

# U.S. Structured Finance Newsletter

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## MONTHLY PRINCIPAL PAYMENT RATE TRENDS IN CREDIT CARD SECURITIZATIONS

In a credit card securitization, a master trust's monthly principal payment rate (PPR)<sup>1</sup> is an important variable, as it is a measure that estimates the speed at which investors may be repaid in an amortization situation. For example, assuming a constant receivable balance and positive excess spread levels, a PPR rate of 20% would indicate that all bondholders could potentially be repaid principal in five months.

The PPRs for benchmark credit card issuers, which account for approximately 70% of the market, have steadily increased from 2003 to 2006 (see chart below). This upward trend is due to a variety of factors: (1) product innovation, including the proliferation of co-branding, affinity and rewards programs, which have drawn more interest from convenience users; (2) the increase in credit card usage for "everyday" purchases (e.g., groceries, gas, utilities), making credit cards a virtual substitute for cash; (3) increased competition among credit card issuers, which has fueled the growth of "teaser" low promotional interest rates, creating attractive financing terms for credit card customers; and (4) consolidation of total debt, where consumers have used either home equity products or mortgage refinancings to pay down higher-cost credit card debt.

Principal Payment Rates (PPR)



Industry average is the average of Capital One, Chase Issuance, Citibank and Bank of America.  
Source: Intex.

More recently, PPR levels for the industry have been at or close to 19%. While the 2007 numbers show a slight year-over-year decrease, these levels are still strong by historical standards. The recent decline is largely due to the slowing of debt consolidation via mortgage cash-out refinancing.<sup>2</sup> However, as the dynamics of the industry have changed over time due to the factors mentioned above, DBRS expects that the PPR will remain high. Credit card access continues to be important to consumers as they seek to maintain financial flexibility. Nevertheless, DBRS is closely watching PPRs as an early indicator of weakening in the credit card sector. This week, DBRS will be publishing a more detailed report on PPR trends, with an analysis on borrower payment behavior.

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<sup>1</sup> The monthly payment rate (MPR) is defined as the total collections (principal and finance charges, fees) in a month divided by the principal receivables outstanding at the end of the previous month. The principal payment rate (PPR) is defined as the total principal collections in a month divided by the principal receivables outstanding at the end of the previous month. Performance reporting varies by issuer, as some issuers report MPR, while others report PPR.

<sup>2</sup> Net home equity extraction for Q1 2007 was \$84 billion, compared to \$109.1 billion for the prior quarter and \$156.0 billion for the prior year quarter. See "Sources and Uses of Equity Extracted From Homes," Alan Greenspan and James Kennedy, Federal Reserve Board FEDS working paper no. 2007-20.