Commentary

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Insight beyond the rating.

The Worst Is Likely Over: 2009 Canadian Credit Card Performance

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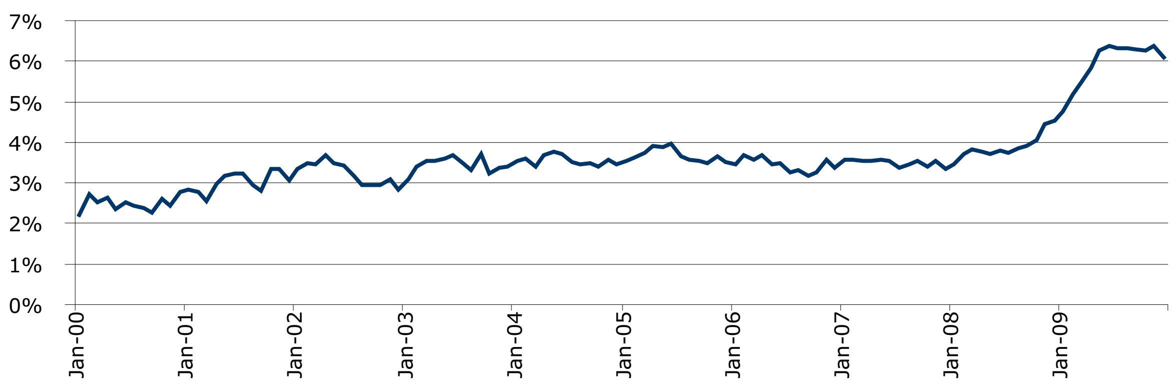
While there are no specialized subprime or small-business credit cards in securitization programs in Canada, the performance of individual Canadian credit card portfolios continued to diverge, specifically in loss rates, payment rates and excess spread.[1] In 2009, two programs received increased credit support through the issuance of additional subordinated notes (Broadway Credit Card Trust and CARDS II Trust) and two programs increased (CARDS II Trust) or added (Golden Credit Card Trust) interchange fees in the yield available to the securitization. Additionally, one class of AAA notes (Gloucester Credit Card Trust, Series 2008-1 Class A Notes) was downgraded to AA as a result of increasing losses and compressed excess spread, marking the first-ever downgrade of an asset-backed security in Canadian securitization history.

LOSS RATES AND DELINQUENCIES REMAIN ELEVATED

After a period of rapid increases in loss rates for all issuers since the end of 2008, the average loss rate in the Canadian credit card industry appeared to have stabilized and moderated by the end of 2009. As of December 31, 2009, the average industry loss rate stood at 6.08%, down from the historical highs of 6.3% and 6.4% experienced between May 2009 and November 2009 (Chart 1). The divergence of loss rates across individual portfolios continued to be significant, between less than 4% and up to 11% or 12% when all issuers are considered (Chart 2).

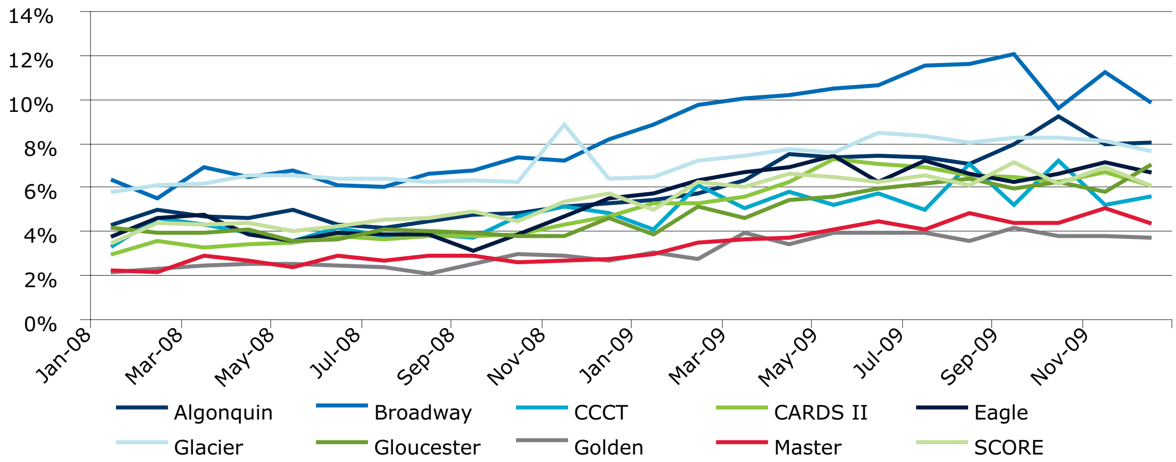
Chart 1: Loss Rate, January 2000 to December 2009



Source: DBRS.

1. The calculations used in all charts presented in this commentary are dollar-weighted and based on the respective balance of the custodial pools designated for securitization for each reporting period for every credit card issuer with securitization activities rated by DBRS in Canada, including both the term and asset-backed commercial paper markets. The securitization programs include Visa and MasterCard issuers and one private-label retail card issuer. The reported receivables in an issuer's securitization program are a subset of an issuer's managed portfolio, depending on the mix of the issuer's receivables and the manner in which eligible receivables are selected for securitization.

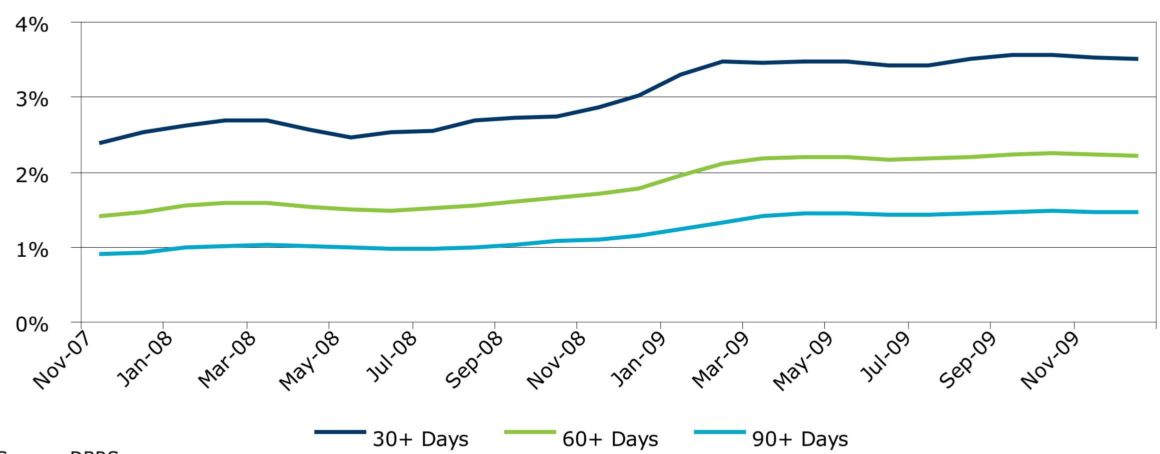
Chart 2: Loss Rates by Program, January 2008 to December 2009



Source: DBRS.

Late-stage delinquencies (more than 60 or 90 days past due) are seen as an early indicator of potential losses as credit card receivables greater than 180 days past due are required to be written off as losses, according to the regulations in Canada.

Chart 3: Deliquencies, November 2007 to December 2009



Source: DBRS.

Similar to the loss rates, the industry experienced a surge in delinquencies toward the end of 2008 (Chart 3). Delinquency levels remained elevated throughout 2009 and corresponded to the overall weakening of the Canadian economy, as well as across-the-board tightening of credit availability, leaving cardholders fewer alternative sources to repay delinquent credit card balances.

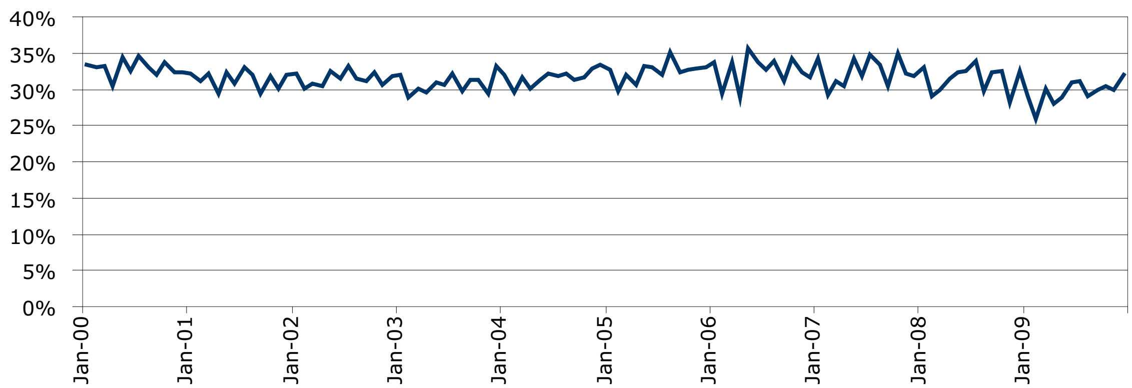
While the average loss rate seems to have retreated from historical highs and delinquencies seem to have stabilized, DBRS expects them to remain elevated in 2010 and beyond given the current state of the challenging economic environment. Looking ahead, DBRS considers an average loss rate of 5% to 6% to be the "new normal," compared with 3% to 4% before the recent economic downturn.

OTHER PERFORMANCE METRICS STILL STRONG

Other key performance metrics, such as payment rate, yield and excess spread, continued to exhibit stability in 2009, without any clear sign of deterioration. While average performance statistics remained relatively stable, individual programs have demonstrated a broad range of performance, particularly in the measurement of payment rate and excess spread.

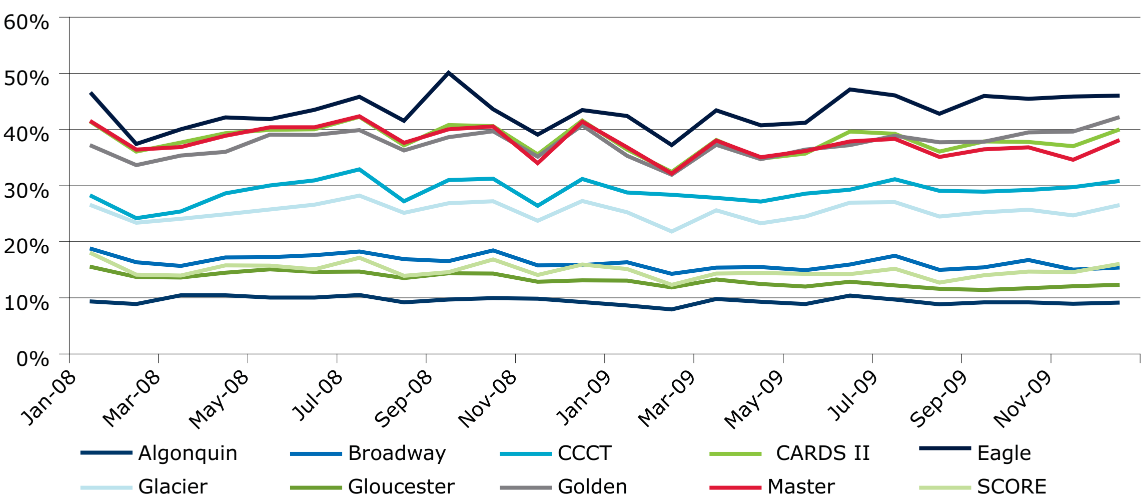
The average payment rate, for example, experienced only a slight decline since late 2008 and remained greater than 30% throughout most of 2009 (Chart 4). A payment rate of 30% indicates very liquid portfolios as they are considered to turn over completely every three to four months. The range of payment rates for individual portfolios remained large, ranging from 10% to greater than 40% each month (Chart 5).

Chart 4: Payment Rate, January 2000 to December 2009



Source: DBRS.

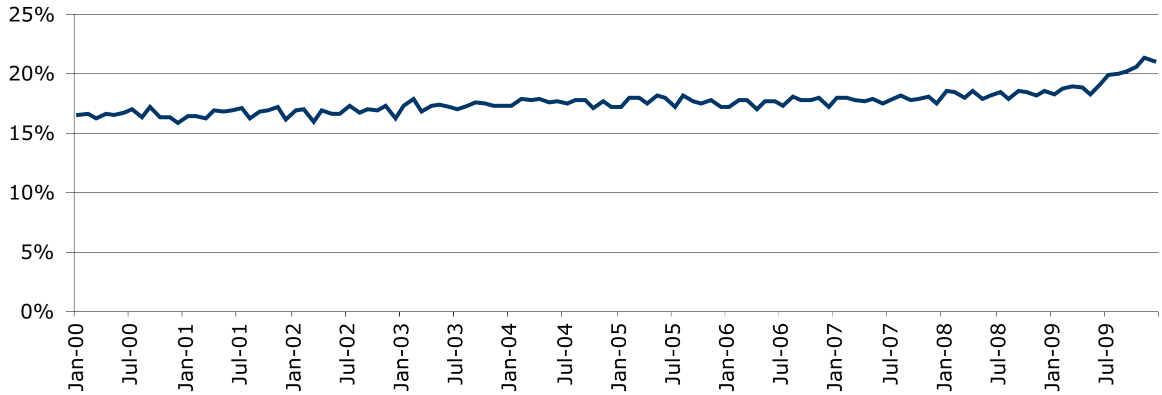
Chart 5: Payment Rates by Program, January 2008 to December 2009



Source: DBRS.

Gross yield continued to demonstrate resilience in 2009 and increased by about 3% at the end of 2009 compared with previous levels (Chart 6). The resilience reflected the issuers' continued efforts to implement a greater degree of risk-based pricing in a time of elevating losses. The increase in 2009 was mostly due to the increase (CARDS II Trust) and the inclusion (Golden Credit Card Trust) of interchange fees available to the securitization transactions in the second part of 2009. There was no significant difference among gross yields reported by individual programs.

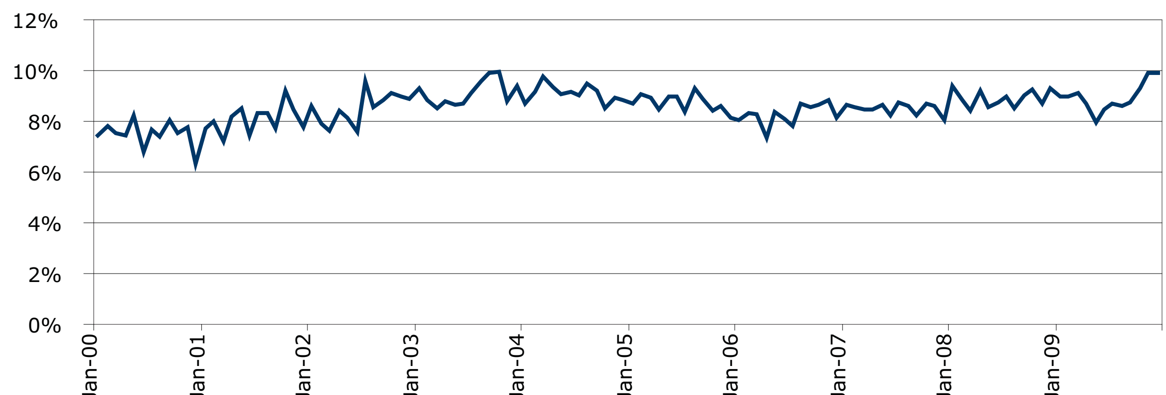
Chart 6: Gross Yield, January 2000 to December 2009



Source: DBRS.

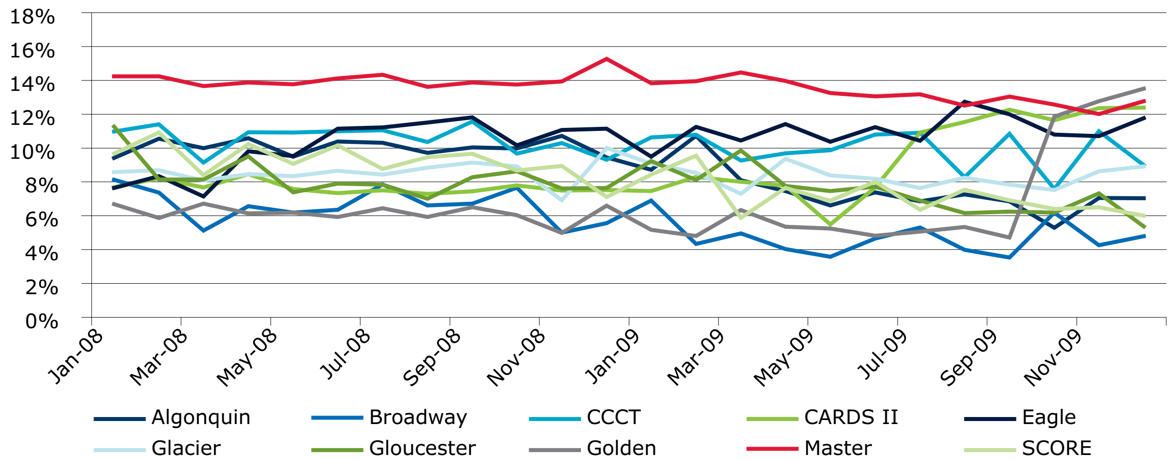
Excess spread provides the first line of protection for investors and determines the portfolio profitability and cash flows for the credit card issuer. In spite of elevated loss rates in 2009, average excess spread continued to remain greater than 8% (Chart 7), thanks to the increasing portfolio yields and, in some cases, decreasing variable funding costs based on the Canadian banker's acceptance rate.

Chart 7: Excess Spread, January 2000 to December 2009



Source: DBRS.

Chart 8: Excess Spread by Program, January 2008 to December 2009



Source: DBRS.

Excess spread at the issuer level, taking into consideration the cost of funds of all outstanding series, continued to show a significant gap between 4% at the low end and greater than 12% at the high end (Chart 8). Nevertheless, excess spread is series-specific, affected by the performance of each portfolio and the cost of funds for each individual series.

In order to provide investors timely and insightful analysis, DBRS monitors each class of credit card transaction on a monthly basis, focusing on the key performance metrics of securitization portfolios in recent months and, if appropriate, revising base case assumptions and performing stress testing under various scenarios.

For further information, please see the Canadian Credit Card Index, which provides Canadian credit card performance data dated from 2000.

Note: All figures are in Canadian dollars unless otherwise noted.