Comparing UK and US Student Loans

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The potential long-term privatisation of UK student loans may present investors with the opportunity to purchase UK student loan asset-backed securities, for which the student loans serve as primary collateral.

The purpose of this report is to compare the UK and US student loan markets, as well as the UK loan programme and the US Federal Family Education Loan Programme and direct and private loan programmes. In addition, the report describes Fitch's cash flow and legal rating criteria for US student loan securitisations.

Summary

In the first quarter of 1998, the UK Department for Education and Employment is expected to sell approximately £1.6 billion, or 64% of its £2.7 billion outstanding student loan portfolio, to the private sector. This sale represents the first stage of a process whereby a growing percentage of student loans for postsecondary education will be funded by the private sector. Since 1990, student loans at below-market interest rates were offered to students through a completely public sector programme to fund room and board expenses above government grants and parental contributions. Tuition costs are currently paid by the government; however, in the future, a portion of tuition costs may become the responsibility of the students. If tuition costs are borne by students and the opportunity to receive government grants is diminished, the number and amount of student loans is expected to rise commensurately.

Compared to the UK market, the US student loan market is significantly more mature, having existed since before the introduction of the Higher Education Act of 1965. In the US market, long-term financing is achieved in the capital markets, with short-term financing typically provided through warehousing lines of credit or commercial paper. The types of financing structures and products have changed over time, reflecting dynamic market conditions and legislative mandates by the US Department of Education (ED).

Background

A recent UK market study, conducted by the government, parallel tested private and public sector student loan programmes. Due to the burdensome administrative costs of running this "twin track" system, the process was ended in favour of the present sale.

Similar to the UK, the US student loan industry has vacillated between a completely public sector and private sector programme that benefits from government-backed payments. Current US policy administers the student loan system through the private/public sectors (Federal Family Education Loan Programme [FFELP]) and the public sector (direct lending). The FFELP, implemented through the Higher Education Act of 1965, has been reauthorised every five years. The programme's primary tenet includes a guarantee mechanism requiring either 98% or 100% reimbursement for loan defaults by the ED. Other fundamentals include US government-paid in-school interest subsidies and special allowance payments (SAP). Direct lending was promulgated through the Omnibus Reconciliation Act of 1993, by which the US government originates student loans directly to borrowers. While the FFELP and direct lending programmes are similar from a programmatic perspective, they differ in terms of distribution.

Another aspect of the US student loan market is the increasing availability of private capital beyond that provided by the FFELP. Private loan programmes were implemented to partially offset the competitive pressures of direct lending and to mitigate the dramatically rising postsecondary academic costs in the US. Typi-

cally, private loans serve to "top off" the student's federal financial aid package. This top-off concept is similar to the student loans available in the UK, which are used to finance student living expenses above those covered by grants and parental maintenance contributions, which serve as the foundation for financing higher education costs. However, some private loan programmes serve as substitutes for the FFELP and direct lending.

In the US, the student loan industry for FFELP loans is well defined in terms of industry participants, including originators (typically commercial banks), servicers, large third-party entities, guarantee agencies and the ED (which provides reinsurance to the guarantee agencies or loanholder up to the same amounts). In addition, an active secondary market provides liquidity to the commercial banks. The same participants also use the direct lending programme, with the exception of commercial bank originators and guarantee agencies. Direct loans are funded by the US government directly to the borrowers and are serviced mostly by the same third-party contractors. Like FFELP loans, private loans are generally originated through a commercial bank or similar lender and are often serviced by large third-party FFELP servicers.

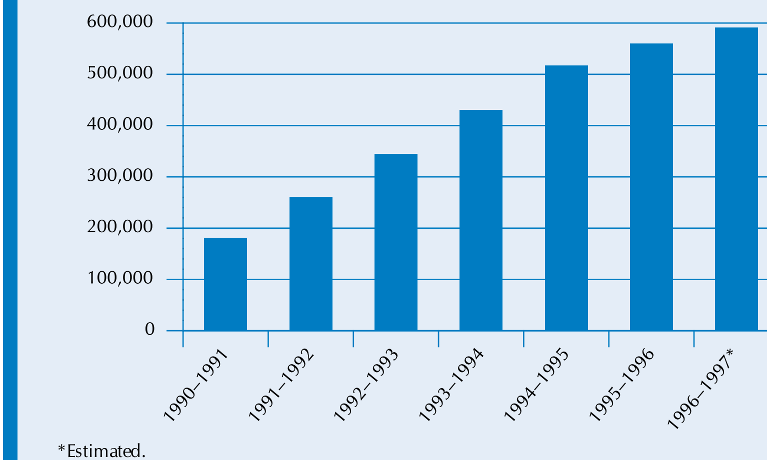
Private loan programmes are typically more expensive than FFELP loans and do not enjoy the guarantee and federal reinsurance characteristics. They may be self-insured or insured by a private student loan guarantor.

UK Student Loan Market

Overview

As of 31 March 1997, there were approximately £2.7 billion in UK student loans outstanding, consisting of 2.7 million unsecured loans to 1.5 million students. The student loan programme is currently administered by Student Loans Co. Ltd. (SLC). SLC, limited by the shares under the Companies Act

Number of UK Student Loan Accounts Advanced Each Academic Year



*Estimated.

1985 and wholly owned by the UK government, was established in 1989. The student loan programme was introduced in 1990 to offer low interest rate loans to students attending postsecondary institutions. The number of loans under administration for the past six academic years is summarised in the chart above.

Originations

All students are permitted to receive a student loan for each year they are continuously enrolled at an eligible higher education institution (HEI), with the typical programme taking three years to complete. The student completes an application form and the relevant HEI validates an eligibility certificate. These items are forwarded to SLC, and, once received, the student is required to complete a credit agreement (regulated by the Consumer Credit Act of 1974) and provide direct debit instructions. The SLC grants the loan on an eligibility basis, without any credit checks. For academic year 1996–1997, average borrower indebtedness per loan is estimated to be £1,487, representing an 18.8% increase from the prior academic year. An analysis of the total number and value of loans issued for the academic years 1990–1991 to estimated 1996–1997 shows that the loan size or average borrower indebtedness is growing at a faster rate than the number of loans originated.

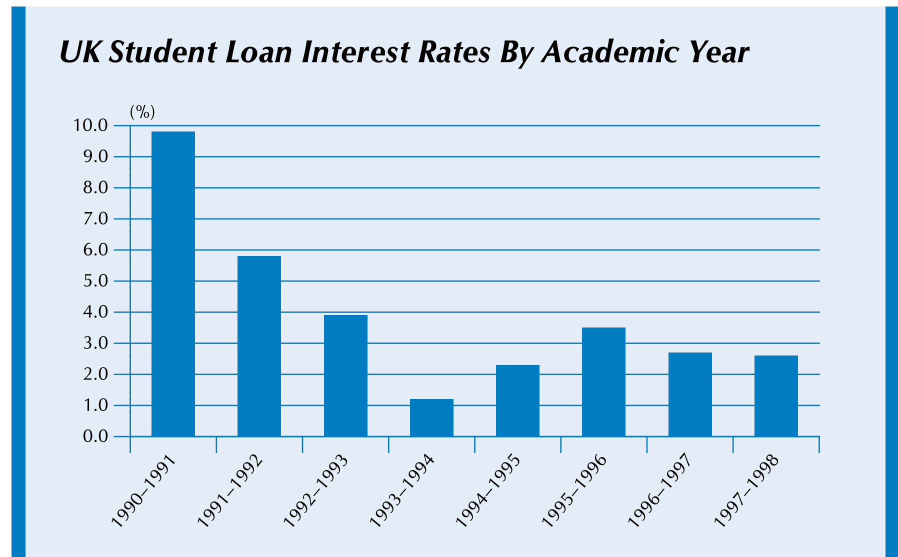
Interest Rates

Interest accrues on the loan from the origination date, regardless of whether the borrower is repaying the loan. Unpaid monthly interest is capitalised and accrues interest. The interest rate charged is based on the year-to-year change in the Retail Prices Index (RPI) in March. The RPI for academic year 1997–1998 is currently at an annual rate of 2.6%. The interest on student loans is indexed to the RPI to take into account inflation, so that the value of the loan repaid will be relatively the same as the value of the amount borrowed. Any change in the interest rate will take effect annually in September, when all borrowers are advised of the change as well as of any resulting revised repayment amounts. The chart at the top of page 3 summarises the interest rates on the loans over the past six academic years.

Repayments and Terms

All loans made to an individual borrower over a particular course of study are consolidated into a single loan account. The student is not obliged to

repay the loan until the April following either graduation, voluntary course termination, or official termination of the eligible course. Prior to this date, SLC sends each borrower due to repay details of repayment and information on how to apply for deferment. The borrower is required to make repayment of the loan account over 60 months if the money borrowed was in support of less than five academic years or 84 months in all other cases. The vast majority of the loans that have commenced repayment have done so under direct debit on one of four specified dates each month. Prepayment is permitted at any time without penalty.



UK Student Loan Interest Rates By Academic Year

If the student misses two or more repayments, the loan is considered to be in default and is passed from the administration department to the collections department, where a more rigorous pursuit of the overdue funds takes place. As of March 1997, 45.2% of the 644,000 borrowers in repayment had been granted deferment *(see chart below)*.

Deferment

Borrowers are allowed to defer payment for one year at a time if either the borrower's gross income is equal to or less than 85% of the national earnings average or if the borrower takes out another loan for a subsequent course. Deferment is usually granted if evidence is provided to SLC. Acceptable evidence includes three original payslips, a stamp from the Department of Social Security, or a letter from whomever may be providing support, such as a spouse. Deferment may also be granted, or adjustments to the loan repayment schedule may be made, at SLC's discretion if a borrower is receiving certain types of disability-related benefits.

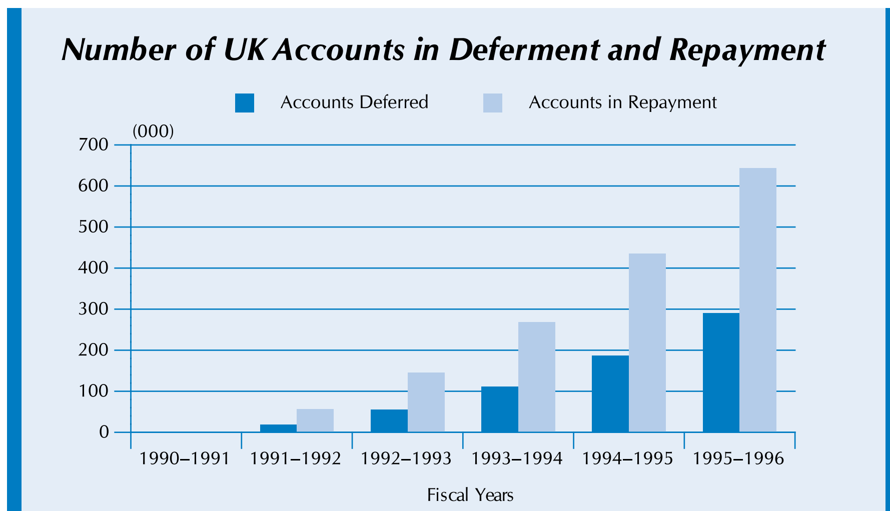
If a borrower demonstrates his/her right to defer, he/she is placed in deferment for 12 months. Those who do not reapply for deferment at the end of the 12-month period are automatically transferred to the repayment category. Arrears are highest in April due to borrowers being slow in applying for deferment.

Cancellation

A borrower's obligations are cancelled if all or part of the borrower's last borrowing has been outstanding for at least 25 years and the borrower is not in arrears or default, the borrower was under 40 years of age when he/she last borrowed from SLC and is now 50 years old and not in arrears or default, the borrower was at least 40 years of age when he last borrowed from SLC and is now 60 years old and not in arrears or default, or if the borrower dies.

Servicing

To ensure timely repayment of the student loans, SLC monitors all repayments and takes prompt action if a borrower goes into arrears. The collection process includes continuous telephone and written contact with delinquent borrowers to explain the consequences of default. In addition, SLC counsels and advises borrowers who are not entitled to defer but who are under financial duress. Also, if necessary, SLC takes the borrowers to court.



Number of UK Accounts in Deferment and Repayment

US Student Loan Market

Overview

Within the US, there are three types of students loans used to finance postsecondary education — FFELP, direct, and private loans. FFELP are guaranteed at 98% or 100% of principal and accrued interest, depending on origination date, by an eligible guarantor and reinsured by the ED up to the same amounts. Direct loans are funded directly by the government to the student. Private loans do not have a federal guarantee but may be self-insured or guaranteed by a private loan guarantor or a surety bond provider. FFELP loans provide the largest proportion of student loans outstanding, with approximately \$19.7 billion originated in academic year 1995–1996, while private loans are estimated by various industry sources at approximately \$1.5 billion. Direct lending currently accounts for 33% of annual student loan volume.

Originations

The student loan system within the US is administered through a private/public partnership, whereby the borrower typically applies for a loan at a commercial bank. The loan application is sent to the appropriate guarantee agency. Once the bank is notified that the loan is guaranteed, the proceeds are paid to the student net of a guarantee fee. As in the UK, US loans are disbursed based on eligibility versus credit status. Most of the US private loans are also originated through the commercial banking system. If the private loan is guaranteed by a private guarantor, such as The Education Resources Institute (TERI), the originator must follow TERI's loan underwriting guidelines before the loan is guaranteed and approved.

Federal Family Education Loan Programme

The FFELP, created under Title IV of the Higher Education Act of 1965, as subsequently amended, affords students and parents of students the means to finance the cost of postsecondary education. A FFELP loan can be made only to qualified borrowers. The qualifications include requirements that the student has been accepted for enrollment or is enrolled and is maintaining satisfactory progress at an eligible institution, the student is carrying or will carry at least one-half the normal full-time academic workload, the borrower agrees to notify the loanholder of address changes, and the student meets application need requirements.

The life cycle of a student loan begins with the in-school period, which generally runs from one to four years, depending on the type of institution attended, such as a four-year private or public university, a two-year private or public institution, or a professional or proprietary school. Once the student graduates, the loan enters a six-month grace period, and, thereafter, the loan goes into active repayment.

Borrowers under the FFELP have the option of applying for deferment and forbearance. Deferment allows borrowers to postpone principal payments on their loans, although interest must be paid. Deferment is granted to students attending graduate school or entering the Armed Forces, among other reasons. Deferment is typically granted in increments of six months, up to a maximum of three years. Forbearance is granted when the borrower is experiencing economic hardship. While interest may be paid on the loan, principal payments are waived for the forbearance period for up to three years.

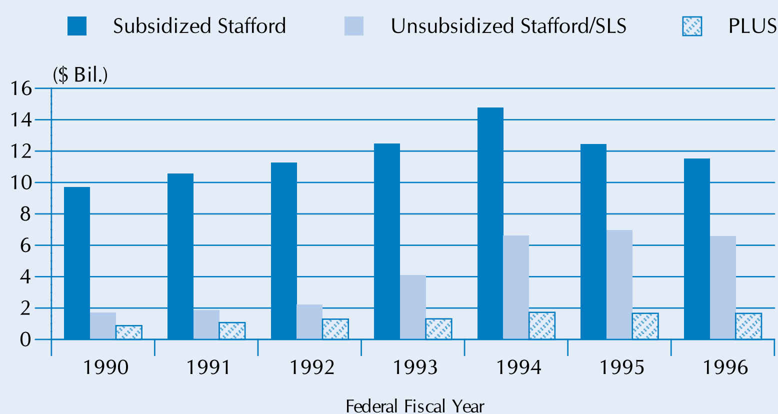
Loan Types

Several types of loans are offered under the FFELP, including subsidised and unsubsidised Stafford loans, Parental Loans for Undergraduate Students (PLUS), Supplemental Loans to Students (SLS), and consolidation loans. Holders of FFELP loans are entitled to receive SAP to ensure the holder is receiving a market rate of return. The rate of special allowance is based on loan type, the date of loan disbursement, and the type of funds used to finance the loan. SAP are paid by the ED quarterly.

Stafford Loans

Subsidised Stafford loans are made to students who pass certain financial needs tests. Unsubsidised Stafford loans are granted to students who do not pass the needs tests or who need to supplement their finances beyond that provided by subsidised loan proceeds. The basic requirements for subsidised and unsubsidised Stafford loans are

US Federal Family Education Loan Programme Origination Volume



SLS – Supplemental Loans to Students. PLUS – Parental Loans for Undergraduate Students.

generally the same, although the terms differ slightly.

The interest rate paid by Stafford loan borrowers prior to 1 Oct. 1992 varies, generally according to when the first disbursement on the loan was made. For Stafford loans disbursed after that date, the rate for any 12-month period beginning 1 July and ending 30 June is determined the preceding June and is equal to the 91-day US Treasury bill (T-bill) plus 2.50% while the borrower is in school, grace, or deferment and the 91-day T-bill plus 3.10% when the borrower enters repayment or forbearance, not to exceed 9%. Subsidised Stafford loan interest is paid by the US government while the student is in school, grace, and certain periods of deferment. Unsubsidised Stafford loan borrowers must pay their interest while in school or may opt to have the interest added to the outstanding loan balance until repayment commences.

Principal repayment for subsidised and unsubsidised Stafford loans begins at the end of a grace period of either six or nine months, with required minimum monthly payments of $50, including principal and interest. As of 1 July 1995, the lender is required to offer borrowers a choice among standard, graduated, and income-sensitive repayment schedules. Each loan must be scheduled for repayment over a period of not more than 10 years after repayment begins. However, with the in-school, grace, deferment and forbearance periods included, a first year Stafford loan's term can be extended to 19 years. The loans may be prepaid without penalty.

PLUS and SLS

PLUS are made to parents of students to meet costs of education beyond that provided by Stafford loans and other sources. The Higher Education Act has also allowed for dependent undergraduate students who need additional loans to supplement their subsidised Stafford loans through SLS. The SLS were replaced by unsubsidised Stafford loans in July 1994.

The interest rate on PLUS depends on the date of disbursement. PLUS disbursed prior to 1 June 1987 are fixed-rate loans, while those disbursed subsequent to that date have a variable rate based off the 52-week T-bill. The holders of these loans are eligible for SAP, but are not eligible for interest subsidy payments. PLUS begin amortising 60 days after disbursement, except for those borrowers eligible for deferment or forbearance. The maximum repayment term is 10 years.

Consolidation Loans

The FFELP allows borrowers to consolidate all outstanding student loans into a single guaranteed and reinsured loan. Consolidation loans are disbursed directly to the owners of the loans to be consolidated. Interest accrues and is paid without deferral. Borrowers may defer periodic payments under certain circumstances. However, in general, repayment options are more limited than those of Stafford borrowers.

Consolidation loans originated prior to 1 July 1994 bear interest at a rate equal to the weighted average of interest rates on the unpaid principal balance of outstanding loans, with a minimum rate of 9%. Consolidation loans originated after 1 July 1994 are not subject to a minimum interest rate, and the weighted average of interest rates is rounded to the next whole percentage. Interest subsidy payments are not currently available to consolidation loan borrowers. Repayment must begin no later than 60 days after the discharge of all prior loans that are consolidated. Repayment options must include graduated and income-sensitive repayment.

Federal Guarantee and Reinsurance

Each student loan is guaranteed as to principal and interest by a guarantee agency and reinsured by the ED. According to the Higher Education Act Amendments of 1992, if the ED has determined that a guarantee agency is unable to meet its guarantee obligations, the holder of the loan may submit claims directly to the ED, which is then responsible for fulfilling the guarantee agency's obligations.

A student loan may be considered in default after the 180th consecutive day of nonpayment from the date of the first missed payment. Upon default, the holder of the loan, typically the servicer, is required to submit a claim package to the guarantee agency. The claim package consists of the promissory note, the due diligence followed in servicing the loan, and other relevant documents.

If the loan package is complete and all due diligence procedures have been followed, the guarantee agency is required to remit either 100% or 98% of principal and accrued interest to the holder of the loan, depending on the date of disbursement. Loans disbursed prior to 1 Oct. 1993 are guaranteed at 100%, and loans disbursed subsequent to this date are guaranteed at 98%. Failure to comply with due diligence procedures may lead to the loss of the guarantee.

Private Loan Programmes

In the US, more than 30 private loan programme originators provide approximately 80 products. Unlike FFELP, many private loan products incorporate borrower creditworthiness standards as part of the loan origination process. The underwriting criteria typically include an analysis of the borrower's credit report and often require a co-maker or co-signer. Primarily due to the creditworthiness tests, these private loan programmes are significantly different from UK loans, except that some of the private loan products do not have a guarantee.

Financing US Student Loans

In the US, student loans are initially financed through the commercial banking system. The originating bank's strategy is to either hold the loans on balance sheet or sell them to a special purpose corporation, where they earn an initial premium in addition to the net present value of the cash flows over the life of the transaction. If the banks sell the loans to the secondary market, it usually finances the purchase with warehousing lines of credit or commercial paper in the short term and, subsequently, with long-term debt financing.

Until 1993, most of the debt issuance was through the secondary markets, either using a senior/subordinate structure, wrapping the transaction using a monoline insurance company, or using a fully supported structure with a direct-pay letter of credit or a standby bond purchase agreement. Subsequent to the relaxation of the Investment Company Act of 1992, which allowed for the securitisation of student loans, this market has grown significantly. Banks which once sold their student loan portfolios to secondary market began securitising their holdings.

Most debt offerings are senior/subordinate transactions with debt service reserve funds to provide liquidity, as the loans are guaranteed. Generally, student loan bonds or notes are repaid with cash flow from the loans pledged to the debt, net of expenses, which typically includes servicing, loan programme administration, and debt issuance costs. Student loan debt maturities are structured for the longest possible loan repayment schedule. Under a more reasonable scenario, the loans and debt will mature earlier than scheduled. Debt yields include a penalty for early redemption calls. The chart on page 7 summarises the cash flows of a federally guaranteed student loan asset-backed transaction.

Fitch reviews the transaction's legal documents to ensure that the payment priorities reflect the senior/subordinate relationship. Fitch ensures that multiple-class structures prohibit optional redemption of subordinate classes unless the senior classes would be sufficiently protected and the reserve fund has a minimum amount sufficient to cover the liquidity demands of student loan defaults occurring at the end of the transaction. If the transaction is a sequential-pay pass-through and no principal payments on the subordinated debt may be made before the senior debt is paid in full, the redemption tests are not necessary. Release of funds from the trust estate should be reflected in a cash flow analysis that demonstrates full and timely payment of debt.

Most transactions finance 100% FFELP loans. However, private loans are also financed either as a stand-alone portfolio or, more commonly, as a small percentage of a predominantly FFELP portfolio. Issuers that are able to finance the private loans on a stand-alone basis have significant historical performance statistics that Fitch can analyse or are guaranteed by a Fitch-rated guarantor. Private student loans issued in concert with FFELP loans either do not have significant historical performance data or are not guaranteed by a Fitch-rated private guarantor. By issuing debt secured by a portfolio of both FFELP loans and private loans with no history nor guarantor, the transaction is able to benefit from the excess spread generated by the FFELP loans to offset the nonreimbursed defaults assumed on the private loans.

Cash Flow Projections for US Student Loan Asset-Backed Transactions

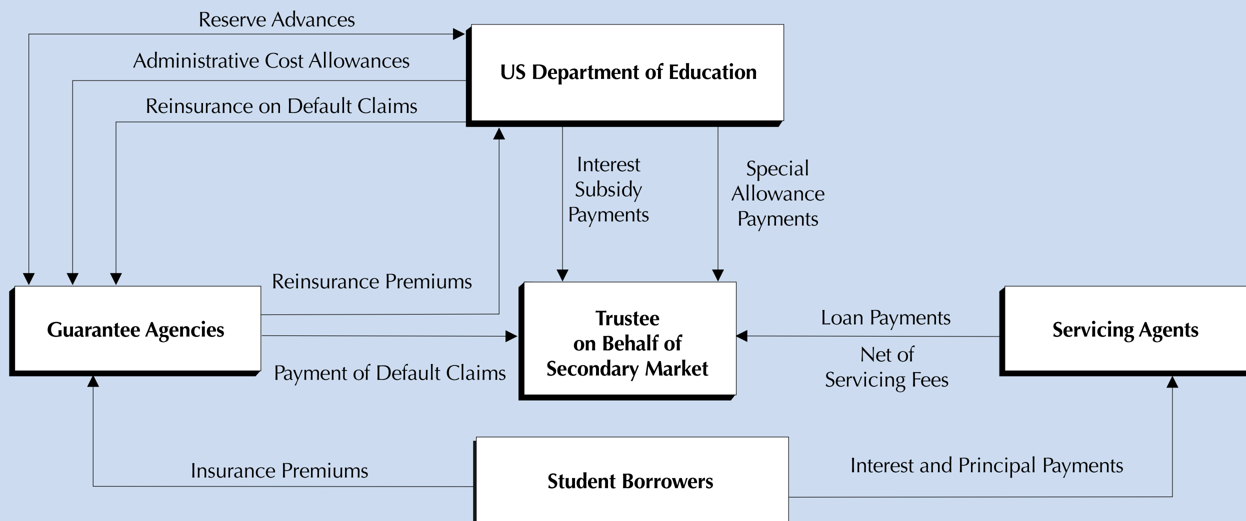
This section describes the bases of Fitch's cash flow projections for a structured financing for FFELP and private loans. The FFELP cash flow parameters are based on the provisions of the Higher Education Act of 1965, which governs the types of assets available to be financed, the guarantee and reinsurance mechanisms, and the calculation of SAP and interest subsidy payments, as well as the timing of those payments. The cash flow assumptions for the private loans are based on each programme's loan product and level of historical data, in addition to the presence of a Fitch-rated guarantor.

Defaults/Default Timing

The ED reports that the most recent data available show a FFELP cohort default rate of 10.7% for fiscal year 1994. This rate is defined as the number of borrowers who entered repayment in fiscal 1994 and defaulted prior to 30 Sept. 1995 divided by the number of students who entered repayment in fiscal 1994. As of 30 Sept. 1993, the cohort default rate was 26.6%. However, the ratio is calculated to include the number of borrowers who entered repayment in fiscal 1990 and defaulted prior to 30 Sept. 1993, representing a three-year versus one-year rate. The ED does not track data on a static pool basis, as the default history for a particular cohort is tracked only over a one-year period versus over the life of the loan.

ED data also reveal that default loss and timing is based on school type (four- and two-year public and private institutions and proprietary schools) and loan type (subsidised and unsubsidised Stafford, PLUS, SLS, and consolidation). The 1994 cohort default rates were: 6.8% for public and 6.3% for private four-year schools; 13.8% for public and 13.5% for private two-year schools; and 21.0% for proprietary schools. Consequently, the school-type breakdown of an expected portfolio has a large impact on Fitch's default assumptions.

Another factor in determining default rates is loan type. The ED reports that PLUS have relatively low default rates. Stafford loan default rates are approximately two times those of PLUS. The ED does not report the default rate for SLS or unsubsidised Stafford loans;



however, the ED says the default rates are probably very similar to subsidised Stafford rates. (The SLS programme was terminated in July 1995.)

The shape of the default curve demonstrates that most of defaults occur within the first three years of repayment, with the largest amount of defaults occurring during the first 18 months. Fitch front loads defaults in the cash flow projections. Defaults for loans in active repayment are defaulted 75.0% in year one and 12.5% in years two and three. Loans not in active repayment are defaulted at the same percentages as they enter repayment. Fitch has developed a seasoning model that adjusts expected defaults for average time in repayment. Some issuers have the statistical information to calculate the seasoning of their repayment portfolios and, consequently, receive lower overall default assumptions. Many issuers have not tracked this information and must structure their transactions to support higher assumed default rates. This may have an impact on reserve size and subordination levels, especially when the new transaction is issued under a master trust with a significant amount of seasoned loans outstanding.

For private loans, default curve information reveals that default curves differ by loan product as each is unique in terms of school and borrower demographics, discipline studied, and whether the loan is made to undergraduate or graduate students. With few exceptions, default curve information is scarce for alternative loans. For these loan products, Fitch is sometimes able to create proxy default loss and severity assumptions based on the FFELP default rates, due to the fact that school and borrower eligibility is often more stringent than FFELP's and the loans are credit underwritten.

Reimbursement/Recoveries on Defaulted Student Loans

US student loans are reimbursed at less than 98% and 100%, due to a servicer loss that is assumed. This assumption is based on the servicers not performing the proper due diligence on the student loans and the loan losing its guarantee. For private loans that are guaranteed, the guarantee percentage depends on the guarantor's rating level and the related rating level of the cash flow stress test. For private loans that are not guaranteed and have no historical performance data, no recoveries on defaulted loans are assumed.

Payment Lags

For FFELP loans, a 60-day borrower payment lag is assumed in most stress tests, with no late charges assessed. Fitch assumes that quarterly federal interest subsidy payments and SAP are 60 days late. Depending on the private loan programme, payment lags range in the 30- to 60-day range. There is no reliance on late fees or prepayment penalties in the cash flow projections.

Portfolio Purchases

If the transactions contemplate the use of some or all of the note proceeds to acquire or originate loans in the future, Fitch requests both last-day and non-acquisition cash flow tests. These cash flow assumptions test the ability of the transaction to support the negative arbitrage between the investment rate on the proceeds and the note rate. Furthermore, even if a transaction is structured to allow loan principal received to be recycled into new loans, Fitch re-

quests that the cash flow assumes no recycling to ensure that the transaction could withstand the loss of excess cash generated by recycled assets. If the legal final maturity on any tranche occurs before the last payment due on any portfolio asset, including recycled loans, Fitch asks for an additional cash flow. In this case, no defaults or prepayments are assumed and deferment and forbearance are significantly increased. All principal is recycled into longer term loans. This maturity stress tests the ability of the transaction to timely meet debt service payments.

Interest and Investment Rates

The interest and investment rate assumptions incorporate the level of interest rates and the relationship among interest rates. As most of the FFELP student loans and many of the private loan programmes are indexed to the 91-day T-bill, with some of FFELP loans indexed to the 52-week T-bill, and the corresponding liabilities indexed to the London Interbank Offered Rate, fixed rate, or auction rate, basis risk is created. Fitch's standard cash flow assumptions minimise basis risk.

Legal Structure for US Student Loan Asset-Backed Transactions

As with all asset-backed transactions, Fitch ensures that issuers of student loan-supported debt are special purpose, bankruptcy-remote entities, as verified by an opinion of counsel. An issuer that is a political instrumentality may qualify as a bankruptcy-remote entity if an opinion is delivered stating that it is not subject to involuntary bankruptcy or receivership; an issuer that is tax-exempt under Section 501(c)(3) may qualify either by providing such an opinion or by furnishing representations and warranties that it is exempt from tax as a not-for-profit organisation under Section 501(c)(3) and that it engages in no activities other than those qualifying it for such status. While such an issuer cannot waive its right to voluntary bankruptcy, Fitch believes it is highly unlikely that such an issuer would do so. Fitch also reviews the legal documents to ensure that the issuer has covenanted not to distribute profits to shareholders.

Fitch is comfortable with this risk in 'AAA' transactions, because these issuers have agreed to little or no recourse debt, to require that 100% of the board of directors approve a voluntary bankruptcy, refrain from initiating bankruptcy proceedings if not insolvent, and to limit their activities by charter to student lending. Furthermore, the public policies that led to the creation and fostering of student loan programmes would be adversely effected by a lender's voluntary bankruptcy.

Other student loan issuers should satisfy Fitch's customary criteria for bankruptcy-remote special purpose entities. In addition, where there is recourse exceeding reasonably expected losses, the student loans should be sold to a bankruptcy-remote special purpose subsidiary of the seller prior to being sold to the issuer, and counsel should furnish "true sale" and nonconsolidation opinions. The activities that the special purpose subsidiary may engage in are restricted so that it is unlikely to become insolvent or be subject to the claims of any creditors.

For all transactions, Fitch ensures that a first perfected security interest opinion has been delivered stating that the trustee must have a first perfected security interest in all collateral securing the debt, including student loans, debt service reserve funds, investments, and all agreements, such as investment, interest rate swap, servicing, guarantee, and loan purchase agreements, among others.

Fitch also ensures that, in the unlikely event of default, the most senior debtholders have the right to direct proceedings. An event of default should not be triggered by a payment shortfall to subordinate holders. Otherwise, subordinate holders could initiate bankruptcy proceedings while amounts due to senior classes were still current.

The issuer must pledge its rights under the servicing agreements to the trustee. The trustee or issuer must be able to remove the servicer for improper servicing, but not before a substitute servicer is engaged.

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