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REWARDING CREDIT CARD ABS INVESTORS

Credit card reward programs have positive effects on cardholders' payment behavior and card usage. As a result, reward programs can benefit credit card issuers and have a positive impact on the cash flows of credit card asset-backed securitization trusts.

Credit card rewards programs have increased in popularity among many credit card issuers. Reward programs typically give cardholders rewards based on the volume of credit card purchases. The rewards are traditionally in the form of a cash rebate or credits for merchandise and/or travel. Most reward payments are made directly by the credit cards' bank sponsors and do not flow through the cash flows of master trusts issuing credit card asset-backed securities (ABS). However, because the incentives offered by the programs promote better payment behavior and increased card usage by cardholders, both the card issuers and credit card ABS trusts can benefit from these programs.

Besides promoting customer loyalty and account retention, rewards programs benefit credit card issuers for the following reasons:

- (1) Cardholders may be inclined to use their cards more frequently because reward programs typically have high thresholds for the amount of points required to be redeemed to receive awards.
- (2) The cost to the card issuer of providing rewards is typically smaller than the amounts of points redeemed by cardholders to "purchase" the awards.
- (3) Finance charges accrue on the outstanding account balances maintained by cardholders.
- (4) Some cards charge annual fees for either general use of the card or for participation in the rewards program.

Reward programs may have positive impacts on the performance of ABS trusts for the following reasons:

- (1) Reward programs provide incentive for cardholders to make timely payments because the programs typically require that points be forfeited if a cardholder is no longer in good standing (e.g., delinquent or having exceeded the credit limit). More timely payments reduce delinquencies.
- (2) Participation in a rewards program encourages cardholders' convenience usage, which increases a trust's principal payment rate. These effects benefit credit card ABS investors by reducing the period of time investors are exposed to performance deterioration during an amortization period.
- (3) Issuers often charge higher annual percentage rates (APRs) on cards affiliated with rewards programs than they charge on cards that do not offer rewards programs. This circumstance allows issuers to bolster the yield on cardholders who carry balances. Additionally, some rewards programs charge annual fees, which further increases yield.

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