



## Stepping up

### **Double boost for FFELP SLABS market**

Industry efforts to address the FFELP student loan ABS maturity issue have stepped up a gear with the launch of Nelnet's investor forum via the DealVector platform (SCI 17 June). The market received a further boost last week when Moody's released its updated FFELP student loan ABS methodology (SCI 15 June).

DealVector now has the top two sponsors of FFELP student loan ABS on its system, with Navient launching a similar investor forum last September (SCI 22 September). Such improved investor connectivity allows information to become actionable and change outcomes for the better, according to DealVector ceo and founder Mike Manning.

"Under the Navient and Nelnet indentures, maturity extensions need 100% consent, so it's critical that every investor is in the loop. When running consents, the DealVector platform allows issuers to view the aggregate face value of investors' holdings that have been registered, enabling them to see what percentage of the total outstanding is represented on the system. It therefore helps them to target their efforts towards the areas that need it most," he explains.

Greer McCurley, executive director of capital markets at Nelnet, says that when his firm first started thinking about extending its FFELP student loan ABS trusts, it believed it would be highly unlikely to achieve the 100% consent necessary. However, the firm was encouraged by Navient's success via the DealVector platform.

"One challenge we'd heard from investors is that some only wanted to communicate with us, while others only wanted to communicate with the bank we're working with on this (RBC) or not at all. DealVector allows them to communicate anonymously, which is a significant benefit," McCurley observes.

He adds: "We've heard from one of our largest holders of our bonds that they're about to load their positions onto the DealVector system and we're expecting significant participation from other investors in the coming weeks. Many are already familiar with the process from their experience with Navient and we've already had communication from other investors looking to target further Nelnet deals after the initial six have been extended. We want to ensure that as many of our bonds remain triple-A rated as possible."

The DealVector platform is currently passing 75%-80% of consents first time around. "We have 300 investors registered for the Navient amendments and there is a high degree of overlap with

Nelnet investors. Each time we go through the process, we are increasing critical mass, so that consents become easier to pass," Manning observes.

He suggests that in future cases where an issuer has decided against extending maturities or making other transaction amendments, investors may decide to step up and seek action themselves. "Where investors want to find each other and split the cost of an extension, for example, our platform is perfect. As the process becomes more efficient, it becomes more economical - if you have a network, it's possible to unlock value by taking tangible action. We just launched [www.DealVector.com/FFELPwatch](http://www.DealVector.com/FFELPwatch) to make it easier for investors holding FFELP paper to do exactly this."

McCurley believes that similar synergies can be achieved in other asset classes. "The big selling point of a platform like DealVector is that it facilitates investor communication, which is exceptionally problematic within the traditional fixed income custodian system. Every investor will need to have a conversation about restructuring or amendments at some point, no matter the asset class. DealVector is trying to tackle a problem that isn't easy to solve - unlocking value for both issuers and investors."

DealVector has been involved in a handful of cases when CLO equity investors called the deals, but Manning believes the next area of potential for the platform is in RMBS. He points to many deals where it makes sense to execute a clean-up call; for example, where the residual holder's position isn't cashflowing and they want to crystallise value or the servicer is facing expense, or investors want to arbitrage the value between the underlying loans and bonds.

"Servicers have the right to clean up once there is only 10% or less of the deal outstanding, but it's predicated on calling the bonds at par. There are many cases where bonds aren't trading at par, yet investors may be happy for them to be called because it still makes economic sense," Manning explains.

He continues: "This requires a vote, as does calling a deal if more than 10% is outstanding. Because voting is so hard to do today, investors and servicers end up leaving money on the table in these cases."

Meanwhile, generic FFELP student loan ABS spreads tightened by 10bp-20bp on the publication of Moody's final FFELP student loan ABS methodology. "My sense is that the market views Moody's methodology as positive - some participants view it as mildly so and others very positively. Participants had been concerned that a significant number of bonds would be downgraded to sub-investment grade, but although many bonds still have the potential to be downgraded, hopefully it will be at a lesser magnitude than expected," McCurley notes.

He continues: "Moody's expected loss approach will force participants to recalibrate their models, so it will take time for the impact to filter through. The agency's consideration of qualitative factors is also positive, as are some of the reassuring statements about the strong credit quality of the FFELP asset class."

Among the changes made to Moody's initial proposal are: the use of an expected idealised loss table as a benchmark for model output ratings; a probability-weighted model rather than a ratings-targeted pass/fail model; an increase in the number of scenarios to 28; expanded assumptions surrounding loan repayment rates to include death/disability probabilities, as well as IBR loan forgiveness rates; and allowing for both quantitative and qualitative analysis in final rating decisions. Structured product analysts at Wells Fargo suggest that such significant revisions highlight the modelling complexity and uncertainty associated with FFELP student loan cashflows.

"By calculating a probability-weighted net loss rate for 28 unique scenarios and comparing the combined loss rate to an expected idealised loss benchmark table, this builds in some flexibility around cashflow uncertainty, compared to a ratings-targeted pass/fail model," they observe.

The highest-weighted scenario is 'most likely' (at a 60% weight), with the other 27 scenarios based on a combination of the remaining scenario category assumptions (three remaining degrees of likelihood, three interest rate scenarios and three loan repayment behaviour scenarios). Each remaining scenario's weight is based on the product of the three scenario category weights used.

Voluntary prepayment rate assumptions, as well as forbearance and deferment assumptions appear to be more lenient than in the initial proposal. But the Wells Fargo analysts note that the updated income-based repayment assumptions may have differing impacts, depending on a loan pool's current performance.

Between 45% and 55% of a pool's IBR percentage will now be included in the forbearance assumption, compared to 75% in the initial proposal. However, the final assumptions take into account rising IBR rates that are higher relative to the average actual usage rates of 10% for consolidated loans pools and 15% for non-consolidated loan pools. Consequently, rising IBR rate assumptions may offset the lower 45%-55% inclusion percentage, depending on performance.

Moody's placed a further 266 tranches (totalling US\$44.9bn) on review for downgrade, following its initial assessment of FFELP transactions under the updated methodology, on top of the 101 tranches (US\$30.7bn) previously placed on review (SCI 10 July 2015). Accounting for roughly US\$160bn in FFELP ABS outstanding, the agency now has just under half of the sector under review for possible downgrade, according to JPMorgan figures.

Downgrades to non-investment grade ratings are expected to be limited to a small percentage of the market, but investors will ultimately need to run bond-level analysis to assess this risk. JPMorgan ABS strategists note that modelling and insufficient data remain major hurdles in FFELP ABS, made only more complex by the final methodology.

"We expect investors will require significantly more resources to analyse the FFELP ABS sector, which could translate to lower liquidity and higher required spread concessions. Unfortunately, until Moody's actually takes rating action, the rating cloud does not simply disappear overnight with this publication of the final methodology," they observe.

The JPMorgan strategists suggest that FFELP ABS may not fully recover versus plain vanilla asset classes. The generic spread differential between FFELP ABS and credit card ABS was 9bp one year ago, before Moody's announced revisions to its rating methodology, versus 55bp now.

Nevertheless, with Fitch's stance also appearing to be less punitive than earlier communications had suggested, the worst-case scenario now seems to be off the table, according to McCurley. "It will be interesting to see how bonds trade this week in light of the news and what direction the market moves in now. The question is where will the consensus shake out from here."