



# U.S. STRUCTURED FINANCE NEWSLETTER

Issue 144, January 2, 2007

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## SLABS Reset Rate Notes

Student loan asset-backed securities (SLABS) backed by Federal Family Education Loan Program (FFELP) Consolidation loans will often include longer-dated, time-tranched senior notes (average lives can range from nine to 15 years). This is a function of the long tenor of Consolidation loans which can have repayment terms of up to 30 years. To address the challenge presented by the longer maturity profile of Consolidation loan collateral, issuers began to include reset-rate notes (RRNs) in the capital structure of SLABS in 2003 beginning with Sallie Mae's SLM 2003-1 transaction.

RRNs typically have initial reset periods of three to seven years. During the reset period, note holders receive note interest, typically quarterly, and note principal payments are deposited into an accumulation account, thus protecting investors from prepayment risk. At the end of the reset period, the RRNs are remarketed and can be offered as an auction-rate security, another RRN or a term note, and may be denominated in any currency and indexed to any reference rate<sup>1</sup>. This provides issuers with maximum flexibility to remarket the RRNs. Proceeds from the remarketing and any deposits in the accumulation account are then used to affect a mandatory redemption of the outstanding RRNs, thereby creating a "soft bullet" maturity for the initial investors.

If there is a lack of sufficient bids or the inability of the remarketing agent to determine a clearing rate, a "failed remarketing" event is declared and the sponsor can then choose to exercise its call option. If the RRNs are not successfully remarketed or called, current note holders receive a stepped-up coupon, typically equal to 3mL plus 75 basis points, and the notes will again be remarketed on a quarterly basis. Since most sponsors are residual holders in the transaction, the stepped-up coupon that results from a failed remarketing serves as an additional economic incentive to ensure that the notes are redeemed on their initial reset date.

RRNs offer multiple advantages to issuers. First, issuers can lower their all-in cost of funds by including RRNs as they are priced as shorter-term notes (e.g., soft bullet maturity at the reset date). Second, RRNs allow issuers to broaden their investor base by structuring notes to better match specific investors' needs in terms of currency denomination, interest rate and duration. Finally, RRNs assist issuers in financing the large volume of FFELP Consolidation loans that continues to be originated. For investors, RRNs may offer greater prepayment protection relative to amortizing notes with comparable average lives.

To date, three Sallie Mae RRN classes have reached their initial reset-date and all were successfully remarketed. As of December 31, 2006, cumulative RRN issuance has exceeded \$16 billion. Given the continued increase in Consolidation loan volume, the flexibility that RRNs can offer issuers and investor interest, DBRS expects RRNs to increase in popularity in 2007.

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<sup>1</sup> Transaction documents typically require rating agency confirmation if the remarketed notes are to be denominated in a currency other than U.S. dollars or if indexed to a reference rate other than 3mL or 90-day commercial paper.