



Methodology

*Swap Criteria for European Structured
Finance Transactions*

JUNE 2011



Insight beyond the rating.

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Related Research:

Legal Criteria for European Structured Finance Transactions and Addenda
Unified Interest Rate Model for European Securitisations
The Effect of Sovereign Risk on Securitisations in the Euro Area

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This methodology replaces and supersedes all related prior methodologies. This methodology may be replaced or amended from time to time and, therefore, DBRS recommends that readers consult www.dbrs.com for the latest version of its methodologies.



Swap Criteria for European Structured Finance Transactions

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Executive Summary

Swaps are a common feature of European structured finance transactions, allowing the issuer of rated securities (the “Issuer”) to convert cash flows, such as receipts from an underlying collateral pool, into the form needed in order to meet its obligations in respect of the securities it has issued. Swaps may also be used by the Issuer to assume or hedge credit risk directly.

Where rated securities are dependent on the performance by the swap counterparty of its obligations pursuant to the swap, those securities are exposed to the risk that the counterparty may default on those obligations. The purpose of this methodology is to describe the criteria applied by DBRS in reviewing swaps in the context of a structured finance transaction where a DBRS rating has been requested. The criteria include a framework for mitigating the risk associated with counterparty default in structured finance transactions, which, if followed, may provide a number of benefits. Firstly, where it is possible for Issuers to meet the criteria, the reduction in exposure to the swap counterparty should result in reduced risk to the rated securities, and therefore the potential for higher ratings. Secondly, assuming the criteria described herein are met, DBRS believes that the exposure of the rated securities to the risk of counterparty default may be mitigated to an extent sufficient to avoid modelling that risk in a transaction¹.

A central principle of the framework is the removal of credit risk associated with the counterparty from the transaction before the counterparty defaults. This is achieved by the inclusion of structural features sufficient to ensure that, as its creditworthiness deteriorates, as evidenced by its ratings, the counterparty will be replaced or its obligations will be collateralised or otherwise guaranteed, prior to the point where it might be expected to default.

The structural features necessary to provide sufficient comfort that the risk associated with the counterparty can be treated in this way depend on a variety of factors, including:

1. the rating of the swap counterparty;
2. the nature of the swap, including both the importance of the swap to the ability of the Issuer to meet its obligations in respect of rated securities and DBRS view of the likelihood that, in due course, a replacement counterparty might be found who would be willing to step into the transaction, and;
3. the rating(s) requested for the rated securities.

The methodology described applies to the use of swaps in the securitisation of residential mortgages, auto loans, trade receivables, leases, secured and unsecured consumer loans, small to medium-sized enterprise loans and other corporate debt, or other structured finance transactions generally referred to as asset-backed securities². It may also be applied by DBRS to other types of structured finance transactions including commercial mortgage-backed securitisation transactions, arbitrage collateralised debt obligations, balance sheet collateralised loan obligations, and covered bonds³. The methodology is intended to cover interest rate and basis swaps, caps, floors, collars and currency swaps, and is relevant to both swaps with fixed notional amounts and swaps where the notional amounts amortise or otherwise follow an uncertain payment profile. It is not intended to apply to credit default swaps or other derivatives whose primary purpose is to provide protection against the default of one or more reference entities.

1. No framework however can apply to every transaction or to every set of circumstances that might exist or arise. Therefore, even where a transaction on its face meets the framework's criteria DBRS may decide that the risk of the counterparty and/or the circumstances are such that that treatment may not be appropriate. Transaction parties and their advisors are encouraged to contact DBRS to discuss any of the matters described herein in the context of a specific transaction.

2. While the fundamentals of structured finance transactions remain the same, different transactions present their own issues. Consequently, this publication should not be read in isolation, but rather in conjunction with, and as a complement to, the methodologies and criteria DBRS publishes on various structured finance asset classes.

3. For further information on how DBRS analyses swaps in covered bond transactions please refer to DBRS published methodology on covered bonds, the latest version of which is available at www.dbrs.com.

Key Points

- For transactions where the highest ratings assigned⁴ are “AA (low)” or higher, in order to qualify for the treatment contemplated by the framework, the counterparty should be rated at least “A” at the outset of the transaction. In addition the counterparty should agree as soon as practicable following a downgrade of its rating to below “A”, but in any event no later than 30 business days after such date, to either:
 - post collateral meeting the framework criteria;
 - obtain a suitable guarantee of its obligations; or
 - replace itself with an eligible counterparty

If the counterparty is subsequently downgraded to below “BBB” the obligation to post collateral remains, but the collateral levels increase, to reflect the increased credit risk associated with the counterparty at this rating level. In addition the counterparty should use commercially reasonable efforts to either obtain a suitable guarantee of its obligations or replace itself with an eligible counterparty.

A counterparty rated below “A” at close of a transaction may still qualify for the treatment contemplated by the framework provided that (i) it is rated at least “BBB” and (ii) it agrees to post collateral consistent with the framework from the outset.

- For transactions where the highest ratings assigned⁵ are not higher than “A (high)” the counterparty should be rated at least “BBB” at the outset of the transaction. In addition, the counterparty should agree as soon as practicable following a downgrade of its rating to below “BBB”, but in any event no later than 30 business days after such date, to post collateral meeting the provisions of the framework, and to use commercially reasonable efforts to either obtain a suitable guarantee of its obligations, or to replace itself with an eligible counterparty.

A counterparty rated below “BBB” at close of a transaction is not eligible for the treatment contemplated by the framework, even if it agrees to post collateral consistent with the framework.

- The framework is intended to apply to swaps where the exposure of the rated securities to the performance of the swap counterparty is such that the failure of the swap counterparty to perform its obligations would not, in and of itself, be expected to result in a default by the Issuer in respect of those rated securities becoming either inevitable or significantly likely⁶. Swaps on which rated securities are more reliant for their continued performance will be reviewed by DBRS on a case-by-case basis.
- Regardless of the nature of the swap DBRS monitors the exposure of the transaction to the swap

4.To securities whose performance relies on the performance of the swap.

5.To securities whose performance relies on the performance of the swap.

6.Examples of scenarios where a default of the swap counterparty might have such an effect would include (i) transactions where the nature of the swap is such that the performance of the rated securities is heavily dependent on the performance of the swap counterparty, such as may be the case in synthetic securitisations; (ii) where the mark-to-market of the swap is, or has the potential to become, such that the cost of replacing the counterparty should it default without having replaced its risk would present ultimate credit losses for the transaction inconsistent with the ratings requested and (iii) transactions where the swap counterparty performs a variety of roles, including, for instance, acting as servicer, collection account bank, reserve account bank and/or Issuer account bank, such that a default of the swap counterparty would not be mitigated by the availability of alternative cash flows, making it highly likely that the Issuer would be unable to meet its timely payment obligations in respect of the rated securities.

counterparty⁷ throughout the life of the deal, and may, notwithstanding compliance with the provisions of the framework, take rating action in relation to the rated securities in situations where the risk to the transaction posed by counterparty default is no longer consistent with the then assigned ratings.

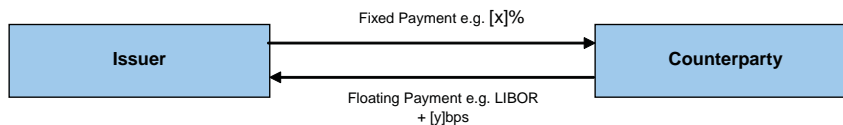
Swaps in Structured Finance Transactions

Swaps are commonly used in structured finance transactions to convert the cash flows received by the Issuer from the underlying collateral pool into the cash flows it requires in order to meet its payment obligations in respect of the securities it has issued to fund that collateral⁸. As a result they can occur in a variety of different forms.

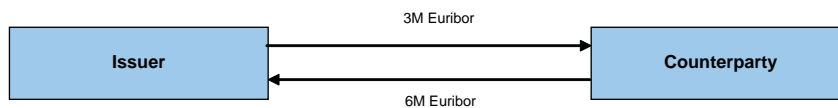
INTEREST RATE AND BASIS RISK SWAPS

Interest rate and basis swaps can be used to convert fixed payment amounts to amounts based on a floating index such as LIBOR⁹, or to convert amounts determined in accordance with one basis to another e.g. 3 month EURIBOR¹⁰ to 6 month EURIBOR.

Fix/Floating Swap:



Basis Swap:



CURRENCY SWAPS

Currency swaps exchange a payment stream in one currency for a payment stream in another, and are often found in transactions where the currency of the underlying assets is different from the currency of some or all of the Issuer's liabilities. Both interest and principal cash flows will typically be exchanged in a currency swap. The exposure of the transaction to the swap counterparty therefore has the potential to be greater with this type of swap, than, for instance, with a single currency interest rate swap or a single currency basis swap.

7. Represented by, among other things, the mark-to-market value of the swap.

8. Swaps may attempt to hedge transaction cash flows perfectly, or may be based on assumptions as to the nature of future cash flows, which may result in an imperfect hedge. Where cash flows have not been perfectly hedged DBRS considers whether the potential for a mismatch in cash flows is consistent with the ratings requested.

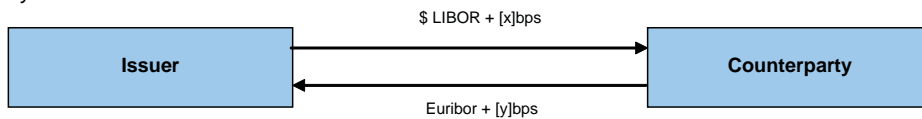
9. London Interbank Offered Rate.

10. European Interbank Offered Rate.

Initial Leg:



Ongoing Payments:



Final Leg:



CAPS, FLOORS AND COLLARS

Caps, floors, collars and other options can be used to limit exposure to movements in interest rates or currencies.

BALANCE GUARANTEED SWAPS

While in many swap agreements the notional amounts that determine the parties' respective payment obligations are fixed for the life of the transaction, for collateral pools with an amortising or otherwise uncertain repayment profile, the swap may specify a notional amount that is linked to either the actual or a projected paydown profile of the underlying assets or the outstanding balance of the Issuer's liabilities. Swaps that track the actual amortisation profile of a transaction are referred to as 'balance-guaranteed'.

'REVENUE' SWAPS

Swaps may also attempt to match transaction cash flows more closely, such as where the swap counterparty agrees to convert whatever cash flows are received in connection with an underlying pool of assets (or at least that portion of the collateral pool that is still performing) into whatever cash flows are necessary in order to make payments on the notes issued by the Issuer. For the purposes of this report such swaps are referred to as 'revenue' swaps.

CREDIT DEFAULT SWAPS

In addition to swaps that hedge against payment mismatches, an Issuer may also enter into a swap that directly references credit risk. A credit default swap allows the risk of default of one or more specified reference entities¹¹ to be transferred, with one party (commonly referred to as the protection buyer) paying a periodic 'premium' in exchange for its counterparty's undertaking to either make a payment or purchase one or more specified obligations of the reference entity on its default. Credit default swaps may be used either to transfer risk synthetically to an Issuer, or occasionally to enable an Issuer to buy protection against a credit risk to which it is exposed. Total return swaps may be used to exchange both interest and principal payments in respect of specified assets, regardless of whether those payments have actually been received, thus also providing protection against collateral default. As mentioned above, the framework described in this methodology is not intended to apply to credit default swaps or total return swaps. DBRS reviews such swaps on a case-by-case basis.

11. Reference Entity is the term used in the ISDA Credit Definitions to describe the particular credit being referenced in a credit default swap i.e. the party in respect of which the existence of a Credit Event may trigger payment obligations from the seller of protection to the buyer of protection.



SWAP PROVIDERS

A number of different types of entity, such as banks, insurance companies and derivative product companies (“DPCs”), may act as swap counterparty in a structured finance transaction. DBRS considers the identity of the swap counterparty in the context of its review of the transaction. Where the swap counterparty is itself a structured entity, such as a DPC, DBRS reviews the structural features applicable to the counterparty to determine whether they are consistent with the structural features of the relevant transaction and the requested ratings.

DBRS Framework For Mitigating Risk Of Swap Counterparty Default

Where rated securities are dependent on the performance by a swap counterparty of its obligations, those securities are exposed to the risk that the counterparty may default. This section of the methodology describes a framework for mitigating the risk associated with that default in structured finance transactions. A central principle of the framework is the removal of credit risk associated with the counterparty from the transaction, or the mitigation of that risk, before the counterparty defaults. This is achieved by the inclusion of structural features sufficient to ensure that, as its creditworthiness deteriorates, as evidenced by its ratings, the counterparty will be replaced or its obligations will be collateralised or otherwise guaranteed, prior to the point where it might be expected to default.

Issuers are under no obligation to follow the framework¹². However, the potential benefits of following the criteria described herein are twofold.

Firstly, where it is possible for Issuers to meet the criteria, the reduction in exposure to the swap counterparty should result in reduced risk to the rated securities, and therefore the potential for higher ratings.

Secondly, assuming the criteria described herein are met, DBRS believes that, for appropriate transactions, the exposure of the rated securities may be mitigated to an extent sufficient to avoid modelling the counterparty risk associated with the swap. In order to be comfortable that the risk of a swap counterparty default can be treated in this way, DBRS must be satisfied that this risk is limited when compared with the risk addressed by the rating(s) assigned to the securities issued. In determining whether this is the case, DBRS examines the rating of the swap counterparty, the nature of the swap and the rating requested for those securities.

The potential for default of a swap counterparty can present both liquidity and credit risks for a transaction. Liquidity risks might arise where the Issuer depends on the performance of the swap counterparty to provide it with funds required to meet its upcoming payment obligations in a timely manner, such as where the Issuer receives payments in one currency from an underlying pool of assets but is required to make payments in a different currency in respect of its liabilities, or where the Issuer receives fixed cash flows from an underlying pool of assets but is required to make payments on its liabilities based on an index. Even if the default of the counterparty does not result in an ultimate credit loss for the Issuer, it may find itself temporarily without the cash flows it requires in order to meet its obligations. Credit risk may arise in respect of a swap counterparty where the swap becomes significantly ‘in the money’ for the Issuer. In such circumstances, some or all of the cost to the Issuer of replacing the swap if the original counterparty were to default may need to be provided from the Issuer’s assets, thus reducing the amount of collateral available to support the rated securities.

12. The criteria described herein are not requirements. Originators and their advisors may choose to incorporate features in their transactions that differ from those discussed in this publication and DBRS assesses those structures to determine whether those transactions may be rated, and if so, what rating may be appropriate.



In order for DBRS to be satisfied that it is not necessary to separately model the risk of counterparty default, the exposure of the rated securities to the swap counterparty should be such that failure of the swap counterparty to perform its obligations would not, in and of itself, be expected to result in a default by the Issuer in respect of those securities becoming either inevitable or significantly likely, either in the short term (for instance as a result of liquidity risk) or in the longer term (because the swap represents ultimate credit risk). Depending on the nature of the swap, structural features such as excess spread, liquidity facilities or reserve accounts may be capable of mitigating the impact of the non-performance of the counterparty from a liquidity perspective¹³. Similarly, the timing of available cash flows, the ability of the Issuer to apply principal receipts to cover obligations in respect of interest amounts due, and, where it can be shown to exist¹⁴, the ability of the Issuer to enter the market and convert available cash flows into the required currencies pending replacement of the counterparty may, if relevant, each mitigate the immediate effect of a counterparty's default. In examining the credit risk associated with the swap counterparty's default DBRS reviews both (i) the nature of the swap, and (ii) the ongoing mark-to-market value of the swap through the life of the transaction to determine the extent of the exposure to the swap counterparty.

Where the nature of the swap is such that a payment default by the counterparty would result in a significant likelihood that the Issuer might default in respect of its obligations under the rated securities, whether in the short term, or ultimately, the rating criteria described herein are unlikely to be sufficient to avoid separately modelling the counterparty risk as part of DBRS analysis of the transaction. In such circumstances compliance with the criteria may nevertheless serve to mitigate the counterparty risk, allowing higher ratings to be assigned to rated securities than might otherwise have been possible. Alternatively the Issuer may consider other structural features to mitigate the counterparty risk, such as for instance including an obligation of the counterparty to post collateral, arrange a guarantee of its obligations or to replace itself on loss of a higher rating than "A". Similarly, an obligation of the counterparty to start posting collateral once the exposure of the Issuer to the counterparty under the swap exceeded a certain threshold, regardless of the counterparty's rating, could in appropriate circumstances be effective in limiting the risk to the holders of the rated securities of a default of the counterparty¹⁵. DBRS considers any such structural mitigants proposed on a case-by-case basis.

ISSUES TO BE ADDRESSED AT TRANSACTION CLOSING

The framework relies on the principle that the transaction documentation provides for the counterparty to be removed from the transaction before it defaults. In practice, this is achieved by the inclusion of structural features sufficient to ensure that, as its creditworthiness deteriorates, as evidenced by its ratings, the counterparty is either replaced or its obligations are collateralised or otherwise guaranteed, prior to the point where it might be expected to default.

DBRS relies on the ratings it has assigned¹⁶ to the swap counterparty as an indicator of its proximity to default. To fall within the parameters of the framework, at closing the swap counterparty is expected to be rated at least "A"¹⁷, or at least "BBB" if collateral consistent with the framework is to be posted from the outset.

13. Provided, of course, that the source of those features is not the swap counterparty itself, such as where the originator simultaneously performs a number of roles in the transaction, including servicer, collection account bank, issuer account bank, reserve account bank and swap counterparty.

14. Such as by the nomination of a transaction party responsible for and capable of carrying out the necessary tasks on the Issuer's behalf.

15. Such a feature might be incorporated by setting a finite Threshold within the CSA documentation. DBRS understands that this practice is common in connection with swaps entered into between non-SPV market participants.

16. In cases where DBRS does not maintain a public or private rating for a particular institution, the DBRS Financial Institutions Group provides an internal assessment, which is monitored over the life of the transaction. DBRS will notify the relevant institution if any such internal assessment results in a downgrade that results in the counterparty being rated below a relevant threshold, so that such institution can decide which of the applicable remedies to implement. In certain cases, DBRS may rely on public ratings assigned and monitored by other credit rating agencies.

17. Where the counterparty is rated at each of the rating thresholds such rating must not be Under Review (Negative).



ISDA-standard documentation¹⁸, including a Credit Support Annex or Credit Support Deed, is expected to be in place at the transaction's closing. Regardless of whether the counterparty is required to post collateral from the outset, a collateral account should be established.

RATING THRESHOLDS

The DBRS framework anticipates that the Schedule to the ISDA Master Agreement provide for the following actions should the rating of the swap counterparty be downgraded below the thresholds described.

First Rating Threshold

Assuming the swap counterparty is rated "A" or above at closing, if the counterparty is subsequently downgraded such that it is rated below "A", the swap counterparty, at its own cost, is expected as soon as practicable, but in any event no later than 30 business days after such date, to:

1. Post eligible collateral sufficient to meet the criteria for the First Rating Threshold (described below) OR
2. Arrange for its obligations pursuant to the swap to be guaranteed in a manner consistent with the framework (see further below) by a third party rated at least "A" OR
3. Arrange for its obligations pursuant to the swap to be assumed by a third party rated at least "A".

If at closing the swap counterparty is rated below "A" but at least "BBB", the counterparty may still meet these criteria by posting collateral consistent with the framework from the outset. At any time after closing, the counterparty may stop posting collateral if:

1. It is upgraded such that its rating is at least "A" OR
2. It procures a guarantee for its obligations pursuant to the swap consistent with the framework (see further below) by a third party rated at least "A" OR
3. It arranges for its obligations pursuant to the swap to be assumed by a third party rated at least "A".

Second Rating Threshold

DBRS does not consider that the posting of collateral sufficiently mitigates the risks associated with the default of a counterparty rated lower than "BBB". As a result, when a swap counterparty in an existing transaction has been downgraded below "BBB" the swap documentation is expected to provide for:

1. the swap counterparty to post eligible collateral sufficient to meet the criteria for the Second Rating Threshold (described below) as soon as practicable, but in any event within 30 business days, AND
2. the counterparty to use commercially reasonable efforts to either
 - arrange for its obligations pursuant to the swap to be guaranteed in a manner consistent with the framework (see further below) by a third party rated at least "A" OR
 - arrange for its obligations pursuant to the swap to be assumed by a third party rated at least "A"¹⁹.

The Schedule to the ISDA Master Agreement is expected to provide that a failure by the swap counter-

18. DBRS notes that swap documentation based on other standards may also be used, such as the CMOF form commonly found in Spanish transactions. While this paper focuses on the ISDA standard, DBRS will review other forms of swap documentation on a case-by-case basis to ensure that the principles set forth in this methodology are met.

19. Or a counterparty rated at least "BBB" if collateral consistent with the framework is to be posted from the outset.



party to comply with its obligations on a breach of either the First or Second Rating Threshold should enable the Issuer to terminate the swap transaction²⁰.

As mentioned above, once a counterparty is rated below “BBB”, DBRS no longer considers the credit risk associated with a counterparty default to be adequately addressed solely by the provision of collateral. Consequently, the aim of the framework from this point is to facilitate the removal of this credit risk, either by having the counterparty replaced or by having its obligations guaranteed by an entity rated at least “A”. The framework provides for an increase in the collateral to be posted once the counterparty is no longer rated above the Second Rating Threshold to mitigate the increased credit risk associated with the counterparty while a search for a replacement continues.

DBRS recognises however that in certain circumstances replacement of the counterparty may prove difficult. To provide the greatest chance of this occurring, the framework also contemplates that if replacement or guarantee does not occur within 30 business days of a downgrade below the Second Rating Threshold, the Issuer will have certain rights to terminate affected transactions, as described in more detail below.

Where the rating(s) assigned to the highest rated securities issued by the Issuer which are dependent on performance of the swap do not exceed “A (high)”, the above framework may also be applied, although in such circumstances the First Rating Threshold would not need to apply. For the avoidance of doubt, a counterparty related below “BBB” at close of a transaction is not eligible for the treatment contemplated by the framework, even if it agrees to post collateral consistent with the framework.

If a transaction where the rating(s) assigned to the highest rated securities issued by the Issuer which are dependent on performance of the swap were initially rated above “A (high)” but were subsequently downgraded such that they no longer exceeded “A (high)”, DBRS may continue to regard the risk of the counterparty to be adequately mitigated provided that the framework criteria for a transaction with the new, lower, ratings continues to be satisfied, and that this is consistent with what had been reflected in the transaction documentation. Similarly, if a transaction initially rated no higher than “A (high)” were to perform such that an upgrade to a rating higher than “A (high)” might otherwise be supported, such upgrade might be limited by the swap counterparty’s rating and/or the failure of the transaction documentation to incorporate the swap counterparty criteria for transactions rated at the higher level.

POSTING COLLATERAL

One-way posting

ISDA credit support documentation contemplates bilateral collateralisation. Whichever party suffers an ‘exposure’ (where the agreed value of collateral provided by the other party is less than the amount by which the swap is ‘in-the-money’ for the first party), the other party must transfer sufficient collateral to remove that exposure.

Consistent with the purpose of the framework, as well as the general nature of structured finance transactions, DBRS anticipates that the form of credit support documentation entered into provide only for a one-way transfer of collateral i.e. only the swap counterparty may be required to post collateral.

Swap Counterparty as Calculation Agent

The Issuer in a structured finance transaction is likely to be a special purpose vehicle, lacking either significant operational infrastructure, or the systems or expertise necessary to adequately value derivative obligations. The framework recognises this fact, assuming, as is the case in the majority of structured finance transactions that include swaps, that the swap counterparty also acts as Calculation Agent. Consistent with ISDA documentation, DBRS expects that in performing its obligations, the counterparty be subject to a contractual obligation to act in good faith and in a commercially reasonable manner.

20. Whether as a consequence of an Additional Termination Event or an Event of Default under the ISDA Master Agreement.



Minimum Transfer Amount

ISDA credit support documentation requires collateral (or additional collateral) to be posted where the amount required to be delivered (the Delivery Amount) exceeds the Minimum Transfer Amount. DBRS reviews the Minimum Transfer Amount proposed to determine whether it is consistent with the ratings requested. DBRS typically expects a Minimum Transfer Amount not exceeding \$100,000, or its equivalent, to be specified unless an Event of Default or Termination Event has occurred, in which case the Minimum Transfer Amount should be zero.

Determining Delivery Amount²¹

The Delivery Amount is determined based on the excess of the Credit Support Amount (the amount required to be covered i.e. the Issuer's exposure to the counterparty in respect of the swap) over the value of collateral (if any) already posted (referred to in ISDA credit support documentation as the Credit Support Balance).

The process therefore begins with the determination of the Issuer's exposure to the counterparty. The framework regards the exposure of the Issuer to the swap counterparty as being the amount the Issuer would need to pay to a replacement swap counterparty to enter into a similar swap transaction with it. The framework takes as the starting point for the determination of the replacement cost, the mark-to-market or 'close-out' value of the swap, as reflected in the valuation of the swap performed by the counterparty.

Notwithstanding the obligation, when acting as Calculation Agent, to act in good faith and in a commercially reasonable manner, DBRS may nevertheless request the counterparty to confirm that the valuation it applies to the swap for the purposes of determining the Delivery Amount is consistent with that used for its own internal valuation purposes. DBRS may also periodically request the counterparty to approach third parties for quotations in relation to the swap. Where the valuation of the swap depends on a weighted average life or other amortisation profile for notional amounts under the swap, DBRS requests details of the method used to determine that weighted average life or paydown profile.

As discussed in more detail below, the framework assumes that the valuation of both the swap and any collateral posted occur no less frequently than weekly. As the mark-to-market of a swap can fluctuate between valuation dates, the method for determining the amount of collateral to be posted at each rating threshold provides for an additional swap volatility cushion²² to account for the volatility of the swap's mark-to-market value from one period to the next.

Credit Support Amount at the First Rating Threshold

If the counterparty is, or has been downgraded to below the First Rating Threshold, but remains above the Second Rating Threshold, the framework determines the exposure to be collateralised as follows:

Max (0; Mark-to-market + hedge notional²³ * swap volatility cushion)

The swap volatility cushions are as follows:

21. For the purposes of simplifying the explanation in this section, it has been assumed that a single swap has been entered into under the ISDA Master Agreement.

22. The swap volatility cushions described in connection with the valuation of the swap transaction for the purposes of collateralising upon the breach of rating thresholds as described herein are appropriate for swaps denominated in the following currencies: United States Dollars, British Pounds, Euro, Swiss Francs, Japanese Yen, Danish Krone and Swedish Krona. Other currencies are considered on a case by case basis.

23. Where different notional amounts exist under the swap, such as for a currency swap, the relevant notional amount will be for the leg of the transaction whose cash flows support the rated securities.



For Single Currency Interest Rate Swaps, Caps, Floors, Collars, Swaptions and Balance Guaranteed Swaps:

Swap Weighted Average Life (years)**	Note Rating*	
	AA (low) or Higher	Less Than AA (low)
0-1	0.25%	0.15%
1-3	0.50%	0.30%
3-5	1.00%	0.75%
5-7	1.50%	1.25%
7-10	2.50%	2.00%
10-20	3.50%	2.50%
Greater than 20	4.00%	3.00%

* i.e. the highest rating on securities issued by the Issuer supported by the swap.

** DBRS expects, for the purposes of determining the swap volatility cushions throughout the criteria, that the weighted average life be determined based only on scheduled payments i.e. the possibility of voluntary prepayments by underlying obligors is ignored, as is the potential for their default.

For Cross Currency Swaps and all 'Revenue' Swaps:

Swap Weighted Average Life (years)	Note Rating	
	AA (low) or Higher	Less Than AA (low)
0-1	2.00%	1.25%
1-3	2.50%	1.50%
3-5	2.75%	2.00%
5-7	3.00%	2.25%
7-10	3.50%	2.50%
10-20	4.25%	3.00%
Greater than 20	5.00%	4.00%

Credit Support Amount at the Second Rating Threshold

Upon a downgrade to below the Second Rating Threshold, the credit risk of the hedge provider becomes more of a concern. The framework now assumes a higher likelihood of the Issuer being exposed to movements in the value of the swap (and therefore the cost of replacing the original counterparty) and as a result provides for higher swap volatility cushions.

Where the counterparty is downgraded to below the Second Rating Threshold the framework determines the exposure to be collateralised as follows:

Max (0; Mark-to-market + hedge notional * swap volatility cushion; next payment²⁴)

The swap volatility cushions are as follows:

For Single Currency Interest Rate Swaps, Caps, Floors, Collars, Swaptions and Balance Guaranteed Swaps:

Swap Weighted Average Life (years)	Note Rating	
	AA (low) or Higher	Less Than AA (low)
0-1	0.75%	0.50%
1-3	1.25%	0.75%
3-5	2.00%	1.50%
5-7	3.00%	2.00%
7-10	5.00%	3.00%
10-20	7.00%	5.00%
Greater than 20	9.00%	6.50%

24. The net amount due from the counterparty on the immediately following payment date. In relation to currency swaps this amount would be calculated based on the difference between the counterparties' payments, expressed in the currency required by the Issuer, even if such payments would not actually required to be netted under the swap.



For *Cross Currency Swaps* and *all 'Revenue' Swaps*:

Swap Weighted Average Life (years)	Note Rating	
	AA (low) or Higher	Less Than AA (low)
0-1	7.00%	5.00%
1-3	7.50%	5.50%
3-5	8.00%	6.00%
5-7	9.00%	7.00%
7-10	10.00%	8.00%
10-20	12.00%	9.00%
Greater than 20	14.00%	12.00%

Several points are worth noting:

Firstly, the exposure of the Issuer is floored at zero, consistent with the premise that it is only the swap counterparty who may be subject to an obligation to post collateral.

Secondly, while the framework contemplates that the mark-to market of the swap may be netted against the swap volatility cushion, note that it is nevertheless possible that collateral may need to be posted by the counterparty at a time when the mark-to-market value of the swap shows it to be 'in the money' for the counterparty. This would occur where the mark to market value of the swap in favour of the counterparty was less than the swap volatility cushion, reflecting the risk that the value of the swap might move during the relevant valuation period such that it would become in the money for the Issuer.

Finally, where the counterparty has been downgraded below the Second Rating Threshold, in determining the amount of collateral that needs to be posted the framework includes in the calculation the net amount due from the counterparty on the next following payment date. This ensures that the Issuer is provided with sufficient funds to cover its imminent obligations in respect of the rated obligations, therefore mitigating immediate liquidity issues associated with the counterparty's default.

Valuing Collateral to be Delivered

The purpose of collateral arrangements is to remove one party's exposure to another under a swap by requiring the other party to provide collateral with sufficient value to remove that exposure. In addition to determining the amount of the exposure that needs to be covered, the framework must also consider the nature of the collateral that may be provided, and assuming that the value of that collateral is itself subject to fluctuations in value, how to ensure that collateral with sufficient value is provided such that the credit risk associated with the counterparty is adequately mitigated.

The framework assumes that collateral provided by the counterparty is limited by the transaction documentation to either cash or interest-bearing debt issued by sovereign entities rated at least "AA (low)". Where the currency of the collateral matches the currency of the rated securities whose payment obligations are supported by the swap the value attributed by the framework to collateral posted is reduced in accordance with the following tables of advance rates, reflecting the potential for the value of the collateral to move between the date on which it is provided and the date when the Issuer may need to realise the collateral in order to obtain a replacement counterparty.

First Rating Threshold:

Collateral Maturity (years)	All Rating Levels
0-1	99.7%
1-3	99.0%
3-5	98.5%
5-7	98.0%
7-10	97.5%
10-20	97.0%
Greater than 20 years	96.0%



Second Rating Threshold:

Collateral Maturity (years)	Note rating	
	AA (low) or Higher	Less Than AA (low)
0-1	99.0%	99.5%
1-3	98.0%	99.0%
3-5	96.5%	97.5%
5-7	95.0%	97.0%
7-10	93.0%	95.0%
10-20	90.0%	93.0%
Greater than 20 years	86.0%	90.0%

Where the currency of the collateral does not match the currency of the rated securities²⁵ whose payment obligations are supported by the swap the value attributed by the framework to collateral posted is reduced in accordance with the following tables of advance rates:

First Rating Threshold:

Collateral Maturity (years)	Note rating	
	AA (low) or Higher	Less Than AA (low)
0-1	95.50	96.50
1-3	95.00	96.00
3-5	94.50	95.50
5-7	94.00	95.00
7-10	93.00	94.50
10-20	92.50	94.00
Greater than 20 years	91.50	93.00

Second Rating Threshold:

Collateral Maturity (years)	Note rating	
	AA (low) or Higher	Less Than AA (low)
0-1	91.00	92.50
1-3	90.50	92.00
3-5	90.00	91.50
5-7	89.50	91.00
7-10	89.00	90.00
10-20	85.00	88.00
Greater than 20 years	79.00	84.00

The advance rates above apply to both fixed rate and floating rate collateral.

Delivering Collateral – Timing and Frequency

As mentioned above, the framework assumes that the valuation of both the swap and any collateral posted occur no less frequently than weekly. To reflect the likely operational capacity of the Issuer, and to ensure that delays do not occur, transaction documentation should provide that the Issuer is deemed to have made the required demands for collateral once the Delivery Amount exceeds the Minimum Transfer Amount i.e. where conditions requiring the posting of collateral (or further collateral) arise.

Collateral Accounts

A separate collateral account should be established by the Issuer (or the arranger on its behalf) at closing. The account should be established such that it is isolated from the insolvency of the swap counterparty. DBRS expects opinions from counsel confirming that securities posted to the account would not form part of the bankruptcy estate of the counterparty nor would they be affected by any moratorium or other stay on enforcement which might prevent access to those securities in a timely manner should the counterparty become insolvent. DBRS checks whether the securities intermediary or custodian with whom the

25. For collateral denominated in the following currencies: United States Dollars, British Pounds, Euro, Swiss Francs, Japanese Yen, Danish Krone and Swedish Krona. Other currencies are considered on a case by case basis.



account is to be held meets the general criteria for securities intermediaries and custodians described in DBRS “Legal Criteria for European Structured Finance Transactions”. While DBRS recognises that the laws of certain jurisdictions provide protection for securities that are held in trust, custody or fiduciary accounts from the insolvency of the securities intermediary or custodian, in jurisdictions where this is not the case DBRS considers whether the ratings of such parties are consistent with the criteria described in that methodology. DBRS reviews transaction documentation to determine whether collateral accounts are secured in favour of the Security Trustee from the outset of the transaction.

REPLACEMENT

The framework allows a counterparty to mitigate its credit risk by collateralising its obligations, and provided that the counterparty’s rating remains above the Second Rating Threshold, the counterparty retains the option to continue providing collateral in accordance with the framework as an alternative to finding a replacement. Once the counterparty’s rating is below the Second Rating Threshold, however, the framework assumes that the counterparty is subject to an obligation to use commercially reasonable efforts to replace²⁶ itself. The continued provision of (increased) collateral amounts supports the obligation to replace, but does not remove it.

DBRS recognises however that, depending on a number of factors including the nature of the particular transaction and the state of the market at the relevant time, replacement of the counterparty may prove difficult. Given the likely importance of the swap to an Issuer’s ability to meet its obligations in respect of rated securities, DBRS does not consider that the framework should prescribe termination of an existing swap in the absence of a suitable replacement, provided that the existing counterparty is complying with its obligations pursuant to the framework i.e. it is continuing to post collateral and is actively seeking a replacement counterparty.

The framework also contemplates that once the counterparty’s rating is downgraded below the Second Rating Threshold, the Issuer be in a position to terminate the existing swap agreement if, at any time not earlier than 30 business days after a breach of the Second Rating Threshold, it manages to locate an eligible counterparty²⁷ willing to enter into the transaction and at that stage the original swap counterparty has failed to procure its own replacement.

Once a replacement swap counterparty is found, depending on whether the swap is in- or out of the money for the Issuer, a payment is likely to be required either to or from the replacement swap counterparty for it to assume the original counterparty’s obligations.

Whether the replacement counterparty has been located by the original swap counterparty or by the Issuer, DBRS assumes that the swap documentation reflects that the amount payable in connection with the termination of the original swap be determined in accordance with the amount required to be paid to or received from the new counterparty for entering into the swap.

Provided that the original counterparty is not in default, such payment is likely to be made between the original counterparty and the replacement counterparty, and as a result, transaction cash flows should not be affected. Once the replacement swap agreement has been executed, the Issuer would return any collateral that had been posted by the original counterparty.

DBRS assumes that transaction documentation specify clearly that any costs associated with finding a replacement would be borne by the counterparty.

26. Or provide a guarantee from an eligible party in respect of its obligations.

27. DBRS appreciates that the Issuer is likely, in most instances, to need assistance in locating a replacement counterparty. DBRS reviews the transaction to determine whether a suitable party has been nominated to whom the task may be delegated in such circumstances.



GUARANTEE

DBRS recognises that guarantees need to be drafted to address specific jurisdictional and structural requirements, and reviews each guarantee on a case-by-case basis. However, DBRS typically expects that the guarantee meet the criteria for guarantees described in “Legal Criteria for European Structured Finance Transactions”.

DBRS generally requests an opinion from counsel for the guarantor stating that the guarantor has the capacity and authority to issue the guarantee; the guarantee is an irrevocable and unconditional obligation of the guarantor, ranking equally with the senior unsecured debt of the guarantor; and constitutes its legal, valid and binding obligations enforceable by either the Issuer or the security trustee or other noteholder representative in accordance with its terms. If the guarantor is located in a jurisdiction that differs from the governing law of the guarantee, DBRS requests an opinion that a judgment obtained under the guarantee is enforceable against the guarantor in the guarantor’s jurisdiction. The opinion should also address whether any payments from the guarantor would be subject to withholding or other taxes.

SURVEILLANCE - REPORTING

The ongoing mark-to-market value of the swap is an important indicator of the exposure of the transaction to the swap counterparty. DBRS therefore requests that such valuation be disclosed (i) on closing of the transaction²⁸ (or when DBRS first assigns ratings to the transaction, if later) and (ii) on an ongoing basis, no less frequently than other reporting required in connection with the transaction, thereafter.

In addition to the above, once the swap counterparty is downgraded below either the First or the Second Rating Thresholds, DBRS requests periodic information in relation to:

1. The valuation of the swap and the collateral provided pursuant to the credit support documentation; and
2. Where relevant, efforts made by the swap counterparty to facilitate its replacement.

TRANSACTION PRIORITY OF PAYMENTS ON COUNTERPARTY DEFAULT

It is possible that, notwithstanding compliance with the framework, a counterparty may nevertheless default prior to its replacement. In such circumstances, the Issuer would have the ability to terminate any outstanding transactions, and it is expected that this would typically occur. It would then be for the Issuer to seek a replacement counterparty. DBRS appreciates that the Issuer is likely, in most instances, to need assistance in locating a replacement counterparty. DBRS reviews the transaction to determine whether a suitable party has been nominated to whom the task may be delegated in such circumstances.

Once a replacement has been found, assuming the swap was in the money for the Issuer, an upfront payment would be required to be made to the new swap counterparty. Such payment would be made from the proceeds of collateral posted by the counterparty and, assuming such proceeds were sufficient, would occur outside the transaction’s payment waterfall.

If the swap was out of the money for the Issuer at the time of the counterparty’s default (and assuming the swap was terminated), the Issuer would be required to make a payment to the original counterparty notwithstanding such counterparty’s default. In most structured finance transactions, payments to swap counterparties rank at or close to the top of the waterfall, typically higher than the payment of interest and principal on rated securities. However, in order to ensure that sufficient cash flows remain available to meet the Issuer’s rated obligations, in circumstances where amounts might be due to a swap

28. The mark-to-market valuation of the swap at its inception is useful in analysing whether the swap was entered into on market terms. If the swap has a significant mark-to-market valuation at the outset it may indicate that the swap is performing an additional function, which may be relevant to DBRS analysis of the risk associated with the counterparty’s default.



counterparty as a result of its own default, the framework assumes that the payment of such amounts be subordinated to all amounts due in respect of the rated securities, or amounts otherwise required in order for the Issuer to continue performing its obligations in respect of those securities²⁹.

DBRS notes that in a recent U.S. decision³⁰, the U.S. Bankruptcy Court for the Southern District of New York held that the ipso facto³¹ prohibitions of the U.S. Bankruptcy Code prevented enforcement of such a provision (commonly referred to as a ‘flip clause’) because the clause was triggered by a bankruptcy filing and was not contained in any agreement protected by the safe harbors of the Bankruptcy Code³². The case was appealed but was settled shortly after the U.S. District Court for the Southern District of New York granted interlocutory review of the bankruptcy court’s decision. In another recent decision³³ the same bankruptcy court held that a contractual provision that subordinates a termination payment owing under a credit default swap to a debtor in bankruptcy, and which caps the amount of the termination payment, may be an unenforceable ipso facto clause under the Bankruptcy Code. In reaching its decision, the court held that a swap participant’s contractual rights to liquidate, terminate or accelerate one or more swap agreements may not be applicable to a provision that seeks to reorder distributions based on a bankruptcy filing. This decision was rendered on an order denying a motion to dismiss filed by the non-debtor swap counterparty, and therefore the case has yet to be decided on the merits.

In order for DBRS to view the counterparty risk as adequately mitigated in transactions where the counterparty may be subject to the jurisdiction of the U.S Bankruptcy Court, DBRS expects to see an opinion from U.S counsel as to the effectiveness of any ‘flip’ clauses.

Swap Documentation

Swaps are typically documented pursuant to a master agreement in a form produced by the International Swaps and Derivatives Association, Inc. (ISDA).

The ISDA Master Agreement

The ISDA Master Agreement is a document that describes the basic framework for one or more transactions entered into between two counterparties. ISDA has published several versions of the Master Agreement, the two most commonly reviewed by DBRS in the context of structured finance transactions being the 1992 ISDA Master Agreement (Multicurrency-Cross Border)³⁴ and the 2002 ISDA Master Agreement (referred to hereafter as the 1992 ISDA Master Agreement and the 2002 ISDA Master

29. DBRS notes that a similar payment might typically be expected to be received from the replacement counterparty, in which case only the net amount (if any) required to be paid by the Issuer to the swap counterparty would be subordinated as described above.

30. *Lehman Brothers Special Financing Inc. v. BNY Corporate Trustee Services Limited* (In re Lehman Brothers Holdings, Inc.), 422 B.R. 407 (Bankr. S.D.N.Y. 2010).

31. Section 541(c) of the Bankruptcy Code provides that an interest of the debtor in property becomes property of the debtor’s bankruptcy estate under Section 541(a)(1), (a)(2), or (a)(5) of the Bankruptcy Code notwithstanding any provision in any agreement, transfer instrument or applicable non-bankruptcy law that restricts or conditions such ownership because of the insolvency or financial condition of the debtor, or due to the filing of a bankruptcy case. Section 365(e)(1) generally makes ipso facto provisions in executory contracts unenforceable.

32. DBRS notes however that the initial ruling of the U.S. Bankruptcy Court may be limited to the facts at issue—specifically the fact that the swap agreement did not include the subordination provisions and a provision modifying the calculation of an early redemption amount on a default by the Lehman Brothers entity within the terms of the swap agreement itself, or by reference. Had the swap agreement expressly included those terms, the court would have had to consider whether such provisions pertained to the termination, liquidation or acceleration of a swap agreement, thus potentially making them subject to the safe harbor provisions of section 560 of the Bankruptcy Code.

33. *Lehman Brothers Special Financing, Inc. v. Ballyrock ABS CDO 2007-1 Limited* (In re Lehman Brothers Holdings, Inc.), Adv. P. No. 09-01032 (JMP) (Bankr. S.D.N.Y. May 12, 2011).

34. A ‘Local Currency – Single Jurisdiction’ version of the 1992 ISDA Master was also produced by ISDA.



Agreement, respectively). The ISDA Master Agreements are governed by either New York or English law and describe the terms that will govern the relationship between the parties, providing a framework for payment and delivery obligations, describing representations that each party makes concerning its status and information it is expected to provide, prescribing a variety of other matters concerning the parties' ongoing relationship and setting out the events of default and other termination events that may cause the relationship between the parties to terminate either in its entirety, or in relation to specific transactions entered into pursuant to the Master Agreement.

An important feature of the ISDA Master Agreement is that it provides for the netting of amounts owed from one counterparty to another, either in respect of payment obligations that arise between the parties during the life of transactions entered into pursuant to the Master Agreement, or on a termination of those transactions. A central aim of the ISDA Master Agreement is therefore to reduce the exposure of each party to the risks associated with the bankruptcy of its counterparty, providing a framework for outstanding transactions to be valued, and for amounts owed by each party to the other pursuant to transactions entered into pursuant to the ISDA Master Agreement to be set-off against each other, such that only a net amount needs to be claimed in the bankruptcy of the defaulting counterparty.

Schedule to the ISDA Master Agreement

As the ISDA Master Agreement is a printed form document, amendments to any of the terms contained therein are made by way of a separate Schedule entered into by the parties. The Schedule tailors the standard form of the ISDA Master Agreement to the specific relationship intended to be entered into by the counterparties, and describes how certain sections of the ISDA Master Agreement will apply, as well as how specific provisions of the ISDA Master Agreement need to be amended in respect of one or both parties.

Confirmations

Having determined the terms that will govern their relationship in relation to derivative transactions generally, the parties document the economic terms of individual transactions pursuant to one or more confirmations. The ISDA Master Agreement is intended to be used in connection with a broad range of derivative transactions and ISDA has published a variety of different transaction confirmations, supported by sets of definitions that may be used to document those transaction types.

Credit Support Annex/Deed

The 1994 ISDA Credit Support Annex, the 1995 ISDA Credit Support Annex and the 1995 ISDA Credit Support Deed each allow parties to establish arrangements requiring the provision of collateral to 'cover' the obligations each might have to the other pursuant to the ISDA Master Agreement³⁵.

The 1994 Credit Support Annex is designed for use in transactions subject to New York law, contemplating the establishment of bilateral mark-to-market security arrangements. The 1995 Credit Support Annex allows parties to establish bilateral mark-to-market arrangements under English law. Unlike the New York law governed Annex the English Credit Support Annex does not involve the creation of a security interest however, instead relying on transfer of title to posted collateral which, in the event of a default, is included in the close-out netting provided by Section 6 of the ISDA Master Agreement. The 1995 ISDA Credit Support Deed allows parties to establish bilateral mark-to-market collateral arrangements under English law, relying on the creation of a formal security interest in posted collateral. Unlike the Credit Support Annexes the Credit Support Deed is a stand-alone document.

35. ISDA has published additional forms of credit support documentation in addition to those mentioned above. The 2008 ISDA Credit Support Annex (Loan/Japanese Pledge) is intended for use in connection with transactions for which the parties intend to use assets located in Japan as credit support, and follows the 'security interest' route. The 2001 ISDA Margin Provisions update and simplify the four existing credit support documents in a single document, allowing parties to select jurisdiction-specific provisions to apply to their margin arrangements under New York law, English law and Japanese law.



Whichever form is used, ISDA credit support documentation contemplates a ‘two way’ collateralisation. Whichever party suffers an ‘exposure’ (where the agreed value of collateral provided by the other party is less than the agreed market-to-market value of the swap in its favour), the other party must transfer sufficient collateral to remove that exposure.

ISDA Master Agreement 1992 versus 2002

DBRS continues to review derivative documentation in structured finance transactions based on both versions of the ISDA Master Agreement.

While both 1992 and the 2002 versions of the ISDA Master Agreement provide a similar framework for the documentation of derivative transactions, there are a number of notable differences³⁶, perhaps the most important of which is the replacement of the First Method, Second Method, Market Quotation and Loss options for the determination of payments on an early termination with a single new measure, Close-out Amount.

Termination Events and Events of Default

The ISDA Master Agreement defines two broad categories of event that can cause a termination of a swap transaction. Events of Default are intended to provide the non-defaulting party with the right to terminate all transactions entered into pursuant to the Master Agreement in circumstances where the counterparty has failed to perform a fundamental obligation under the Master Agreement³⁷, or has become subject to bankruptcy proceedings or other insolvency-related events. A Termination Event gives either one or both counterparties the right to terminate individual transactions entered into pursuant to the Master Agreement where such transactions have been affected by certain specific events, for example where a change in law renders performance of the transaction unlawful, or the transaction is affected by changes in taxation.

For structured finance transactions the Schedule to the Master Agreement typically includes additional termination events in addition to those standard events specified in the ISDA Master Agreement, and may also modify the standard ISDA events to better suit the relationship between the counterparties.

SWAP DOCUMENTATION – SPECIFIC PROVISIONS

The following section describes various features of or amendments to swap documentation that DBRS typically expects to find in a structured finance transaction. DBRS recognises however that each swap needs to be tailored to the particular structured finance transaction. Therefore, DBRS reviews swap documentation on a case by case basis to determine whether the provisions included are consistent with the ratings requested.

Conditions precedent to performance

Section 2(a)(iii) of both the 1992 and 2002 Master Agreement provides that each party’s payment or delivery obligations are subject to the condition precedent that no Potential Event of Default has occurred or is continuing with respect to the other party. A Potential Event of Default is defined in broad terms as any event which, with the giving of notice or the lapse of time or both would constitute an Event of

36. These include the shortening of grace periods for Events of Default such as Failure to Pay, Default Under Specified Transaction and Bankruptcy; the amendment of the definition of Specified Transaction to include repo and securities lending transactions with consequential changes to the related Event of Default, the amendment of the Illegality Termination Event, and, in particular, the ability to terminate less than all affected transactions; the introduction of a new termination event, the Force Majeure Event; the incorporation of a set-off clause; the consolidation of various interest provisions; the clarification of the position in relation to multibranch parties and an updated jurisdiction clause. In addition, each of the Credit Support Annexes and the Credit Support Deed were drafted with the 1992 ISDA Master Agreement in mind and need to be amended for use with a 2002 ISDA Master Agreement. The necessary amendments are contained in the 2002 Master Agreement Protocol.

37. Or with respect to other obligations that have been identified as relevant for this purpose – see 5(a)(v) Default under Specified Transactions and 5(a)(vi) Cross Default.



Default. DBRS reviews this provision in connection with the Events of Default applicable to the Issuer to determine whether it is consistent with the ratings requested.

Events of Default

Failure to Pay or Deliver

This Event of Default typically applies to both the swap counterparty and to the Issuer. DBRS reviews whether grace periods specified in connection with the performance by both parties of their obligations are consistent with the ratings requested.

Breach of Agreement

This Event of Default typically applies to the swap counterparty only. As the transaction parties typically rely on separate covenants provided by the Issuer (see “Legal Criteria for European Structured Finance Transactions”) this Event of Default typically does not apply to the Issuer.

The 2002 ISDA Master introduces a new Event of Default: **Repudiation of Agreement**. DBRS expects this Event of Default to apply to the counterparty. Given the nature of the Issuer as a special purpose vehicle it is not expected that this Event of Default would apply to the Issuer.

Credit Support Default

DBRS expects this Event of Default to apply to the counterparty, with any guarantee provided in respect of the swap counterparty’s obligations being designated as a Credit Support Document. It does not typically apply to the Issuer.

Misrepresentation

DBRS expects this Event of Default to apply to the counterparty. For the same reason that the Breach of Agreement does not typically apply to the Issuer, DBRS does not expect the Misrepresentation Event of Default to apply to the Issuer either. If it is deemed appropriate for this Event of Default to apply to the Issuer in a particular transaction DBRS expects to see legal opinions supporting each of the representations the Issuer is required to make.

Default Under Specified Transaction

This Event of Default may apply to the counterparty, depending on the nature of the transaction. It is unlikely to be applicable to the Issuer.

Cross Default

This Event of Default may apply to the counterparty, depending on the nature of the transaction. It is unlikely to be applicable to the Issuer.

Bankruptcy

DBRS expects this Event of Default to apply to the swap counterparty. Given the nature of the Issuer as a bankruptcy-remote entity it should not be necessary to have the Bankruptcy Event of Default apply to it. Where the Bankruptcy Event of Default is nevertheless applied to the Issuer DBRS reviews the terms of section 5(a)(vii) of the ISDA Master Agreement (as amended) to ensure that the Event of Default is not capable of being triggered inadvertently or in a manner inconsistent with the ratings requested.

Merger Without Assumption

DBRS expects this Event of Default to apply to the counterparty. Given the nature of the Issuer and likely prohibitions contained elsewhere in the transaction documentation on its merging with third parties it is unlikely to be of relevance to the Issuer.



Termination Events

Illegality

DBRS typically requests legal opinions addressing relevant aspects of the transaction (see “Legal Criteria for European Structured Finance Transactions”). Regardless of whether the Illegality Termination Event is applied DBRS reviews any changes of law to determine their impact on the ratings assigned to the rated securities.

Tax Event

This Termination Event allows a party to a transaction to terminate a swap transaction where a change in law results in that party either (i) being required to pay to the other party an additional amount in respect of a gross up for withholding tax or (ii) receive from the other party a reduced amount as a result of the application of withholding tax. DBRS typically requests opinions addressing the likelihood of withholding taxes applying to payments under the swap. Regardless of whether the Tax Event Termination Event is applied DBRS reviews any changes of law to determine their impact on the ratings assigned to the rated securities.

Tax Event Upon Merger

The nature of the Issuer should make its merger unlikely, and this Termination Event should not therefore be relevant to it as an Affected Party. DBRS would typically expect the counterparty to be under an obligation to gross up payments in the event that a merger of the counterparty resulted in the application of a withholding tax to payments to the Issuer. DBRS would not expect the Issuer to be subject to an obligation to gross up payments by it to cover the imposition of a withholding tax resulting from the merger of the counterparty.

Credit Event upon Merger

The nature of the Issuer should be such that its merger is unlikely. This Termination Event may apply to the counterparty, although assuming the swap counterparty resulting from the merger is itself subject to similar documentation as the original swap counterparty, the risk of its default should itself be addressed by the framework.

Additional Termination Events

Where the framework is being relied upon to mitigate the risk of the counterparty’s default, Additional Termination Events consistent with those described herein should apply to the counterparty. Further Additional Termination Events may apply to both the counterparty and the Issuer consistent with the transaction.

Transfer; Security

DBRS typically expects to see the rights of the Issuer pursuant to the swap transaction secured in favour of the security trustee for the holders of the rated securities (and other relevant transaction parties). Depending on the nature of the security being granted it may be necessary therefore to amend the provision of Section 7 of the ISDA Master Agreement which contains a general prohibition on transfers of rights pursuant to the swap, including by way of security.

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