (BA) rates offered by the main banks operating in Canada. Each morning at 10:00 a.m. EST, a survey of "BID" BA rates is taken at each bank in a pool of nine banks. The highest and lowest BIDs are removed from the sample, and the average is published as the day's CDOR effective rate.

<sup>2</sup> Consolidation loans have repayment terms of up to 30 years and have demonstrated low prepayment behavior as the borrower's ability to refinance their loans through reconsolidation is restricted.

<sup>3</sup> The increase in volume stemmed from the elimination of in-school consolidation and the increase in coupon rates (approximately 200 basis points) for FFELP Stafford and Parental Loans for Undergraduate Students (PLUS) loans at the July 1st reset date.