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# U.S. Credit Card ABS Is Expected To Withstand Higher Losses In A Recession

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# U.S. Credit Card ABS Is Expected To Withstand Higher Losses In A Recession

The current volatility in the structured finance market has raised concerns about the resilience of U.S. credit card asset-backed securities (ABS). Magnifying those concerns is the decline in home prices that brought an end to a long credit cycle in which banks and other financial institutions provided easy, low-interest-rate credit to consumers. Factoring in rising energy costs, declining economic growth, and growing unemployment, many market participants have begun to wonder whether credit card ABS can remain impervious to the credit crunch facing consumers.

Standard & Poor's Ratings Services Chief Economist David Wyss expects that the economy will likely skirt a recession this year; however, many things can go awry. A deeper housing downturn, higher bond yields created by a falling dollar, and higher oil prices would be enough to create at least a mild recession that could run from now through the second quarter of 2008. Although considered unlikely, a deeper recession with unemployment rates reaching 7% by the spring of 2009 is also discussed in this article.

If the U.S. economy experiences a mild recession, similar to the path of the 2001 recession, or even falls into our economist's deeper-recession scenario stated below, in our opinion 'BBB' rated credit card ABS investors are unlikely to experience payment defaults for timely interest and ultimate repayment of principal by the transactions' legal final maturity dates. However, in both recession scenarios, it is conceivable that a number of trusts would be required to trap excess spread and some securities may be placed on CreditWatch with negative implications or downgraded. Should the portfolio performance variables deteriorate and current base case assumptions become inappropriate for any credit card issuer, the transactions would be subject to review for negative rating action.

The following is a sensitivity analysis comparing break-even cash flow model results with our economist's view on losses under several economic projections. The analysis focused on a hypothetical credit card ABS industry portfolio based on the Standard & Poor's Credit Card Quality Index (CCQI) as well as selected master trusts. The CCQI is a monthly performance index that aggregates performance information across Standard & Poor's rated bankcard transactions. This article is intended to provide market participants with an understanding of the impact of various stress tests and increased transparency with respect to ratings criteria. The sensitivity analysis was applied at the 'BBB' rating level as lower-rated structured finance securities tend to have more rating transitions than higher-rated classes.

## Hypothetical CCQI 'BBB' Rated Credit Card ABS Analysis

To analyze the likely impact to credit card ABS in a recessionary environment, we used CCQI performance data to represent the hypothetical portfolio performance. As of the November 2007 performance month, the aggregate outstanding principal receivables amounted to \$430.1 billion, representing almost two-thirds of the total U.S. bankcard market.

Looking at each of the cash flow performance variables since January 2000, we can observe that the CCQI's annualized yield fell at the start of the last recession (which lasted from March 2001 to November 2001 before recovering in the second half of 2004) (see the chart and table 1). Monthly payment rates began to rise beginning in the second half of 2003, coinciding with the notable increase in home values and an increase in the minimum payment requirements proposed by the Office of the Comptroller of the Currency for credit card companies. The

CCQI's annualized charge-offs ranged from 5.0%-7.6% before the new bankruptcy law came into effect.

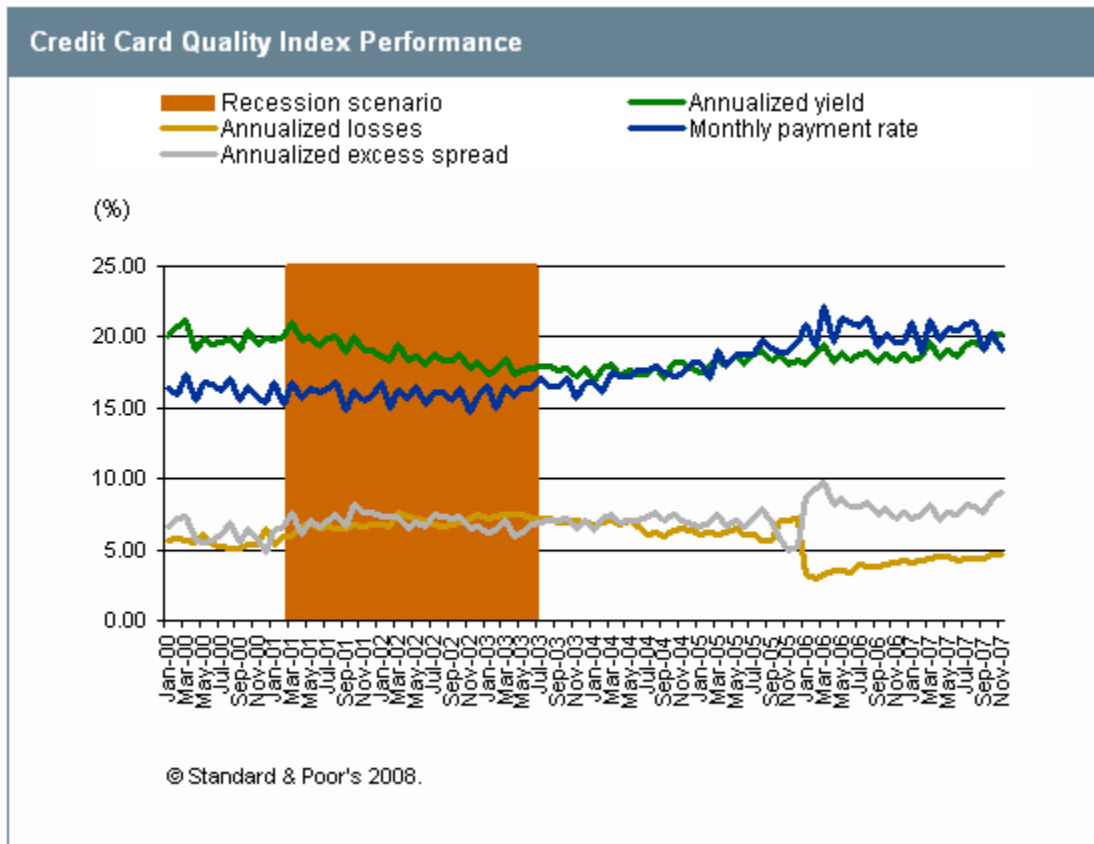


Table 1

Credit Card Quality Index Historical Performance (%)		Prior recession (March 2001-June 2003)			
	Post-B/R avg. (Jan. 2006-Nov. 2007)	Pre-B/R avg. (Jan. 2000-Sept. 2005)	Min.	Avg.	Max.
Yield	18.9	18.7	17.3	18.8	21.0
Charge-offs	4.0	6.7	6.0	7.0	7.6
Payment rate	20.3	16.7	14.7	16.0	16.9
Excess spread	8.1	6.8	5.9	7.0	8.2

B/R—Bankruptcy Reform.

### Prior-Recession Scenario

To determine how well 'BBB' rated credit card ABS will likely perform during a recession similar to that in 2001, we analyzed the CCQI performance data from March 2001 (the start of the last recession) to June 2003 (19 months after the end of the last recession). According to the National Bureau of Economic Research, the recession technically ended in November 2001. However, credit card losses typically lag recessions by approximately 12 months. We identified the period in which performance for the combined yield, charge-offs, and payment rates were the weakest to determine the recession stress. Based on the CCQI data, this period occurred during the second

quarter of 2003. The cash flow scenario then modeled each of the key factors deteriorating from their current levels to their prior recessionary levels over a six-month period. This time period coincides with Mr. Wyss' view of the potential for a mild recession beginning in the first quarter of 2008 and continuing through the second quarter of 2008. We modeled the certificate rate to rise to 6.75%, reflecting LIBOR and market spreads at year-end 2007. Finally, to reflect the structure of the large credit card ABS programs, we modeled structural features that trap excess spread cash flows if excess spread falls below 4.50% and which result in early amortization of the rated securities if excess spread declines below zero.

## Findings

The cash flow analysis based on the above scenario indicates according to our modeling that the typical outstanding 'BBB' rated credit card ABS, with 0% initial subordination or cash deposit, is adequately enhanced through the excess spread-trapping feature to withstand the deterioration in yield, charge-offs, and payments experienced during the last recession and to avoid payment default. Our cash flow models also reflect that excess spread trapping starts in the fifth month. An early amortization event triggered by negative excess spread did not occur, because excess spread was at least 1.0% throughout the cash flow simulation.

## Break-Even Levels

We also modeled scenarios to determine likely break-even levels for yield, charge-offs, and payment rates. To determine the likely break-even levels, each of the key factors were deteriorated individually (other variables were held constant according to the recession stresses above) up to the point just before a breach of the enhancement deficiency test. The break-even results and the recession stresses for the other key factors are summarized in table 2.

**Table 2**

Credit Card Quality Index Break-Even Analysis (%)			
	Yield	Charge-offs	Payment rate
Yield	<b>15.2</b>	4.5-7.4	20.0-16.0
Charge-offs	18.8-17.4	<b>9.7</b>	20.0-16.0
Payment rate	18.8-17.4	4.5-7.4	<b>5.0*</b>

\*Assumes a 28-month legal final maturity.

The break-even results suggest that under the prior-recession scenarios, charge-offs in the hypothetical portfolio can increase to 9.7% when yield falls to 17.4% from 18.8% over a six-month period and the payment rate falls to 16.0% from 20.0% over the same period before resulting in a payment default. Similarly, yield can decline to 15.2% if charge-offs increase to 7.4% from 4.5% and payment rate decreases to 16.0% from 20.0% over a six-month period before resulting in a payment default. The break-even payment rate is calculated based on the minimum rate of collections required to repay the credit card ABS over the average 28-month period between the expected maturity date and the legal final maturity date for most issuances.

## A Deeper-Recession Scenario

To determine the break-even level of charge-offs that 'BBB' rated credit card ABS can likely sustain under a deeper-recession scenario, we reduced both the current yield and the payment rate by 28.0% over a 15-month period. This time period coincides with our chief economist's views of the potential for losses to exceed 9.0% by the spring of 2009 in a deeper-recession projection. Under this alternative recession scenario, the model reflects that charge-offs can increase to 9.3% if yield falls to 14.1% from 18.8%, and payment rates could fall to 15.0% from 20.0% before resulting in a payment default. This lower break-even charge-off percentage is due principally to the lower resulting yield and payment rate stress in the deeper-recession case compared with CCQI experience during the prior recession. To provide context for these results, since the creation of the CCQI almost 15 years ago, charge-offs have never exceeded 7.6%, yield has never fallen below 16.8%, and the payment rate hasn't fallen below 15.0% for the past 10 years. This scenario suggests that excess spread trapping starts in the fourth month and an early amortization event triggered by negative excess spread occurs in the 10th month of the cash flow simulation.

## Issuer-Specific 'BBB' Rated Credit Card ABS Analysis

We applied similar prior-recession and deeper-recession scenario analyses to 'BBB' rated credit card ABS supported by portfolios originated by Washington Mutual (WaMu), Capital One, and Discover. These issuers were selected based on their unique characteristics:

- WaMu ('A-/A-2') has the highest proportion of below-660 FICO receivables, due principally to the acquisition of Provident's credit card portfolio in 2005;
- Capital One ('A-/A-2') has a relatively high proportion of below-660 FICO receivables and is a former monoline credit card originator that expanded its business model with the acquisition of several regional banks; and
- Discover ('BBB/A-3') has used a nondiversified, credit card-only business model since it was spun off from Morgan Stanley in July 2007.

The cash flow analyses for these issuers suggest that, in all cases, break-even charge-offs would exceed projections by our economic forecast in both the mild- and deeper-recession scenarios.

The break-even charge-offs for WaMu's portfolio under a prior-recession scenario suggest that charge-offs can increase to 28.6% if yield remains at 25.8% (the portfolio yield was higher historically) and payment rate declines to 6.9% from 10.3% over a six-month period (see table 3). The WaMu portfolio's higher break-even charge-offs compared with the CCQI's break-even charge-offs reflect the portfolio's higher historical charge-off rates, and are consistent with the greater subprime component of the portfolio (see table 4). Similarly, the break-even yield can decline to 17.0% if charge-offs increase to the prior-recession peak of 20.9% from 8.3% and payment rates decrease to 6.9% from 10.3% over a six-month period. The break-even payment rate is determined based on the minimum rate of collections required to repay the credit card ABS over the 48-month period between the expected maturity date and the legal final maturity date typical of WaMu's issuances, if yield remains at 25.8% and charge-offs increase to 20.9% from 8.3%. These break-even scenarios suggest that excess spread trapping may start in the third and fourth month and an early amortization event may be triggered in the fourth and sixth month of the cash flow simulation.

Under the deeper-recession scenario in which the current yield and payment rate is reduced 28.0% over a 15-month

period, WaMu's break-even charge-offs are 34.2%. This higher break-even charge-off percentage is due principally to the lower historical payment rate of WaMu's portfolio applied in the mild-recession case compared with the 28.0% payment rate stress applied in the deeper-recession case. In addition, the longer period in which yield and payment rate are reduced under the deeper-recession scenario also contributes to this result. This scenario suggests that excess spread trapping starts in the fourth month and an early amortization event triggered by negative excess spread occurs in the sixth month of the cash flow simulation.

**Table 3**

<b>Washington Mutual Master Trust Break-Even Analysis (%)</b>			
	<b>Yield*</b>	<b>Charge-offs</b>	<b>Payment rate</b>
Yield	<b>17.0</b>	8.3-20.9	10.3-6.9
Charge-offs	25.8-25.8	<b>28.6</b>	10.3-6.9
Payment rate	25.8-25.8	8.3-20.9	<b>4.2¶</b>

\*The current average yield of approximately 25.8% is lower than yield in the prior recession. ¶Assumes a 48-month legal final maturity.

**Table 4**

<b>Washington Mutual Master Trust Historical Performance (%)</b>					
	<b>Post-B/R avg. (Jan. 2006-Nov. 2007)</b>	<b>Pre-B/R avg. (Jan. 2000-Sept. 2005)</b>	<b>Prior recession (March 2001-June 2003)</b>		
			<b>Min.</b>	<b>Avg.</b>	<b>Max.</b>
Yield	25.9	28.1	26.1	28.1	31.4
Charge-offs	8.3	14.0	10.6	17.1	20.9
Payment rate	10.6	7.9	5.9	6.7	7.9
Excess spread	9.8	6.8	1.8	4.9	9.9

B/R—Bankruptcy Reform.

Capital One's break-even results suggest that charge-offs could increase up to 13.6% in a scenario where yield declines to 21.0% from 22.0% and payment rate decreases to 16.2% from 19.0% over a six-month period (see table 5). According to the model, the break-even yield could drop to a minimum of 12.4% if charge-offs rise to 5.9% from 4.3% and payment rate decreases to 16.2% from 19.0%. The break-even payment rate is determined based on the minimum rate of collections required to repay the credit card ABS over the 24-month period between the expected maturity date and the legal final maturity date typical of Capital One's issuances, if yield declines to 21.0% and charge-offs increase to 5.9%. These break-even scenarios suggest that excess spread trapping may start in the fourth and fifth month and an early amortization event may be triggered in the seventh month of the cash flow simulation.

In the deeper-recession scenario, the break-even charge-offs for Capital One's portfolio are 10.3%. This lower break-even charge-off percentage is due principally to the lower resulting yield and payment rate stress in the deeper-recession case compared with Capital One's experience during the prior recession (see table 6). This scenario suggests that excess spread trapping starts in the seventh month and an early amortization event triggered by negative excess spread occurs in the 12th month of the cash flow simulation.

**Table 5**

<b>Capital One Master Trust Break-Even Analysis (%)</b>			
	<b>Yield</b>	<b>Charge-offs</b>	<b>Payment rate</b>
Yield	<b>12.4</b>	4.3-5.9	19.0-16.2
Charge-offs	22.0-21.0	<b>13.6</b>	19.0-16.2
Payment rate	22.0-21.0	4.3-5.9	<b>5.4*</b>

\*Assumes a 24-month legal final maturity.

**Table 6**

<b>Capital One Master Trust Historical Performance (%)</b>					
	<b>Post-B/R avg. (Jan. 2006-Nov. 2007)</b>	<b>Pre-B/R avg. (Jan. 2000-Sept. 2005)</b>	<b>Prior recession (March 2001-June 2003)</b>		
			<b>Min.</b>	<b>Avg.</b>	<b>Max.</b>
Yield	19.4	22.5	19.9	23.2	28.8
Charge-offs	3.0	4.2	3.0	4.6	5.9
Payment rate	17.9	16.4	14.3	16.1	17.8
Excess spread	9.1	10.4	7.4	11.2	16.7

B/R—Bankruptcy Reform.

Discover's break-even charge-offs could increase up to 8.8% in a modeled scenario where yield declines to 17.0% from 19.5% and payment rate decreases to 16.6% from 21.3% over a six-month period (see table 7). According to the model, the break-even yield could decline to a minimum of 15.0% if charge-offs rise to 6.9% from 4.3% and payment rate decreases to 16.6% from 21.3%. The break-even payment rate is determined based on the minimum rate of collections required to repay the credit card ABS over the 30-month period between the expected maturity date and the legal final maturity date typical of Discover's issuances, if yield declines to 17.0% and charge-offs increase to 6.9%. These break-even scenarios suggest that excess spread trapping may start in the fourth month and an early amortization event may be triggered in the seventh month of the cash flow simulation.

Under the deeper-recession scenario, the break-even charge-offs for Discover's portfolio are 9.4%. This higher break-even charge-off percentage is due principally to the longer period in which yield and payment rate are reduced under the deeper-recession scenario compared with the prior-recession case (see table 8). This scenario suggests that excess spread trapping starts in the fifth month and an early amortization event triggered by negative excess spread occurs in the 11th month of the cash flow simulation.

**Table 7**

<b>Discover Card Master Trust I Break-Even Analysis (%)</b>			
	<b>Yield</b>	<b>Charge-offs</b>	<b>Payment rate</b>
Yield	<b>15.0</b>	4.3-6.9	21.3-16.6
Charge-offs	19.5-17.0	<b>8.8</b>	21.3-16.6
Payment rate	19.5-17.0	4.3-6.9	<b>4.2*</b>

\*Assumes a 30-month legal final maturity.

Table 8

Discover Card Master Trust I Historical Performance (%)					
	Post-B/R avg. (Jan. 2006-Nov. 2007)	Pre-B/R avg. (Jan. 2000-Sept. 2005)	Prior recession (March 2001-June 2003) <sup>†</sup>		
			Min.	Avg.	Max.
Yield	20.8	17.5	15.2	17.2	18.7
Charge-offs	3.9	6.2	5.3	6.3	7.3
Payment rate	21.6	18.2	15.9	17.1	19.0
Express spread	9.5	5.3	3.1	4.9	6.4

B/R—Bankruptcy Reform. <sup>†</sup>Excludes interchange.

## Potential Rating Actions

Credit card ratings can and will change when circumstances warrant a revision. An increase in charge-offs or a decline in a portfolio's yield, payments, or purchase rate could result in a downgrade. The rate of deterioration of any of these variables and its interaction with the other three variables makes scenario testing more complex. For example, the effects of deterioration in one variable could be offset by stability or improvement in another. The level of excess spread is a strong indicator of overall portfolio health and is likely to be a key determinant of potential rating actions.

Standard & Poor's is likely to take rating actions on all classes of an issuer's credit card ABS transaction if its excess spread-trapping trigger is breached. This would occur when yield, charge-offs, certificate rate, and servicing costs have deteriorated to the point that the portfolio's excess spread is less than a specified trigger level, commonly 4.50% for most bankcard transactions. Based on November 2007's performance data, the 12-month rolling average excess spreads for WaMu, Capital One, and Discover would have to decline by approximately 54%, 53%, and 51%, respectively, before their corresponding excess spread-trapping triggers are breached. In November, the CCQI annualized charge-off rate was 4.7% and excess spread was 9.0%. In a scenario where charge-offs for the hypothetical CCQI-representative portfolio reached the levels forecasted in the mild recession (7.8%) or even the deeper recession (9.0%) discussed below and all other variables remained constant at the November levels, excess spread would fall to 5.9% and 4.7%, respectively, according to the model. In determining the break-even levels for the CCQI-representative portfolio, as well as for most of the issuer-specific portfolios, the excess spread trapping in the cash flow simulations begins from months three to seven, and the early amortization event occurs between months four and 12.

We also evaluate factors unrelated to the spread-trapping trigger breach when determining rating actions, such as portfolio payment and purchase rates and the ability of the issuer to fund new purchases. Furthermore, our review of the outstanding ratings will take into account the magnitude, speed, and potential duration of the performance deterioration and compare them with the available credit enhancement to determine the ultimate rating impact.

In addition to performance deterioration, a significant change in the originator's credit rating would also prompt a review of the related credit card ABS ratings. Our analysis assumes that a certain level of future cardholder purchases will result in additional receivables arising in the accounts designated for the securitization portfolios, which will be transferred to the issuer. Higher-rated originators are assumed to have higher purchase rates because they should be more likely to survive adverse business conditions and fund future cardholder purchases.

## Large, Diversified, Investment-Grade Originators Contribute To Ratings Stability

There are several characteristics of U.S. credit card ABS structures, and of the underlying securitized portfolios, that, in our view, help mitigate some of the risks that other sectors of the structured finance market are currently facing (see "Experienced Issuers Helped Credit Card ABS Dodge The Negative Headlines In Other Sectors," published July 18, 2007, on RatingsDirect). First, consolidation over the past 10 years has resulted in several large, diversified, investment-grade card originators that dominate the credit card ABS sector. As of November 2007, the top seven bankcard originators (American Express, Bank of America, Capital One, Chase, Citibank, Discover, and WaMu) accounted for more than 88% of credit card ABS issuance volume. These large bankcard issuers have contributed to the stability of this sector given their financial, operational, and technological capabilities, as well as their experience in managing their card business through various economic and credit cycles. Only a few single-retailer credit card ABS issuers remain, and there are an even smaller number of pure subprime credit card ABS issuers.

The securitized credit card portfolios of these originators are diversified by obligor and FICO score. With the exception of WaMu, receivables of prime borrowers (those with FICO scores higher than 660) make up more than two-thirds of the securitized portfolios, while receivables from nonprime and subprime borrowers (with FICO scores lower than 660) represent less than a third (see table 9).

**Table 9**

FICO Distribution (%)			
Issuer	< 660*	660-720	> 720
American Express Credit Account Master Trust¶	16.7	17.0	66.3
BA Master Credit Card Trust II	30.6	35.3	34.1
Capital One Master Trust	30.2	27.0	42.8
Chase Issuance Trust	18.6	25.4	56.1
Citibank Credit Card Master Trust I	26.3	33.2	40.6
Discover Card Master Trust I	27.0	31.5	41.5
Washington Mutual Master Trust	47.9	37.0	15.2

\*Includes receivables from accounts without FICO scores. ¶American Express reports data for the following categories: <660, 660-700, and >700.

These portfolios are also geographically diverse, as reflected in the top five U.S. states for origination, which, in our view, mitigates exposure to any local or regional economic events (see table 10). Currently, California and Florida are experiencing the greatest declines in home prices, and most of these portfolios have less than 25% exposure to those two states.

**Table 10**

Geographic Distribution (%)					
Issuer	Calif.	Texas	N.Y.	Fla.	Ill.
American Express Credit Account Master Trust	16.7	7.3	10.2	8.5	0.0
BA Master Credit Card Trust II	12.6	6.8	6.3	7.9	3.5
Capital One Master Trust	11.9	6.4	6.3	6.3	4.5
Chase Issuance Trust	12.6	6.4	9.4	5.8	5.4
Citibank Credit Card Master Trust I	14.7	8.1	9.4	6.5	5.4
Discover Card Master Trust I	9.3	8.6	6.7	5.8	5.7
Washington Mutual Master Trust	15.5	7.3	7.3	7.9	4.2

Lastly, the receivables are generated predominantly from seasoned accounts (see table 11). Longer seasoning generally helps reduce the risk of fraud and allows card issuers to refine the credit underwriting process as accounts age without defaulting. Seasoning also provides the card issuers with valuable information on the borrowers' card use and payment behavior, which can be valuable in the monitoring, servicing, and collections of these receivables. The weighted average seasoning for these major issuers is at least three years and typically more than four years.

**Table 11**

<b>Account Age (%)</b>						
<b>Issuer</b>	<b>&lt; 12 mos.</b>	<b>13-24 mos.</b>	<b>25-36 mos.</b>	<b>37-48 mos.</b>	<b>49-60 mos.</b>	<b>&gt; 61 mos.</b>
American Express Credit Account Master Trust	0.0	0.1	12.3	13.2	11.5	62.9
BA Master Credit Card Trust II	3.5	8.9	9.3	12.5	9.1	56.7
Capital One Master Trust	8.6	12.1	13.4	12.5	10.5	43.0
Chase Issuance Trust	0.6	20.9	33.7	14.3	5.4	25.1
Citibank Credit Card Master Trust I	4.6	6.2	6.1	5.8	5.6	71.7
Discover Card Master Trust I	3.2	5.0	4.1	2.9	4.9	79.9
Washington Mutual Master Trust	1.9	20.4	10.6	11.9	11.6	43.7

## The Economy And Credit Card Losses

In our view, the principal economic drivers of credit card losses are unemployment and the consumer financial obligation burden. Recent loss rates on credit card portfolios have remained much lower than expected. Although we had projected a sharp decline in defaults after the new bankruptcy law took effect in October 2005, we expected default rates to revert back to normal within a few months of the bankruptcy change. As it turns out, they have remained low, for reasons that remain unclear. Some industry participants have hypothesized that lawyers and their clients are still uncertain of the operations of the new bankruptcy law and are holding off on filing for now. Others have observed that the banks have tightened up on credit, due in part to experiences related to subprime mortgages. The cause may be important, since it would determine whether the rise in defaults to normal levels will be slow, or whether they will remain below their historic norms. In fact, loss rates have risen only slightly, to 4.7% in November 2007 from 4.2% a year earlier, and they remain well below the 2003-2004 average of 6.4%. Based on current information, we expect that loss rates will revert to normally higher loss rates, but that the reversion will be slow.

Our baseline forecast thus assumes that the loss rate will rise from its 2007 average of 4.5% to a peak of 6.6% by fourth-quarter 2008. This level is above normal because the economy is expected to perform below normal, with a near-recession in the first half of 2009. Thereafter, default rates are expected to gradually fall back toward 6%, the average before the change in the bankruptcy law.

Table 12 shows historical data and Standard & Poor's chief economist's forecast for credit card losses.

**Table 12**

<b>The Drivers Of Credit Card Losses</b>					
<b>Baseline projection</b>					
<b>(%)</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Average credit card loss rate (S&P rated pools)	6.3	6.2	4.5	3.8	6.3
Unemployment rate	5.0	5.0	4.6	4.6	5.1

**Table 12**

<b>The Drivers Of Credit Card Losses(cont.)</b>					
Prime rate	7.5	7.3	8.0	8.0	6.2
Financial obligations (% of income)	18.8	19.2	19.4	19.3	19.0
<b>(% change)</b>					
Real GDP	2.9	1.9	2.1	2.9	3.1
Real consumer spending	6.6	3.7	5.2	5.4	2.1
Consumer prices	1.8	2.5	2.9	3.2	3.4
Consumer installment debt	0.2	2.6	5.0	4.0	5.0
Revolving credit outstanding	2.9	(3.2)	1.1	7.6	3.3

On the other hand, a recession could increase credit card losses. Although we expect the economy to avoid recession this year if conditions remain stable, in our view, the economy could be in for more shocks. A combination of a deeper housing downturn, higher bond yields resulting from a falling dollar, and higher oil prices would likely be enough to create a mild recession. This could continue through second-quarter 2008, with the unemployment rate rising to 6.2% in early 2009. Under this scenario, credit card losses, especially if they revert back to their normal rates more quickly, could rise to 7.8% in fourth-quarter 2008 and remain a percentage point higher than the baseline forecast through 2011.

A deeper recession—more reminiscent of 1982 than the milder recession of 1991-1992—would have even more severe consequences. If oil prices surge while financial disruptions continue in the credit markets, the recession could last longer and real GDP could drop further. The unemployment rate could hit 7% by the spring of 2009, and credit card losses could exceed 9% in that year.

## Overview Of Standard & Poor's Credit Card ABS Ratings Methodology

To determine the likelihood that any one credit card ABS transaction will pay timely interest and repay principal by the legal final maturity date, we focus on the following cash flow variables: yield, charge-offs, payment rate, purchase rate, interest rates, and excess spread. We evaluate the cash flows for the portfolio of credit card receivables supporting the transaction under various economic scenarios in which each of the aforementioned variables are simultaneously stressed. We apply stress to our assumed performance levels (base case assumptions) for each of these variables, increasing the magnitude of the stresses as higher ratings are assigned to the transaction.

When determining our base case assumptions, we analyze the historical performance of each variable for a specified portfolio of credit card receivables of a specific credit card issuer. We evaluate the performance data in context, considering the historical health of the economy, how the cards are used, the origination strategy, underwriting practices, and the servicing platform, along with account management, collateral quality, payment terms, the financial strength of the credit card issuer, and the regulatory environment, among other factors. Our aim is to determine a sustainable performance level for each variable. We adjust the base case assumptions based on an ongoing quantitative and qualitative analysis of issuer-specific origination practices and servicing performance. For instance, when credit card charge-offs fell dramatically in 2006 after the new bankruptcy law was passed, we did not lower our base case charge-offs assumptions, because we expected charge-offs to return to (or approach) their historical levels. Nor did we raise our base case charge-offs assumptions when charge-offs spiked for several months due to the increased number of bankruptcy filings before the new law took effect.

When analyzing 'BBB' rated credit card ABS issued by investment-grade banks, we typically apply the following stresses simultaneously to the cash flow variables:

- Yield declines to 75% of our base case yield assumption over an 18-month period;
- Charge-offs increase 1.5x to 2.0x our base case charge-offs assumption over an 18-month period;
- The payment rate declines to 75% of our base case payment rate assumption in month one;
- The purchase rate declines in line with payments and is modeled to maintain a steady portfolio principal balance;
- The certificate rate increases to 15% over an 18-month period; and
- Excess spread declines to the transaction's trigger level in month one, and we then calculate it for future periods.

## **Credit Card ABS Stability To Be Tested In 2008**

Credit card ABS has historically been one of the most stable sectors of the securitization market. In the 20 years since Standard & Poor's began rating credit card ABS, there have been only nine defaults, all of which resulted from the insolvencies of Heilig Meyer, Next Card, and First Consumer.

Based on our recent transition study, the rating stability for this sector was 91.91% for the first 10 months of 2007 (see "Transition Study: U.S. Housing Market-Related Securities Lead The Credit Quality Decline For Global Structured Securities Through October 2007," published Nov. 30, 2007). That is, 91.91% of the credit card ABS ratings at the beginning of the year remained unchanged between January 2007 through October 2007. Moreover, 7.75% of the rating changes during that period were upgrades, and just 0.35% were downgrades. The credit card ABS downgrade rate was one of the lowest among all sectors analyzed in the transition study.

Ultimately, we expect the performance of U.S. credit card ABS to hinge on several factors, including the unemployment rate (currently 5.0%) and consumers' ability to manage their debt, especially in cases where they face resets to higher mortgage interest rates and declining home prices.

Standard & Poor's will continue to closely monitor all outstanding ratings on U.S. credit card ABS transactions and adjust our loss expectations for new issuances as appropriate, given economic, market, and performance conditions.

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