



Methodology
*Rating Canadian Auto Loan
Securitizations*

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Insight beyond the rating.

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Rating Canadian Auto Loan Securitizations

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Introduction

Since the last update to DBRS's *Rating Canadian Auto Loan Securitizations* methodology in January 2009, there have been some significant developments in the market, including:

- An increase in the term of loans to address the reduction in availability of lease financing.
- New products that combine lease-type features with traditional loan financing.
- Increased regulatory oversight.
- A funding shift from the asset-backed commercial paper (ABCP) market to the asset-backed securities (ABS) term market.
- The growing acceptance by investors of monthly pay amortizing bonds.
- Structural developments including dynamic enhancement proposals.
- A decrease in the number of auto finance companies accessing the securitization market.
- An increase in the size of the average securitization transaction pool.
- Continued stable delinquency and loss performance statistics through a global financial crisis that included the bankruptcy and re-emergence of Chrysler LLC and General Motors Company.

Notwithstanding the stable performance within the retail auto loan securitization market, concern continues to centre upon the financial health of the vehicle manufacturers, the finance companies underwriting the loans and the prevailing state of the economy as it impacts consumer behaviour with respect to the consumer's ability to meet various payment obligations. Of particular note, the difficult economic environment combined with the cessation of lease financing availability from a number of originators over the past several years has led to an increasing trend in the length of auto loan terms. Prior to the economic downturn, loan terms traditionally ranged from 48 to 60 months. They now stretch from 72 to 84 months, and in some cases beyond. Given that historical performance is a fundamental input when DBRS evaluates enhancement proposals, the minimal historical performance data available on longer-term loans continues to be to be dealt with using conservative assumptions.

The collateral backing auto asset-backed securitizations continues to be comprised of loans to prime-rated obligors (with very few super-prime or sub-prime participants in the Canadian securitization market) on numerous vehicle types. The value of the underlying collateral in the used market continues to fluctuate as it is impacted by the global forces of supply, demand, oil prices and, in Canada, foreign exchange rates.

Regulatory oversight by Canadian and U.S. regulators has impacted all stakeholders with additional disclosure and reporting requirements being placed on issuers, originators, underwriters and credit rating agencies in an effort to increase transparency in ABS transactions. The Dodd-Frank legislation has resulted in additional disclosure and processes affecting public securitization transactions rated by DBRS in Canada, including the requirement to comply with Rules 17g-5 and 17g-7 specifically. Undoubtedly, this area will continue to evolve in the years to come.

Against this backdrop, DBRS has updated its auto loan methodology and has made only minor changes as the performance and robustness of the approach to rating securitizations backed by auto loan portfolios has continued to support ratings stability even through the lowest points of the current economic cycle.



The following describes the DBRS rating approach for retail auto loan transactions, which is designed with the goal of maintaining ratings stability through an entire economic cycle. The methodology is divided into three main sections, which cover:

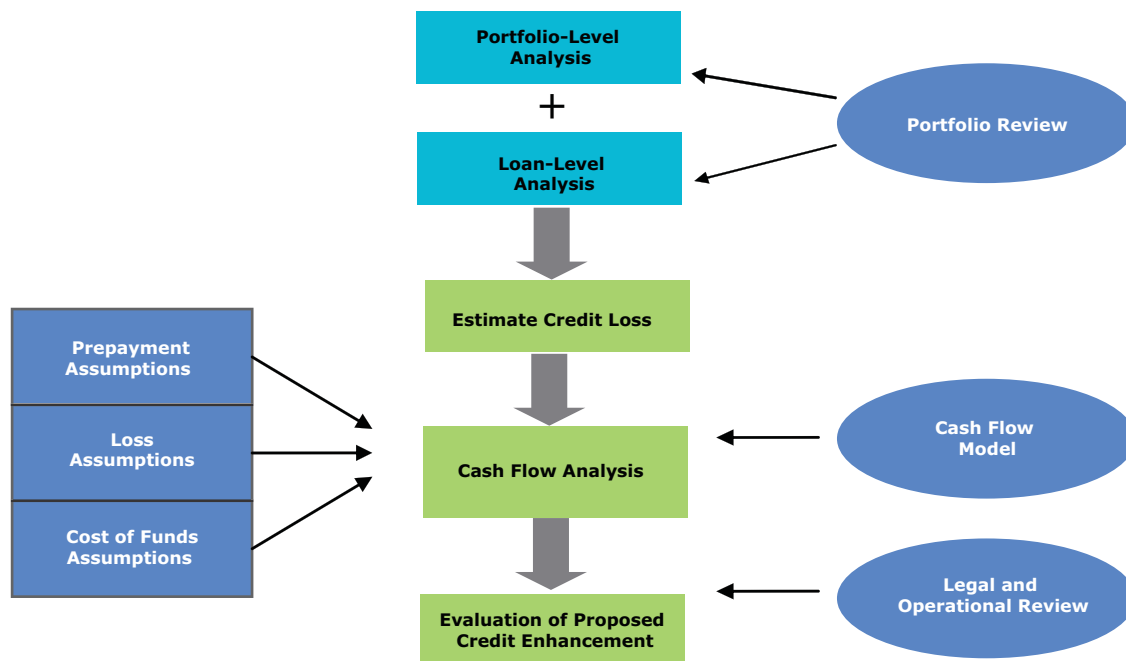
- Portfolio Review – the analytical process, including a review of the originator/seller and the historical auto loan performance.
- Pool Review – a specific review of the composition of the pool in estimating a base-case cumulative loss assumption.
- Additional Structural Considerations – a discussion on minimum rating criteria, excess spread and other structural considerations that impact the rating assessment.

CANADIAN AUTO LOAN METHODOLOGY

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

- (1) DBRS conducts portfolio-level and loan-level analysis in order to establish a base-case expected cumulative net credit loss.
- (2) DBRS performs a cash flow analysis using a proprietary financial model that incorporates assumptions regarding prepayments, default rates, recoveries and cost of funds in order to assess the adequacy of the proposed credit enhancement supporting each rating level.
- (3) The legal and operational aspects of the transaction are reviewed and taken into consideration in addition to the enhancement proposal.

DBRS Rating Process for Canadian Auto Loan Transactions





Rating an Auto Loan Securitization Transaction

DBRS may assign short-term or long-term credit ratings to the securitization transaction rated. The DBRS short-term debt rating scale provides an opinion on the risk that an issuer will not meet its short-term financial obligations in a timely manner. Ratings are based on quantitative and qualitative considerations relevant to the issuer and the relative ranking of claims. The R-1 and R-2 rating categories are further denoted by the subcategories “(high),” “(middle),” and “(low).”

The DBRS long-term rating scale provides an opinion on the risk of default (i.e., the risk that an issuer will fail to satisfy its financial obligations in accordance with the terms under which obligations have been issued). Ratings are based on quantitative and qualitative considerations relevant to the issuer and the relative ranking of claims. All rating categories other than AAA and D also contain the subcategories “(high)” and “(low).” The absence of either a “(high)” or “(low)” designation indicates the rating is in the middle of the category.

PORTFOLIO REVIEW

Review of the Originator (Seller)

At the outset of the transaction process, DBRS reviews the financial stability, management experience and the overall corporate strategy with respect to an originator that is proposing to sell assets through a securitization structure that is rated by DBRS. In addition to the originator analysis, DBRS reviews obligor default risk as measured by a third-party consumer credit score, such as Fair Isaac. Finally, DBRS will also employ static pool analysis, considering historical default, recovery and delinquency data associated with the originator’s owned and managed portfolio as well as its previous securitization programs, if available. DBRS typically looks for three to five years of monthly/quarterly performance data from the originator. The objective of the longer time frame review is to ensure that the performance of the pool is evaluated 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. Originators that demonstrate a lengthy history of well-managed assets (i.e., consistent and stable loss history) 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, repossession rates and recoveries.

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 originator/seller/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/seller/servicer to continue to generate additional receivables and could impact the servicing capability and performance of existing pools. DBRS analyzes an originator’s access to bank funding, public markets and other sources of capital to determine sufficiency of liquidity and overall funding capacity. The credit rating of the originator is also considered a key indicator of its financial stability and ability to access a variety of funding sources. As a further measure of protection to the structure, standby servicers are either identified and engaged at the outset of the transaction or provisions for a replacement servicer are provided in the transaction documentation to ensure the continued servicing of the pool of assets backing the ABS or ABCP



in the event the originator/seller/servicer needs to be replaced. The originator's credit rating is often used as a benchmark in determining whether a standby servicer is expected at the outset of the transaction or whether a replacement servicer will be engaged at a later stage (i.e., downgrade events trigger a replacement servicer). 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 predominance in Canadian portfolios of 95% to 99% of preauthorized debit, this transition would be expected to be relatively smooth.

Portfolio Analysis - Underwriting

Because DBRS relies heavily on past performance as a predictive measure for proposed transactions, a stable and consistent track record of portfolio performance is paramount when evaluating the efficacy of an originator's underwriting standards. To achieve consistency of collateral performance, it is important that an originator has underwriting standards that are applied consistently across the portfolio with respect to its origination and management. Firms that have decentralized underwriting require more careful analysis 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 a benchmark for the cumulative loss that is expected to be experienced throughout the life of the securitized pool of assets. DBRS also looks for consistency of underwriting standards in a historical context to establish the stability of the portfolio performance over a variety of economic conditions. From a structural standpoint, it is also important that material changes to the underwriting policies, as outlined in the originator's credit and collection policy, are reviewed by DBRS as they could have a material impact on the performance of the portfolio.

The analysis of underwriting procedures takes into consideration issues specific to each originator's underwriting criteria. Originators generally evaluate potential obligors and assign an internal credit rating based on criteria that includes a third-party credit score as provided by Fair Isaac or Equifax; the historical experience the originator has had with the obligor; income and financial obligation ratios; the requested loan term; the loan amount, including the down payment, to arrive at a loan-to-value score; new versus used; vehicle type; and, in some cases, whether the car was financed under an interest rate subvention sales program. Many originators 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 auto loan.

For most originators, credit scoring has become an efficient, standard tool used 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 confirm or enhance 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 rated by DBRS, appropriate benchmarking can be applied during the course of the review 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 loan programs, including: (1) contract terms; (2) down payment requirements and advance rate; and (3) collateral condition (vehicle valuation).



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 their 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 and the availability of lease financing has significantly decreased, loan terms are being offered in the market at 72 months and beyond.

From a risk perspective, longer-term loans (greater than 60 months) lead to greater loss potential, largely due to the expectation that longer-term loans result in higher incidents of default 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. In most revolving transactions, an upper limit on the number of such long-term loans permitted to be included in a securitized pool is set. The limit is established on a case-by-case basis, with reference to the specific originator's experience and the composition of the pool.

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, thereby increasing the potential exposure to loss. 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.

Balloon, Deferral and Buyer's Choice Loans

Some auto finance lenders offer balloon and deferral loans to obligors as options, which 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 having to enforce its security and liquidate the vehicle at the end of the set period in the event that the obligor experiences financial difficulties and is unable to meet its final payment obligation. This process self-selects the portfolio toward 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.

The market has also seen the re-emergence of buyer's choice programs as some issuers are attempting to bridge the gap between lease financing and loan financing. A buyer's choice program typically takes on features that resemble both a traditional loan and a traditional lease. Under these types of programs, the monthly payment is structured similarly to that of a loan, in that a five-year loan would amortize to a zero loan balance rather than having a residual value that exists in a lease. However, like a lease, the customer would have the option to return the vehicle to the originator at a pre-determined point in time prior to the end of the contract term, leaving the originator with the task of liquidating the vehicle. For example, a customer may have the option to return the vehicle at the end of two years on a five-year buyer's choice loan, leaving the originator with the risk of the remaining balance owing on the vehicle.

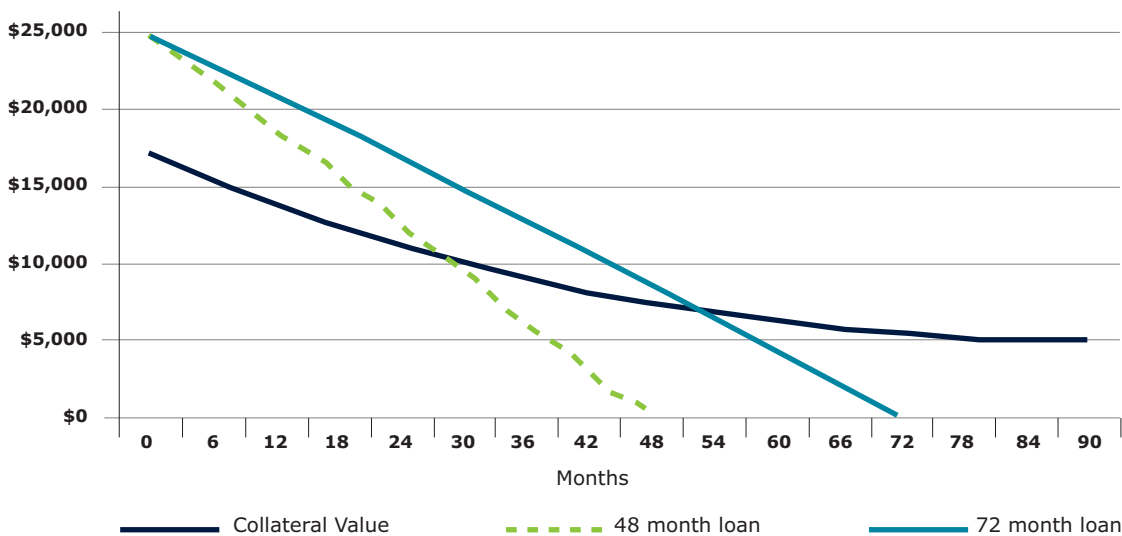


To date, DBRS has not seen the inclusion of any significant number of these loans in Canadian securitized transactions. From a ratings perspective, it is anticipated that the buyer's choice loans would be treated by DBRS as leases in cases where the potential residual value risk is assumed by the originator when offering its customers the ability to return the vehicle prior to payout of the loan. In these instances, a review of the conditions upon which the vehicle can be returned to the seller, including the third-party residual value estimate, will be considered as part of the analysis in determining an appropriate turn-in rate for the pool of vehicles securitized. As noted in *Rating Canadian Auto Lease Transactions*, the turn-in rate is the basis upon which an estimate for residual value losses is derived. The lack of historical data on the performance and the likelihood of consumers opting to return the vehicle early are also problematic from a ratings perspective, resulting in a more conservative approach to enhancement expectations by DBRS to mitigate these risks.

Down Payments 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-in) 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. In general, a higher advance rate increases the severity of losses if the loan defaults, and in the case of sub-prime obligors, the likelihood of default as well. 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 vehicle type are important considerations, in addition to the broader economic environment, time of year, new vehicle product and pricing and the overall supply of used vehicles, when determining the value of a vehicle at any point in time. Due to the variability in wear and tear, used vehicles are more complicated 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 vehicle loan. Data obtained by DBRS indicates that used vehicle loan performance consistently underperforms new vehicle loan performance, even when factors such as credit score are taken into account. Ongoing roadworthiness of the vehicle, in many cases the absence of a factory warranty, and the better liquidity of lightly-used vehicles contributes to this observation.

The value of a vehicle is determined by an assortment of factors. Depreciation is the largest factor contributing to the decline in a vehicle's value. Depreciation rates vary by manufacturer, vehicle make and model, with luxury vehicles usually having the greatest vehicle decline in the first year. Most of the 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 vehicle values affect 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, gas prices and other factors, including import and export levies charged by the manufacturers for moving vehicles cross border); remarketing distribution channels (i.e., original or landing dealer, the wider dealer network, an online auction managed by the originator or the physical third-party auction houses such as Manheim or ADESA); and rental fleet, corporate fleet and consumer lease disposition cycles, which can result in an oversupply of used vehicles creating downward pressure on values. New vehicle incentives for new purchases will also negatively affect the value of used vehicles.

POOL REVIEW – ESTIMATING THE BASE-CASE EXPECTED CUMULATIVE LOSS

Loss on a securitized auto loan portfolio is a function of the frequency of default and severity of loss on a loan by loan basis. The aggregate loss value experienced by a portfolio of auto loans is referred to as the cumulative loss. DBRS's modeling process begins with the determination of a cumulative loss expectation for the proposed portfolio included in the structure to be rated. The originator's actual loss history is combined with the specific attributes of the asset pool to be securitized to form the basis of the expected cumulative loss. The DBRS expected cumulative loss is defined as the total dollar value of receivables that default over the life of the transaction as a percentage of the dollar value of the total receivables in the securitized pool.

To analyze loss history, DBRS examines the originator's owned and managed portfolio and 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, whereas portfolio data can mask losses during periods of rapid portfolio growth or changing credit and collection policies. 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 through complete economic cycles. 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 to the extent that separate performance statistics are available.



Without the use of static pool data, DBRS will extrapolate annual loss rates to determine expected loss projections. 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 “expected loss” levels to reflect changes in credit scores, 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 the analysis. The resulting adjusted loss levels are used for stress testing purposes. In estimating weighted average life, DBRS will assume no defaults and no prepayments.

For each pool of loans, DBRS will derive an expected base-case loss by applying historical static loss experience for each stratification within the pool where losses are provided. For most loan portfolios, historical static losses are available based on new or used contract terms of less than 48 months or more than 60 months, and in some cases by vehicle type or by obligor credit tier. For loans where historical static losses are not available, conservative assumptions will be made for that specific stratification. As a result, expected base-case loss for the same originator will be different depending on the composition of the pool.

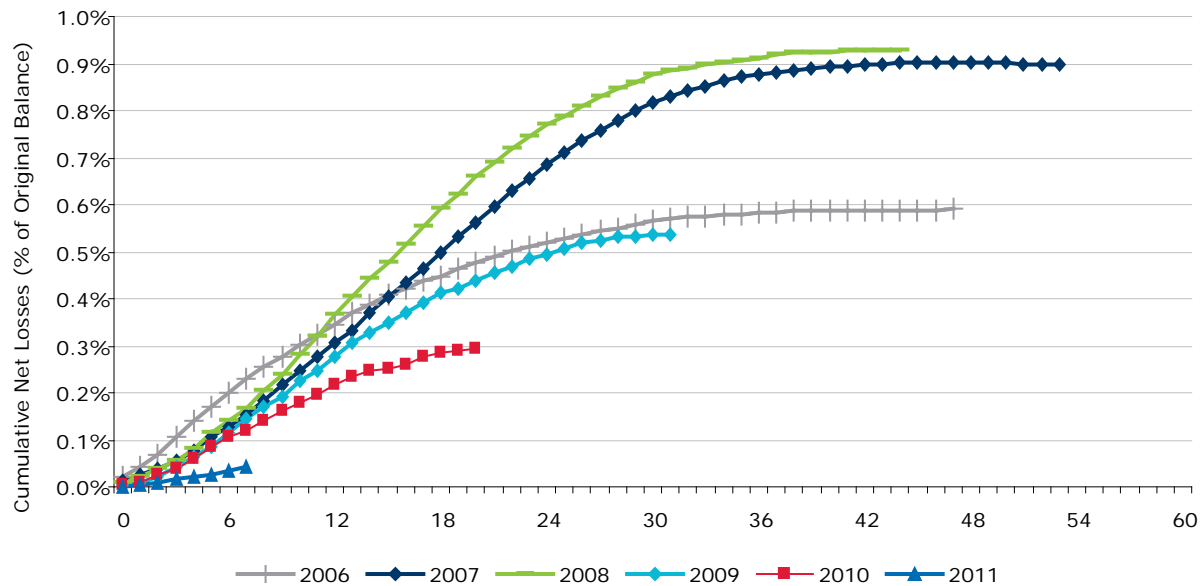
Loss Curves

Static pool data is the basis used to determine the shape of the loss curve and the total or cumulative losses expected based on the historical information provided by the issuer. DBRS observes the cumulative 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 (i.e., losses occur early in the transaction), 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. As shown below, DBRS monitors and publishes monthly cumulative loss curves for the Canadian auto loan market based on the transactions it has rated. This allows DBRS to track market trends that can provide context to loss expectations when reviewing enhancement proposals from any one originator.



Automotive Cumulative Credit Losses by Issuance Year



Source: DBRS.

Recovery Rates

In general, gross losses and net losses are differentiated by recoveries and resale expenses and as such can be analyzed separately. The timing of loss recognition differs among issuers, depending on the company's collection and recovery processes. From an enhancement perspective, DBRS models based on net losses, which typically include a timing lag for any estimated recoveries. 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. In cases where DBRS receives detailed net cumulative static loss information on a historical basis from large originators that exhibit consistent and stable performance, DBRS will model the transaction based on the expected base-case cumulative net loss adjusted for the portfolio composition and the timing lag on recoveries as described above. For originators that exhibit more volatile gross loss, net loss and recovery performance, DBRS will apply the recovery variables noted in the table below prior to arriving at an expected base-case net loss assumption.

DBRS will consider recoveries beyond the disposition of the vehicle (i.e., additional proceeds from the obligor) as long as documentation included in the proposed transaction provides for the inclusion of recoveries as part of the proceeds available for distribution to the noteholders. In evaluating enhancement levels for a particular rating level, DBRS will adjust the amount and timing of recovery credit for a particular rating level based on the track record of the servicer in collecting recoveries and incorporate the results into the base-case loss analysis. The recovery time lag is included in the modeling process and will result in a longer payout to the noteholders on a stressed basis. Performance volatility in the originator's historical data will impact the amount of recovery credit for any rating category.

Recovery Stress 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



Seasoning

Seasoning represents the number of months since a loan was originated. A portfolio with a high number of seasoned loans is less risky than that of newly-originated loans, given that the securitization process will have excluded any defaulted loans that occurred early in the loan term. DBRS has observed that 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 is 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 defaults, will experience a lower ultimate loss level compared to a similar portfolio with little to no seasoning.

In general, pools with six months or less 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 expected base-case cumulative loss assumption may be acceptable, particularly if seasoning is very significant (over 12 months). Additionally, strong selection criteria may eliminate many of the obligors most likely to default in a transaction during the initial six to 12-month period.

ADDITIONAL STRUCTURAL CONSIDERATIONS

Revolving Pools

Revolving securitization structures feature the ability for the transaction to accommodate the periodic addition of new seasoned or unseasoned loan receivables to the transaction. As noted above, seasoning has an implicit impact on a pool as it decreases the risk of default and delinquency. Further, the pool composition after an addition has occurred may differ from the initial purchase which may alter the overall risk. Although guidelines may be in place to limit a company's ability to add loans during the revolving period, the actual composition of a pool may be subject to some variability. As a result, enhancement levels for a revolving pool will typically be higher than that of an otherwise similar discrete pool of assets.

DBRS will assume the pool will be unseasoned during the revolving period, and any credit otherwise given for seasoning would be limited. In addition, in determining the base-case expected cumulative loss assumption, DBRS will assume that the composition of the combined portfolio (i.e., initial tranche plus subsequent additions) is set at the limits of the eligibility criteria that would create the highest possible loss. For example, if the transaction documents permit 20% of the pool to be comprised of loans in respect of used vehicles, DBRS will assume that 20% of the combined portfolio will include loans for used vehicles in deriving the expected base-case cumulative loss, regardless of the actual composition in the initial tranche of loans.

DBRS will review the combined pool and enhancement structure on at least an annual basis and may review each new tranche of loans added to the portfolio of securitized loans.

Prepayments

Most consumers pay their auto loans on a timely basis, in large part via pre-authorized payment options used by 95% to 99% of Canadian consumers with an auto loan. Because the cash flow that is used to pay down a securitization is from the receipt of scheduled payments, any payments not on schedule need to be considered. 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. However, 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 lowest incidences of prepayments 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 transactions show their influence in the front-loaded nature of the prepayment curve. Subvention tends to reduce but not eliminate prepayments. In keeping with a conservative approach, DBRS generally ignores prepayments in its modeling.

Delinquency

Servicers use different methods to track delayed payments from obligors. One method of tracking delinquencies is the recency method, which is based on how recently an obligor made a payment. For example, if a severely delinquent obligor (in reference to the terms of the relevant contract) made one payment within the last month, then the obligor would be considered contractually delinquent but 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 not to rely as heavily on the transaction's delinquency triggers as a form of performance control.

For DBRS, the appropriate way to measure delinquencies is a contractual approach: an obligor is considered delinquent as long as any of the contractually scheduled payments which have come due have not been made. 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.

Portfolio Yield - Interest Rates, Subvention and Excess Spread

Most automobile lenders provide fixed-rate loans to obligors that finance their automobiles. As noted earlier, originators incorporate a variety of risk-based strategies to underwrite loans. These strategies often include risk-based pricing where originators charge higher rates to obligors that represent additional risk. Historical experience suggests that obligors borrowing to finance used vehicles, on average, are riskier in both frequency and severity of default than obligors borrowing to finance new vehicles; therefore, an originator may charge higher rates for used vehicles. Conversely, loans to prime obligors often have rates as low as zero percent (sometimes subsidized or subvented by auto manufacturers to stimulate sales). Any loan offered to an auto purchaser at a rate that is lower than the prevailing or prime rate otherwise charged to its customers is referred to as a "subvented" loan. The interest rate on the underlying loan included in a securitized portfolio is a key consideration in determining portfolio risk.

If a subvented loan is included in a securitized portfolio, negative interest rate carry is a likely result since the interest rate on the notes issued to investors will be higher than the interest rate offered to the customers. DBRS reviews the negative carry on a loan contract by loan contract basis regardless of whether the weighted average annual percentage rate (APR) on a given portfolio of loans is greater than the cost of borrowing on the issued notes. To avoid the occurrence of negative interest rate spread, subvented loans included in a securitization pool are discounted at a pre-determined rate that is high enough to generate positive cash flow on a monthly basis to cover the cost of funds of the notes, to pay potential replacement servicer fees, to pay other expenses and in some cases to generate additional excess interest rate spread available to cover credit losses.

DBRS considers the discount rate applied to the portfolio on a loan-by-loan basis in order to ensure that future yield on the assets is not advanced prior to it being earned. This occurs when the yield on a loan is higher than the discount rate applied to the pool of assets being securitized. DBRS expects the discount rate applied on a portfolio of vehicle loans for the purposes of calculating the present value of the assets (and thus the amount of notes that can be issued to investors) to be the higher of the discount rates used to create interest on low yielding assets and the contract rate on the individual loans in the pool to be securitized.



An alternative option to compensate for insufficient yield on a portfolio of loans is to include additional loans to create a yield supplement overcollateralization amount (YSOC), whereby the cash flow generated from the additional loans is sufficient to provide additional cash on a monthly basis to offset the lower yielding subvented loans.

In modeling these pools, it is important to make a distinction between the discounted value and the book value. The book value (i.e., the aggregate principal amount of loans outstanding prior to discounting) is used by DBRS to determine the rate of delinquencies and defaults. This value represents the amount of credit at risk for a given transaction, whereas 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 inherent in the pool.

As noted above, the 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. To the extent that excess spread generates enough cash flow to cover trust expenses (including any hedging costs) on a monthly basis, any surplus is available to be applied to absorb cash flow shortfalls arising from delinquencies and collateral losses. The additional liquidity that excess spread provides to the transaction is analyzed by DBRS, depending on the structure presented.

While excess spread can be instrumental in helping offset losses in the securitized pool, it is often the case where the excess spread that is not required to cover any cash shortfalls on a monthly basis is released to the originator/seller, and as a result, it cannot be given 100% credit in the overall enhancement structure. Due to the combination of credit losses and prepayments, which occur throughout the life of the pool, DBRS only gives limited credit to excess interest rate spread unless there is a structural mechanic in the transaction that prevents the release of monthly excess spread to the originator/seller.

Excess spread is often used not only to absorb losses on a monthly basis, but it is also used to build or replenish any shortfalls in the cash account. The amount of excess spread available to replenish the cash account varies each month and it is impacted by factors such as delinquencies, defaults, recoveries and prepayments.

If excess spread is retained in the structure, DBRS will allocate credit to excess spread to the extent that it is available after deducting a provision for replacement servicer fees. However, in most transactions, excess spread that is not applied to cover any cash shortfalls on a monthly basis is released to the originator/seller and thus is not available to cover any future shortfalls. In this scenario, DBRS will only allocate credit to excess spread for the first 12 months of the transaction given that losses typically do not begin to accumulate until month 12. It should also be noted that excess spread deteriorates quickly in modeling scenarios when defaults and prepayments are incorporated into the analysis.

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 erode most or all available spread, thereby preventing the return of any excess cash to the seller or the replenishment of the cash account if it has been depleted to cover interest expenses or losses. Generally, in a loan securitization, excess cash is available to be paid out to the seller provided that 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.



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, including fixed rate-floating rate mismatches, banker's acceptance-commercial paper (BA-CP) basis risk mismatches, prepayment risk and counterparty risk. For the most part, retail auto loans are fixed-rate monthly pay loans whereby a mismatch occurs when the securitized assets are offered through a conduit issuing floating-rate ABCP or variable-rate notes 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 of the notes being issued. Additionally, basis risk (arising due to the difference between the reference rate on the CP 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. For a more detailed review of DBRS's hedging criteria, please refer to the *Swap Criteria for Canadian Structured Finance Transactions* methodology available at www.dbrs.com.

Maturity

DBRS ratings are an opinion of the issuer's risk of default in meeting its payment obligations within the terms of the documentation provided. In evaluating the likelihood that an issuer will meet its payment obligations by the 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 maturity of the underlying loans to extend beyond the maturity of the notes issued in the related securitization. The maturity date of the notes issued in the securitization transaction is generally set to correspond with the latest scheduled maturity date of the collateral in the securitized pool, plus six to 12 months, to allow for extensions and lagged collections on any defaulted or delinquent loans.

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. DBRS will review the necessity of a back-up servicer on a case-by-case basis. The analysis includes consideration of the credit rating of the various entities involved (servicer and seller), the likelihood of default, the number of years in business and the track record of the servicer.



Servicing Fee

The servicing fee is the amount paid to a company hired to service the underlying obligations in the event that the originator no longer acts as servicer. In its cash flow model, DBRS assumes that a replacement servicer fee is charged 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 assume an appropriate servicer fee based on observed market rates for comparable portfolios, which has traditionally been estimated at approximately 1% in Canada for prime portfolios. Most Canadian securitizations backed by portfolios of auto loan receivables include the sale of the assets to the structure on a fully serviced basis, resulting in a 1% cushion in the transaction from an enhancement perspective as long as the seller remains in place as the servicer.

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 tendency to repossess an obligor's vehicle; (2) the credit 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 either internal or external online channels. Remarketing vehicles through their dealership network or online 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 modeling exercises. Based on transactions DBRS has rated, repossession rates have averaged 1% to 2% for prime portfolios.



Credit Enhancement Analysis

Enhancement is expected to cover the cost of funds, stressed losses and the cost of servicing. As described, stressed losses will be determined by adjusting historical losses to reflect changes in the risk profile of the loans being securitized (i.e., the composition of the proposed pool), 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 a proprietary cash flow model to determine the effect of servicing expenses, delinquencies, repossessions, losses and recoveries. Credit will be given for overcollateralization (beyond what will provide a positive yield to the program), cash reserves, appropriately structured subordination and positive excess spread in the first year adjusted for defaults and basis risk. The discussion below relates to the typical structure that is seen in current Canadian auto loan ABCP and ABS transactions.

ENHANCEMENT PROPOSAL EVALUATION

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 proposals are evaluated based on stressed multiples of the expected base-case cumulative loss depending on the rating category, as 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 (i.e., Sub-Prime, Prime or Super Prime) of the obligors in 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 originator/seller acting as 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 expect 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. It should be noted that the loss estimates and enhancement requirements are the same whether the transaction is financed privately or publicly in the ABS or ABCP market.



FORMS OF ENHANCEMENT

Once the expected credit losses are calculated for a loan pool, the adequacy of enhancement is determined by applying the multiple ranges that correspond to the rating being assigned to the notes being issued. A typical loan portfolio will require approximately 4% to 10% of the outstanding notes in the form of enhancement at the outset of the transaction depending on the composition of the pool and the historical losses incurred by the specific originator. DBRS has established minimum thresholds for the amount of cash that should form part of the enhancement and these are applied on a pool-by-pool basis to ensure a minimum level of liquidity is available on a month-to-month basis to cover monthly expenses that the transaction incurs. At the outset of the transaction, the seller is expected to deposit the cash enhancement in Permitted Investments in compliance with DBRS's *Legal Criteria for Canadian Structured Finance* methodology¹. Note that the cash enhancement (generally a minimum of 50 basis points (bps)) is in addition to the liquidity support used in transactions securitized in bank sponsored conduits issuing ABCP.

The balance of the enhancement is generally comprised of a combination of overcollateralization and subordinated notes. Overcollateralization simply refers to the inclusion of additional loan contracts to which the holder of the note has the contractual 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. A subordinated note holder should understand that 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.

The form of enhancement will also depend on whether the issuer intends to sell notes through the ABS term market or the ABCP market. Generally, subordinated notes are not utilized in ABCP financed transactions.

Dynamic Enhancement-ABCP Funded Transactions

As noted earlier, for revolving pools funded in the ABCP market, enhancement needs to reflect the changing nature of the asset, originations and composition as they are added to the pool. Similarly, in limited cases, an established originator that has demonstrated considerable expertise and consistency, including collection and submission of very detailed static loss data and historical portfolio performance, may be able to benefit from a dynamic enhancement calculation that takes into consideration the asset composition of the pool and ongoing performance of the assets originated by the seller. In these cases, enhancement will increase when more risky assets are added and as performance worsens (and may decrease to a limited extent if performance improves).

1. Permitted Investments are defined in each transaction 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. DBRS's methodology has been used to analyze 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 to evaluate risk and the protection expected 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 securitization transactions has demonstrated its robustness through the volatile economic downturns witnessed to date.

Auto Transaction Risk Matrix

	Retail Auto Loan	Retail Auto Lease	Corporate Auto Fleet	Daily Rental Car Fleets	Floorplan
Concentration Risk	Low (more than 10,000 obligors)	Low (more than 10,000 obligors)	Moderate (Less than 5,000 obligors)	Highest (reliance on rental car company as operator)	High (150 to 750 obligors)
Credit Risk	Low to medium (10 to 200 bps)	Low to medium (10 to 200 bps)	Low (0 to 25 bps)	Low (0 to 25 bps)	Low (0 to 25 bps)
Residual Value Risk	n/a	Medium to high (40% to 60% of pool balance)	Nominal	Medium to high (25% to 100% of pool balance)	n/a
Manufacturer Risk	Low (no reliance)	Medium (end-of-term considerations)	Low (no reliance)	Medium (higher on program vehicles)	High (linked closely to the manufacturer)
Asset Features	Amortizing	Amortizing	Revolving	Revolving	Revolving
Enhancement	<ul style="list-style-type: none"> • Cash • Overcollateralization • Subordinated notes • Excess spread 	<ul style="list-style-type: none"> • Cash • Cash (embedded loss) • Overcollateralization • Subordinated notes • Excess spread 	<ul style="list-style-type: none"> • Cash • Overcollateralization • Subordinated notes • Letters of credit • Excess spread 	<ul style="list-style-type: none"> • Cash • Overcollateralization • Subordinated notes • Letters of credit 	<ul style="list-style-type: none"> • Cash • Overcollateralization • Subordinated notes • Excess spread



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.
Output	Detail	Application



Summary of Risk Analysis Process Applied to Auto Loan Transactions

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 expected credit loss assumption is estimated based on review of the key variables identified at the loan-level, portfolio-level, economic and legal structure reviews. • The base-case expected 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.
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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 assumptions on base-case expected credit loss, prepayments, recoveries and cost of funds to the cash flow model. Replacement servicer fees are included in estimated cost contingencies.</p>
Output	Appropriate rating level based on the proposed enhancement and the stress ranges outlined in Table 1 and Table 2.

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	Methodology¹
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	Prime Portfolio	Super-Prime Portfolio
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

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.

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