

Canadian Structured Finance Newsletter

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MAVS AND PIIGS: CONSIDERING THE IMPACT OF A POTENTIAL EUROPEAN DEFAULT ON THE MAV NOTES

Financial markets have taken investors on a vertigo-inducing ride over the last few weeks, with concerns about European sovereign debt responsible for much of the recent volatility. Indeed, talk of public debt and deficit levels throughout the European Union, particularly in the so-called PIIGS countries (Portugal, Italy, Ireland, Greece and Spain), has become a staple of the financial press. It is against this backdrop that DBRS has considered the impact that a default by one of the PIIGS countries could have on holders of certain Canadian structured finance products.

As part of its ongoing surveillance process, DBRS monitors economic developments and pro-actively considers scenarios that, however remote, could come to pass. Typically, DBRS will model worst-case assumptions to better understand what impact such scenarios could have on DBRS ratings. In addition to providing insight on specific rated securities, this process allows DBRS to verify that its rating methodologies are sufficiently holistic to take into account broad macroeconomic factors.

The notes issued by Master Asset Vehicle I (MAVI) and Master Asset Vehicle II (MAVII; together with MAVI, the MAVs) are exposed to the credit of over 800 entities through collateralized debt obligation (CDO) asset interests held by the MAVs. Thirty-nine of the entities to which the MAVs are exposed are corporations domiciled in one of the PIIGS (see table below). Of the 39 corporations, fifteen are financial intermediaries. Financial intermediaries are considered especially vulnerable to a sovereign default due to their holdings of sovereign debt and the perceived inability of governments that would be in crisis to provide adequate support to their financial sector. Twenty-four CDOs held by the MAVs have exposure to one or more of the financial intermediaries domiciled in the PIIGS.

In order to understand how the MAVs could potentially be affected by a PIIGS country debt default, DBRS has modelled a scenario in which the 15 PIIGS-based financial intermediaries are assumed to have defaulted with a 33% recovery rate. Under this scenario, there would be no expected rating impact on the DBRS-rated notes issued by the MAVs. The rating stability of the DBRS-rated MAV notes under this scenario reflects (i) sufficient credit enhancement levels in the 24 CDOs that reference the PIIGS-based financial intermediaries to absorb the losses and (ii) the fact that the CDO asset interests held by the MAVs with the lowest enhancement levels have little or no exposure to these financial intermediaries.

As explained in the DBRS rating reports on MAVI and MAVII published on January 21, 2009, the ratings on the MAV notes are exposed not only to the credit quality of the underlying asset interests, but also to the probability of the structure facing a margin call that it could not satisfy with available collateral and/or available margin funding facilities. The MAVs' liability for margin calls will be determined by spread-loss collateralization triggers that are linked to credit default swap index spreads and loss from defaults or credit events experienced by names referenced by the indexes. Losses experienced by corporate names referenced by the indexes reduce the collateralization trigger levels to which the MAVs are exposed. While current spreads are at a comfortable distance from trigger levels, a substantial increase in spread levels and credit losses in the wake of a sovereign default could potentially lead to a terminal unwind of certain asset interests held by the MAVs, which could result in substantial losses for noteholders. This concern is especially significant in light of the July 16, 2010, expiry of the moratorium period on collateral calls from which the MAVs have benefited since the issuance of the MAV notes. Spread levels are very volatile and DBRS closely monitors the index spreads to which the MAVs are exposed. DBRS would release updated information on a timely basis if the ratings of the MAV notes were to come under pressure due to any precipitous change in spread levels or a significant increase in credit losses.

For more information, please contact Andrew Fitzpatrick at afitzpatrick@dbrs.com.

PIIGS-Based Corporations Referenced in MAV Structures

Company Name	Country	Industry
Banco Comercial Portugues, SA	Portugal	Financial Intermediaries
Banco Espirito Santo, SA	Portugal	Financial Intermediaries
Brisa-Auto Estradas de Portugal, SA	Portugal	Surface Transport
CIMPOR Cimentos de Portugal, SA	Portugal	Building & Development
EDP Finance BV	Portugal	Utilities
Portugal Telecom SGPS, SA	Portugal	Telecommunications
Altadis, SA	Spain	Beverage & Tobacco
Banco Bilbao Vizcaya Argentaria, S.A.	Spain	Financial Intermediaries
Endesa, S.A.	Spain	Utilities
Gas Natural SDG S.A.	Spain	Oil & Gas
Iberdrola, S.A.	Spain	Utilities
Repsol YPF, S.A.	Spain	Oil & Gas
Banco Santander Central Hispano, S.A.	Spain	Financial Intermediaries
Telefónica, S.A.	Spain	Telecommunications
Unión Fenosa, S.A.	Spain	Utilities
Eircom Limited	Ireland	Telecommunications
Allied Irish Banks, plc	Ireland	Financial Intermediaries
The Governor and Company of the Bank of Ireland	Ireland	Financial Intermediaries
Irish Life & Permanent plc	Ireland	Financial Intermediaries
Ingersoll Rand Company	Ireland	Industrial Equipment
Hellenic Telecommunications Organization S.A.	Greece	Telecommunications
Atlantia SpA	Italy	Surface Transport
Banca Monte dei Paschi di Siena SpA	Italy	Financial Intermediaries
Banca Nazionale del Lavoro SpA	Italy	Financial Intermediaries
Banca Popolare di Lodi S C A R L	Italy	Financial Intermediaries
CIR – Compagnia Industriali Riunite SpA	Italy	Conglomerates
Capitalia SpA	Italy	Financial Intermediaries
Edison SpA	Italy	Utilities
Enel SpA	Italy	Utilities
Fiat SpA	Italy	Automotive
Finmeccanica SpA	Italy	Aerospace & Defence
Assicurazioni Generali SpA	Italy	Insurance
Banca Intesa SpA	Italy	Financial Intermediaries
Mediobanca SpA	Italy	Financial Intermediaries
Seat Pagine Gialle SpA	Italy	Publishing
Sanpaolo IMI SpA	Italy	Financial Intermediaries
Telecom Italia SpA	Italy	Telecommunications
UniCredito Italiano SpA	Italy	Financial Intermediaries
Compagnia Assicuratrice Unipol SpA	Italy	Insurance

Note: Financial Intermediaries are highlighted in green.

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