

U.S. Structured Finance Newsletter

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IS THE CREDIT CARD BUSINESS SUSTAINABLE?

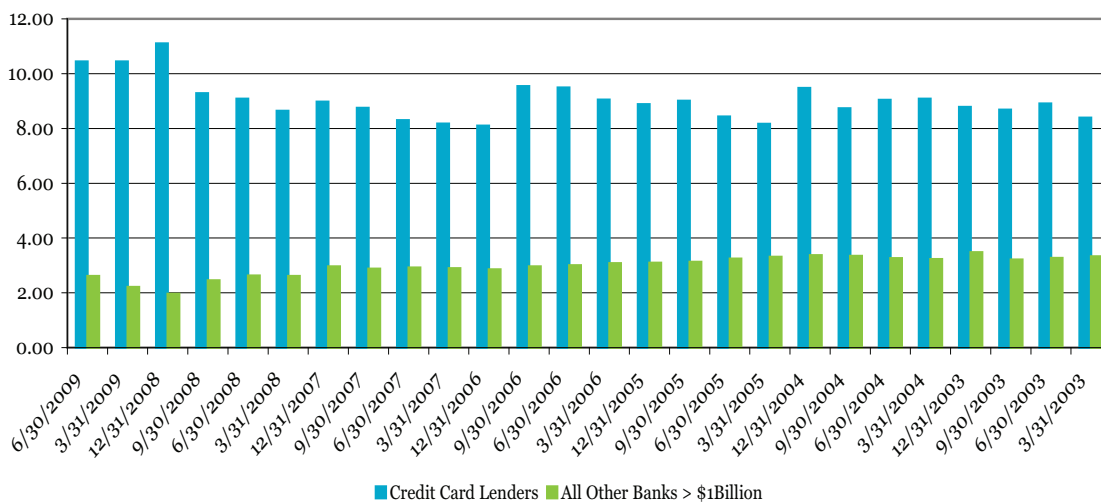
Credit card issuers have seen new legislation introduced and signed into law earlier this year which has resulted in a review and, in many cases, changes to their program's features. The Credit Cardholders' Bill of Rights Act of 2009, intended to protect consumers, limited the ability of credit card issuers to reprice or raise interest rates and certain fees on their customer's credit card accounts, thereby affecting the ability of issuers to increase revenues. The repricing is completed on an account-by-account basis and has the effect of offsetting increases in charge-offs or other expenses associated with the portfolio. As a result of an issuers' inability to reprice receivables, the impact of any increase in charge-offs is a reduction in excess spread in the underlying credit card trusts. Most credit card trusts include triggers which, when tripped, result in the capture of excess spread as incremental credit enhancement. The triggers are tied to the amount of excess spread generated by the trusts. As excess spread declines, additional trigger levels may be breached, which requires additional spread to be trapped. The declination results in a decrease to net interest margins (NIMs) for the business line.

Prior to the implementation of the legislation, many issuers repriced their credit card portfolios and reduced outstanding credit lines made to higher credit risk customers. DBRS expects the change to an issuers' ability to reprice the risk of a borrower's account (if their risk profile changes) will change the manner in which credit card companies compete for business in the future. It will also have a direct impact on consumers, who may have less available credit going forward. An additional factor impacting profitability include deteriorating receivables' performance throughout the credit crisis and the corresponding decline in excess spread generated by the trusts.

Historically, credit card lenders have generated significantly higher NIMs in their credit card business lines versus other areas in the bank. Over the past 7 years ending June 30, 2009, net interest margin figures averaged 9.07% for banks focusing on credit card lending compared with 2.94% for all banks in total over the same period.

Net Interest Margin (%)

Source: FDIC



The credit card market is highly competitive and is shrinking as consumers try to reduce their debt loads and creditors tighten underwriting standards. DBRS expects the issuers who succeed in this business line will be those whose portfolios are large enough to provide economies of scale, companies with diversified business lines that are not reliant solely on their credit card operations for their profitability or niche issuers who can closely manage their portfolio going forward to ensure that charge-offs remain in line with expectations in order to maintain a minimum ongoing level of profitability. Compliance has always been a cost of business for banks, and today it is even more important.

For questions or comments, please contact Chris O'Connell at coconnell@dbrs.com.

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