

# C - Pieces

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## Subordinated Credit Card Receivables

### What are *C-pieces*?

It seems as though everywhere you turn Wall Street's investment bankers have created a new investment vehicle in conjunction with a new acronym. C-pieces are not necessarily a new investment tool. Actually, they have been around for several years. What is innovative is the fact that they are much less restrictive in their new structure. C-pieces have been in existence since 1986 in the form of a letter of credit and have progressed over time into ERISA –eligible notes with no trading restrictions.

The structure itself is a simple senior/subordinated structures shown below:

<b>Class A Certificates</b> AAA rated 83%
<b>Class B Certificates</b> A rated 7½%
<b>Class C Notes (C-piece)</b> BBB rated 9½%

<p><i>Reserve Account</i>  <i>(available only to Class C)</i>  <i>Not rated</i>  <i>Up to 4%</i></p>
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C-pieces are investment grade securities rated BBB. These securities have excess spread as subordination and a reserve account that is only available to the C-piece holder.

The new feature that was added in 1998 is that cash flows associated with the Class C notes are placed into an owner trust and notes (debt) are issued from the owner trust. This creates an extremely liquid security for the investor community, while maintaining debt treatment for the issuer.

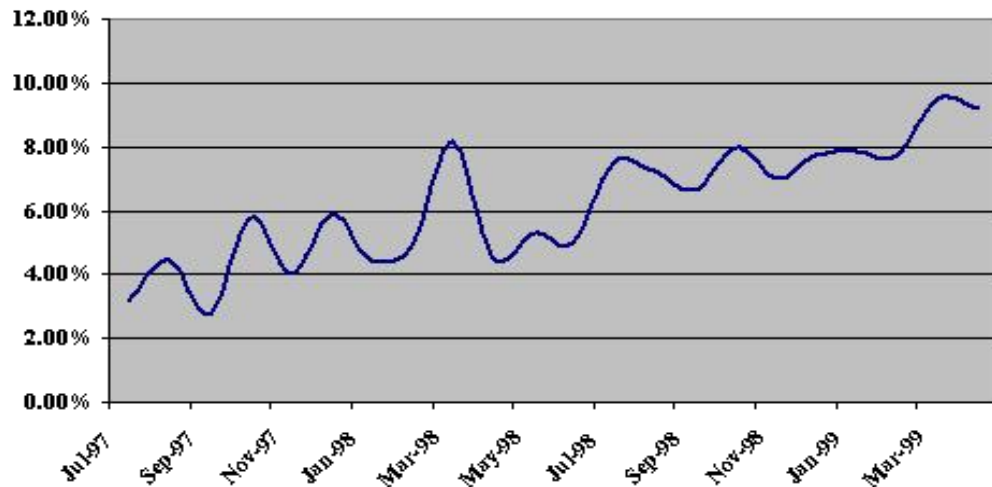
What about credit risk?

A C-piece's credit exposure is measured via its excess spread. Excess spread is defined as the portfolio of receivables yield minus the coupon on the certificates/notes issued, minus servicing fees, minus net losses to the trust. For example:

Weighted average portfolio yield on First USA receivables .....	20.50%
Less: Weighted average coupon .....	5.50%
Servicing Fees .....	1.50%
Net Losses .....	<u>4.50%</u>
Excess spread	9.00%

The chart below illustrates the improving credit environment that the credit card industry has enjoyed. Excess spread could be thought of as the profitability of the trust. The assets here are the return on future receivables and the liabilities are the coupon payment, servicing fees, and underwriting losses that net to a profit or excess spread. This excess spread is providing subordination to the C-piece. In addition, it is implied but not guaranteed that if a trust's excess spread were to fall below a certain threshold the parent company would take action to enhance or raise the excess spread. One such action would be to add additional receivables to the trust. The banks and/or finance companies realize that the credit quality of the trust must be maintained if they wish to continue to access the capital markets.

## Excess Spreads



In addition, if excess spreads decline the reserve account begins to accumulate cash in a reserve account based on the following trigger events.

Excess Spread	Required Reserve Amount
< 4.50 %	1.50 %
< 4.00 %	2.00 %
< 3.50 %	3.00 %
< 3.00 %	4.00 %

This reserve account is additional subordination that can **only** be utilized by the Class C note holders.

Several years ago credit card companies attempted to compete for new customers on the basis of price (i.e., yield paid on outstanding balances). As a result, the credit card companies experienced a dramatic increase in losses which reduced excess spread to approximately 3.50%. Credit card companies quickly realized that they must price the risk appropriately. In the current marketplace, these same credit card companies compete for new and existing accounts via service.

Since their introduction in the mid-1980's there has only been one default on a credit card portfolio and that default was due to an act of fraud that occurred during the S&L crisis.

## Do C-pieces represent value?

In the table below, we compare a First USA C-piece to a First USA senior debenture across the maturity spectrum.

### Libor Spreads:

	3-year	5-year	7-year
Senior Debt	34	36	40
C-piece	90	100	105
<i>difference</i>	56	64	65

Essentially, for the same business risk investors can pick-up substantial spread over the senior debt of the same company. This spread differential exists today largely as a result of the limited dissemination of the new structural advantages enjoyed by C-pieces.

## Conclusion

C-pieces are a means of adding additional return to your portfolio at the same or lower risk levels than the comparable corporate debt. As information is circulated in the marketplace and more investors are educated on the structure and the ERISA-eligibility of C-pieces we believe spreads will tighten significantly.

Vanderbilt Research Team

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Emad is the Managing Partner and Chief Executive Officer of Vanderbilt Avenue Asset Management LLC. Vanderbilt's client base includes Multi-national Corporations, Public Funds, Foundations/Endowments, and Taft Hartley accounts.

Previously, Emad was Chairman of Institutional Business at Pioneer Investments. Pioneer investments has more than \$300 Billion in assets under management. The parent of Pioneer, UniCredit S.p.A., is the largest bank in Italy and the second largest bank in Europe. Pioneer had purchased Vanderbilt Capital Advisors, of which Emad was the founder and Chief Executive Officer.

Emad has had numerous articles published in professional and academic journals such as The Journal of Forecasting, The American Economist and The Journal of Fixed Income. He is a Board member of The National Investment Company. Emad was a member of the Board of Advisors of the Pacific Institute, The Advisory Committee of Fulcrum Global Partners, The Chief Executive Officers Club and formerly a board member of The Foreign Policy Association. He also served on the Board of Directors of the University of Albany Foundation, NextGen Healthcare Inc., The Park Avenue Bank, AA Bank and The New Providence Fund and Associates LP.

Emad is an FINRA Arbitrator. He is also a member of the National Association for Business Economists and The Economic Club of New York. Emad served as an adjunct professor at the University of Kansas and St. John's University.

Emad holds a Bachelor of Science from the University of Albany, and a M.A. and Ph.D. in Economics from the University of Kansas.