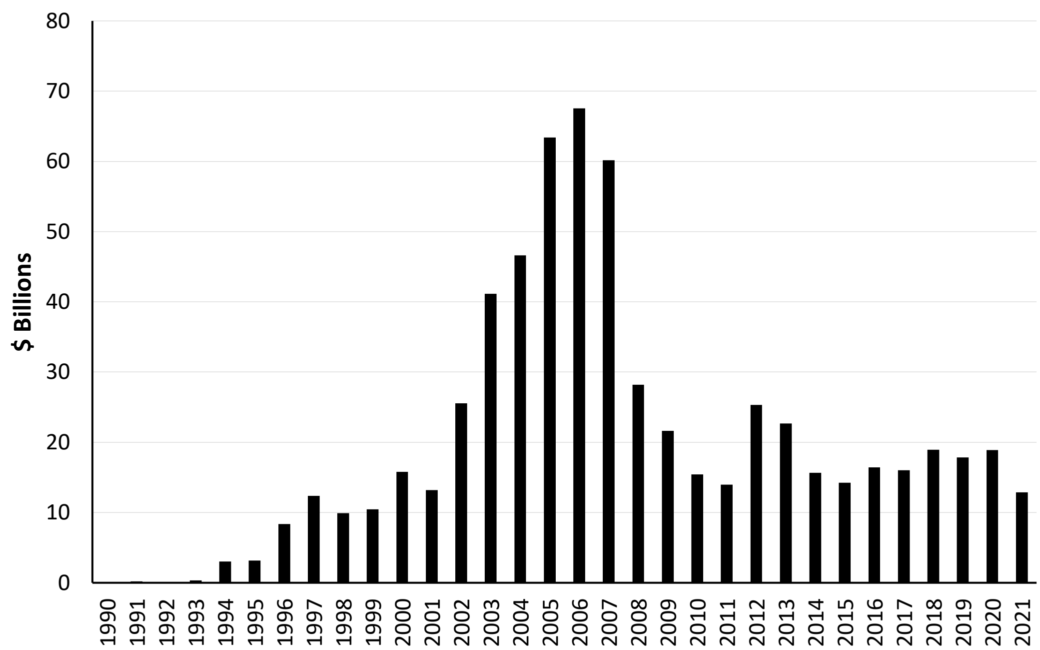
September 2021

Part 3: Student Loans and the SLABS Landscape

As of the first quarter 2021, there is over $136.31 billion in outstanding private student loan debt. Lenders and investors have bundled many of these student loans into Student Loan Asset Backed Securities, or SLABS.[1] Many SLABS have received investment-grade ratings from national rating agencies and have been an increasingly popular securitization over the past decade. As shown in **Figure 1:** *Total SLABS Issuance*, while annual issuance of SLABS has declined since their peak right before the Financial Crisis, annual issuances have remained steady since 2010, averaging $18 billion over the past decade.

Figure 1: Total SLABS Issuance[2]



[1] "The MeasureOne Private Student Loan Report." *MeasureOne* (June 15, 2021). <https://f.hubspotusercontent00.net/hubfs/6171800/assets/downloads/MeasureOne%20Private%20Student%20Loan%20Report%20Q1%202021.pdf> (last accessed July 26, 2021).

[2] 2021 data is year-to-date. "US ABS Securities: Issuance, Trading Volume, Outstanding." *SIFMA* (July 2, 2021) <https://www.sifma.org/resources/research/us-asset-backed-securities-statistics/> (last accessed July 26, 2021).

SLABS: Opportunities and Risks for Investors

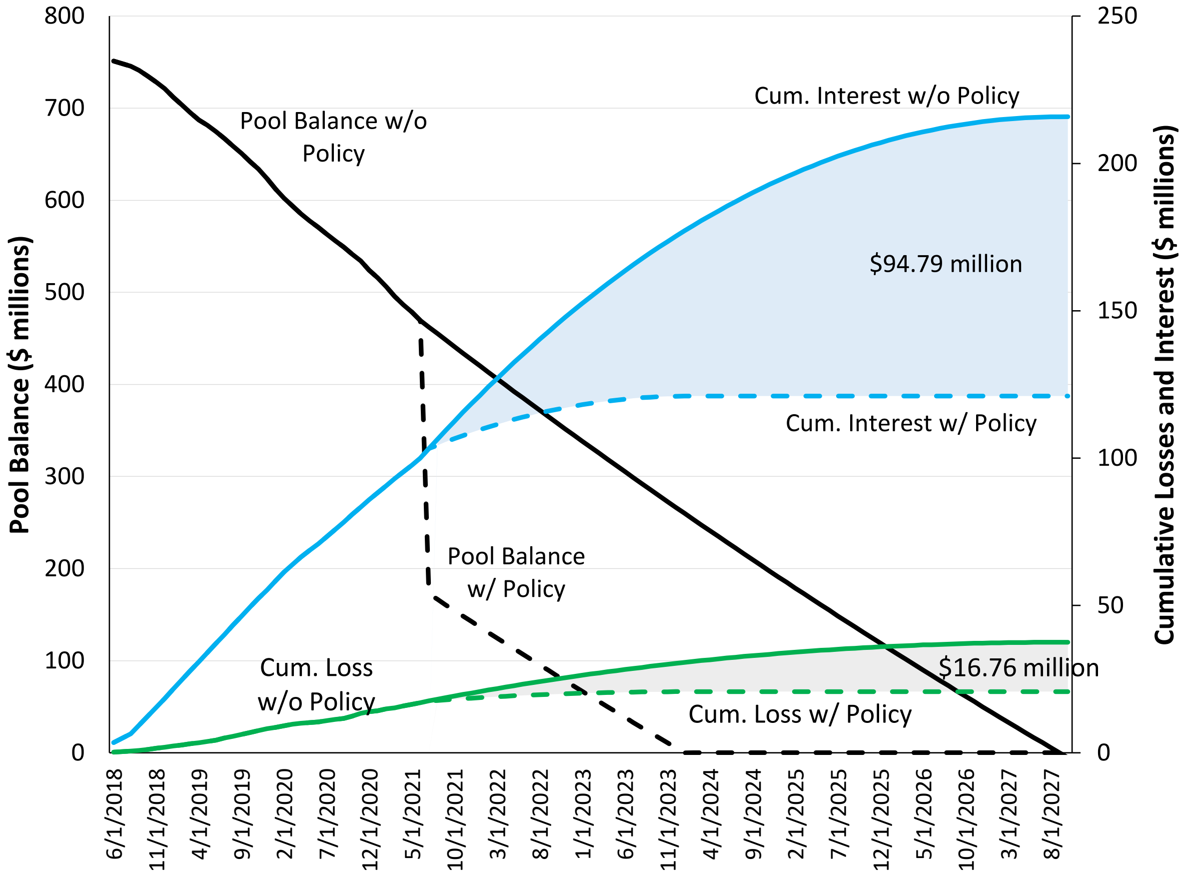
Investors in asset-backed securitizations face many types of risks associated with their investments, and SLABS are no different. However, there are a few unique features of SLABS that lead to differing risks as compared to RMBS, CDOs, or other asset-backed securitizations.

Student loans are unique among consumer loan products in that, barring rare circumstances, they are not dischargeable in bankruptcy. As a result, SLABS investors enjoy a great deal of protection against default risk because they are virtually guaranteed that the underlying loans will not be written off but, instead, will be paid in full, even if payments are sometimes delinquent.

Despite this protection, SLABS investors face risks that investors other types of asset-backed securities typically do not face. In particular, SLABS carry exposure to various political risks. One large risk factor specific to SLABS is the possibility of large-scale government student loan relief. Indeed, President Biden's presidential campaign included an explicit goal of relieving up to $10,000 per borrower, and several progressive politicians have suggested an even larger relief program of up to $50,000 per borrower. From the viewpoint of SLABS investors, any government relief of student loans is functionally equivalent to a massive, simultaneous prepayment by all borrowers impacted by the program.

Somewhat mitigating the negative impact of the effective prepayment risk that governmental student loan relief creates for investors is that such a program would reduce default risk. Many of the student loan borrowers receiving governmental relief will likely experience periods of delinquency or even default on their loans. In fact, Governmental relief of loans that would otherwise be defaulted upon could even yield a net gain for SLABS investors, as the lost dollars due to prepayment could exceed the dollars lost through default. However, any such offset would depend on the specifics of the relief policy enacted and of each trust in which loans are securitized. Using the SMB 2018-B trust as an example, **Figure 2:** *Impact of a $10k Loan Forgiveness Policy on SMB 2018-B* illustrates how a $10k per borrower relief policy could result in $16.76 million in averted losses but up to $94.79 million in foregone interest.

Figure 2: Impact of a $10k Loan Forgiveness Policy on SMB 2018-B



SLABS investors face other potential risks from governmental action. Politicians of both parties have proposed legislation that would greatly increase borrowers' ability to discharge student loan debt during bankruptcy or allow for greater flexibility and altering of repayment plans for borrowers struggling to make their payments. If such legislation is passed, the result to SLABS would be a substantial reduction in future cashflows from defaulted borrowers who, at present, continue to make occasional payments.

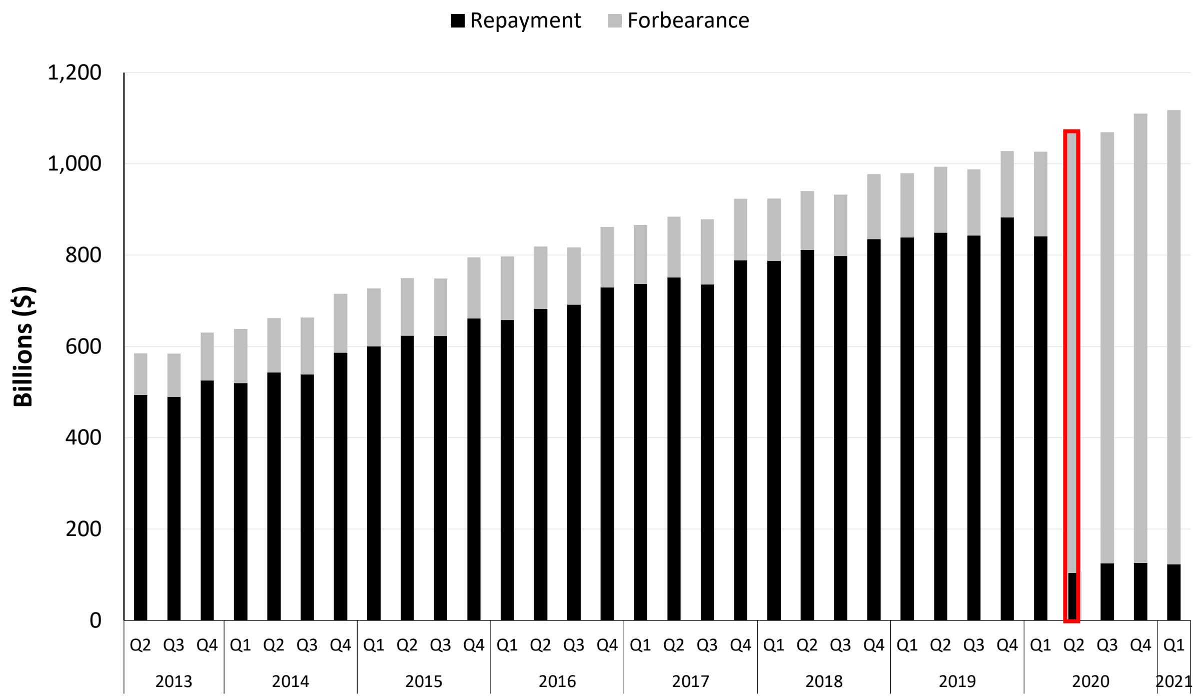
SLABS and COVID-19: Forbearances and Reductions in Cash Flow

In the past year, the COVID-19 pandemic has devastated large parts of the U.S. economy. The unemployment rate jumped from under 4% pre-pandemic to over 14% by mid-2020. As of June 2021, over 5.7 million fewer people were employed than before the pandemic. Job loss, furloughs, and associated income declines have impacted millions of Americans.

The COVID-19 pandemic has had a dramatic impact on both student loan borrowers and SLABS investors. With millions out of work or furloughed throughout the pandemic, borrowers have struggled to make their student loan payments. The government has taken steps to reduce this pandemic-related burden by providing for automatic interest-free forbearance for public student loans. As shown in **Figure 3:** *Over $700 Billion in Federal Loans Converted from Repayment to Forbearance in Q2 2020*, more than

$700 billion in outstanding federal loans was converted from repayment to forbearance in the second quarter of 2020. That amount represents almost half of the federal student aid portfolio that entered forbearance all at once.

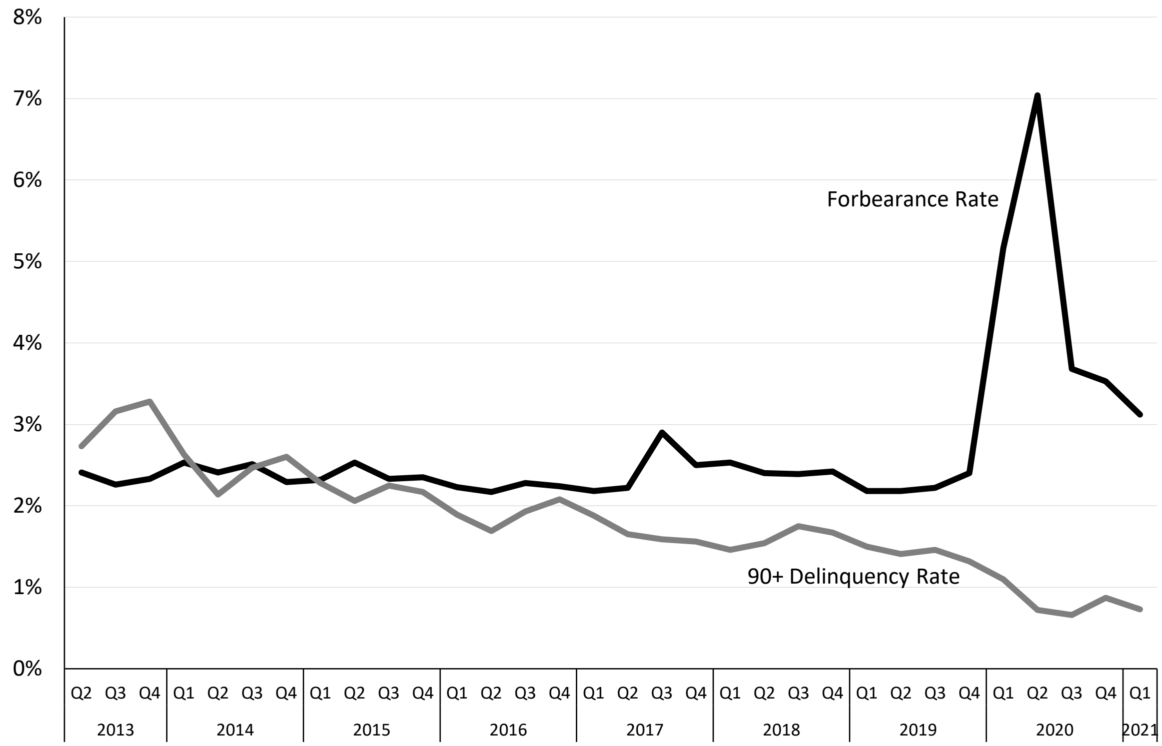
Figure 3: Over $700 Billion in Federal Loans Converted from Repayment to Forbearance in Q2 2020[3]



[3] This figure does not include federal Perkins loans. The Department of Education does not report forbearance data for Perkins loans which account for $4.7 billion (0.30%) of the federal student aid portfolio as of March 31, 2021. "Portfolio by Loan Status (DL, FFEL, ED-Held FFEL, ED-Owned)." *Federal Student Aid* <https://studentaid.gov/data-center/student/portfolio> (last accessed July 26, 2021).

While not as generous as the interest-free forbearances offered to public student loan borrowers, private student loan lenders have also responded to the COVID-19 pandemic by providing support to borrowers. This support has chiefly taken the form of expanding forbearance options and alternative repayment plans for impacted borrowers. Private student loan borrowers have still struggled to make their payments throughout the pandemic. As **Figure 4:** *Forbearance and Delinquency Rates of Private Student Loans* shows, private student loan borrowers have also seen a marked increase in forbearance rates and a corresponding decline in delinquency rates.

Figure 4: Forbearance and Delinquency Rates of Private Student Loans[4]



[4] Private student loan rates are based on MeasureOne's Private Student Loan Consortium, a data cooperative of the five largest student loan lenders and holders as well as nine other contributors. In total, these 14 data contributors represented 55.87% of the private student loans outstanding in the U.S. as of March 31, 2021.

The increase in student loan forbearances throughout the COVID-19 pandemic have directly impacted cashflows to SLABS. **Figure 5:** *Drop in Collection for Navient Private Education Refi Loan Trust 2018-B* shows that principal and interest collections decreased sharply in the first half of 2020 for the Navient Private Education Refi Loan Trust 2018-B.

Figure 5: Drop in Collections for Navient Private Education Refi Loan Trust 2018-B