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## CANADIAN CDOS AND THE U.S. AUTOMOTIVE INDUSTRY: GAUGING THE IMPACT OF POTENTIAL BANKRUPTCIES

Over the past year, the credit quality of the “Big Three” U.S. automotive manufacturers (General Motors, Ford and Chrysler) has deteriorated substantially as the economic slowdown has resulted in significantly less consumer demand for new vehicles. Furthermore, the rise in oil prices and fuel prices during 2008 led to a major shift away from larger vehicles (such as SUVs and pickup trucks), which were a main focus of the Big Three. Each of the Big Three companies now has an Issuer Rating of CCC (high) or lower by DBRS, and a bankruptcy filing by General Motors and Chrysler (both rated CC by DBRS) may be imminent. These potential bankruptcies would likely have a ripple effect on automotive suppliers.

Today’s newsletter will consider the potential impact of automotive bankruptcies on the DBRS Canadian collateralized debt obligation (CDO) universe, outlining the results of two hypothetical stress scenarios performed on those CDO transactions with automotive industry exposure.

In analyzing the ratings stability of CDO transactions from a credit perspective, DBRS utilizes the stability cushion concept. A stability cushion represents the buffer of subordination that is available to a CDO tranche in excess of the minimum subordination required to achieve a particular rating for that tranche. Put another way, a stability cushion is equal to a transaction’s attachment point minus the required subordination level for a given rating.

To demonstrate the level of ratings stability of the 72 CDO transactions<sup>1</sup> currently monitored by DBRS, two stress scenarios were applied:

(1) Assume that General Motors and Ford default immediately, with a 33% recovery assumption<sup>2</sup>. Assume immediate default by all non-investment-grade auto suppliers, with a 33% recovery assumption.

(2) Assume that General Motors and Ford default immediately, with a 0% recovery assumption. Assume immediate default by all non-investment-grade auto suppliers, with a 0% recovery assumption<sup>3</sup>.

Note that these are hypothetical scenarios designed to demonstrate the stability of the DBRS CDO universe. DBRS is not anticipating that General Motors, Ford and all non-investment-grade automotive suppliers will file for bankruptcy.

The results indicated that 49 transactions would withstand both scenarios and maintain their current ratings. While the required subordination levels would increase, each of these 49 transactions’ stability cushions is sufficient to withstand the stress scenarios applied.

For the scenario assuming 33% recovery, the model results indicate that 54 of the 72 transactions would be able to withstand this scenario and maintain their current or implied ratings (as shown in Table 1 below). Many of the downgrades required under the scenario are not severe (one or two notches).

Table 1

### Scenario 1: 33% Recovery Assumption

Required Downgrade from Scenario (Number of Notches)	Number of Transactions
0	54
1	5
2	7
3	3
4	3

For the scenario assuming zero recovery for defaulted entities, the model results indicate that 49 of the 72 transactions would be able to withstand this scenario and maintain their current or implied ratings (as shown in Table 2). Both the number and severity of downgrades increase because a greater amount of loss is modelled for each defaulted reference entity.

Table 2

**Scenario 2: 0% Recovery Assumption**

Required Downgrade from Scenario (Number of Notches)	Number of Transactions
0	49
1	1
2	6
3	5
4	2
5	2
6	2
7	4
8	1

There are currently ten non-investment-grade automotive suppliers referenced by CDO transactions rated by DBRS. Despite the fact that more than ten defaults were applied to each stress scenario, the majority of CDO transactions would not require a downgrade. How can this stability be explained? A majority of CDO transactions rated by DBRS had large stability cushions when initially rated. Also, DBRS's CDO Toolbox assumes higher probabilities of default for non-investment-grade entities, especially those rated in the CCC range or lower. As a result, a portion of the losses resulting from the stress scenario defaults would have already been incorporated into DBRS's ongoing surveillance results.

DBRS-rated CDO transactions may be funded by asset-backed commercial paper (ABCP), Master Asset Vehicle (MAV) Notes or other sources. Revisions to the ratings of the transactions may affect the ratings of such ABCP, MAV Notes or other notes.

DBRS will continue to monitor these transactions and will release rating updates or other information as appropriate on [www.dbrs.com](http://www.dbrs.com).

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1. The 72 Canadian collateralized debt obligation (CDO) transactions mentioned in this newsletter include all public transactions rated by the DBRS Canadian Structured Credit Group that reference corporate obligors, as well as transactions that were part of a restructuring process under the Montréal Accord and now collateralize the MAVI and MAVII Class A-1 and Class A-2 Notes (the MAV Notes). For the purposes of this newsletter, DBRS will use the terminology "implied rating" when referencing the credit strength of transactions monitored for the rating of the MAV Notes. Please note that all transactions rated by the DBRS U.S. Structured Credit Group and all private transactions are not included in the transaction total.
2. Note that Chrysler is not referenced by any CDO transactions monitored by DBRS. Many of the CDO transactions originally referenced DaimlerChrysler but now exclusively reference Daimler following its sale of Chrysler in May 2007, as indicated by the definition of a successor event in the 2003 International Swaps and Derivatives Association Credit Derivatives Definitions.
3. A small number of the transactions have fixed recovery rates for each of their reference entities (normally between 30% and 40%). In the scenario analysis, DBRS has applied the appropriate fixed recovery rates for these transactions.

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