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LEGISLATIVE REFORM AND STUDENT LOAN INDUSTRY ECONOMICS

On September 7, 2007, both houses of the U.S. Congress passed the *College Cost Reduction and Access Act* (the Act), which significantly reforms the Federal Family Education Loan Program (FFELP). The Act incorporates provisions of two separate proposals from the House of Representatives and the Senate and is expected to be signed into law by the President.

Under the Act, the following key modifications will be made to the FFELP:

- **Reduction in the special allowance payments (SAP).** For not-for-profit lenders, the margin will be reduced by 40 to 70 basis points, depending on the loan type, effective October 1, 2007. For other lenders, the margin will be reduced by 55 to 85 basis points, depending on the loan type.
- **Reduction in borrower interest rates for *subsidized* Stafford loans.** The 6.8% fixed rate for borrowers is scheduled for annual reductions over the next four years, with an aggregate drop of 50% by July 1, 2011. However, the rate cut is temporary as the Act currently permits the rate to revert back to 6.8% for loans whose first disbursement is made on or after July 1, 2012. There is no rate cut for unsubsidized Stafford loans.
- **Reduction in the federal loan guarantee to 95%** (from 97% currently), effective October 1, 2012.
- **Elimination of Exceptional Performer (EP) designation,** effective October 1, 2007.
- **Increase in lender-paid loan origination fees:** The loan origination fee paid to the Department of Education by lenders at the time of disbursement of a FFELP loan will increase from 0.50% to 1.00% of the loan balance.

The proposed changes under the Act affect only future loans and, therefore, the impact on existing SLABS transactions should be negligible.[1] However, the modifications proposed under the Act will likely impact lender profitability and other industry dynamics. Future SLABS transaction structures may undergo change as lenders may seek to monetize more of the collateral cash flow through the inclusion of new classes of subordinated notes within SLABS capital structures.

With increased competition and lower lender profitability, DBRS anticipates some industry consolidation among lenders as economies of scale increase in importance. Competition may also increase in the private student loan industry as lenders look to increase loan volume in the more profitable private loan arena.

The DBRS commentary *U.S. Student Loan Legislation Impacts Industry Dynamics* provides a more comprehensive discussion regarding key modifications under the Act and the corresponding impact on industry dynamics and can be accessed at www.dbrs.com.

For questions or comments, contact David Hartung at dhartung@dbrs.com or David Laterza at dlaterza@dbrs.com.

[1] Even in existing master trusts that can acquire new loans originated after October 1, 2007, it is unlikely that the trusts would acquire such loans due to collateral eligibility restrictions or the need to avoid the commingling of new and old loans that have different characteristics.