FitchRatings

NON-RATING ACTION COMMENTARY

U.S. Private Student Loan ABS Outlook Negative on Coronavirus Pressure

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Fitch Ratings-New York-10 April 2020: Fitch Ratings has revised its 2020 sector Asset Performance Outlook for U.S. Private Student Loan ABS (PSL) to Negative from Stable. The coronavirus pandemic and associated containment measures will result in a sharp economic contraction, causing a global recession and a rapid spike in unemployment and loss of income. Recovery is expected to begin from 3Q20 onward as the health crisis subsides, after a short but severe global recession with GDP remaining below its 4Q19 level through most of 2021, creating challenging conditions for U.S. student loan borrowers. The net effect of the contagion and contagion-containment measures will result in increased forbearance and delinquencies in the near term and higher defaults as unemployment increases.

Fitch expects ratings on PSL to remain largely stable driven by through-the-cycle base case default assumptions that utilize previous recessionary performance. However, using Fitch's Coronavirus Baseline and Downside Scenarios, Fitch is re-evaluating current sustainable constant default and prepayment rate assumptions for all transactions in surveillance, and for new ratings, will continue to benchmark base case default assumptions to recessionary performance while other assumptions, such as forbearance, will reflect changes to servicing policies. Transactions with lower seasoning in repayment or with loans originated under weaker underwriting criteria (pre-08/09 vintages) will be most sensitive.

IMPACT ON ASSETS

The impact of the coronavirus pandemic is starting to become apparent following the surge in about 17 million initial jobless claims filed over a period of three weeks ending April 4. Loans entering repayment in 2020-2021 are most vulnerable to the changing employment picture. At the same time, transactions with more regional concentration may have higher default volatility as it remains to be seen how differentiated the shocks of the pandemic are regionally. Refinance loans will have more stable performance due to tighter originations, including higher educational degrees that are generally associated with more stable employment.

PSL presents certain mitigating factors, some of which are more prevalent in post-08/09 originations, which are expected to support performance:

--85% or more of traditional PSL collateral now has a co-borrower (vs. closer to 70% during the financial crisis), on average. Loan default will occur only if both the main borrower and the co-borrower fail to meet scheduled loan payments.
--Materially tighter underwriting criteria in Fitch-rated transactions compared with pre-crisis origination. This includes, among others, no direct-to-borrower loans in pools, close-to-100% school certification and higher co-signer rates. Consequently, default volatility is expected, for the same level of stress, to be lower than what observed during the 08/09 recession period;
--Flexible default-mitigation tools. While PSL generally lack income-based repayment options available to federal direct and FFELP borrowers, many PSL lenders are offering extended forbearance periods (from one month to three years, with 12-month forbearance being the most common guideline), for both principal and interest installments, to borrowers submitting a request as a consequence of the coronavirus outbreak:
--PSL loans are generally represented as non-dischargeable in bankruptcy, reinforcing borrowers' willingness to pay PSL loans ahead of other unsecured loans that are instead dischargeable in bankruptcy.

When setting default assumptions, Fitch expects PSL collateral to undergo at least one full economic cycle, including a recession period and subsequent recovery. Thus, when available, recessionary vintages from 08/09 are taken into account. Forwardlooking macro expectations as well as qualitative considerations on the market and originator's specific products and underwriting criteria, in addition, short-term performance indicators such as delinquencies and forbearance levels are used to define final default assumptions for a transaction.

While Fitch acknowledges that government support initiatives may provide some relief to certain segments of U.S. consumers, including student loan borrowers, this will only partly offset a rapid spike in unemployment and reduced income. Fitch will monitor additional developments and consider implications as more information becomes available. It's also worth noting that the student loan interest waiver and other payment relief initiatives in the economic stimulus package passed on March 25, 2020 for all federally held student loans is not applicable to privately-held PSL.

IMPACT ON CAPITAL STRUCTURES AND RATINGS

Under its Coronavirus Baseline Scenario, Fitch expects some Outlook changes for investment grade notes and limited PSL non-investment grade rating changes for tranches with thinner levels of enhancement compared with the expected Baseline default rate assumption. Most default assumptions are expected to remain unchanged as described above.

Protection from a temporary disruption in the collection process or larger-than-expected take-up in forbearance levels is provided by business continuity plans implemented by PSL servicers, available liquidity reserves and combined waterfalls that allow for the use of principal funds to cover interest payments on the bonds. Fitch's survey of both larger third-party servicers and smaller local servicers indicated that no delays in customer service or the collection process (including operation of call centers) are expected; all servicers already implemented remote working for virtually the entire staff.

Available liquidity reserves, enhancement levels and servicing continuity plans in place are expected to limit the 2020 impact of the coronavirus outbreak on ratings. Hence, despite some downgrade pressure on a limited number of non-investment grade tranches, the Stable sector 2020 Ratings Outlook for PSL is maintained.

NEAR-TERM FOCUS

Fitch will focus on the following in the coming months:
--Macro developments, including jobless claims and unemployment;
--Ongoing interactions with PSL servicers to gauge short-term performance changes and updates to forbearance policies;

--Completing a full portfolio review of Fitch-rated PSL transactions.

Fitch will closely monitor developments and will comment further as additional clarity is available on the impact of the coronavirus pandemic on Fitch-rated PSL transactions.

Contact:

Pasquale Giordano, CFA
Senior Director, ABS North America
+1-212-908-0797
Fitch Ratings, Inc.
33 Whitehall Street
New York 10004

Ian Rasmussen
Senior Director, ABS North America
+1-212-908-0232

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

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