

To: ARRC Secretariat (arrc@ny.frb.org)

From: Education Finance Council

Date: June 1, 2020

RE: Comments on ARRC Consultation Regarding More Robust LIBOR Fallback Contract Language for New Variable Rate Private Student Loans (March 27, 2020)

Thank you for the opportunity to comment on the March 27, 2020 version of the *ARRC Consultation Regarding More Robust LIBOR Fallback Contract Language for New Variable Rate Private Student Loans*.

Education Finance Council (EFC) is the national trade association representing nonprofit and state-based education finance and college success organizations. EFC supports its state-based and nonprofit members' public purpose mission to expand access to postsecondary education and training, facilitate student success, assist students and families in identifying their best sources of education funding, assist individuals with connecting postsecondary education and career outcomes, encourage responsible borrowing, and advocate for and with individuals in support of successful management of their postsecondary education financing. EFC state-based, nonprofit members who originate, hold, and service private education loans along with their attorneys and financial advisors, provided input into EFC's comments below.

General Comment: Portfolios of private student loans are typically financed on a substantially or totally non-recourse basis through securitization, floating notes, bilateral loan agreements, and syndicated loan agreements, the types that have been the subject of prior ARRC consultations regarding more robust LIBOR fallback contract language and may be the subject of interest rate exchange agreements to which ISDA protocol LIBOR fallback contract language may apply. Such financings are typically structured on the basis of portfolio repayment performance as the expected source of interest payment and principal amortization. Such structuring is done on the basis of stress case assumptions that magnify the impact of uncertainty in terms such as interest rate. Financings may be for a term of years or the anticipated life of the loan portfolio.

Legal and beneficial holders of private student loan portfolios that are subject to such financing arrangements could not include in their loan notes a fallback provision that used different trigger, alternative reference rate waterfall, or spread terms than that used in the applicable financing agreement without creating basis risk should the differing fallback provisions result in the loan notes utilizing a different reference rate or spread than the financing agreement. With respect to existing financings, it is probable that either the consent of financing agreement counterparties or perhaps, for rated obligations, some degree of rating agency review would be contractually required before loan notes with terms that differ in these regards could be included in financing agreement collateral.

It is not possible to meaningfully quantify this risk in the abstract. Moreover, the limited data that is currently available with respect to the relationship between the historical SOFR averages and other reference rates does not permit the basis risk of collateralizing a financing payment obligation that utilizes a reference rate other than SOFR with assets that utilize a historical average of SOFR to be quantified with any high degree of confidence. Such non-quantifiable risks cannot be addressed

economically in a structured portfolio financing without recourse to the sponsoring entity. Accordingly, any consensus statement with respect to a preference or commitment to use any specific private student loan fallback provision trigger, alternative reference rate waterfall, or spread terms should be expressly conditioned upon the absence of an applicable financing agreement with a LIBOR fallback provision that differs with respect to one or more of these terms. EFC's responses to the Consultation questions, are subject to this important limitation, whether or not expressly stated.

Responses to Consultation Questions:

Question 1: *Should fallback language for variable rate private student loan include a pre-cessation trigger (trigger 4(G)(ii))?*

Inclusion of a pre-cessation trigger based on a determination that USD LIBOR for the applicable periods is no longer representative is preferable. The fallback language should be similar to the language that is used in the financing of the asset.

Question 2: *Please indicate whether any concerns you have about a pre-cessation trigger relate to differences between such a trigger and those for standard derivatives or relate specifically to the pre-cessation trigger itself.*

As noted in the General Comment above, a difference between loan note and derivative provisions may be of concern to holders of private student loan portfolios that are the subject of interest rate exchange agreements.

Question 3: *If a pre-cessation trigger is not included, what options would be available to market participants to manage the potential risks involved in continuing to reference a Benchmark whose regulator has publicly determined that it is not representative of the underlying market?*

Existing private student loan portfolio financings, at the time when LIBOR is no longer representative, should not be directly affected in a material way if their fallback provisions are consonant with the provision in the loan notes included in the underlying collateral portfolio.

Question 4: *The variable rate private student loan language proposed uses simplified language in an effort to be more comprehensible for the consumer market. Is the simplified language proposed here appropriate, or are there concerns with the language not matching ISDA or other cash product language precisely?*

Trigger term language for private student loan notes that closely track the desired financing or derivative form model would be preferable as reducing the risk of interpretive issues.

Question 5: *Is the replacement index determined by the Federal Reserve Board, the Federal Reserve Bank of New York, or a committee endorsed or convened by the Federal Reserve Board or the Federal Reserve Bank of New York the best choice for the first step of the waterfall? Why or why not?*

As noted in the General Comment above, it would be highly problematic if private student loan notes that are collateral for a financing or interest rate exchange agreement were subject to a fallback provision with terms that varied from the applicable financing provision. Use of a fallback provision for private student loans that references a currently unknown alternative reference rate to be

recommended at some point in the future by the Federal Reserve Board, the Federal Reserve Bank of New York, or a committee endorsed or convened by those entities for consumer loans, instead of existing capital market recommendations, is likely to heighten these concerns.

Question 6: *As noted above, in addition to recommending SOFR, the ARRC may recommend forward-looking term SOFR rates if it is satisfied that a robust, IOSCO-compliant term rate that meets its criteria can be produced. If the ARRC recommends forward-looking term rates (e.g., 1-month, 3-month, 6-month, etc.) and a corresponding spread adjustment, should a spread-adjusted term rate be the replacement index for variable rate private student loans, or would a spread-adjusted average (simple or compounded) of SOFR be more appropriate? Please provide support for your answer.*

Forward looking SOFR rates may be attractive, however, its use would only be appropriate for portfolios financed after it becomes available.

Question 7: *Should the Note Holder have the responsibility as the 2nd and last step of the waterfall? Why or why not?*

Fallback provisions provide that the Note Holder will have the discretion to select a reference rate, consistent with applicable consumer lending law requirements and portfolio financing contractual obligations as the 1st or 2nd and last step of the waterfall. However, this should not be an obligation because of the financing concerns noted in the General Comment and the response to Question 9.

Question 8: *Should the Note Holder have the ability to make adjustments (positive or negative) to the loan's margin to more closely approximate the LIBOR-based interest rate present as the time of replacements? Why or why not? If you do not believe the Note Holder should make adjustments to the loan's margin, and potential replacement indices diverge from the value of the current Index, what provision or step should be taken to preserve that consistency?*

Please refer to the responses provided to Question 7 and Question 9, as they address this question as well.

Question 9: *If the Note Holder is a trust, is there some entity other than the Note Holder that should be responsible for identifying the replacement Index if Step 1 of the waterfall fails? Please provide sufficient rational for your answer.*

If the legal owner is a trust, the financial institution lenders or holders of publicly sold obligations secured by that trust would typically have a right to approve changes to the interest rate formula applicable to the underlying loan notes; however, any requirement to obtain the approval of holders of publicly sold obligations would likely depend upon the number of expected holders and the expected difficulty of obtaining such approval. In some current trust transactions, an administrator, which is likely an affiliate of the trust sponsor, may make certain determinations (e.g. whether a triggering event has occurred), but generally those determinations are factual, rather than discretionary, and it is questionable whether a fiduciary would make such a determination were more discretion provided. The loan note Holder who established the trust for financing purposes is not typically able to reserve the right to change the interest rate basis of either the underlying loan notes or the financing on a unilateral basis. The entity that should be responsible for identifying the replacement Index and the mechanism for making that change would be dependent upon the governing language of the trust. Typically, in

these types of arrangements, neither the Note Holder nor any fiduciary may affect a reference rate change without consent (or at a minimum, notification) from other parties, as outlined in the trust.

Question 10: *Will this language have unintended consequences not considered by the ARRC working group? If so, please explain and provide information about why this language would present challenges. If there are concerns with this proposed language, please be sure to specify if concerns relate to this proposed language, or to index replacement language in general.*

Any post-origination index replacement in private student loan note variable rate interest calculation may be expected to result in operational costs and borrower confusion and may result in asserted borrower defenses to repayment based on claims relating to its disclosure. Uncertainty as to the basis of interest accrual may also affect demand for private student loans and repayment performance.

Question 11: *Is there any provision in the proposal that would significantly impede variable rate private student loans originations? If so, please provide a specific and detailed explanation.*

Some state entities that make private student loans operate pursuant to state statutes that may limit interest rate-setting discretion.

Question 12: *Please provide any additional feedback on any aspect of the proposal.*

Section 4(C) Calculation of Changes: Under the added language in blue, “The Margin may change if the Index is replaced by the Note Holder in accordance with Section 4(G)(2) below. We believe the reference should be to Section 4(G) as it could also change under 4(G)(1).

Section 4(D) Limits on Interest Rate Changes: Private student loan note term disclosure is subject to federal and state regulation and specific disclosure recommended in the Consultation should be kept to a minimum. Specifically, under section 4(D) Limits on Interest Rate Changes, the ARRC is recommending specific language that is already regulated under the Truth in Lending Act, Section 1026.46, Special Disclosure Requirements for Private Education Loans. Specifically, Section 1026.47 speaks to the content of disclosures. For the Application and Solicitation Disclosure (1026.47(a)(1), it states that the interest rate or range of interest rates applicable to the loan and actually offered by the creditor at the time of application or solicitation must be disclosed. It also requires the disclosure of the factors determining the rate, whether it is fixed or variable and if any limitation on the rate is determined by applicable law. This section may have been modeled upon Adjustable Rate Mortgages as they often have periodic interest rate change and life of loan rate caps; however, it is not typical for student loans. The Consultation should limit its disclosure to those items that relate to the replacement of LIBOR as an index. It is unnecessary to include specific disclosure with respect to interest rate caps, floors, or interest rate adjustment caps. With respect to interest rate adjustment caps, it seems that such a limitation should be included in the waterfall provision rather than imposed by disclosure and that its feasibility would be limited by the concerns expressed in the General Comment.

4(G) Replacement Index and Replacement Margin: Under (ii) “the Administrator or its regulator issues an official public statement that the Index is no longer reliable or representative.” We recommend deleting “reliable” as this is not a term used in financial products — “representative” is and should be sufficient.

In the second paragraph, we suggest adding language as provided in red: “If a Replacement Event occurs, the Note Holder will select a new ~~index reference rate and related terms~~ (the “Replacement Index”), ~~and may, if needed under subsection (2) also select a new margin (the “Replacement Margin”), if it may do so consistent with applicable consumer lending law requirements and contractual commitments~~, as follows:”

4(G)(2) assumes that the Note Holder has discretion to select a Replacement Index and Replacement Margin. In the case where the Note Holder is the issuer or sponsor it will not have retained sufficient discretion to specify a Replacement Index or Replacement Margin without consent by the holders. We believe the suggested language we provided in the paragraph above will address this concern.

Thank you again for the opportunity to comment on this Consultation. Should you have any questions, please contact Gail daMota at gaild@efc.org.

Regards,

A handwritten signature in black ink that reads "Debra J. Chromy". The signature is written in a cursive, flowing style.

Debra J. Chromy, Ed.D.
President