

# U.S. Structured Finance Newsletter

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## THE INCREASINGLY ENDANGERED FFELP

On June 17, 2009, the U.S. Secretary of Education (Secretary) announced a significant development in the federal student loan program. The Secretary announced that four companies were awarded contracts to service a portion of the outstanding federal student loan portfolio currently held by the Department of Education (ED), which is estimated to be approximately \$550 billion, as well as loans originated by and sold to the ED in the future.<sup>1</sup> The companies receiving the new contracts include: AES/PHEAA, Great Lakes Education Loan Services, Inc., Nelnet, Inc. and Sallie Mae Corporation.

AES/PHEAA, although a not for profit quasi-state agency, has been one of the largest Federal Family Education Loan Program (FFELP) loan secondary market servicers and securitization issuers in the student loan industry. Great Lakes is part of a not-for-profit organization and, although not a secondary market entity, serves as one of the largest FFELP servicers. Nelnet and Sallie Mae are public, for-profit companies and two of the largest FFELP loan originators, servicers and securitization issuers in the student loan industry.

For those wary of the ongoing debate between the use of the William D. Ford Federal Direct Loan Program (FDLP) and FFELP, the announcement by the ED is significant because the actions, as well as statements included in the press release regarding the intention of the current Administration to transfer originations from FFELP to FDLP starting in 2010 infers a more certain outcome. The press release also cites the potential savings the ED believes it will achieve through the process of originating all federally-backed student loans through the FDLP, as described in President Obama's fiscal year 2010 budget proposal. Although the idea of steering all federal student loans through the FDLP and the purported savings is not a new concept, the awarding of the loan servicing contracts to some of the largest participants in the FFELP is a noteworthy development.

The ED already has a contract with Affiliated Computer Services, Inc. to service all FDLP loans. Therefore, the new contracts appear to position the Department to be able to handle increased loan origination volume and benefit from continued private sector involvement in the federal student loan business.

The Department's release stated further that, "the new performance-based contracts offer the Department the capability to manage all types of Title IV student aid obligations, including, but not limited to servicing and consolidation of outstanding debt. The contracts have a base ordering period of five years with an optional five-year ordering period. The minimum contract award for compliant and performing firms is valued at \$5 million, with a maximum assignment to service up to 50 million student loan borrowers over the five-year ordering period."

The monetary value of the new contracts are expected to bolster the financial condition of the four companies as they provide a new revenue channel, capitalize on their existing infrastructure to grow economies of scale and promote the stability of their servicing capabilities for their own as well as third party servicing contracts for many outstanding ABS transactions. The revenues earned by the companies will be based on their performance from a customer service and default aversion perspective. While the ED's actions may allow some traditionally FFELP-oriented companies to continue, if and when the FFELP is eliminated, others not originating and servicing loans on behalf of the ED may not be so fortunate.

Aside from the four companies tapped by the ED, several others operate on smaller scales and perform similarly vital functions. These entities include not-for-profit agencies that tend to have more local or regional scopes of operations and provide other value-added services associated with education finance. Without the business of FFELP loan origination and servicing, the viability of these companies could be at risk. Further, for the ABS market in general, the elimination of the FFELP would ultimately reduce an entire consumer loan ABS sector that contributed over \$350 billion in new issuance over the past eight-plus years.

For questions or comments, please contact David Hartung at [dhartung@dbrs.com](mailto:dhartung@dbrs.com).

1. The ED holds loans originated under FDLP and, more recently as a result of the loan purchase programs implemented under the Ensuring Continued Access to Student Loans Act (ECASLA), loans originated under the FFELP. However, the new servicing contracts addressed in the announcement appear to solely involve FFELP loans.