Student loan giant Navient highlights risks of sector

by Lee Yanru

The crash of the US financial sector in 2008 had highlighted the potential of delinquent household debts in crippling the nation's economy, as well as the importance of remaining vigilant to these debts. On a seemingly bright side, the latest statistical data from the Federal Reserve Bank of New York Consumer Credit Panel/Equifax has illustrated that the percentage of serious delinquencies for most categories of household debt to be generally on the decline since the Global Financial Crisis of 2008. However, the student loan category of serious delinquent household debt still remains to be stubbornly an exception, contrary to the general trend of declining delinquent household debt. (see Figure 1)

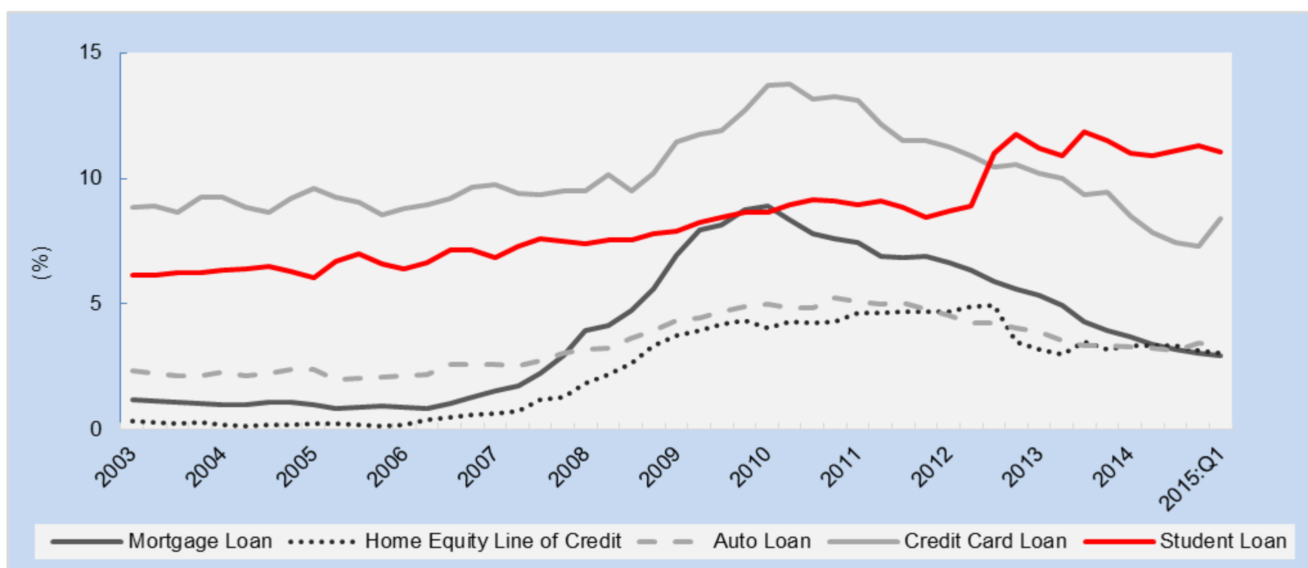

Figure 1: Percent of Balance on US serious delinquent loans (by loan type). *Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax*

The student loan market is the largest source of consumer debt in the US economy, after mortgages. As the Federal Reserve Bank of New York has defined loans that are more than 90 days late to be serious delinquent debt, this worsening trend of serious delinquent student debt has been aggravated with the sharp rise in the cost of obtaining a college degree over the past ten years, at an approximate rate of 3% to 10% each year, according to the US Bureau of Labor Statistics. This is primarily attributed to the over-generous lending for college education, in a situation resembling the lending scheme for mortgages leading up to the 2008 mortgage crisis. This worsening trend is reflected in the financial profile of the US largest student loan servicing and management company, Navient Corp.

Spun-off from Sallie Mae in April last year, Navient Corp manages more than USD 300bn out of the USD 1.2tn student loan market, which is more than a quarter of the overall student debt in the US, according to the latest financial results released for Q2 2015. Its business strategy primarily includes servicing and managing of Federally Guaranteed Student loans, Private Educations loans, as well as Asset Recovery services. Navient first provided a preview of the deteriorating trend of student debt in the US economy through signs of its poor financial performance, when it first announced a reduction in the financial forecast for the year on 13th July 2015. The firm attributed this to the dismal performance of its private education loan segment, where it generates revenue from acquiring and servicing of private education loans. Navient announced that large segments of higher credit risk private education loan borrowers deferred repayment on their existing loans as these borrowers returned to college to pursue further education. With the increase in loan balances exiting deferment, Navient Corp increased its provision for these loans and currently projects a private education loan loss provision of USD 191mn for the quarter and USD 575mn to USD 600mn for the year. This could be a

huge setback to Navient's earning capability, considering that it holds USD 28.1bn of its portfolio in Private Education loans, which is about 22% of its overall portfolio.

The financial outlook of Navient Corp turned from bad to worse when it officially released its financial performance for Q2 2015 on 23rd July 2015, highlighting an almost 75% decline in earnings for its private loan portfolio, from USD 86mn in Q2 2014 to USD 22mn in Q2 2015. This was mainly due to an increase in the provision for private education loan losses by USD 46mn, as well as a squeeze on the interest margin, where net income decreased by USD 54mn. Additionally, Navient also reported an overall 40% reduction in profit, based on GAAP financial reporting standards as core earnings plunged from USD 307mn in Q2 2014 to USD 182mn in Q2 2015. The deterioration in the credit profile of Navient Corp is reflected in the RMI-CRI 1-year Probability of Default (PD) as seen in the sharp increase of PD from 8.16bps at the end of February to 75.05 bps at the end of July. Simultaneously, its market capitalization also decreased sharply from USD 8.58bn to USD 6.11bn during the same period of time. (see Figure 2) Consistent with the PD trend, there has also been a more than double increase in the last price of the 1-year credit default swap contracts for Navient Corp from 96.89bps on 13th July 2015 to 200bps at 28th July 2015, its highest price in the recent years.

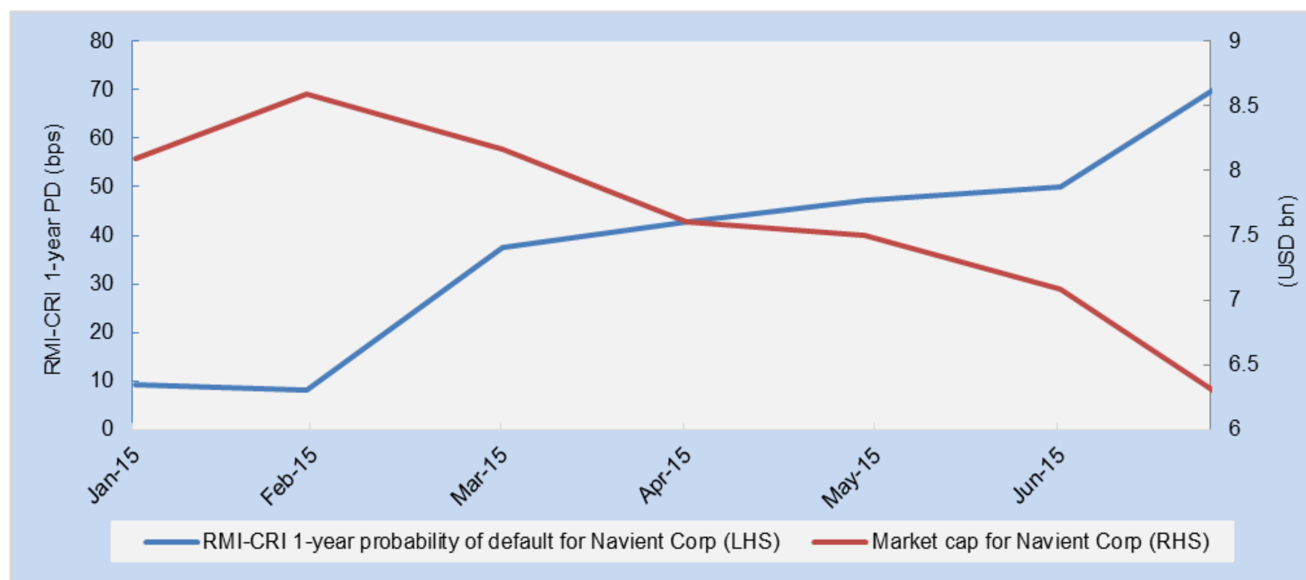

Figure 2: RMI-CRI 1-year Probability of Default and market cap for Navient Corp. *Source: RMI-CRI, Bloomberg*

Navient is facing greater financial challenges, as seen in the latest release of its financial performance in Q2 2015 (see Table 1). With the poor performance of its private loan portfolio, Navient Corp's net income margin has significantly declined in Q2 2015. Additionally, it also faces a severe worsening of its liquidity. In view of the aftermath of 2008 Global Financial Crisis and its underlying root cause in delinquent mortgage loans, the current issue of rising serious delinquent US student debt is certainly an issue for concern, especially after witnessing this worsening trend being reflected in the credit profile of the largest US student loan servicing and management company, Navient Corp.

	Q2 2014	Q3 2014	Q4 2014	Q1 2015	Q2 2015
Net income margin (in %)	21.17	25.28	20.25	21.69	14.39
Total sources of primary liquidity (USD mn)	3,409	3,632	3,358	3,858	2,665

Table 1: Financial data for Navient Corp. *Source: Bloomberg, Company Report*

Credit News

China's stock rescue chief never saw the crisis coming

Aug 3. The Chinese government placed more than USD 400bn at China Securities Finance Corp, in the hope that the firm could prop up Chinese stocks after the crash of the stock market. The firm's plan was to intervene in the stock market to buy stocks using money borrowed from the central bank and other sources. However, the plan has not been proven to be very effective. Nie, the head of the firm, states that he did not expect to take on the role of a market savior and he now faces a difficult task of being one. (Bloomberg)

Another Dubai debt crunch is looming as oil slump hits Gulf

Aug 2. Dubai looked set to recover from its debt crisis in 2009 until last year when the oil prices plunged. Although it has diversified its economy, it is heavily dependent on the wealth of energy superpowers such as Saudi Arabia. With oil prices hovering around USD 50 per barrel, Dubai's economy looks vulnerable to a decline. The International Monetary Fund (IMF) has warned that Dubai has been taking on more debt recently. Concurrently, the key drivers of the Dubai's economy have started to pull back. The real estate sector, which is one of the key drivers of the economy in Dubai, has begun to deteriorate.(Telegraph)

Puerto Rico set for debt default

Aug 2. Puerto Rico did not make a USD 58mn payment on Public Finance Corporation bonds, according to Victor Suarez, chief of staff for Puerto Rico's governor. The missed payment will push Puerto Rico formally into default after the close of business on Monday, according to credit rating agency analysts. Puerto Rico has argued that a failure to make a payment on the PFC debt would not constitute a default because they are morally obliged bonds, which do not carry the same legal protection that general obligation debt does. Analysts at two major rating agencies have refuted that claim. (FT)

Corporate giants sound profits alarm over China slowdown

Jul 30. Some of the world's largest corporations have braced themselves for the slowdown of China's economy as they anticipate that weak growth would adversely affect their profits in the second half of the year. Car companies such as Audi and Ford have cut their growth forecast and industrial goods group such as Caterpillar have also voiced out their concerns about the negative impact of China's slowdown. Figures in July showed that China's factory activity has contracted the most in 15 months. China's slowdown has been shocking to many as it occurred after years of extraordinary growth.(FT)

Noble Group's buybacks exceed almost all its recent acquisitions

Jul 30. Noble Group Ltd., the Singapore-listed trader that has been targeted by short-sellers and critics of its accounting, has recently spent more on its own shares than it has on all but one of its investments in four years. Standard & Poor's changed Noble's outlook last month to negative from stable. Moody's Investors Services in May said it will maintain a stable outlook for the company. The stock fell 12% at the close on July 30 to 52 Singapore cents, the lowest since November 2008. So far, the amount spent by Noble is "not huge" compared with the trading company's liquidity, said Cindy Huang, an analyst in Standard & Poor's. If the pace of buybacks accelerates "that could be something we could be concerned about," she said. (Bloomberg)

Yelp shares plunge after earnings loss (CNBC)

Chevron cutting 1,500 jobs to help cut costs by USD 1bn (CNBC)

ExxonMobil Q2 profit plunge 52% to USD 4.2bn, worst in 6 years (RT)

Regulatory Updates

China central bank defends online payment rules amid criticism

Aug 3. The PBOC released draft rules that raised eyebrows among online payment processors, including Alipay and Caifutong, payment platforms of ecommerce giants Alibaba and Tencent, respectively. The new regulations propose to limit the size of payments made through these third-party payment processors significantly. Payments exceeding RMB 5,000 per day or RMB 200,000 per year must be routed through the payer's account at traditional banks. The new rules also forbid these payment service providers from opening accounts for financial institutions involved in peer-to-peer lending, crowdfunding, wealth management, or foreign exchange. Though the central bank said the proposal comes with a holistic consideration of payment efficiency, anti-money laundering and client fund security, it has been criticized for protecting incumbent banks' interests and for raising the market entry barrier. (FT)

A safety net for dying power plants surfaces in US carbon rule

Aug 3. Power plants run on fossil fuels that were planned to close because of federally mandated limits on greenhouse-gas emissions were thrown a potential lifeline. As utilities, federal energy regulators and electricity grid operators called on the U.S. Environmental Protection Agency (EPA) to impose a safeguard to prevent service disruptions and for reliability purposes, warning that states may see waves of power plant retirements under the new carbon regulations, the agency eventually succumbed to industry demand. The EPA has now included a safety valve in its Clean Power Plan that eases compliance with pollution restrictions if the mandate threatens to shut power plants. (Bloomberg)

Bank of England may toughen stress tests as economy rallies

July 29. The Bank of England might consider using stress tests of various severities to assess the resilience of the financial system counter-cyclically as economic booms turn to busts. A harsher scenario would be used as economic growth accelerates and risk builds up in the system; but when the economy weakens and there is less risk in the system, and looser bank lending is required, a softer scenario would be used. Regulators also seek to broaden their view of the financial system after the crisis showed how risks can build unseen, creating feedback loops and contagion that can cause seemingly solid institutions to collapse. (Bloomberg)

Singapore's MAS creates FinTech & Innovation Group, to start in August (Channel Newsasia)

HSBC said to increase provisions for misconduct probes (Reuters)

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