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Student Debt Attracts Private Equity

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Private-equity firms are helping traditional lenders shed credit risks by acquiring student loans even as debt forgiveness remains a hot topic in Washington.

Carlyle Group and KKR underlined the trend in July, when they bought a $10.1 billion portfolio of private student loans at auction from Discover Financial Services, a **digital banking** and payment services company, with the purchase price expected to reach about $10.8 billion once the deal closes later this year. Half of the loans carry fixed rates and the rest have floating rates, according to the asset managers.

Carlyle and KKR have taken advantage of pending new capital requirements for U.S. banks, which require banks to set aside more capital to guard against risk and which have drawn criticism from bankers as too restrictive. JPMorgan Chase's Jamie Dimon has derided the proposed capital requirements as a gift to private-credit firms. The prospect of tighter rules has prompted asset sales by traditional lenders, even as fund managers step into the broader business of making loans.

"The biggest investment thematic in the asset-based finance part of the business for us, for the last year, has been the selling of assets out of some of the banks," said Dan Pietrzak, the global head of private credit at New York-based KKR. Banks have been looking to shed assets -- including student loans -- for a number of reasons including regulatory, capital and compliance concerns, he said.

Both KKR and Washington-based Carlyle were already active investors in secondary debt offered by banks before the Discover deal. Earlier this year, Carlyle bought a $415 million collection of student loans from financial services company Truist Financial. KKR's activity in the market has been increasing since 2016, including through forward-flow loan purchases, or commitments to buy loans originated at a later date.

Discover sold privately issued loans, a category that represents less than 10% of the overall total of $1.75 trillion in student debt outstanding. That relative scarcity makes private student loans attractive to secondary investors, and the Discover auction was competitive, according to Akhil Bansal, Carlyle's head of credit strategic solutions.

Efforts to forgive federal student debt could also benefit buyers of private student loans, Bansal said.

The Biden administration in February approved the cancellation of nearly $138 billion in federal loans taken out by about 3.9 million borrowers. And in April, the president laid out fresh plans to forgive loans for another 23 million borrowers, although subsequent court rulings have stifled those efforts so far. The administration's actions came after a U.S. Supreme Court ruling last year blocked a broader plan to forgive some student debt.

"Forgiveness of the federal student loans can be a credit positive for us as the private student loan owners," Bansal said. "If the government were to forgive the federal loans, that makes that student more creditworthy to service our loan."

Most student borrowers take out both federal and private loans, with interest rates as high as 9% on the former compared with as high as 17% for the latter, according to consumer financial-services company Bankrate.

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