

# U.S. Structured Finance Newsletter

Volume 4, Issue 45, November 3, 2008



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## GIVING CREDIT WHERE CREDIT IS DUE IN CREDIT CARD ABS

DBRS recently issued an updated report describing its methodology for rating credit card asset-backed securities (ABS) in the United States (*Rating U.S. Credit Card ABS*, October 2008). The report reflects our updated approach to the criteria surrounding the analysis and treatment of sponsors of credit card platforms and how DBRS's assessment of sponsorship quality translates both qualitatively and quantitatively into the ratings assigned by to credit card ABS.

At the heart of these refined criteria is a belief that the quality of a sponsor directly affects the likelihood that investors will be repaid according to the terms under which they invested. DBRS posits that sponsors maintain an abiding interest in sustaining the credit quality of the receivables backing the rated debt as these entities expend considerable resources to actively manage their credit card accounts and corresponding receivables to promote consistent and robust levels of excess spread. This active management includes reviewing and modifying credit limits, raising and lowering a credit card's interest rate and performing collection activities to minimize charge-offs. On the front-end origination process, these entities devote significant resources to originate receivables amid intense competition. Additionally, sponsors' interests are aligned with investors, as sponsors hold various investments in the credit card receivables through the seller's interest, retained subordinated tranches and the receivables that are not contributed to a trust but remain on the entity's balance sheet.

From a financial structure perspective, credit card securitizations incorporate the concept of an early amortization event, which, when triggered, accelerates the end of the revolving period and the onset of the amortization period. Early amortization may be triggered due to the insolvency of the sponsor and other sponsor-related issues, in addition to declining performance of the credit card receivables. From a modeling perspective, DBRS assumes a transaction enters an early amortization period due to a breach of the base rate trigger, which signals a decline in the performance of the collateral. For all rating levels, DBRS assumes the trigger to be breached. Depending on the variables in the cash flow stress scenarios, a breach typically occurs between months six and ten in the cash flows for the AAA rating scenario and between months ten and 18 for the subordinate debt stress scenarios.

For certain highly rated credit card sponsors, with sizable and well-managed businesses in the origination and servicing of receivables, DBRS believes that the likelihood of an early amortization trigger being breached is reduced. As a result, DBRS models the breach of the base rate trigger at a later date in the cash flow stress scenarios used to evaluate the subordinate classes of notes. In the modeling of these stress scenarios, the rate of change in the trust's collateral performance variables (i.e., yield, principal payment rate and charge-offs) is reduced due to the quality of the sponsor's operational capabilities. By flattening the curves for these variables by (1) lengthening the decline in yield and payment rate and (2) lengthening the increase in the loss rate (i.e., charge-offs), the breach of the base rate trigger occurs at a later date, which delays the onset of an early amortization event. As a result, the trust continues to generate positive excess spread for a longer period of time and the subordinated classes in the capital structure thus benefit from additional credit enhancement.

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