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IS THE WORLD OF SLABS CAPITAL STRUCTURES EXPANDING?

Student loan ABS (SLABS) transactions secured by Federal Family Education Loan Program (FFELP) Consolidation loans are most frequently issued using a senior subordinate structure. While the vast majority of transactions have included only one subordinate tranche, the GCO Series 2007-1¹ transaction breaks from this tradition with the inclusion of a \$55 million junior subordinate class of notes. Junior subordinate notes can achieve an investment grade rating given the high credit quality of the collateral along with the structural nuances that are included to protect the senior and senior subordinate notes.

Excess spread is the primary source of credit enhancement for SLABS subordinated notes and can range from 70 to 100 basis points (bps) at closing. Excess spread levels are driven by two key factors: (1) the low level of collateral losses (FFELP loans are guaranteed to at least 97% of principal and interest) and (2) the slower and stable level of prepayments associated with Consolidation loans – these loans can only be refinanced under very limited circumstances. Therefore, excess spread levels are relatively stable and healthy over the life of the transaction. This dynamic also enables SLABS FFELP transactions to close with total parity levels (i.e., total trust assets divided by total trust liabilities) below 100%. As the transaction seasons, parity levels increase to their required levels, generally within two to four years, through the retention of excess spread.

In addition to collateral quality and stable excess spread, structural elements also facilitate the inclusion of additional subordinate classes in Consolidation FFELP-backed SLABs. These structural features are intended to provide adequate support to more senior notes and include a note trigger that redirects junior subordinate note interest to pay principal on senior notes. The note trigger is tied to collateral defaults. In the absence of a trigger event, the junior subordinate notes receive interest sequentially and their interest is paid before principal payments are made to any class of notes. Also, junior subordinate note principal is paid only after required payments are made to senior and senior subordinate notes and targeted overcollateralization levels are met.

Leveraging the SLABS structures backed by FFELP Consolidation loans to include additional classes of subordinate notes should facilitate better execution for issuers while providing those SLABS investors who have higher risk tolerance levels greater investment opportunities within the sector. Given the current level of FFELP Consolidation loan origination volume and a growing investor appetite for subordinate debt, DBRS expects more SLABS issuers to use a structure that includes additional subordinate classes.

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¹ The GCO Education Loan Funding Master Trust II, Series 2007-1 transaction is expected to close on March 6, 2007. See the [GCO Series 2007-1](#) presale report for further details. The transaction includes a junior subordinate tranche rated A (low) that was priced at 3mL+ 38 with a weighted-average life of 5.5.