

# U.S. Structured Finance Newsletter

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## THE POTENTIAL IMPACT OF THE COLLEGE STUDENT RELIEF ACT OF 2007

On January 17, 2007, the U.S House of Representatives voted overwhelmingly to pass the *College Student Relief Act of 2007* (H.R. 5) (the Act). The legislation will now go to the Senate for deliberation. If passed by the Senate and signed into law by the President, the law would impact loans disbursed on or after July 1, 2007. The primary goal of the Act is to lower borrower interest rates on Federal Family Education Loan Program (FFELP) subsidized Stafford loans from 6.8% to 3.4%. The reduction of borrower rates would be phased in over five years as follows: 6.12% in 2007, 5.44% in 2008, 4.76% in 2009, 4.08% in 2010 and 3.40% in 2011, with the rate returning to 6.8% in January 2012. To pay for the costs associated with the interest rate cut, which is estimated to be \$7 billion, the Act includes several cuts to the FFELP that are of interest to all student loan ABS (SLABS) participants. The proposed cuts and their potential impact on future SLABS transactions include the following:

- **Reducing special allowance payment (SAP) margins by 10 basis points (bps):** The reduction of the guaranteed lender yield margin would reduce excess spread levels in FFELP transactions backed by collateral originated after July 1, 2007. However, the level of excess spread in SLABS transactions is typically high (75 bps to 100 bps), and a 10 bps reduction in the SAP margin may only have the effect of slowing the time it takes for trusts to reach 100% parity or required overcollateralization levels, as opposed to impairing the ability of trusts to trap sufficient amounts that provide liquidity and credit support.
- **Reduction of guarantee insurance from 97% to 95% for new FFELP loans:** The reduction of guarantee insurance would expose future SLABS transactions to higher potential net losses. This reduction may result in the need for increased levels of credit enhancement or more conservative structural triggers for future transactions backed by collateral originated after July 1, 2007.
- **Repeal of the Exceptional Performer (EP) Designation:** Currently, student loans serviced by servicers that have received the EP designation from the Department of Education (the ED) are entitled to 99% reimbursement of defaulted loan principal and accrued interest. The repeal of the EP designation would result in all servicers receiving the standard reimbursement level. DBRS rating criteria does not give credit to EP designated servicers in stressed cash flow scenarios; therefore, eliminating the designation would not affect required credit enhancement levels.
- **Increase lender-paid loan origination fees on all FFELP loans from 0.5% to 1.0%:** Higher origination fees increase the costs of acquiring collateral (originated after July 1, 2007) in SLABS trusts. For existing trusts, when new collateral is acquired with funds on deposit in the prefunding or recycling accounts, the potential result is a reduction in parity ratios and a slowing in the time it takes for trusts to reach 100% parity or reach required overcollateralization levels.
- **Increase in consolidation loan rebate fee from 1.05% to 1.30% annually:** The increase of the Consolidation loan rebate fee for lenders whose cumulative FFELP loan holdings, either directly or indirectly held, comprise at least 90% Consolidation loans may have the effect of slowing the time it takes for trusts to reach 100% parity or reach required overcollateralization levels.

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