

## Domestic Credit by David Goldman

### Now, credit card-backed securities

*Plastic now joins home mortgages and auto loans in "securitization."*

**I**n discussions with *EIR* Banking columnist Kathy Wolfe during 1980-81, Salomon Brothers executives bragged that a global market in commercial paper would replace the banking system as it then existed.

Savings banking died with the first "Volcker shock" of 20% interest rates during 1980-81, and commercial banking died with the Third World debt crisis of 1982, and Salomon's prediction has come true: what the bankers call "securitization" has now replaced normal commercial-banking functions.

Mortgage-backed securities, of which a dozen varieties are now competing, make up the biggest sector of borrowing in the U.S. economy. But home mortgages are only the beginning of a process which is already reaching into the absurd. Now, we have credit card backed securities.

That is all the more remarkable, given the mounting panic over the safety of hundreds of billions of dollars of consumer debt. Consumers have been expanding their indebtedness at a nearly 20% per annum rate, making up for continued erosion of spendable income. Credit card debt rose to over \$120 billion this year, double the 1980 level. Wall Street's motto appears to be: If it's ready to go bankrupt, market it.

Again, Salomon is the leader in the field; the investment bank brought out the first of the kind earlier this year, and even published a handy manual on the subject, "An Introduction to Credit Card Backed Securi-

ties," in August 1986. Its authors, Michael Waldman and Thomas Delehan-ty, manage to keep a straight face throughout.

"During the past year, a market in securities that are collateralized by such short-term financial assets as automobile loans and computer leases has emerged alongside the mortgage securities market. In the latest phase in asset securitization, Salomon Brothers recently brought to market the first security backed by credit card receivables," they write.

Like most "securitization," re-packaging credit card loans, and selling them on the securities market, is a function of the banks' own desperate desire to raise cash, as the authors freely admit:

"Credit card loans are part of the large and rapidly expanding consumer installment debt market. The high volume of credit card activity creates a sizeable potential supply of assets for securitization. The largest prospective issuers of credit card securities are commercial banks. Because banks' primary objective in issuing credit card-backed securities is to free up regulatory capital, offerings will be structured as asset sales."

Regulatory capital refers, of course, to the minimum net worth banks must maintain, in order to keep their doors open. Since a large number of commercial banks are scraping against the bottom of their capital, selling off assets—loans, real estate, branches—is a life-or-death matter for many institutions.

The vultures in the Wall Street investment banks hang around the dying commercial banks, waiting for a chance to make a commission on such sales.

Salomon calls the securities it issues with credit card backing "CARDS" (Certificates for Amortizing Revolving Debts), and reports happily that "they provide a significant yield premium over short-term corporate paper."

That is not surprising, since the "net finance charge" to credit card customers during 1986 rose to 17%, from only 13% in 1980, more than double what corporations pay for money.

What about the rising delinquency rate on credit card loans? No problem, says Salomon Brothers. True, the delinquency rate on credit-card lending is up to 4%, from under 3% in 1983—this after years of supposed economic recovery.

Salomon explains, "Charge-off rates rose steadily in 1984-1985, despite relatively favorable economic conditions [for Salomon Brothers, if not for the rest of us]. This trend can be explained by the continued rapid expansion of credit-card lending. Aggressive campaigns to solicit accounts have added a large number of new and, in many case, less creditworthy accounts."

However, even after deducting the 4% delinquency, Salomon shows in a graph, the "net finance charge yield"—the banks' take, after writing off the deadbeats—still exceeds 13%.

So the usury game with plastic money still works fine (until delinquencies top, say 8%). The banks are so pressed for cash that they are constrained to sell off these profitable assets, and Salomon has proceeded to spread the benefits of usury around a much larger base of investors.