



Methodology
*Rating Canadian
Auto Loan Securitization*

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Appendix summarizing methodology added April 2011



Insight beyond the rating.

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All DBRS ratings and research are available in hard-copy format and electronically on Bloomberg and at DBRS.com, our lead delivery tool for organized, Web-based, up-to-the-minute information. We remain committed to continuously refining our expertise in the analysis of credit quality and are dedicated to maintaining objective and credible opinions within the global financial marketplace.



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Introduction

Retail automobile loans continue to be among the largest and most consistent offerings of the classes of assets securitized in Canada. From a new issuances perspective, the Canadian auto securitization market has plateaued, with new tranches generally offset by run-off of prior portfolios. As has been the case with other asset classes, auto securitization has seen its share of developments with issuers ranging from the largest captive auto finance companies to third-party sub-prime loan portfolios.

Notwithstanding the stable performance within the retail auto loan securitization market, concern has grown based on the continued deterioration of the financial health of some of the vehicle manufacturers and the related captive finance companies underwriting the loans. Although all auto finance securitizations are somewhat linked to the health of the captive finance company (as it generally performs the servicing role), auto finance transactions are less reliant on the related auto manufacturer. Of the various forms of auto securitizations (retail loan, retail lease, rental vehicles and floorplan) retail loan transactions are the most removed from the risks associated with the financial health of the related auto manufacturer. (Refer to the table on page 15.)

The importance of securitization as a form of funding has impacted the underwriting of the loans themselves. The underlying contracts and hence the collateral have been impacted by market developments, pressures and competition as well as global forces such as foreign exchange rates and used vehicle pricing. Transaction structures have developed to monetize the prevalence of low interest rate loans in the market while underwriters are targeting loan terms that fit within the maturity time frames preferred by the capital markets. Also, the rapid deterioration of the credit ratings of the North American automotive manufacturers has resulted in the evolution of structural features designed to further isolate the health of the manufacturer from the consumer credit to which the loans are provided.

Over the last decade, not only has the number of vehicle manufacturers and issuers participating in these transactions increased, there has also been an increase in the types of assets included in such pools. The collateral backing asset-backed securitizations is now comprised of loans to obligors with a variety of credit risks (i.e., prime versus sub-prime obligors) on numerous vehicle types. Within Canada, the auto loan market is predominantly represented by prime loans with a small percentage of securitized transactions represented by non-prime loans. The following report describes the DBRS rating approach for retail auto loan securitizations.

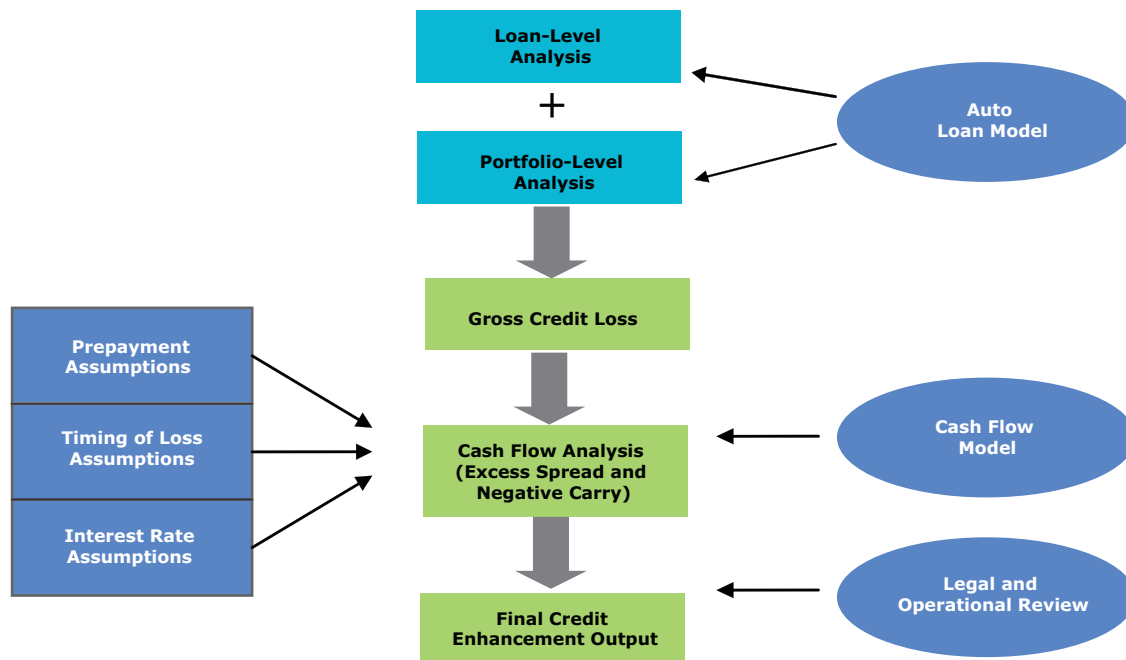


APPLICATION OF CANADIAN AUTO LOAN METHODOLOGY

The following diagram describes the overall process used by DBRS to analyze a Canadian auto loan transaction.

- (1) DBRS conducts loan-level and portfolio-level analysis using the model. The resulting output of the model is the expected gross credit loss.
- (2) DBRS performs a cash flow analysis based on the output from the model by incorporating assumptions regarding prepayment, timing of loss and interest rates in order to estimate the excess spread available over the life of the transaction and the required credit support for each rating level.
- (3) The legal and operational aspects of the transaction are also reviewed with the understanding that the credit enhancement is subject to adjustment if necessary.

DBRS Rating Process for Canadian Auto Lease Transactions





DBRS Rating Methodology

DBRS credit ratings are forward-looking opinions, determined at issuance date, that assess the probability of timely payments of interest and ultimate payments of principal. If actual asset performance results in a fundamental change of the credit parameters from those exhibited prior to the issuance date, DBRS will reassess its ratings. Reassessment of ratings may result in an upgrade, a confirmation or a downgrade of the ratings or a notification that the ratings are under review with positive, negative or developing implications. The under review status will ultimately lead to either an upgrade, a confirmation or downgrade of the ratings.

At the outset of a transaction, DBRS will review the financial strength, as well as management's experience and the overall corporate strategy with respect to an originator that is proposing to sell assets through a DBRS rated structure. In addition to analyzing aspects associated with the issuer, DBRS reviews obligor default risk in the pool of receivables. Finally, DBRS will also employ static pool analysis considering historical default and delinquency data associated with an issuer's previous securitization programs. To adequately analyze this data, DBRS looks for three to ten years of monthly performance data. The objective of the longer time frame review is to ensure that the performance of the pool is ascertained through complete economic cycles. It is important to note that when reviewing the portfolio performance and setting base case loss parameters, DBRS will generally assume a worst-case scenario rather than an averaging scenario in the absence of significant mitigating evidence. Additionally, because most transactions are also serviced by the seller, DBRS will review the owned and managed pool rather than limiting the review to performance of the securitized pools. This strategy will protect the structure from adverse selection criteria on specific assets that may be included in the pool. Issuers that demonstrate a lengthy history of well-managed assets may be entitled to a more generous scope of asset eligibility and underwriting discretion. In the context of the overall review of the originator, DBRS reviews a number of important topics covering both macroeconomic and microeconomic issues including its access to funding, underwriting standards including its credit and collection policies and specific offerings of the sellers with respect to loan programs, vehicle valuation, loss analysis, prepayments, seasoning, servicing, interest rates, delinquencies and repossession rates.

SELLER ACCESS TO FUNDING

Performance of the collateral is always important; however DBRS also considers sufficient enterprise funding to be a key element in a successful asset-backed securitization. Without a financially stable servicer, a transaction's servicing may need to be transferred, causing a potential for delay in collections of obligor payments. Diminished liquidity limits the ability of an originator to continue to generate additional receivables and could impact the servicing capability and performance of existing pools. DBRS analyzes a company's access to bank funding, public markets and other sources of capital to determine sufficiency of liquidity and overall funding capacity. As a further measure of protection to the structure, standby servicers are either determined at the outset of the transaction or provisions for a replacement servicer are provided to ensure the continued servicing on the pool of assets. In the auto industry there are a number of capable and willing entities that would be able to provide this service should the need arise. With a pre-dominance in Canadian portfolios of 95% to 99% preauthorized debit, this transition should be relatively smooth.

UNDERWRITING

For consistency of collateral performance, it is important that an originator has underwriting standards that are applied consistently across the portfolio. Firms that have decentralized underwriting require more careful analysis in order to ensure that adherence to underwriting guidelines remains consistent because the performance of the pool is used to determine an appropriate base case loss scenario. The base case loss scenario is used as an expectation of the minimum cumulative loss that will be experienced throughout the life of the securitized pool of assets.



The analysis of underwriting methods takes into consideration issues specific to each originator's underwriting criteria. The key criteria considered are: an obligor's credit bureau history and credit scores; income and financial obligation ratios; and requested loan term and amount. Many lenders use these factors to determine whether an obligor is super prime, prime or sub-prime, and in turn to determine applicable interest rates, advance rates and term limits for the loan.

For most originators, credit scoring has become an efficient, standard tool in underwriting decisions. Credit models utilized by originators focus on variables in the data gathered from obligors that have proven to be sound indicators of future credit performance. Such models range from standard, off-the-shelf products, to bankruptcy scoring models, to highly sophisticated proprietary models that incorporate specific originator-based credit considerations. Credit scoring models are periodically validated to ensure their predictive capabilities and to adjust their weightings of certain variables. This approach allows the originator to structure loans or employ risk mitigation techniques, such as higher down payments, to meet their targeted risk profile. The originators are then able to apply the results of their underwriting to create a portfolio with an appropriate risk/return profile. DBRS evaluates the results and use of credit models as part of its understanding of an originator's underwriting process. Because DBRS reviews periodic due diligence presentations from each of the originators that have a transaction in the public markets, appropriate benchmarking can be applied during the course of the review and structuring of the transaction.

Experience has shown that as the economy contracts and expected performance deteriorates, average credit scores in new originations tend to creep higher as originators tighten underwriting standards. Reduced availability of alternative forms of funding for originators also results in higher credit scores in portfolios to ensure the continued availability of asset-backed funding sources.

LOAN PROGRAMS

DBRS reviews originator programs, including: (1) contract terms; (2) down payment requirements and advance rate; and (3) collateral condition (age and mileage of vehicle).

CONTRACT TERMS

Contract terms offered by originators attempt to balance consumer demand with risk mitigation. Generally, as competitiveness in the automotive market increases, originators begin to push the envelope on duration of loan contracts in order to (i) differentiate their product offerings from its competitors and (ii) attempt to increase volume by providing the consumer with a lower published monthly loan payment. Securitization transactions executed in the past have evidenced the cyclical nature of the automotive market with average term length that ranges from 36 to 60 months. More recently, as the competitiveness has amplified, loan terms are being offered and tested in the market at 72 months and beyond. From a risk perspective, longer loans lead to greater loss potential and for this reason DBRS will require that a securitized pool set an upper limit on the percentage of vehicles in the pool that have a contract length in excess of 60 months. The limit is established on a case by case basis with reference to the specific originator's experience and the composition of the pool. The expectation that longer-term loans result in higher incidents of default is based on the fact that obligors who need longer-term contracts, and related lower monthly payments, may be more likely to run into financial obstacles over the extended lives of their loans. Loan terms can therefore affect the levels of obligor defaults which in turn impact the enhancement required to achieve various ratings thresholds.

From a credit standpoint, it is clear that longer amortization terms reduce the amount allocable to principal each month, causing a slower reduction in the principal balance and delaying the buildup of equity in the vehicle. Unlike a mortgage, which has real estate collateral that traditionally appreciates in value, auto loans are extended to obligors to finance depreciating assets. As a result, a slower reduction in loan principal creates a higher loan loss severity already exacerbated by having a depreciating asset as collateral. Finally, the length of a loan term impacts the equity an obligor has in the vehicle. The smaller the down payment on a loan, the smaller the initial equity in the automobile, increasing the potential exposure to loss caused by delayed buildup in vehicle equity.



DBRS expects total losses will generally be higher on six- and seven-year loans than on three- and four-year loans. Longer term or lower equity in the asset results in a longer time frame before the automobile can be disposed of to cover the remaining principal of the loan, which leads to the timing of losses in securitizations of these loans which may be pushed farther out. Absent performance information to the contrary, DBRS will generally assume that losses are higher on the 60 plus month loans than on the three- to four-year loans.

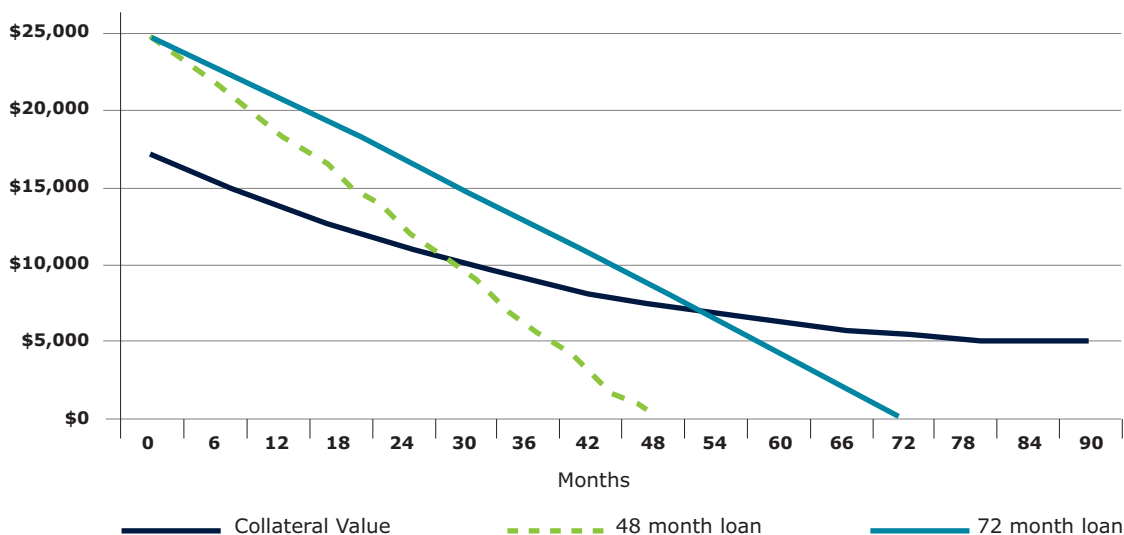
Some auto finance lenders offer balloon and deferral loans to obligors as options to incent them to buy their automobiles. Balloon loans offer a lower monthly payment for a set period of time (generally two to five years). At the end of the set period, the remaining balance of the loan is due in one lump sum either to be repaid or refinanced by the obligor. Such terms assist obligors that are struggling to qualify for a loan while leaving the originator with the downside risk of the automobile at the end of the set period in the event that the obligor experience difficulties. This process self-selects the portfolio towards weaker obligors, causing these loans to be riskier than similar non-balloon loans of equivalent terms.

Loans originated under a deferral program allow obligors to forgo payments of principal or interest for a set period of time. Typically, deferred loans are extended only to obligors that meet stringent credit guidelines. If an obligor with a deferred loan defaults on the loan, severity of loss may be higher than that of a non-deferred loan, since no payments have been made to reduce the principal balance of the loan, even though the vehicle has been depreciating.

DOWN PAYMENT REQUIREMENTS AND ADVANCE RATE

For auto transactions the concept of “advance rate” is analogous to the concept of “loan-to-value” in other asset classes. The advance rate is defined as the loan balance expressed as a percentage of the sale amount. The sale amount can either be the manufacturer’s suggested retail price (MSRP), the wholesale value of the car or something other than these two prices. The financed amount typically includes the sale amount (less the value of any trade) plus taxes, insurance, extended warranty or other fees, less any cash down payments. The lower the advance rate, the more equity an obligor has in the vehicle. All else being equal, a higher advance rate increases an obligor’s likelihood of default, particularly for sub-prime obligors. Since new vehicles depreciate very rapidly in the first year, negative equity may exist for the first half of the life of the loan or more (see chart below).

Negative Equity





If a vehicle is repossessed during this period of negative equity value, a lender will usually incur a loss, especially if the used car market softens. The amount of the loss would be the difference between the current outstanding loan amount and the proceeds after paying related disposition costs. Therefore, the higher the advanced amount relative to the value of the vehicle, the higher the potential loss at repossession – both in dollar terms and as a percentage of the remaining amount owed on the contract.

VEHICLE VALUATION

The age, mileage and depreciation of a vehicle are important when determining the value of a vehicle at any point in time. Used vehicles are very difficult for finance companies to value, potentially leading to over-advancing. A new vehicle will always have a list price to at least establish an opening valuation, whereas the condition and market for a used vehicle is so varied that collateral underwriting often cannot determine the amount of exposure (the amount of negative equity in a vehicle) that is inherent in a used car loan. Data obtained by DBRS indicates that mass market used car loan performance consistently underperforms new car loan performance, even when factors such as credit score are taken into account. Ongoing roadworthiness of the vehicle, the presence or absence of a factory warranty, and the better liquidity of lightly-used cars all contribute to this observation.

The value of a car is determined by an assortment of factors. Depreciation is the single largest reason for the decline in a vehicle's value. Depreciation levels vary by manufacturer, vehicle make and model. Some luxury cars have the greatest vehicle decline in the first year. Much of this decline occurs as soon as the vehicle is purchased as there is a small market for almost new but previously owned luxury vehicles. There is further depreciation in the second year when the next year's models become available. Purchasers of used vehicles will also encounter decreasing values, albeit at a slower rate than new vehicles.

Used car values impact the loss severities in an auto securitization, as the disposition value impacts the proceeds from sale generated when the vehicles are remarketed. In fact, receivables for many near-prime and most sub-prime securitizations arise from loans to finance used vehicles. For these transactions it is important to be aware that prices in the used market can be volatile and are impacted by: economic variables (interest rates, exchange rates and other factors including import and export levies charged by the manufacturers for moving vehicles cross border); and rental fleet cycles, which can result in an oversupply of used cars creating downward pressure on values, as can the expiration of consumer and fleet leasing programs from various car finance companies. New vehicle incentives for new car purchases will also negatively affect the value of used vehicles.

LOSS ANALYSIS

Loss on a securitized auto loan is a function of the frequency of default and severity of loss on a loan by loan basis. DBRS will determine a "base case loss curve" by considering the frequency and severity calculated for the collateral, the issuer's actual loss history and the loan servicer. The DBRS-expected cumulative loss is defined as the annualized rate of the dollar value of receivables that default as a percentage of the dollar value of the total receivables outstanding over the weighted average life of the securitized portfolio.

To analyze loss history, DBRS prefers the use of static pool data to project cumulative expected losses in order to measure and predict performance in a securitization. Static pool data best reflects expected losses over the life of a transaction; portfolio data can mask losses during periods of rapid portfolio growth. Generally, the greater the number of years of historical data, the more comfort DBRS can take in using such data for deriving projected asset performance. When less data is available, there is a greater likelihood that such data will be influenced by unrelated events. Longer time periods of historical data also allow DBRS to effectively observe trends, and can allow DBRS to observe such performance through an economic cycle. If a securitization includes receivables from both new and used vehicle loans, DBRS will examine static pool loss data for loans in a pool collateralized by used vehicles separately from the static pool data for the loans in a pool generated for new vehicle purchases.



Without the use of static pool data, DBRS will use growth-adjusted portfolio data to determine expected loss projections. The lag period to determine the adjustment factor will depend on when it is estimated that collateral would typically reach its peak loss period. Once expected annual losses are estimated, multiplying these expected annual losses by the weighted average life of the pool would derive expected cumulative losses. DBRS will also adjust the resulting “expected loss” levels to reflect changes in credit, sales channel and risk in current pools in relation to the historical data from which expectations were derived. The state of the auto market, loan terms, vehicle mix and recovery values also factor into this analysis. The resulting adjusted loss levels are used for stress testing purposes. In estimating weighted average life, DBRS will assume 0% defaults and low voluntary prepayments. Where information is available on both a portfolio basis and a static loss basis, DBRS will consider both variables.

LOSS CURVES

Static pool data is often utilized to determine the shape of the loss curve and the total or cumulative losses. DBRS observes the cumulative static default or loss rate implied by the annual rate over the life of the transaction. With a complete set of static pool history from an originator, DBRS can extrapolate cumulative net losses on less-seasoned pools based on the loss curve of more-seasoned pools. This technique is only possible if the historical underlying pools have a similar collateral profile as the pool currently being examined.

Loss curves vary by obligor type. Sub-prime losses tend to be the most front-loaded, as weaker obligors are more susceptible to payment problems earlier in their loan commitments. For prime pools, losses are slightly more delayed, and at much lower absolute levels.

RECOVERY RATES

The timing of loss recognition can differ significantly among issuers. In general, gross losses and net losses are differentiated by recoveries and resale expenses and as such can be analyzed separately. From an enhancement perspective, DBRS models based on net losses which typically includes a minimum six month lag on estimated recoveries as noted below. This allows DBRS to examine both the frequency of default and the severity of default. Gross losses reflect the outstanding balance of the contract at time of default. Net losses incorporate proceeds from disposition and should include all expenses incurred in repossessing, refurbishing and liquidating the vehicle.

DBRS will consider net loss history, as opposed to gross loss history, of a portfolio when determining enhancement levels as long as documentation provides for the capture of recoveries within the transaction. In determining required enhancement levels for a particular rating level, DBRS will adjust the amount and timing of recovery credit for a particular rating level. This is particularly important if the servicer is rated below the rating requested for a particular transaction since the likelihood of a default by the servicer is increased. If this is the case, the variables cited in the table below will be reduced even further. Performance volatility will impact the amount of recovery credit for any rating category. Highly volatile recovery data will result in less credit than referenced in the table below. This table assumes that typical recoveries are in the 40% to 60% range.

Recovery Variables by Rating Category

	AAA	AA	A	BBB	BB	B
Recovery Credit	50%	66%	75%	80-85%	90%	90-100%
Recovery Lag (months)	3-5	3-4	2-3	2	1-2	1



Expected cumulative losses serve as the basis for DBRS's base case loss assumptions. The base case loss curve incorporates default frequency and severity assumptions, as well as historical loss data. Enhancement levels are based on stressed multiples of the base case. DBRS loss multiples from the base case to the other rating categories are shown in the following table:

Multiple Loss Range			
Rating Level	Sub-Prime	Prime	Super Prime
AAA	2.5x-4x	4x-6x	5x-10x
AA	2.25x-3.5x	3x-5x	4x-8x
A	2x-3x	2.5x-3.5x	4x-6x
BBB	1.5x-2.25x	2.25x-3x	3x-4x

Multiples vary in accordance with the credit quality of the pools being analyzed because the variation in pool performance is wider for pools that experience high absolute losses than it is for pools that experience very low losses. In addition, enhancement must also protect against event risk (such as the failure of a brand or insolvency of the servicer) that may cause obligor behaviour to change. In determining loss estimates, the originator's experience, scale and servicing consistency are considered. To the extent that poor underwriting and/or poor servicing have caused volatility in historical performance data, DBRS will require a higher enhancement level for the transaction. Seasoned, large-scale originators will tend to have more control over the timing of losses, in accordance with their credit and collection policies, whereas non-investment grade and/or less experienced originators may be subject to deemed loss provisions after a certain number of days elapse. Any adjustments, both upwards or downwards, will be made depending on the view of the future performance of the specific collateral pool.

SEASONING

Seasoning represents the number of months since a loan was originated; in general, highly-seasoned loans are less risky than newly-originated loans, given that the securitization process will have excluded any defaulted loans that occurred early in the loan term. In general, losses tend to peak between 12 and 30 months following contract origination. Therefore, an obligor that has paid a loan through the period when the probability of default is highest is less likely to default after that period has passed. Seasoning is an important factor, and it should be considered together with default history in order to project static pool loss levels. If underwriting has been consistent, DBRS believes that seasoned pools, which have already experienced an element of defaults, will experience a lower ultimate loss level over time.

By itself, a pool with six months of seasoning would not warrant a reduction in credit support since the losses incurred in the first six months are not normally material. If seasoning is combined with strong selection criteria, however, DBRS believes a lower credit support may be warranted, particularly if seasoning is very significant (over 12 months). Strong selection criteria may eliminate many of the obligors most likely to default in a transaction during the initial six- to 12-month period.

REVOLVING POOLS

Revolving pools periodically add receivables from new loans to securitizations. Therefore, unseasoned loans can be transferred into a transaction. As noted above, seasoning has an implicit impact on a pool as it decreases the risk of default and delinquency. Furthermore, the pool composition after an addition has occurred may differ from the initial purchase. Although guidelines may be in place to limit a company's ability to add loans during the revolving period, the actual make-up of a pool may be subject to some variability. As a result, enhancement levels for a revolving pool will typically be higher than for an otherwise similar amortizing pool.

To address this, DBRS will usually conservatively assume a worst-case pool composition (given the negotiated eligibility criteria defined in the transaction documents). In addition, DBRS will assume the pool



will be unseasoned during the revolving period, and any credit otherwise given for seasoning would be limited. Additionally, DBRS may review each new tranche of loans added to the portfolio of secured loans as well as review the combined pool on a quarterly basis.

PREPAYMENTS

Most consumers will endeavour to pay their auto loans in a timely fashion. In fact, most of the cash flow that is used to pay down a securitization is from the receipt of scheduled payments. Payments that are received in advance of the scheduled payment dates are termed prepayments. When obligors have new cars, they may be less likely to prepay their loans. Voluntary prepayments result from factors such as obligors deciding to pay off auto loans early as a result of trade-ins or sales of the financed vehicles. Rate-driven re-financing takes place infrequently, except in sub-prime pools. Involuntary prepayments are due to loan liquidations arising from insurance claims or obligor defaults.

Prime ABS prepayment curves have the flattest profile among the different categories. As with the computed baseline cumulative loss curves, different characteristics exist among the various obligor pools. In Canada, pools of prime obligors exhibit prepayment rates, during the earlier stage of the transaction that approximate 1% to 2% of the monthly collections, and then trend slightly lower through the remaining life of the deal. In contrast, the sub-prime prepayment curves show variation, but typically with a sharp peak occurring early in the transaction and significantly tapering off in the subsequent months. Since these prepayment speeds include both voluntary and involuntary prepayments, the higher default rates incurred by sub-prime deals show their influence in the front-loaded nature of the prepayment curve. Subvention tends to reduce but not eliminate prepayments.

INTEREST RATES AND EXCESS SPREAD

Most automobile lenders provide fixed-rate loans to obligors who elect to finance their automobiles. Most lenders incorporate a risk-based strategy to underwrite loans. These risk-based strategies allow lenders to charge higher rates to obligors that represent additional risk to them. An example of this is used car loans, which are riskier in both frequency and severity of default than new car loans. Conversely, loans to prime obligors may have rates that are subsidized by auto manufacturers that are below market interest rates (“subvented”).

When subvented loans are included in a securitization pool, the interest earned on the loans is insufficient to cover interest payments on the financing. As a result, transactions typically discount the notional book value of the assets in order to ensure that they yield a level of interest necessary to make such interest payments. Securitizations that rely on this discounting factor (represented in dollar terms) may use a yield supplement amount (YSA). The YSA is sized to compensate for receivables included in the securitization with interest rates below a specified level.

In modelling these pools, it is important to make a distinction between the discounted value and the notional value. The notional value (i.e., the value prior to incorporating the yield supplement amount) is used by DBRS to determine the rate of delinquencies and defaults. This value is believed to be the actual amount of credit at risk for a given transaction. Using the discounted value in this case would artificially deflate the loss and delinquency figures, and would not be a true reflection of the risks of the pool. When determining replacement servicer expenses, DBRS also uses the aggregate notional value of the pool. On the other hand, the discounted value is used as the base value in determining any overcollateralization amount, if applicable.

Excess spread arises when the interest rate earned on the collateral in the underlying asset pool is greater than the sum of expenses and funding costs. Excess spread creates an additional cushion to withstand delinquencies and cash flow shortfalls, as the excess spread is additional cash that is available at the end of every month to cover collateral losses. Excess spread deteriorates quickly in scenarios when defaults and prepayments are incorporated into the analysis. Excess spread can be viewed as internal support or liquid support for a securitization transaction. When excess spread flows through a securitization every



month, it can either be retained as internal support or be released back to the originator, depending on the transaction structure and pool performance. Such support may be used as direct loss mitigation, overcollateralization or trapped in a reserve account. Excess spread is modelled based on the loss assumptions, prepayment speeds and loss timing curves.

HEDGING

As is the case in many securitization transactions, the process of funding retail auto loans introduces a number of risk elements that require structuring support in order to appropriately mitigate the risks. These risks include fixed rate-floating rate mismatches, BA-CP basis risk mismatches, prepayment risk and counterparty risk. Because most auto loans are typically based on fixed rates of interest, a mismatch occurs when the securitized assets are offered through a floating rate bank conduit or variable rate note in the case of public term securitizations or ABS. A common structural solution to mitigate this risk is to use external interest rate hedges that offset the mismatch between the fixed rate loans and the floating rate notes. Hedge arrangements must be in place at closing to ensure this potential risk is mitigated for the duration of the transaction. The use of hedges introduces counterparty risk and basis risk. DBRS ensures that the hedge counterparty meets a minimum rating threshold commensurate with the rating on the transaction. Additionally, basis risk (arising due to the difference between the reference rate on the commercial paper (CP) rate, compared to the reference rate on the hedge or the BA rate) can be mitigated through either cost of funds interest rate swaps or alternatively can be mitigated through the use of additional enhancement. Another risk introduced by the use of hedges is fast pay/slow pay risk, otherwise known as notional risk that arises when a customer prepays or defaults on the loan. The prepayments and defaults change the expected maturity of the retail loan portfolio as a whole and DBRS ensures that the hedge is structured to mitigate this additional risk.

LEGAL FINAL MATURITY

DBRS ratings address timely payment of interest and ultimate payment of principal. In determining the legal final maturity date, DBRS considers various cash flow scenarios. This is an important consideration since the servicer may extend or renegotiate contract terms for an obligor as long as such extensions cannot cause the final maturity of the underlying loans to extend beyond the final maturity of the related securitization. The legal final maturity date is generally the latest schedule maturity date of the collateral in the securitized pool plus 12 months, to allow for extensions.

SERVICING

While it is clear that underwriting and funding of the loan are among the most crucial functions in the overall process, the servicer plays an equally important role. Servicer collection efforts will range from typical collection activities to a host of stepped-up activities that are consistent with their credit and collection policies as reviewed by DBRS. Servicers must be experienced at each collection stage, especially late stage collection and remediation. Anticipated and unforeseeable circumstances can conflict with an obligor's responsibilities to pay down its debt. Since the efficient servicing of a portfolio is necessary, companies invest heavily in sophisticated systems. Servicers must also have the resources to manage a staff of collectors and document specialists. Limited financial resources can hamper a servicer's ability to maintain a collection staff that can service delinquent obligors. Servicers also need to be conscious of various legal limitations involved in servicing accounts. Compliance with all laws requires a significant effort. DBRS expects to see clear guidelines and effective systems to handle legal requirements when reviewing servicing operations, especially in the sub-prime area.

SERVICING FEE

The servicing fee is the amount paid to a company hired to service the underlying obligations. DBRS will apply the appropriate fee to the transaction from the outset, even if the seller is the initial servicer. DBRS believes a transaction should be established and structured such that it can be run by an outside servicer without any impact to noteholders. The servicing fee is ultimately a function of the size of the portfolio, the underlying assets and the complexity in managing such assets. As the complexity increases, the cost of servicing such assets will also increase. Likewise, a small portfolio will require a larger fee (defined as a



percentage of total assets), as the economies of scale from managing a larger portfolio are no longer available. Based on this review, DBRS will assign an appropriate servicer fee based on observed market rates for comparable portfolios, which have traditionally ranged from 1% to 2% in Canada for prime portfolios.

DELINQUENCY

Servicers use different methods to track delayed payments from obligors. For DBRS, the appropriate way to measure delinquencies is a contractual approach: an obligor is considered delinquent as long as all of the contractually scheduled payments which have come due have not been made. An alternative method to tracking delinquencies is the recency method, which is based on how recently an obligor made a payment. For example, if a severely contractually delinquent obligor made one payment within the last month, the obligor is considered contractually delinquent, but considered current under recency standards. The recency method gives the lender the opportunity to adjust whether or not a loan is considered delinquent, which can be a concern. If recency is used as a measure of delinquency in a transaction, it could be a reason to not rely as heavily on a deal's delinquency triggers as a form of performance control.

As a leading indicator, later stage delinquencies (60 days or more) tend to be an accurate leading indicator of defaults, since obligors that fall behind in payments tend to have difficulty recovering, especially for sub-prime obligors.

REPOSSESSION

A servicer will repossess a vehicle from an obligor after an obligor defaults on an auto loan, typically not more than three to six months after the first delinquency date. Originators that extend loans to prime obligors typically repossess as soon as it is feasible if the obligor's credit scores have deteriorated. Servicers with near-prime and sub-prime obligors tend to repossess over a much quicker time frame (e.g., two months). The timing of repossession generally depends on: (1) the servicer's willingness to repossess an obligor's vehicle; (2) the credit quality history of the obligor; and (3) the legal ability to collect. DBRS expects servicers to be aggressive in repossessing collateral.

Servicers have a handful of options to sell vehicles once they are repossessed. They can auction repossessed vehicles or remarket the vehicles through a dealership network, or increasingly through online channels. It is likely that remarketing vehicles through their dealership network will normally produce higher recovery proceeds for the lender in addition to saving auction fees; however this process can be slow at times. Conversely, the auction process provides a more timely liquidation of units and can handle larger numbers of vehicles.

Once a loan requires remediation by the repossession and collections department, a notice of intent to repossess is sent to an obligor. Some jurisdictions have onerous repossession requirements, so DBRS will typically assume recoveries are lagged in any cash flow modelling exercises. Some jurisdictions, such as Alberta, have "seize or sue" legislation in place that allows a servicer to either repossess the vehicle or sue the obligor for unpaid amounts, but not both. Enhancement levels are generally higher for collateral within these jurisdictions.

Total Enhancement Requirements

Enhancement requirements will be equal to the aggregate of amounts required to cover the cost of funds, stressed losses and the cost of servicing. Stressed losses will be determined by adjusting historical losses to reflect changes in the risk profile of the loans being securitized, and multiples will be assessed based on the volatility of performance, the creditworthiness of the obligor population and the applicable desired rating level. DBRS uses proprietary asset and cash flow models to determine the effect of servicing expenses, delinquencies, repossessions, losses and recoveries. Credit will be given for overcollateralization (beyond



what is required to provide a positive yield to the program), positive excess spread adjusted for defaults and basis risk, cash reserves and appropriately structured subordination. The discussion below relates to the typical structure that is seen in current Canadian auto loan securitization transactions.

FORMS OF ENHANCEMENT

Once the expected credit losses are calculated for a loan pool, the amount of enhancement is determined by applying the multiple ranges that correspond to the desired rating. A typical loan portfolio will require approximately 4% to 10% of the outstanding notes, as enhancement at the outset of the transaction depends on the composition of the pool and the historical losses incurred by the specific originator. As the portfolio amortizes, enhancement will usually increase as a percentage of the notes outstanding since some of the enhancement is structured to stop amortizing once it reaches a certain floor level (often 40% to 50% in the case of overcollateralization and higher for cash). DBRS has established minimum thresholds for the amount of cash that must form part of the enhancement and these are applied on a pool by pool basis. At the outset of the transaction, the seller is required to deposit in cash 100% of the required cash which is to be invested by the Trust in Permitted Investments.¹ The balance of the enhancement is generally comprised of a combination of overcollateralization and subordinated notes. Overcollateralization simply refers to the deposit of additional loan contracts to which the holder of the note has the right to collections from. Depending on the prevailing market conditions, subordinated notes may be sold to investors and form a part of the enhancement by taking on additional risk in exchange for a higher rate of return. However, should losses break through the stressed levels for that subordinated note, the holder of the subordinated note will experience a loss prior to the holder of a senior note.

VALUING THE CAPTURE OF EXCESS SPREAD

While excess spread can be instrumental in helping offset losses in the securitized pool, it is often the case that a spread account cannot be given 100% credit in the overall enhancement structure. The reason for this is due to the combination of credit losses and prepayments which occur throughout the life of the pool.

Eligibility criteria typically exclude loans which are scheduled to come to term in less than six months. It is often the case, however, that once loans are scheduled to end and the structure has to begin covering stressed credit losses, very little or no spread can accumulate. Accordingly, the structure has five months to build additional cash enhancement arising from the collection of excess spread, during which it must also compensate for stressed credit losses. As an example, if there is annual spread (above cost of funds) of 100 basis points (bps) to 125 bps, only around 40 bps to 50 bps of spread would actually accumulate. Credit losses experienced in the stressed scenario would drive this number even lower.

In summary, the amount of excess spread available is an important determinant of overall enhancement levels and the forms of enhancement used, mainly due to the fact that monthly stressed credit losses will effectively soak up most or all available spread, thereby preventing the return of any excess cash to the seller or rebuild the cash account if it has been depleted to cover interest expenses or losses. Generally, in a loan securitization excess cash is available to the seller provided losses do not reach a pre-determined level. This structural mechanic means that excess spread cannot be accumulated in the cash account to compensate for subsequent months which do not have an equivalent amount of excess collections due to rising interest costs or losses.

1. Permitted Investments are defined in each transaction document and are generally restricted to risk free investments such as government of Canada bonds. Concentration limits apply where less than 100% of the Permitted Investments are invested in non government of Canada bonds



Conclusion

The auto loan market, once comprised almost exclusively of straightforward paydown structures with short repayment terms to prime obligors, has evolved to fulfill the needs of finance companies and obligors. At present, the methodology has proven effective in assessing a variety of unique market offerings including balloon payments, long loan terms, subvented financing rates, used car loans and loans to sub-prime obligors. The approach used by DBRS to evaluate risk and the protection required to survive stressed environments has evolved alongside these developments by assigning credit or penalties for their effects on obligor quality, collateral performance and reliance on the servicer. The DBRS ratings methodology for automotive retail loan transactions is applied consistently and has demonstrated its robustness through the volatile economic downturns witnessed to date.

Auto Transaction Risk Matrix

	Retail Auto Loan	Retail Auto Lease	Daily Auto Rental Fleets	Wholesale Floorplan
Concentration Risk	Low 20-60k Obligor	Low 20-60k Obligor	High Only One Obligor	High 250-500 Obligor
Credit Risk	Low – Medium (10-125 bps)	Low – Medium (10-125 bps)	Low (0-25 bps)	Low (0-25 bps)
Residual Value Risk	n/a	Medium to High 40%-60% of pool balance	Medium to High 25%-100% of pool balance	n/a
Manufacturer Risk	Low No reliance	Medium (End of Term Considerations)	Medium (Higher on Program Vehicles)	High Linked closely to the Manufacturer
Maturity Features	Amortizing	Amortizing	Revolving	Revolving
Enhancement	Cash (Min 50-100 bps) Overcollateralization Subordinated Notes Excess Spread	Cash (Min 50-100 bps) Cash (Embedded Loss) Overcollateralization Subordinated Notes Excess Spread	Cash (Min 50-100 bps) Overcollateralization Subordinated Notes Excess Spread Letters of Credit	Cash (Min 50-100 bps) Overcollateralization Subordinated Notes Excess Spread

bps = basis points. n/a = not available.



Appendix: Rating Canadian Auto Loan Securitization Summary

LIMITATIONS

- Future performance may deviate significantly from past performance.
- Recoveries may fall below DBRS-stressed performance assumptions and model results are dependent on expected levels of credit losses.
- The methodology considers the current legal and regulatory framework (including consumer protection regulations) and its impact on the structure of transactions as at the date of publication of this summary.

APPLICATION OF QUALITATIVE AND QUANTITATIVE METHODOLOGY CONCEPTS

Summary of Risk Analysis Process Applied to Auto Loan Transactions

Input	Detail	Key Variables
Portfolio-Level Analysis – Historical Performance	A minimum of three to five years of static loss data, with tracking of key variables on the securitized pools.	<ul style="list-style-type: none"> • Originator's historical loss analysis. • Pools are analyzed based on stratification of static pools, including make, model, model year, weighted average original term, weighted-average remaining term, monthly portfolio runoff, distribution by contract term, province, make, model, new, used, truck, sport-utility vehicle (SUV), passenger car, captive or non captive finance company, weighted-average annual percentage rate (APR)
Servicer Analysis	Periodic review of the servicer by DBRS.	<ul style="list-style-type: none"> • Assessment of originator's servicing capabilities, including credit and collection policy, originations, servicing, collections, asset recovery (e.g., time frame for recovery), static loss performance and management experience.
Economic Analysis	Through an economic or credit cycle.	<ul style="list-style-type: none"> • Review of economic cycles and potential impact on auto loan transaction performance, with an emphasis on the used-vehicle market, including factors such as the relative strength of the Canadian dollar and consumer bankruptcies.
Legal Review	DBRS review of transaction structure and underlying legal documents.	<ul style="list-style-type: none"> • Review of all legal documents, including true-sale opinions, priority of cash distributions and bankruptcy remoteness of structure. • Legal document analysis also includes review, consideration and assessment of early amortization events and events of default, such as loss and delinquency triggers and manufacturing and seller bankruptcies, and default analysis. • Review of transaction representations, warranties and covenants for consistency with <i>Legal Criteria for Canadian Structured Finance</i>.
Loan-Level Analysis – Proposed Pool Composition	Cash flow analysis of the proposed enhancement structure for the securitized pool.	<ul style="list-style-type: none"> • Base-case expected credit loss assumption is determined from a review of the portfolio-level analysis, economic analysis and legal document analysis. • Note the loan-level analysis for the proposed pool to be securitized may be analyzed on either a loan-by-loan basis or a stratified pool basis.



Summary of Risk Analysis Process Applied to Auto Loan Transactions

Output	Detail	Application
Credit Loss Assumption	Estimate base-case loss assumption (timing of losses and prepayments may also be considered).	<ul style="list-style-type: none"> • The base-case cumulative loss assumption is estimated based on review of the key variables identified at the loan-level, portfolio-level, economic and legal structure reviews. • The credit loss assumption is stressed based on a multiple in line with the rating levels detailed in Table 1 below. • Recovery estimates are based on the rating level assigned and are applied to the entire portfolio. • Enhancement is evaluated based on the expected base-case cumulative credit loss assumption.

Summary of Process to Evaluate Amount of Enhancement Proposed in Auto Loan Transactions

Input	Process
Evaluating Amount of Enhancement	<p>(1) A cash flow model is used to determine whether the proposed level of enhancement is sufficient to warrant the requested rating.</p> <p>(2) Apply relevant stress multiple ranges in Table 1 and Table 2 to derive an estimated cumulative credit loss assumption. Replacement servicer fees are included in estimated cost contingencies.</p>
Output	Appropriate rating level based on the proposed enhancement.

Summary of Process to Evaluate Form of Enhancement in Auto Loan Transactions

Input	Assessment
Proposed Form of Enhancement	<p>(1) A minimum level of cash is expected to provide short-term liquidity to the transaction, if needed, to address spikes in credit losses or excess spread declines.</p> <p>(2) The remainder of the total enhancement may be provided through a combination of subordination, overcollateralization and excess interest rate spread or acceptably rated third-party forms of enhancement. Floor levels may be included to ensure that a minimum level of enhancement is available throughout the life of the transaction and to protect against losses that can occur in the later stages of the transaction (i.e., tail risk). Subordination considerations include an analysis of the priority of payments and the rate of interest to be paid on the subordinated notes.</p> <p>(3) Excess interest rate spread is evaluated based on the structure of the transaction as the excess spread may be created by way of an interest rate hedge or other structural mechanism or the excess interest rate spread may be exposed to volatility on a monthly basis as a result of pool delinquencies, defaults or losses. Unless there is a structural feature included to guarantee the monthly excess spread, a maximum of one year's credit is applied to DBRS's analysis.</p>
Output	<p>A proposed level of enhancement that includes a cash reserve account¹ that is funded up front as well as additional enhancement to cover remaining stressed credit losses, including the following:</p> <ul style="list-style-type: none"> • Subordination. • Overcollateralization. • Excess spread.

1. Excess cash is subject to deposit and investment restrictions as outlined in DBRS's *Legal Criteria for Canadian Structured Finance*.



Summary of Transaction Risks Addressed through Related DBRS Methodologies

Risk	Description	Methodology ¹
Interest Rate Mismatch	Arises when the interest on the securitized contract is calculated on a different term basis than the notes issued. For example, floating-rate asset-backed commercial paper (ABCP) notes are issued by a conduit secured by a portfolio of fixed-rate auto loan contracts.	<i>Swap Criteria for Canadian Structured Finance Transactions</i>
Basis Rate Mismatch	Arises when the basis for calculating interest charged on the securitized contract is 2.9707 different from the basis for paying interest on the notes issued. For example, an interest rate hedge indexed to banker's acceptance (BA) rates not fully offset by ABCP notes indexed to commercial paper (CP) rates (referred to as BA/CP risk).	<i>Swap Criteria for Canadian Structured Finance Transactions</i>
Foreign Currency Mismatch	Arises when the proceeds received on the securitized contracts is in a different currency than the principal and interest payments due under the note issuance.	<i>Swap Criteria for Canadian Structured Finance Transactions</i>
Cash Commingling	Cash commingling risk refers to the risk inherent in transactions where the seller of the assets collects funds owed from the securitized contracts and manages the funds within its daily operations between monthly remittance dates. If the company were to declare bankruptcy, it may be onerous and time consuming to obtain access to the commingled funds.	<i>Legal Criteria for Canadian Structured Finance</i>
Bankruptcy Risk: Originator, Financial Servicer or Seller,	In order to obtain ratings that are above that of the seller, transactions should be structured to ensure that the assets of the transaction are separate and remote from any claim that secured creditors may have if the originator or seller of the securitized assets file for bankruptcy. Among others, true-sale and substantive non-consolidation opinions are expected and reviewed on a transaction-by-transaction basis.	<i>Legal Criteria for Canadian Structured Finance</i>
Conduit Liquidity Risk	The funding of long-term assets by ABCP has inherent asset-liability duration mismatch and risk for ABCP investors. To address the risk that market demand for ABCP may not be sufficient or the ABCP fails to roll over due to unforeseen events, all conduit sponsors should comply with DBRS conduit liquidity criteria, including Global Liquidity Standard (GLS) liquidity backup lines, in support of outstanding conduit notes.	<i>Rating Canadian ABCP and Legal Criteria for Canadian Structured Finance</i>

1. Available at www.dbrs.com.



SUMMARY OF TRANSACTION MONITORING

Summary of Surveillance Procedures for Auto Loan Transactions

Offering	Information Reported	Frequency	Source ¹
Asset-Backed Commercial Paper (ABCP)	Asset class, seller industry, seller/servicer rating, funded amount, initial credit enhancement, current credit enhancement, loss coverage, delinquency rate, performance ratios, deal rating.	Monthly	<i>Monthly Canadian ABCP Report</i>
Asset-Backed Securities (ABS)	Originator, collateral description, types of credit enhancement available, program size, lead underwriter, original balance, current balance, coupon, expected maturity, legal maturity, current rating, reporting month, pool balance, collections, loss rate, delinquency rate, reserve ratio, overcollateralization (O/C) ratio, debt class name.	Monthly	<i>Monthly Canadian ABS Report</i>
Private Term Transaction	Originator, collateral description, types of credit enhancement available, program size, lead underwriter, original balance, current balance, coupon, expected maturity, legal maturity, current rating, reporting month, pool balance, collections, loss rate, delinquency rate, reserve ratio, O/C ratio, debt class name.	Monthly	Not public

1. Available at www.dbrs.com.

SUMMARY OF APPLIED RATINGS THRESHOLDS FOR AUTO LOAN TRANSACTIONS

Table 1: Summary of Multiple Ranges Applied to Credit Losses for Auto Loan Transactions

Rating Level	Sub-Prime Portfolio ¹	Prime Portfolio ¹	Super-Prime Portfolio ¹
AAA	2.5x to 4.0x	4.0x to 6.0x	5.0x to 10.0x
AA	2.25x to 3.50x	3.0x to 5.0x	4.0x to 8.0x
A	2.0x to 3.0x	2.5x to 3.5x	4.0x to 6.0x
BBB	1.50x to 2.25x	2.25x to 3.00x	3.0x to 4.0x

1. See the "Loss Curve" section on page 10 for performance differences between sub-prime, prime and super-prime portfolios.

Table 2: Summary of Recovery Variables by Rating Category for Auto Loan Transactions¹

Rating Level	Recovery Credit	Recovery Lag
AAA	50%	3 to 5 months
AA	66%	3 to 4 months
A	75%	2 to 3 months
BBB	80% to 85%	2 months
BB	90%	1 to 2 months
B	90% to 100%	1 months

1. In some cases, historical information on recoveries may not be available.

Note: All figures are in Canadian dollars unless otherwise noted.

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