SFIG
Structured Finance Industry Group

# Application of Credit Risk Retention Rule to Revolving Master Trusts

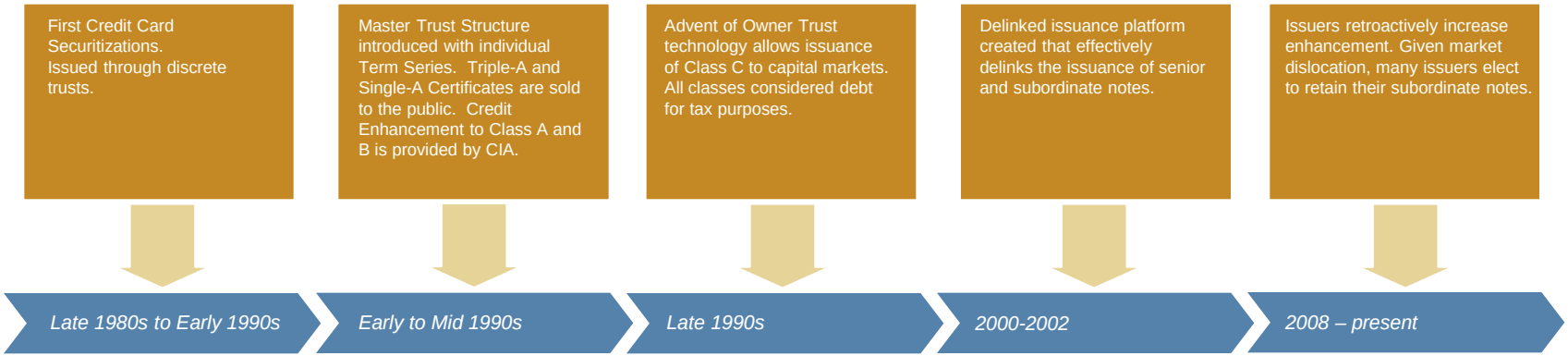
## Appendix

December 16, 2013

# Evolution of Term Credit Card ABS Structures

Credit Card ABS structures have evolved in response to investor preferences and increasingly efficient funding strategies.

**Evolution of credit card ABS structures**




- The US credit card ABS market dates back more than 25 years.
  - While the formative years are characterized by the use of discrete trusts, by the early 1990s most sellers had adopted the master trust as their funding platform.
  - With greater market maturity came greater innovation in terms of master trust technology, most notably in 'publicizing' the subordinated Class C securities.
  - Such development culminated in the creation and broad implementation of the delinked structure in the early 2000s.
- Currently, the majority of issuance is from Delinked Series issued out of Owner Trusts.

# CCABS Structure Evolution:
## Stand-Alone Trusts

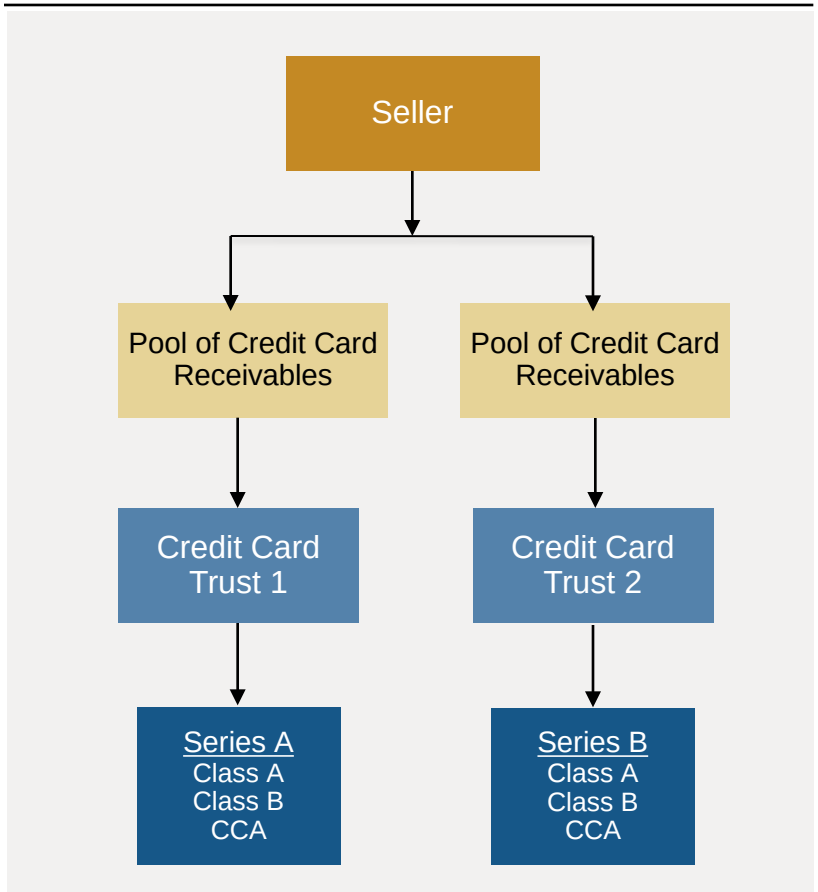
From 1987-1991, the stand-alone trust was the dominant issuance vehicle employed by credit card ABS issuers.

In a stand-alone trust, the originator designates a group of credit card accounts and transfers the receivables arising from time to time in those accounts to a trust that then issues a discrete series of ABS, although there may be several classes within that series.

When the originator intends to issue another series of ABS, it designates a new group of credit card accounts and transfers the receivables arising from time to time in those accounts to a separate trust.

This structure proved cumbersome and not cost efficient. It was used until 1991 when the master trust became the preferred vehicle.

**Stand-Alone Trust**



# CCABS Structure Evolution:
## Master Trusts

Master Trust technology became the market standard in 1991.

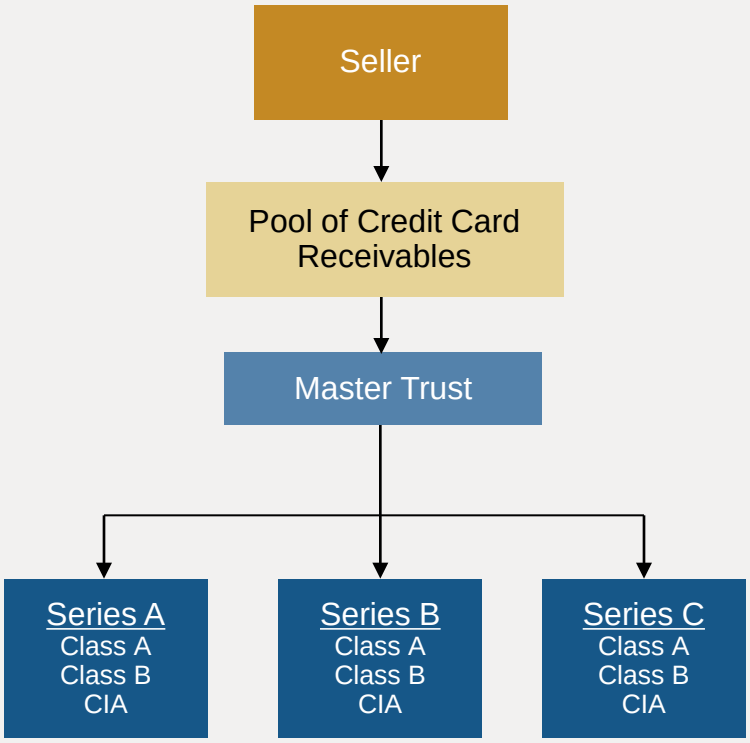
Credit card transactions involve the sale of pro rata shares in a revolving pool of assets.

- Receivables are not segregated to support a certain series.
  - Security holders have an undivided interest in the aggregate pool of receivables.

Multiple series of ABS are issued and can be issued at different times with different liability characteristics: tenor, fixed/floating coupon, etc., all from the same collateral pool.

The most subordinated tranche in the capital structure is usually in the form of a loan, referred to as a "collateral invested amount" ("CIA"), which serves as enhancement to more senior tranches.

**Master Trust**

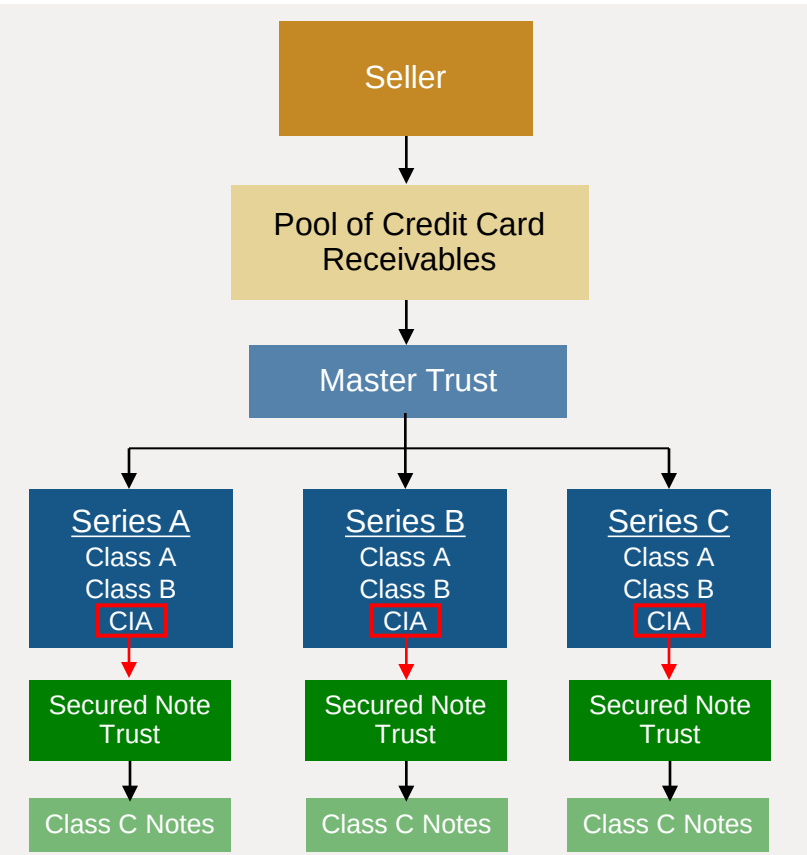


# CCABS Structure Evolution:
## Master Trust/Secured Note Structures

In 1998, issuers developed a structure that allowed them to sell the most subordinate tranche, referred to as Class C notes:

- A secured note trust was created for each series, backed by a collateral certificate representing an interest in the CIA.
- This secured note trust would issue Class C notes secured by its interest in the cash flows allocated to the CIA.

**Master Trust/Secured Note Trust**



# CCABS Structure Evolution:
## Master Note Trusts

Credit Card Master Note Trust ("MNT") technology builds on the traditional Master Trust structure.

In the traditional Master Trust, securities created took the form of certificates, which evidenced ownership in the assets of the Master Trust.

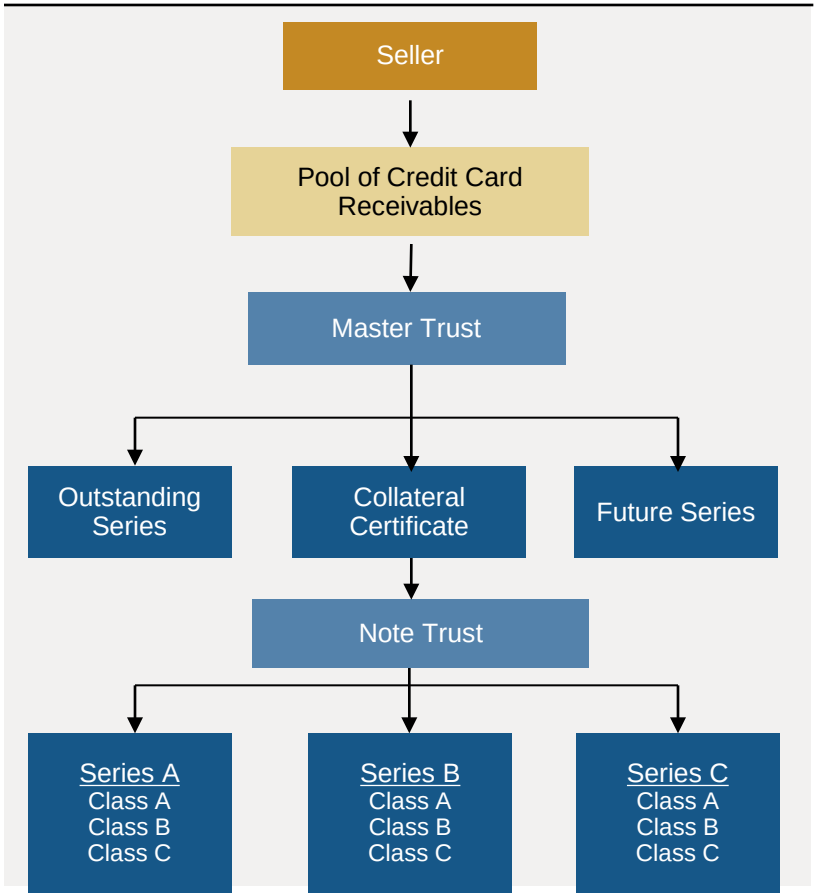
- The key innovation of the MNT was the change in form of issued securities to that of notes, which evidence debt of the trust secured by the conveyed assets.

The MNT, as a business trust, allows for issuance of multiple series of securities backed by a common pool of revolving collateral.

Securities issued are characterized as debt-for-tax and, therefore, ERISA eligible.

The MNT can issue series of ABS with flexibility in tenors depending on issuer's liquidity needs coupled with investor demand.

**Master Note Trust**



# CCABS Structure Evolution:
## De-Linked Structures

The newest technology used for credit card securitization is the De-Linked Issuance Trust, featuring MTN and “De-linking” tranche technology.

The main feature of the structure, “De-linking”, allows each tranche of notes to have an independent maturity schedule.

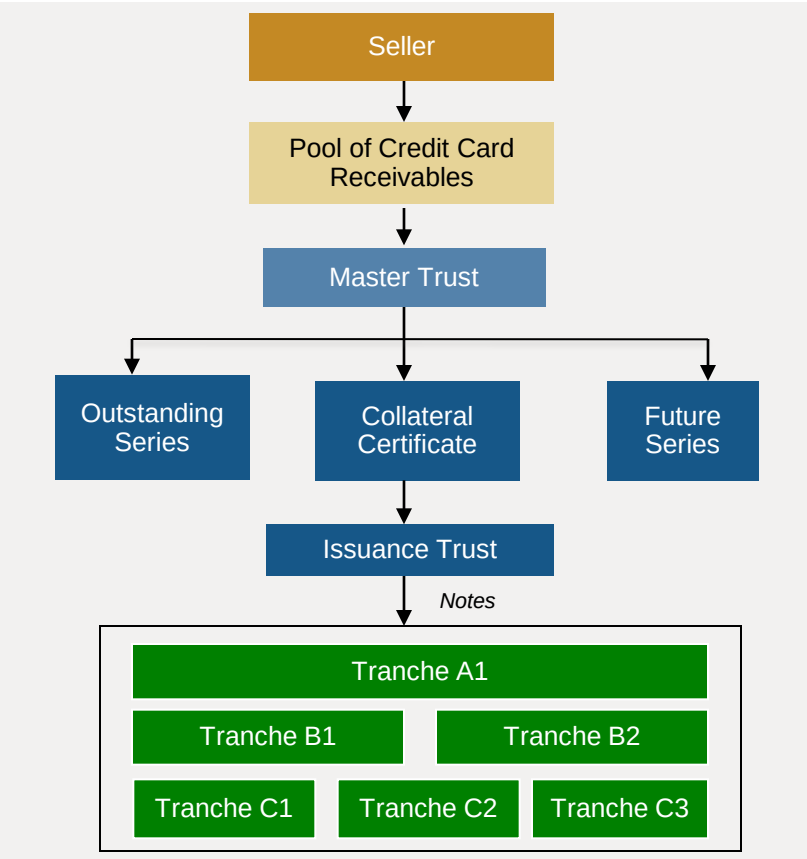
- The subordinated tranches of notes no longer need to be linked to any senior tranche of notes.
- This feature allows issuance of different tranches of notes at different times based on demand or need.

Strict issuance tests ensure there is sufficient enhancement beneath each class.

Issuers tend to over-fund subordinate tranches to allow flexibility to optimize issuance of senior tranches.

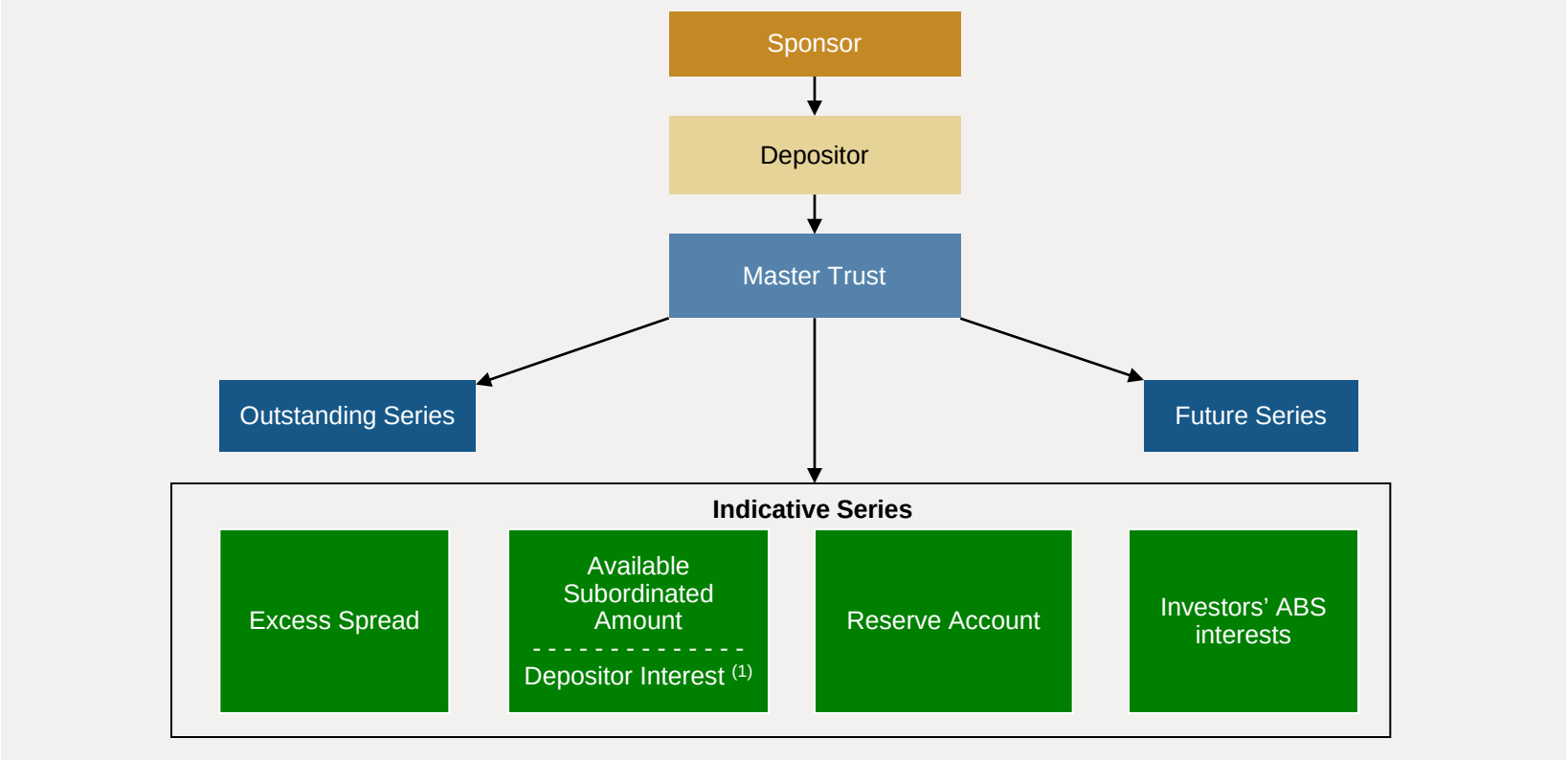
As the credit crisis pushed credit spreads on subordinate notes wider than many credit card banks alternative sources of funds, many issuers have elected to issue and retain the subordinate notes.

**“De-Linked” Issuance Trust**



# Example of Typical Floorplan Securitization Structure

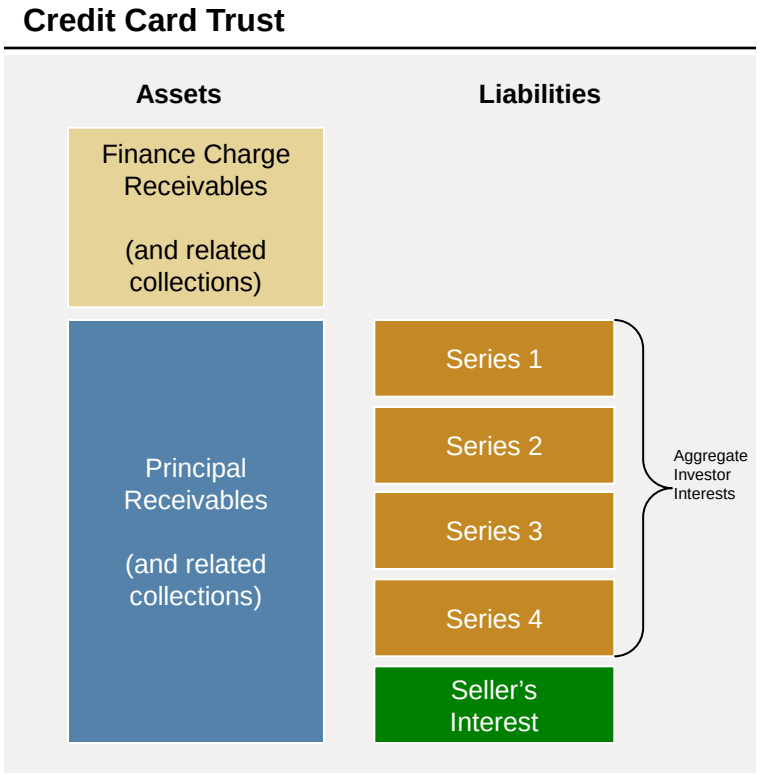
The following diagram provides a simplified overview of the structure for a typical floorplan master trust securitization and the enhancement available for an indicative series issued by a floorplan master trust.




(1) The depositor interest represents the interest in the trust assets not allocated to any series. A portion of the depositor interest equal to the available subordinated amount is subordinated to the investors' ABS interest.

# Investor Interests and Seller's Interest

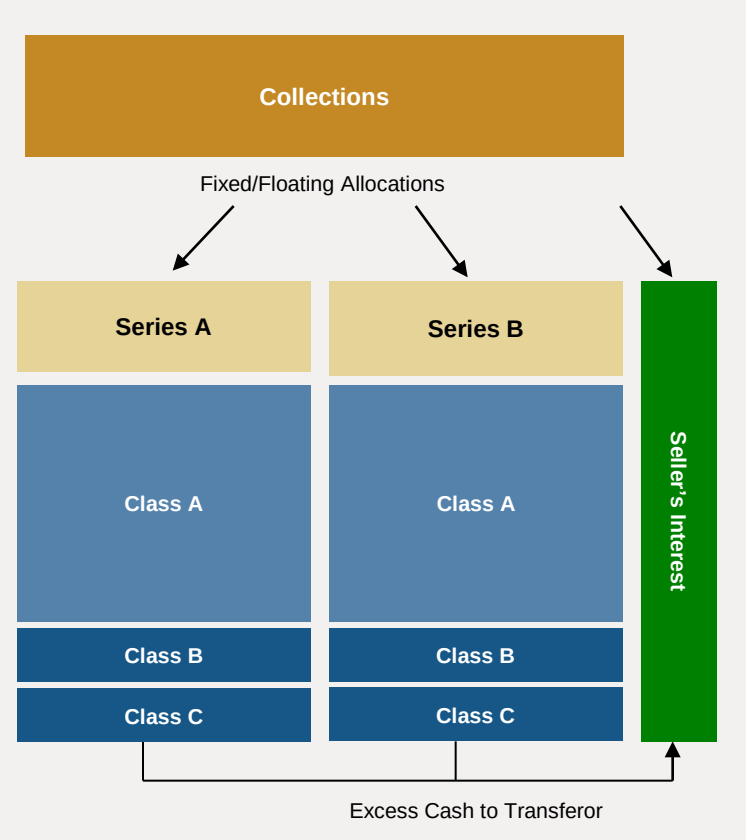
- The receivables and other assets held by the master trust at any time are allocated between the investor interests and the seller's interest.
- The investor interests equal the aggregate interest of each series of ABS issued by the master trust from time to time and represent a proportional share in the assets of the master trust.
- The securitizer is required by the governing program documents to maintain a minimum pool balance in excess of the aggregate investor interests.
- The seller's interest equals the amount of this excess and, like the investor interest, represents a proportional share in the assets of the master trust.
- The seller's interest is issued at the time of the original transfer of receivables to the master trust and fluctuates in size over time as new receivables are added, others are paid, and new series are issued or mature.



# Allocations Between Investor Interests and Seller's Interest

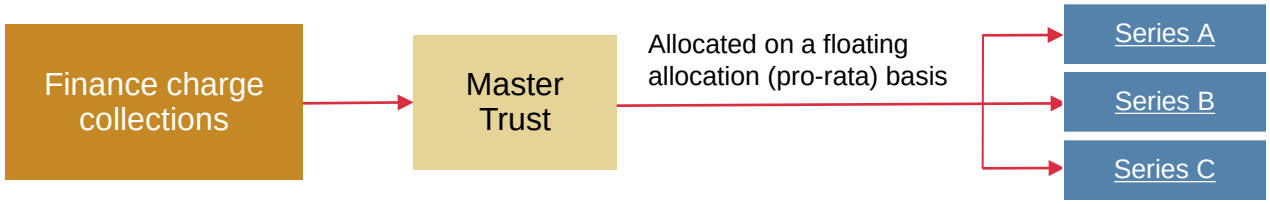
- Finance charge collections, principal collections and loss amounts associated with charged-off receivables are initially allocated between the aggregate investor interests and the seller's interest.
- During revolving periods, virtually all master trusts allocate collections and loss amounts between the investor interests and the seller's interest on a pro rata basis, using a floating allocation percentage.
- During other periods, including scheduled principal accumulation or scheduled principal amortization periods, virtually all master trusts fix the allocation of principal collections to the relevant investor interests at the higher levels applicable before principal payments begin.[1]
- This fixing of allocations of collections to the investor interests provides for the orderly and timely payment of the investor interests, by deferring a full allocation of collections to the seller's interest when a series, class or tranche of investor interests is in any form of principal accumulation or principal amortization period.
- Excess cash flows not required by the outstanding series are paid to the transferor in the form of excess spread.

1 By comparison, the allocation of losses between the investor interests and the seller's interest remains pro rata at all times.

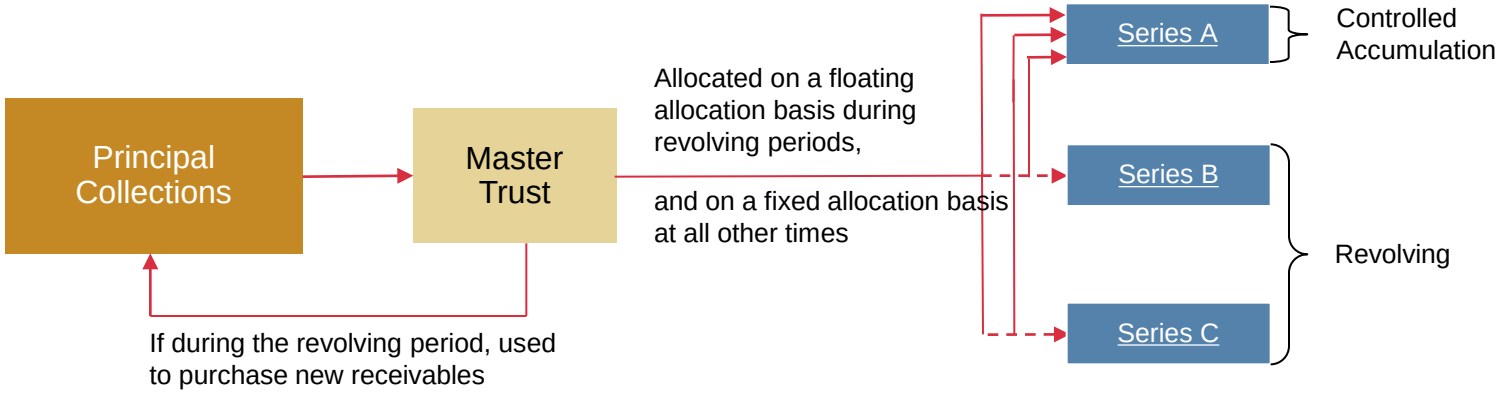


# Allocations Among Investor Interests

Finance charge collections are used to pay bond coupons and servicing fees, and to cover loss amounts.

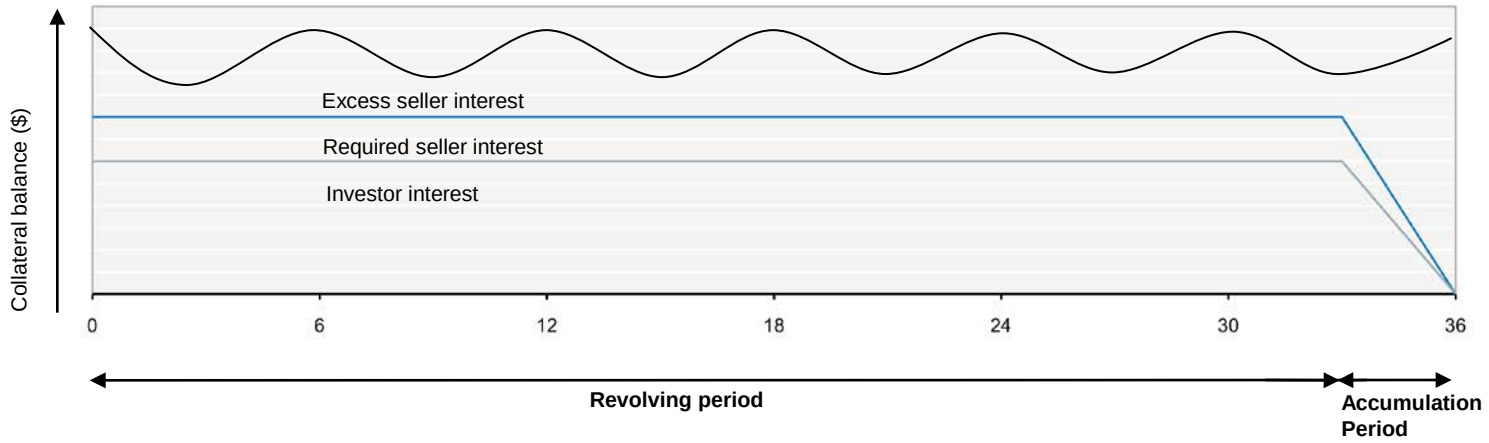



Principal collections are used to pay bondholders when principal is due; otherwise it is used to purchase new receivables.



# Investor Interests and Seller's Interest: Soft Bullet

**Collateral: Credit card accounts, monthly principal and interest receipts**

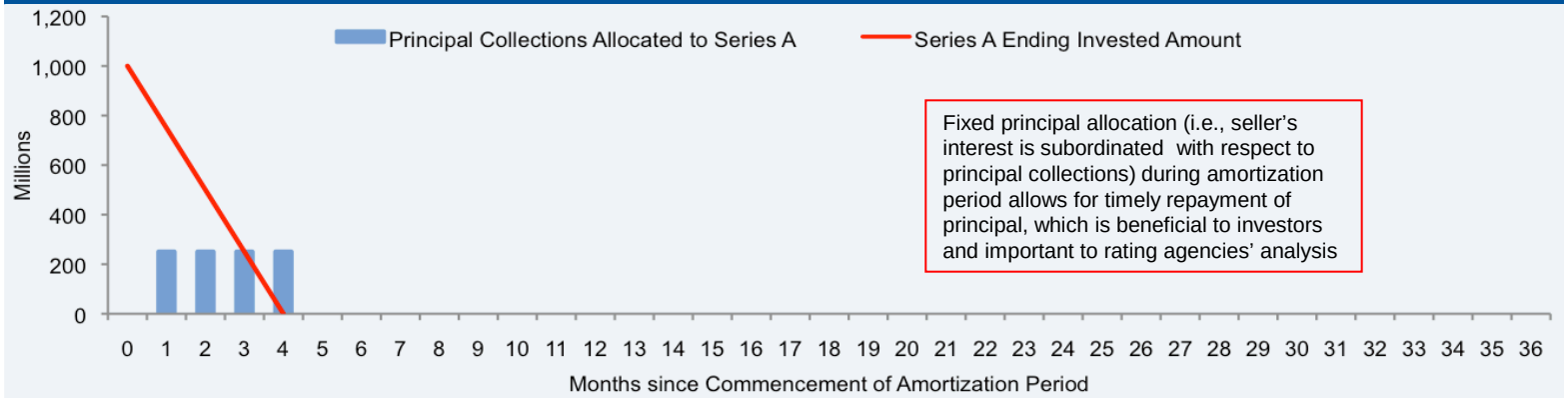



- The primary benefit of the seller's interest is that it provides a cushion as the first tranche to serve as a buffer against seasonal fluctuations in the portfolio and to absorb dilutions (returns).
- Many trusts actually require a minimum seller's interest for protection from dilutive items.

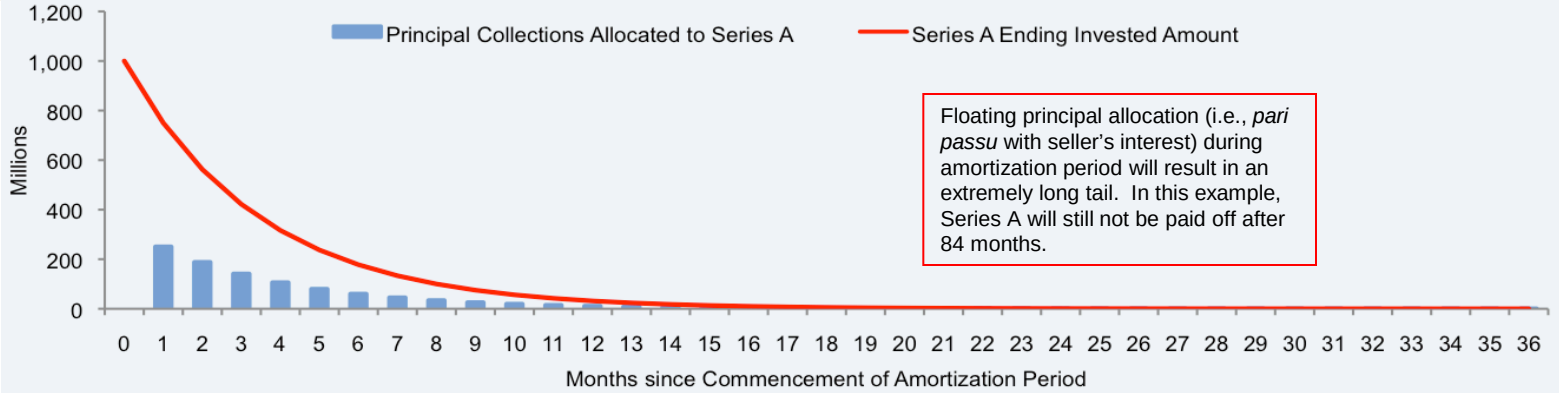
# Fixed vs Floating Principal Allocation

- Assumptions:
  - Trust Receivables Balance: $5bn
  - One series (Series A) outstanding
  - Initial Series A principal balance: $1bn (i.e. Allocation % at the beginning of Amortization Period is 20%)
  - Monthly Principal Payment Rate: 25%

**Example 1: Fixed Principal Allocation during Amortization Period**

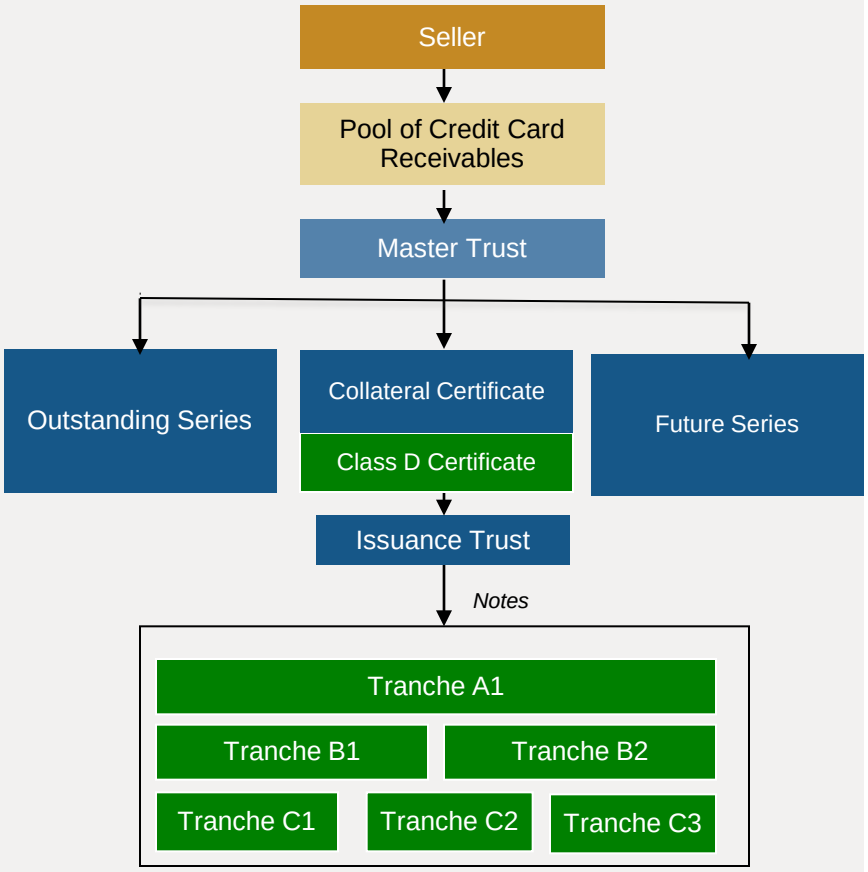



**Example 2: Floating Principal Allocation during Amortization Period**

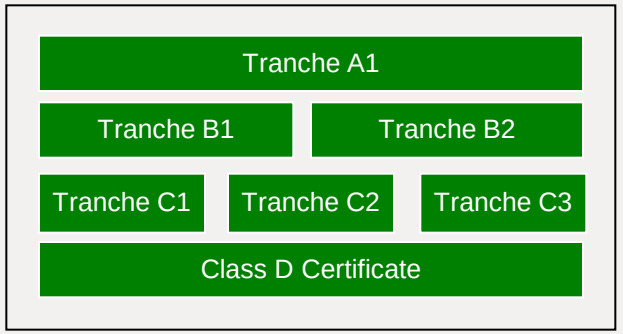


# Example of Horizontal Interest Issued in One Series That is Subordinated to Investor Interests Issued in One or More Other Series

**"De-Linked" Issuance Trust**




**Credit Enhancement Structure**



# Credit for Horizontal Interests on a Proportional Basis

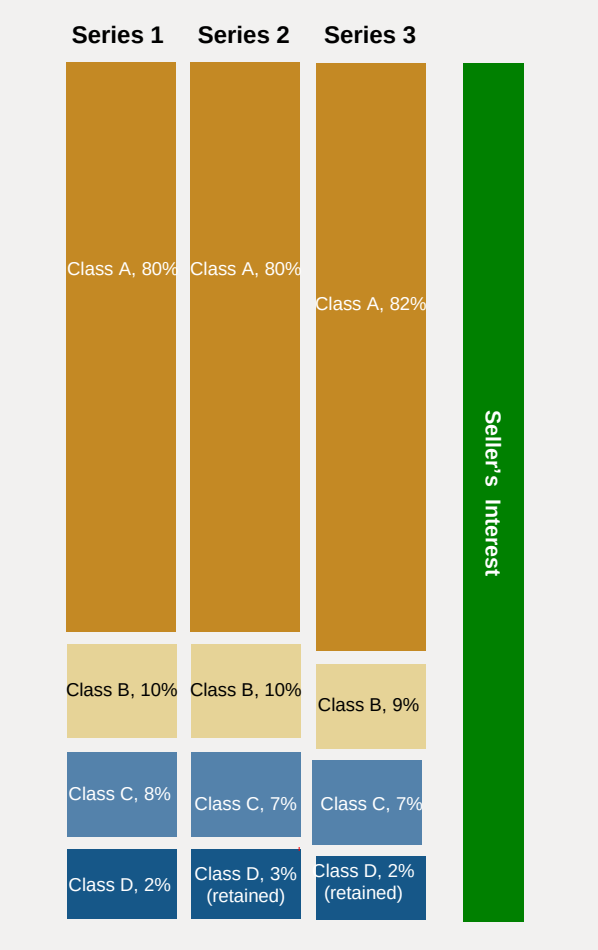
- Three outstanding series, each having an outstanding principal amount of investor interests equal to $100.

- The sponsor does not retain any horizontal interest in Series 1, retains a Class D horizontal interest in Series 2 representing 3% and retains a Class D horizontal interest in Series 3 representing 2%.

- The sponsor should be permitted to reduce the 5% trust-wide risk retention requirement by 1.67%, by weighting the amount of horizontal interest retained by the respective outstanding principal balance of the investor interests of the related series, as follows:

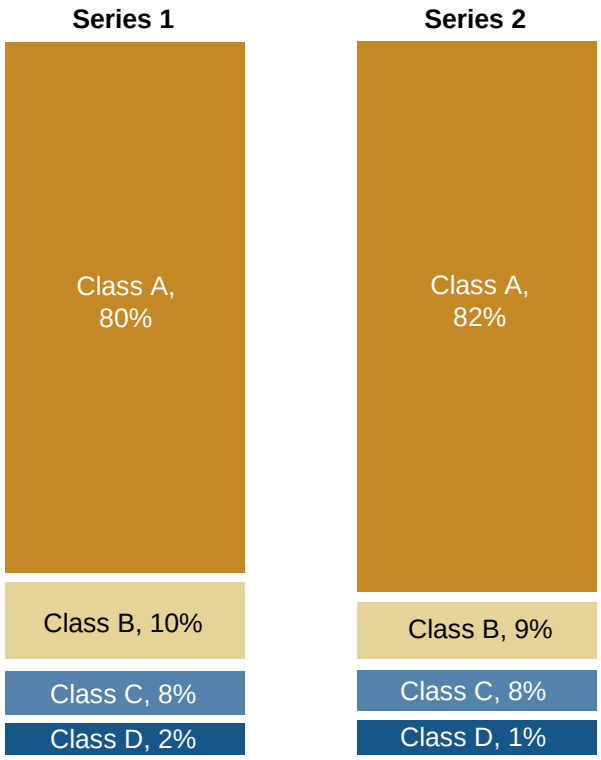
| Series | Retained Horizontal Interest | | Principal Balance of Investor Interests | | Offset to 5% Trust-Wide Requirement |
|---|---|---|---|---|---|
| 1 | -0- | | $100 | | |
| 2 | 3% | | $100 | | |
| 3 | 2% | | $100 | | |
| Total | 5% | ÷ | $300 | = | 1.67% |

- Upon the maturity of any series in which the sponsor retained a horizontal interest that offset the 5% trust-wide requirement, the sponsor would be required to either retain a qualifying horizontal interest in a new series or increase its trust-wide seller's interest requirement, in either case, by an amount sufficient to again satisfy the 5% aggregate requirement.

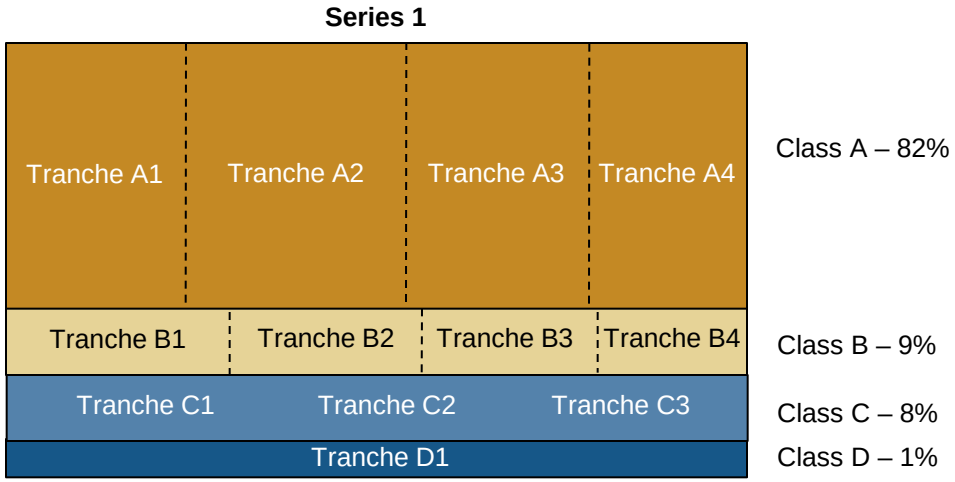


# Linked vs De-Linked Structures

Traditional “Linked” Master Trust




De-Linked Issuance Trust



# De-Linked Issuance Trust:
## Example of Credit Enhancement

**Example for $1,300MM of financing:**

Class A Required Subordination designation as:

5.00% Class B notes ($50)

5.00% Class C notes ($50)

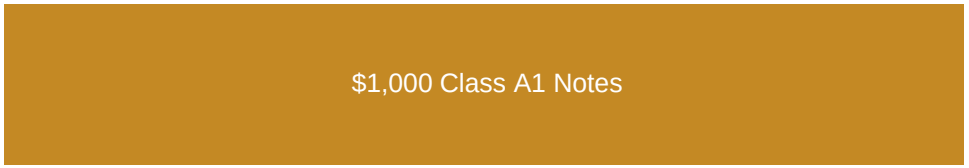
7.50% Class D notes ($75)

**Class A Excess Enhancement:**

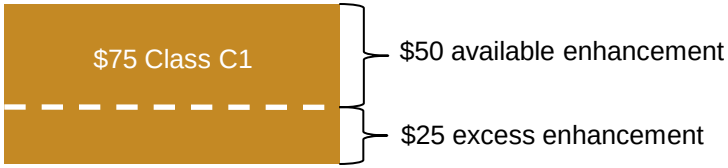
Class B notes ($50)

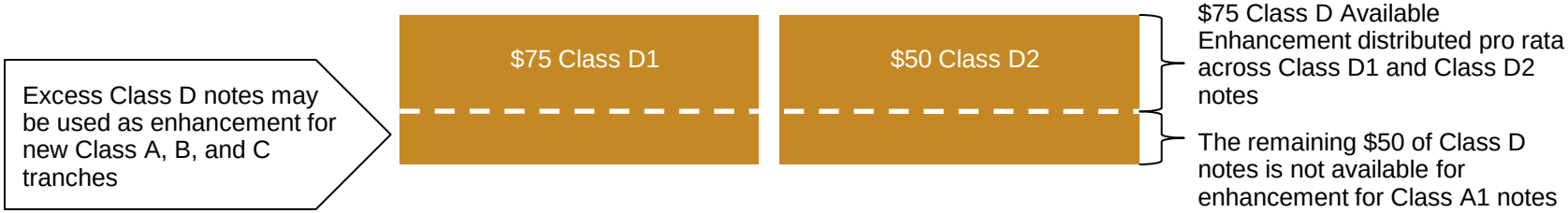
Class C notes ($25)

Class D notes ($50)



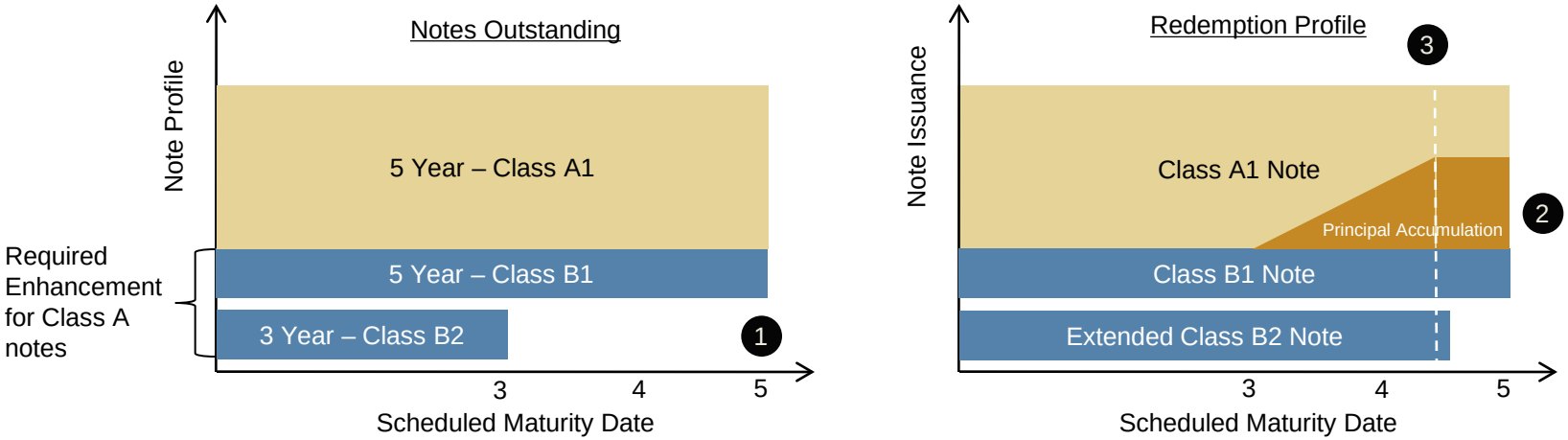




# De-Linked Issuance Trust:
## Subordinate Note Extension

The extension scenario illustrated below assumes that two Class B notes of equal size provide credit support to a single Class A1 note. Under this scenario, the shorter-dated Class B2 note is unable to be refinanced at its scheduled redemption date of 3 years.




1. The Class B2 note is unable to be refinanced at its scheduled redemption date in year 3, which leads to:
   - Extension of the Class B2 note past its scheduled redemption date.
   - A requirement to begin trapping principal to effectively cash collateralize the Class A1 note.
2. Principal is trapped in a principal funding account to effectively reduce the Class A1 Investor Interest to a level where the Class B1 note alone would provide sufficient credit enhancement.
3. Once sufficient principal has been trapped the Class B2 notes can be repaid in full.