

How Tech Allayed SLABS Crisis

Navient and Nelnet avoided downgrades on \$18 billion in FFELP Bonds by extending their maturities. Recent innovations helped them get the required consents from investors.

By Allison Bisbey

Generous repayment plans soured many investors on bonds backed by federally guaranteed student loans. But it could have been worse.

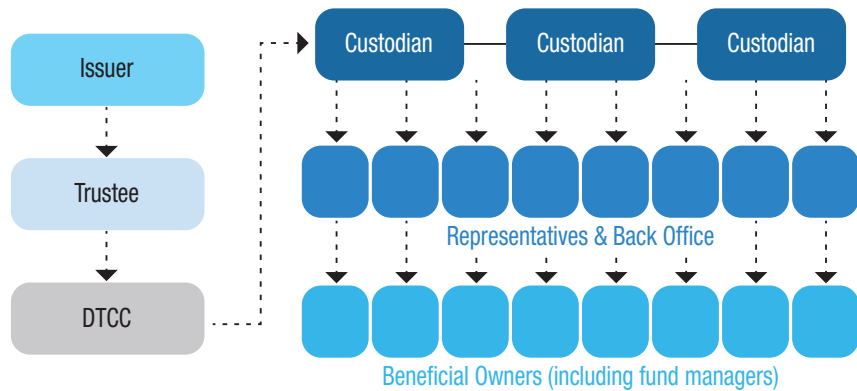
These programs slow the rate of repayment on Federal Family Education Loans, putting the bonds they back at risk of technical default if the securities fail to pay off at maturity. When Moody's Investors Service and Fitch Ratings raised the alarm early in 2015, eventually putting some \$100 billion of bonds under review for downgrade, the market sold off heavily. New issuance ground to a halt.

Yet Navient and Nelnet, the two largest student loan servicers, avoided downgrades on some \$18 billion of FFELP bonds. They did so using a strategy that, at first, did not seem promising: extending the maturities of the bonds. While simple in principle, this solution was complicated by a requirement that 100% of investors in a tranche approve the change. Without consent from every single holder, no matter how small, an amendment cannot pass.

Their efforts were aided by DealVector, an online registry of asset ownership and messaging platform, which helped the two servicers identify holders and collect votes. Over the past year, the two servicers have sent about 165 tranches out for consent; some 60% of those were successful, and about 10% are still in process. The total original face value of tranches passed to date exceeds \$18 billion.

Coordination problem

Bonds are held "in street name," obscuring their true ownership and imposing large costs on an issuer soliciting investor consents to amend deals



Source: DealVector

This undoubtedly helped restore confidence in the sector, allowing Navient and Nelnet to resume issuing FFELP bonds, even though some investors, including banks and credit unions, continue to view the asset class skeptically.

"If we hadn't been able to extend maturities, it definitely would have been harder to sell FFELP bonds," said Greer McCurley, executive head of capital markets at Nelnet.

The market revival, in turn, encouraged banks to resume unloading FFELP portfolios. In April, Navient (which did not respond to a request for interviews) reached a deal to acquire \$3.7 billion of FFELP from JPMorgan Chase. So far this year, it has issued nearly \$3 billion in FFELP bonds. Nelnet completed a

single, \$426 million FFELP securitization in October; it has yet to come to market this year. The company also completed a private student loan securitization, in December.

Like other kinds of financial assets, FFELP bonds are held "in street name" by a brokerage firm, bank, or dealer on behalf of a purchaser, obscuring their true ownership. This isn't just a problem for consent solicitations; it also imposes large costs on determining an appropriate price for a security, forming creditor classes, and many other events requiring communication among deal participants.

This is how the consent process normally works: An issuer sends consent forms to the trustee, which needs to

log onto the Depository Trust Company and complete a form, which then goes out through different systems to the custodian. The custodian must process it and send it to the beneficial owner's back office, which then needs to deliver it to the appropriate portfolio manager.

There are multiple opportunities for delays.

"I talked to one portfolio manager who didn't see a consent sent through the normal channels for five days, and that was quick," said DealVector co-founder and CEO Michael Manning. "Ten to 13 days is the typical lag time. Some didn't even receive it until the day before the deadline, at which point it became a huge fire drill."

By comparison, when investors register directly with DealVector, "on the same day that Navient provides consents to trustees, they give it to DealVector. We load it into the system, and it's in a portfolio manager's inbox within 20 to 25 minutes."

Investors who register their holdings can also download documents and see what other holdings are registered. When they vote, DealVector can prepopulate information, and it allows them to use an electronic signature.

"From an investor standpoint, it's been a fairly simple process," said Tim Sustak, chief credit officer at Vizo Financial, a corporate credit union that has been involved in 10 or 12 consents to extend the maturities of FFELP bonds it holds.

Sustak said that Vizo gets consent solicitations from its third-party custodian as well as from DealVector, and was informed about what was happening to FFELP bonds and why. Still, using an online platform "put some extra grease on the wheel," particularly for deals that were not extended on the first try.

"It's another check and balance," he

said.

As in other walks of life, technology offers a bird's-eye view of the situation.

"For a given deal, I can see how much each custodian has under custody, so I can call one and say, 'we're missing [consents on] \$100 million, can you send reminders to the beneficial holders?'" Manning said. "These tools allow us to work the investor end, the brokers and custodians all at the same time."

Navient was the first to partner with

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the vendor and its first consents went out around March 2016, Manning said. Nelnet did its first consents some four months later, in July 2016, he said.

DealVector contacted numerous other FFELP issuers to offer assistance; however, no other firms retained its services. "For some other issuers, issuance has diminished greatly, some aren't issuing anymore, and they are less inclined to go through the process of extending legal final maturities," he said.

It's not clear how much more FFELP bonds might have sold off if Navient and Nelnet hadn't been able to extend the maturities of so many bonds, avoiding, or in some cases reversing, downgrades. The servicers took other actions to avoid downgrades, including repurchasing bad loans from securitization trusts and calling bonds at risk of not paying off at maturity. However, neither Fitch nor Moody's looks at these other strategies as favorably as it does maturity extensions.

And there was another mitigating

factor, according to several industry participants: The lengthy process of revising rating criteria and reviewing billions of dollars of FFELP bonds gave investors plenty of time to get "credit comfortable" with the possibility of a technical default. Many were able to tweak their investment guidelines, allowing them to hold on to the bonds in the event of a downgrade, since the underlying loans are guaranteed by the U.S. government.

The lengthy ratings review process also gave Navient and Nelnet plenty of lead time soliciting consents. By the time the first downgrade was announced in September 2016, Navient had already extended the maturities of \$6.8 billion of bonds.

Nevertheless, McCurley said that Nelnet would not even have tried to extend the maturities of bonds without a platform like DealVector. "They really made an unmanageable process very manageable."

Moody's concluded its sector-wide review in December; it ended up downgrading roughly \$46.6 billion of FFELP bonds, or about half of 504 tranches of 194 transactions that it originally had under review; most of the securities downgraded were originally rated Aaa; some were cut to below investment grade.

In February, Fitch said it had downgraded 105 of the 629 tranches it had placed under review. It affirmed another 620 tranches, and upgraded 42; another 45 remained under review.