

U.S. Structured Finance Newsletter

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PROPOSED REGULATIONS LOOK TO YIELD BETTER CREDIT CARD ISSUER BEHAVIOR

The Federal Reserve (the Fed) has proposed new regulations for banks under the Federal Trade Commission Act to curb what the Fed perceives to be unfair or deceptive practices in the credit card industry. This proposal, in the form of an amendment to Regulation AA, is currently open for comment. Included in the proposal are provisions that:

- Limit a credit card issuer's ability to adjust the annual percentage rate (APR) charged on existing credit card balances. (Acceptable reasons to adjust the APR include changes in a base index, the end of a promotional APR period and if an obligor becomes 30 days past due.)
- Effectively require that periodic statements be sent at least 21 days prior to the date the payment is due.
- Require that principal payments in excess of the minimum payment be allocated at least partially to reduce higher APR balances when more than one rate is applicable to an obligor. In addition, if the lower APR balance is in a promotional period, principal payments would be used to first reduce the higher APR balances until the promotional period expires.
- Banks would not be allowed to impose interest charges using the "two-cycle" method, which calculates interest owed by looking back to balances from the prior billing cycle to the current billing cycle.

These proposed regulations would limit a credit card issuer's ability to manage its credit card portfolio and would reduce the yield an issuer would likely receive on its portfolio under current credit card account agreements. These changes are therefore disadvantageous in the short term to holders of credit card ABS.

The points listed above would affect yield as well as limit a credit card issuer's ability to influence customer repayment behavior. Since credit card lines are revolving and allow a cardholder to borrow additional amounts in the future based on an account's purchase limit relative to current outstandings, credit card issuers rightly perform periodic reviews of their customers' credit standing. Under existing regulations, the issuer may make changes to the terms of a cardholder's account in the event the issuer believes the customer has become a riskier credit. If the Fed's proposal is adopted, modifications to APR could only be made for new purchases. In addition, the lender would be limited in its ability to reduce the outstanding card balance associated with the lower APR more quickly than the balance associated with the higher APR. The other proposed changes would likely reduce the interest charges or other fees that a cardholder pays, both of which are included in yield and are available to pay amounts owed on credit card ABS.

DBRS expects that while the proposed changes will reduce an issuer's ability to manage consumer behavior and its ability to charge additional yield and fees under current account terms, the issuers will change the account terms over time to adjust for the new rules. In addition, while some of these proposed changes may be appropriate, others may have unintended consequences, such as the APR of cardholders being automatically raised if they go 30 days past due as credit card issuers take advantage of limited opportunities to re-price a cardholder's account for increased risk.

If adopted, the reduced flexibility for credit card issuers to manage their portfolios will be viewed as a negative factor for performance of credit card ABS. However, DBRS does not anticipate significant changes to the underlying risk in securitized credit card transactions as the credit card issuers adapt their practices. DBRS will continue to monitor the proposal and its impact on deal performance.

For questions or comments, please contact Richard Bianchi at rbianchi@dbrs.com.