Methodology

Rating U.S. Auto Fleet Lease Securitizations

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Related Research:
• Legal Criteria for U.S. Structured Finance
• Operational Risk Assessment for U.S. ABS Servicers
• Unified Interest Rate Model for Rating U.S. Auto Fleet Lease ABS Transactions

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Scope and Limitations

DBRS evaluates both qualitative and quantitative factors when assigning ratings to a U.S. structured finance transaction. This methodology represents the current DBRS approach for rating fleet lease securitizations issued in the U.S. with equipment collateral originated in the U.S. It describes the DBRS approach to analysis, which includes (1) a focus on the quality of the sponsor/servicer, (2) evaluation of the collateral pool and (3) utilization of historically employed credit evaluation techniques. This report also outlines the asset class and discusses the methods DBRS typically employs when assessing a transaction and assigning a rating. It is important to note that the methods described herein may not be applicable in all cases. Further, this methodology is meant to provide guidance regarding the DBRS methods used in the sector and should not be interpreted as prescribing a rigid template applicable in all circumstances, but understood in the context of the dynamic environment in which it is intended to be applied.

Executive Summary

This methodology builds on the framework provided by other auto-related methodologies developed by DBRS and outlines the unique structuring elements that are involved in the securitization of receivables related to corporate auto fleets. The purpose of this publication is to provide greater transparency into the rating process by outlining the methodology that DBRS applies when rating U.S. auto fleet securitizations. This methodology should be reviewed in conjunction with the recently published Legal Criteria for U.S. Structured Finance, which is available at www.dbrs.com.

The methodology outlined herein should not be seen as static. DBRS reviews market and legal developments on an ongoing basis to ensure that its policies and practices remain relevant. DBRS recognizes that each transaction is different and that mitigating factors may lead to modification of some of the recommendations.

There have been a number of auto fleet transactions in the U.S. marketplace funded through the asset-backed securities (ABS) and asset-backed commercial paper markets. This transaction history permitted this methodology to have been applied through the stresses of a volatile economic environment from a macroeconomic perspective and within the automotive industry specifically.

Notwithstanding the rating of the sponsoring auto fleet company, DBRS may assign AAA ratings to the ABS notes in these securitizations by applying the methodology on structures that adequately address the main risks inherent in auto fleet securitizations: fleet composition, lessee and industry concentrations, structural risk (including bankruptcy remoteness) and operational risk.

This methodology provides a discussion of the following:
(1) Background information on the auto fleet industry.
(2) A structural overview of transactions, including bankruptcy-remoteness risks.
(3) Key variables affecting auto fleet transactions.
(4) Certain structural risks and historical performance in auto fleet securitizations.
(5) Components of enhancement.
(6) Evaluating credit enhancement considerations.

The methodology also provides a synopsis of the analysis and resulting assumptions used to evaluate the key risks identified. Information on post-transaction surveillance and additional considerations is also provided.
Industry Overview

INDUSTRY OVERVIEW — NORTH AMERICA
Fleet sales represent a significant share of the total number of vehicles sold by manufacturers and include commercial vehicles, government-operated vehicles, police fleets, taxi fleets and rental fleets. DBRS has a separate methodology for rental fleet securitizations that can be accessed via www.dbrs.com. For the purposes of the auto fleet methodology, rental fleets are not considered.

Historically, there have only been a small number of auto fleet operators in North America large enough to participate in the securitization market. While market share ebbs and flows, the industry is dominated by three North American-based entities that currently represent approximately 58% of the top ten auto fleet lessors in North America: GE, ARI and PHH Arval.1 Statistics for 2014 that outline the scope of the fleet business in the United States are outlined in Figure 1 below.

Figure 1: Leading Fleet Lessors by U.S. Car/truck

The auto fleet industry has seen a number of developments in recent years that have resulted in an overall reduction in fleet vehicle sales. The recent recession has led corporations to look for operation efficiencies, resulting in an increase in demand for fuel-efficient vehicles, less expensive vehicles and fewer vehicles. As a result, vehicle fleet management companies have had to become more creative and diversified in their product offerings. Recent technological developments have provided an opportunity for the fleet management companies to enhance the value provided to their customers. For example, telematics is playing a larger role in the suite of logistical offerings within the fleet leasing business. Telematics refers to the use of wireless devices and data tracking technologies to transmit data in real time on vehicle use, maintenance requirements and/or vehicle servicing. Telematics initially started with global positioning systems, which allowed fleet operators to track vehicle usage and locate stolen vehicles. However, today, due to the growing needs of fleet operators, telematics programs are evolving to encompass driver safety, fuel efficiency, increased driver productivity, route compliance and improved customer service. Online fleet management has also given auto fleet customers the ability to manage their fleet more efficiently and take advantage of the additional usage data that is available with this type of service.

1. On July 7, 2014, Element Financial Corporation announced that it acquired the assets and operations of PHH Arval for USD 1.4 billion in cash.
Fleet management operators have broadened their business model in recent years to provide more management services on behalf of their corporate customers. For a fee, some fleet managers will provide fuel services, maintenance, accident service, titling, tax, licensing, remarketing and other ancillary services. The additional services generally necessitate minimal incremental capital and benefits to the fleet manager include a diversification of revenues, increases in margins and increased customer loyalty. As a result, a securitization transaction may include cash flows originating from monthly management fees in addition to the lease payments for the fleet vehicles themselves. Figure 2 below outlines the key steps typically involved in managing a fleet of vehicles for a corporate customer.

It can also be noted that many of these developments have a favorable impact on the ability of the fleet manager to more efficiently acquire, monitor the location of and remarket all of its assets.

Figure 2: Typical Process Diagram for Managing Corporate Fleet of Vehicles
Operational Risk

ORIGINATOR REVIEW
DBRS typically begins the initial originator review process by sending a questionnaire to the company that outlines the topics to be covered during the review, such as organizational charts, financial statements, underwriting guidelines and performance statistics (Appendix I). A date is usually then scheduled to conduct an on-site visit of the company or have a call. During the on-site review and/or call, DBRS meets with senior management to discuss the origination operations, tour the facilities and review system demonstrations, as appropriate. DBRS assesses the information gathered through the review process, along with its surveillance data and industry statistics to determine if an originator is acceptable. In instances where DBRS determines that the originator is below average, issuers may incorporate certain structural enhancements into a proposed transaction, such as additional credit support or a third-party firm to provide the requisite representations and warranties, in order for DBRS to be able to rate the transaction. In the event that DBRS determines that an originator is unacceptable, it may decline to rate the transaction.

The originator review process typically involves a review and analysis of the following:
- Company and management,
- Financial condition,
- Controls and compliance,
- Origination and sourcing,
- Underwriting guidelines and
- Technology.

COMPANY AND MANAGEMENT
DBRS believes that no origination operation can be successful without a strong seasoned management team that possesses demonstrated expertise in the product(s) they are originating. As a result, DBRS views favorably those originators whose management team possesses greater than ten years of industry experience. Additionally, DBRS believes the participation of the credit risk management, quality control, legal and compliance departments in all aspects of the origination and underwriting process is important in order to identify and mitigate risk. Furthermore, adequate capacity and resources to handle fluctuations in fleet lease volume are of paramount importance.

FINANCIAL CONDITION
DBRS typically reviews the originator’s financial condition to determine whether the originator has sufficient resources to make the appropriate representations and warranties on the fleet leases being included in a securitization. The financial condition of the entity performing an origination role may be assessed through feedback, an internal assessment, a private rating from the DBRS Financial Institutions Group or through additional analysis performed in the review of the transaction.

Some items that are reviewed as part of this process may include:
- Company ownership structure,
- Management experience,
- Corporate rating of any parent company (if applicable),
- Internal and external audit results,
- Revenue sources and lines of credit,
- Costs to originate,
- Litigation (past, present and expected),
- Existing business strategy and strategic initiatives,
- Recent or planned mergers or acquisitions,
- Recent or planned transfers or acquisitions and
- Securitization history and future plans.
Any financial stress identified can elicit originator problems either immediately, as in the case of a bankruptcy, or lead to a slow degradation of the performance of the collateral. Therefore, the originator’s financial condition weighs on all aspects of DBRS analysis of fleet lease transactions, including the evaluation of proposed credit enhancement levels and the presence of structural safeguards.

**CONTROLS AND COMPLIANCE**

DBRS believes internal assessments and quality control reviews are critical in recognizing procedural errors that may not be easily detectable. These reviews can be used to identify trends, training opportunities and exception practices. Frequent checks can assist management in quickly instituting changes to areas needing improvement, as well as benchmarking those results to performance. In addition to the aforementioned reviews, a monitoring process should be in place to ensure that the originator is in compliance with all applicable laws, rules and regulations and that all employees in customer-facing positions are appropriately trained.

DBRS views favorably the participation of the credit risk management, quality control, legal and compliance departments in all aspects of the origination and underwriting process in order to identify and mitigate attendant risks. DBRS also views favorably those originators that are not the subject of any regulatory or state investigation(s). Minimal or no repurchases due to breaches of representations and warranties are considered of paramount importance, as are the existence of robust procedures for vendor selection and oversight. Additionally, strong controls for managing potential conflicts of interest associated with parties to a transaction are important.

**ORIGINATION AND SOURCING**

DBRS reviews the origination and sourcing channels to determine if the originator has a clearly defined strategy. Sales and marketing practices are also reviewed to determine the screening process. Origination practices that include regular performance tracking and quality control reviews are viewed favorably by DBRS. Furthermore, procedures that ensure new account setup accuracy and data integrity are fundamental to ensuring minimal errors. As a result, DBRS views favorably those originators with high levels of automation and strong efforts toward compliance with regulatory guidelines and industry best practices.

**UNDERWRITING GUIDELINES**

An originator’s appetite for risk and the underlying quality of its underwriting guidelines can have a significant impact on transaction performance. Therefore, DBRS uses both a qualitative and quantitative approach to conduct its originator reviews and make comparisons among originators. Historical lease performance and repurchase volume are just some of the components that are incorporated into determining the quality of an originator.

DBRS views favorably those originators that have robust guidelines and use reliable means to accurately assess a lessee’s creditworthiness. An originator’s exception and override practices can also help to assess the quality of the originations. Additionally, separation of the origination and underwriting functions in addition to a compensation structure that emphasizes quality over lease volume can help to ensure predictable performance.

**TECHNOLOGY**

Technology resources are an integral component of the originator review process. While DBRS does not subscribe to specific systems architecture, in reviewing the originator, DBRS considers whether adequate systems controls and backup procedures, including disaster recovery and business continuity plans, are in place. Furthermore, originators must ensure that any offshore vendors are monitored and a backup plan is in place to ensure minimal downtime.
Over the past few years, leveraging the Internet has enabled many firms to operate effectively in the fleet lease business. Originators have used the Internet for marketing, customer service and the dissemination of relevant fleet information. As a result, DBRS expects originators to have the appropriate staff and controls in place to ensure website availability, account maintenance and enhancements. Sophisticated technology with robust functionality is viewed favorably by DBRS as it often helps bring large efficiencies to the origination operations, in addition to more predictability in terms of performance.

SERVICER REVIEW

The servicer review process evaluates the quality of the parties that service or conduct backup servicing on the accounts being securitized. While DBRS does not assign formal ratings to these processes, it does conduct operational risk reviews to determine if a servicer is acceptable and incorporates the results of the review into the rating and surveillance processes.

DBRS typically begins the initial servicer review process by sending a questionnaire to the company that outlines the topics to be covered during the review and includes a list of documents to be provided, such as organizational charts, financial statements and performance statistics. A date is usually then scheduled to conduct an on-site visit of the company or have a call. During the on-site review and/or call, DBRS meets with senior management to discuss the servicing operations, tour the facilities and review system demonstrations, as appropriate. The on-site review typically takes one to two days, depending on the complexity of the portfolio. DBRS assesses the information gathered through the review process, along with its surveillance data and industry statistics to determine if a servicer is acceptable. In instances where DBRS determines that the servicer is below average, issuers may incorporate certain structural enhancements into a proposed transaction, such as additional credit support, dynamic triggers or the presence of a warm or hot backup servicer, in order for DBRS to be able to rate the transaction.

The servicer review process typically involves an analysis of the following:

- Company and management,
- Lessee management,
- Lease administration,
- Vehicle maintenance and tracking,
- Remarketing
- Investor reporting and
- Technology.

For details on the servicing review process, please refer to the DBRS methodology *Operational Risk Assessment for U.S. ABS Servicers*. 
Transaction Structure

STRUCTURAL ELEMENTS (INCLUDING BANKRUPTCY-REMOteness RISK)

Prior to evaluating the appropriate level of credit enhancement for a given transaction, an understanding of the legal structure implemented to accommodate the securitization of the fleet is provided. The structure proposed by the issuer is important in providing the framework upon which the bankruptcy-remoteness risk assessment is based.

Fleet lease securitizations generally utilize a revolving master trust or a static pool and have a legal structure similar to retail auto lease securitizations. Since the lessee is not the owner of the vehicle, a titling trust (Origination Trust) is used in most fleet lease ABS structures. In addition, in the U.S., motor vehicle and titling laws vary by state. The securitization structure is specifically designed to address these issues.

The following is an example of a generic structure diagram that could be utilized for a commercial fleet lease ABS transaction. Typically an Origination Trust is established that holds all of the titles of the underlying vehicles and is the lessor to the fleet lease obligors; in other words, the Origination Trust owns all the vehicles. The Origination Trust may issue one or more special unit of beneficial interest (SUBI) certificates representing an undivided interest in the assets owned by the Origination Trust to an intermediate special-purpose vehicle (the Borrower) in a true sale transaction. The sale of the SUBI, rather than the underlying vehicles and corresponding leases, allow for the Origination Trust to remain the title holder. The Origination Trust also issues an undivided trust interest (UTI) certificate to the Borrower, which represents a beneficial interest in the assets of the Origination Trust not allocated to any SUBI. The Borrower then usually pledges the SUBI to the issuer of the ABS notes (the Issuer) pursuant to a loan agreement with the Issuer.
Cash Flow
Investors in the structure generally receive interest and principal payments based on collections from obligors in connection with lease contracts for use of the vehicles, management fees (if applicable) and proceeds received from the disposition of vehicles in the portfolio of leases. As noted in Legal Criteria for U.S. Structured Finance, available at www.dbrs.com, cash is typically deposited into segregated accounts at eligible institutions and held for noteholders. Cash held in the segregated accounts is distributed to the noteholders based on transaction documents and generally includes payments of interest followed by payments of principal.

Commingling and Partial Commingling of Funds
Consistent with other methodologies, DBRS considers a minimum investment-grade rating threshold of BBB (low) to permit the auto fleet company to commingle funds pledged to the securitization with its corporate funds for longer than a short period of time. In cases where the rating threshold is not met, other steps may be taken to mitigate the cash commingling risk, including frequent remittance of funds or a guarantee and indemnity from an appropriately rated company.

DBRS typically reviews the form and substance of the structure and the legal opinions provided that indicate the transaction represents a true sale from the Seller’s/Servicer’s perspective.

Revolving Nature of Structures — Principal Repayment, Eligibility Criteria and Annual Review
Auto fleet securitization structures may be revolving or amortizing in nature. Transactions structured with a revolving period may allocate a portion of, or all, principal collections to be reinvested in new receivables on a regular basis. Asset coverage tests may also be incorporated by issuers in a revolving structure to provide adequate lease receivables to support repayment of the notes.
One key risk in connection with a revolving structure relates to the potential for a reduction in asset quality (i.e., loosening underwriting standards) without a corresponding increase in enhancement to mitigate the risk. An important element of the initial structuring of a revolving transaction is to ensure consistency in asset additions through the use of an eligibility criteria. With an established eligibility criteria in place at the outset of the transaction, the portfolio is more likely to replace maturing assets with new assets that have a similar risk profile. Examples of eligibility criteria may include limitations on the portfolio with respect to:

- Industry concentration,
- Geographic concentration,
- Vehicle type,
- Maximum lease term,
- Maximum percentage of closed-end leases,
- Lessee concentration limits and
- Hell or high water and triple net contracts only.

Notwithstanding the application of eligibility criteria, DBRS reviews the performance of transactions on a periodic basis and evaluates the enhancement assumptions in accordance with the DBRS Master U.S. ABS Surveillance Methodology.

**Amortization Period**

During an amortization period, principal collections are deposited to an account in order to immediately repay principal beginning on a certain date. An early amortization period is usually triggered by predetermined events that can occur during the life of a transaction and may be trust- or series-specific (in a master trust structure). For those transactions operating under a master trust structure, whereby multiple series of notes are issued secured by a single pool, trust-specific triggers are incorporated to protect all series of noteholders as a result of potential adverse performance of the pool of securitized assets or certain events related to the seller. Trust-specific amortization events typically lead to a pro rata repayment of all series of notes in accordance with their priority, regardless of their respective scheduled maturities. Amortization triggers for a specific series of notes can also be incorporated by an issuer and apply only to that specific series. In the event a series-specific amortization trigger is breached, the master trust may continue purchasing new assets for the remaining series of notes.

Trust- and series-specific performance triggers may include loss rates, aging or default ratio limits, thresholds on draws of credit enhancement and a minimum balance of receivables.
Key Variables Affecting U.S. Auto Fleet Securitization Transactions

DBRS has reviewed transactions from large auto fleet management companies that have been in the business for many years and have established credit and collection policies that are implemented on a North American-wide basis. Key variables that typically affect the performance and credit quality of auto fleet transactions include: (1) the credit quality of the auto fleet company as servicer of the fleet in the transaction, (2) the credit quality of the obligors leasing the vehicles and (3) the reliance and valuation of the underlying vehicle collateral including residual value analysis.

AUTO FLEET MANAGEMENT COMPANY (THE SPONSOR)
The performance of a transaction could be affected by the financial condition of the Sponsor as servicer of the fleet being securitized. The Sponsor is responsible for managing the pool on behalf of the note-holders and servicing the leases that support the ABS notes. As such, analysis of the Sponsor includes an analysis of its financial performance, as well as its operational capabilities as servicer/operator. As noted earlier, notwithstanding the results of the review of the servicer/originator, transactions are usually structured such that the underlying assets of the securitization (the leases and related vehicles) are owned by a bankruptcy-remote entity (the Origination Trust), so they would expected to be legally segregated in the event of the bankruptcy of the Sponsor.

Transactions are typically analyzed assuming the auto fleet company and the obligors are under financial stress. Once the expected assumptions are established, DBRS applies stresses that correspond to the target rating levels. The cash flow scenarios incorporate a pool’s assumptions and the structural elements of the transaction. The rating of the Sponsor or its parent (assuming the parent provides a performance guarantee) is also relevant to whether the funds received on a daily basis can be commingled until the settlement date (usually 30 days). Remittance of funds on a daily basis, in the case of lower-than-investment-grade Sponsors, may result in an expectation that the exposure should be less than 30 days and could be as short as one to two days. Other considerations, in addition to the review of the financial performance of the Sponsor, include the underlying terms of the standard form fleet lease contracts and the underwriting of the fleet portfolio.

Standard Form Lease Contracts
As part of the operational review, DBRS usually reviews the standard form contract that governs the lease offered by Sponsor and accepted by the fleet lease obligor. Lease contracts in U.S. structures have typically involved open-end fleet leases of cars; light-, medium- and heavy-duty trucks; SUVs; some specialized trucks; and equipment. Although dominated by open-ended leases, typically, U.S. securitizations may include a very limited number of closed-end lease contracts. These closed-end leases typically result in additional analysis regarding the maturity and the residual value exposure associated with these types of contracts. Regardless of whether the contracts are open- or closed-end, most contracts are triple net (whereby the lessee is responsible for all maintenance, insurance and tax owing on the vehicle) and hell or high water (meaning that the lessee may not terminate the lease prior to the expiration date and that the lessor has no continued obligations other than the provision of quiet enjoyment to the lessee). Leases are typically billed monthly and represent the total amount due for the lease of the fleet of vehicles, as well as any management fees owing for additional services performed as described above.

Technically, many of these underlying leases are known as TRAC (terminal rental adjustment clause) leases or modified open-end leases, intended to be true leases. TRAC leases were introduced under the federal tax code (Tax Equity and Fiscal Responsibility Act of 1982 (Section 7701 IRC)). The residual is normally stated upfront at lease inception (the TRAC amount). The lessee effectively guarantees the residual. At lease termination, the lessee is usually responsible for making up any deficiency between the
market value of the vehicle/equipment and the TRAC amount. Alternatively, the lessee will get a rebate if the market value is greater than the TRAC amount. The lessee benefits from lower monthly payments for taking on the residual value risk.

**Underwriting**

The strength of the transaction is affected by the credit quality of the portfolio underwritten by the Sponsor. The auto fleet companies, and by extension, the noteholders in a transaction, are exposed to the creditworthiness of their obligors. DBRS typically reviews the policies and procedures used by the Sponsor in approving the obligors in its portfolio. As part of the operational review, a number of functions and policies are typically reviewed, including:

- Sales process;
- Granting and adjudication of credit;
- Standard form contracts utilized;
- Credit terms (amount and lease term limits);
- Geographic diversification of the fleet;
- Vehicles class diversification, (cars; SUVs; light-, medium- and heavy-duty trucks; equipment);
- Industry concentration;
- Depreciation rates by vehicle class;
- Fleet management revenue versus vehicle lease revenue (i.e., unsecured versus secured credit);
- Internal credit tiering;
- Billing, collection, write-off and cash management processes;
- Bankruptcy monitoring of its obligors;
- Vehicle disposal and remarketing processes;
- Data warehousing, security, backup and recovery systems; and
- Number of years in the business and experience of management.

Since historical data is utilized in the ratings process, DBRS considers the consistency of the fleet managers’ application of its policies and procedures when reviewing the procedures outlined above.

**Bankruptcy Risk of Sponsor**

To date, there have been no bankruptcy filings of fleet management companies with securitization transactions rated by DBRS. However, given the DBRS approach of rating through the economic cycle, structures proposed by the sponsors need to be reviewed considering a bankruptcy of the Sponsor. Noteholders are generally intended to be protected through the use of bankruptcy-remote structures designed by the Sponsor and underwriters, which, based on opinions provided by seller’s counsel, represent a true sale, thus shielding the assets from claims by the bankrupt entity’s creditors. Additional protections could include triggers and provisions that provide for the appointment of a replacement servicer (in certain transactions) to manage the fleet and facilitate repayment of all obligations. In some transactions, noteholders are afforded some input regarding the approval in the appointment of a replacement servicer (if applicable) subsequent to an event of default.
CREDIT QUALITY OF THE FLEET OBLIGORS
Given that auto fleet transactions are characterized by a portfolio of corporate obligors that lease a small to large number of vehicles, obligor concentration risk is usually greater than in a transaction backed by consumer auto leases. For this reason, mitigation of lessee concentration risk typically involves a consideration of the credit quality of the obligors in the proposed portfolio of fleet leases. A securitized transaction generally means that the size and scope of the Sponsor’s portfolio is large and may include established and well-known corporate obligors. U.S. transactions have often been characterized by portfolios that include corporate obligors with strong credit ratings. The credit rating of the lessee is an important element in the assessment of the portfolio and can supplement or supplant other credit indicators commonly used in other asset classes (for example, credit scores (e.g., FICO) normally referenced in a transaction backed by consumer obligations). As an important indicator for the ability to pay, DBRS utilizes the published credit ratings of the obligors in reviewing the enhancement proposal for transactions it rates. Additionally, industry and geographic concentrations are also considered.

RELIANCE ON AND VALUATION OF THE UNDERLYING VEHICLE COLLATERAL
Fleet lease transactions are secured by the leased vehicles and the value may need to be realized in the used car market in order to meet the obligations due under the transaction. Price fluctuations are normal depending on the timing of the sale, as the used car market has historically been characterized by seasonal fluctuations. Vehicle values in the spring typically represent the highest values and the late fall and early winter represent the lowest. Rising oil prices and fluctuating currency markets also contribute to volatility in the used car market. In its analysis of the valuation of the vehicle security, DBRS notes that fleet portfolios are different from consumer portfolios with respect to depreciation.

Depreciation
The standard form contracts used by fleet management companies usually include agreed upon depreciation rates as part of the calculation of the monthly payment. Historically, losses are also magnified if the depreciation is not properly managed by the Sponsor. The extent to which vehicles do not depreciate in line with market value normally determines the amount of gain or loss on the sale of the vehicles at the time of disposition. Since portfolios are mostly open-ended lease contracts, the gain or loss on the vehicle is usually only relevant if the lessee defaults on its contract. As a result of lessee credit quality, fleet management companies have historically experienced low loss rates on their portfolios (under 1.0%).

Residual Value Exposure in the Auto Fleet
Auto fleet transactions can be exposed to residual value risk to the extent that the portfolio is comprised of closed-end lease contracts. To date, fleet transactions have included only a small percentage of closed-end leases. If a fleet lease transaction was presented that included a significant residual value risk, DBRS may analyze such exposure consistent with transactions that are backed by consumer auto leases (see the DBRS methodology Rating U.S. Auto Lease Securitizations at www.dbrs.com). In summary, expected residual values are reviewed considering potential stressed environments, which could include the use of third-party estimates of the residual value.

In its analysis, DBRS typically incorporates the historical experience of losses by the Sponsor, the depreciation rates applied to the various types of vehicles, the type of contract (open- or closed-end), the used market trends and the diversification of the fleet by make and model. This analysis is usually factored into the haircuts applied to the recovery value of the collateral in determining the rating for a transaction given the proposed credit enhancement levels.
Structural Risks and Historical Performance in Auto Fleet Securitizations

CONCENTRATION RISK
As noted above, concentration limits and eligibility criteria are usually incorporated in revolving structures to provide consistency and diversification in the pool composition. Lessee composition in a pool of fleet leases may be diversified; however, there may be concentrations of a few large obligors in many pools. Generally, a large obligor’s credit quality is determined by its credit rating, if available. The larger obligors tend to involve fleets that are diversified by asset type, which may remove some of the exposure to a single manufacturer. Exposure to these larger obligors is typically analyzed relative to the credit enhancement levels in a securitization structure.

CREDIT LOSSES — HISTORICAL PERFORMANCE
Lessee defaults in a fleet lease transaction have historically been low, in terms of frequency. These losses are often associated with the bankruptcy of the obligor. When a lessee defaults, the recoveries are often greater than 80% to 85% of book value (at time of default), sometimes with only basis points (bps) worth of net losses inuring to the overall portfolio or transaction. This has been the historic experience even through different economic cycles. Measured on an annual basis, the net loss rates in fleet lease portfolios have historically been maintained at low levels (0 bps to 15 bps). Again, a key factor contributing to the low rate of losses experienced in fleet lease pools is the critical service function (sales, delivery, etc.) played by the vehicles in the obligors’ business.
Components of Credit Enhancement

EXCESS SPREAD
Excess spread is the amount by which the weighted-average interest on the pool of assets exceeds the sum of the trust’s funding costs, net losses, servicing fees (if applicable) and other trust fees. Excess spread absorbs the first level of losses incurred by the pool. Fleet lease assets are usually characterized by fixed-rate contracts and floating-rate contracts, while the funding costs of the trust are typically based on LIBOR plus a spread for conduit transactions and may be fixed rate or floating for term ABS transactions.

OVERCOLLATERALIZATION
Overcollateralization can represent the largest single component in the overall credit enhancement structure of a fleet lease securitization transaction. Overcollateralization represents the excess of lease receivable balances over the aggregate outstanding ABS note balance. The collections from additional receivables, such as fleet management, may increase cash flows and assist in the rapid amortization of the outstanding notes in a revolving structure to the extent that such receivables are included in the collateral package.

CASH RESERVE
Similar to other securitization transactions, a cash reserve account is also included for credit enhancement purposes. The cash reserve account provides liquidity to the transaction for losses or delays in cash flows caused by delinquencies or slower-than-expected recoveries. The account is typically funded upfront and may increase due to the trapping of excess spread and other non-principal collections (if available) subsequent to the occurrence of certain events, such as a breach of a performance trigger.

SUBORDINATION
Subordinated notes in certain transactions provide credit enhancement for the senior notes by absorbing losses (up to the subordinated principal amount) and allowing the senior notes preferential access to the cash flows. The level of enhancement for the subordinated notes, however, will typically be subject to cash flow stresses.
Evaluating Credit Enhancement

The assets in fleet lease securitization transactions are, primarily, the obligations of corporate obligors secured by a fleet of leased vehicles. The performance of the assets depends on the credit strength of the obligors supported by a diversified pool of vehicles and an experienced servicer. In the normal course of a transaction these assets generally experience low default frequency and low severity of losses in the instances of lessee default. However, DBRS usually considers an increased severity of default in a transaction that could be caused by the bankruptcy of several large obligors. Further, DBRS typically assumes these leases are rejected by the bankruptcy trustees, although we do recognize that in practice most leases have been affirmed by the lessees in bankruptcy.

LESSEE CONCENTRATIONS

DBRS’s typical approach to evaluating the credit enhancement for fleet lease securitization transactions begins with a review of the lessee concentration levels in order to assess the default levels used in modeling in the cash flow stress exercises. The lessee coverage table below (Table 1) serves to protect the rated securities from harsher and more stressful conditions than assumed within the expected case cash flow scenario. Table 1 indicates the typical lessee coverage range for U.S fleet lease securitizations. Lessee coverage is designed to capture uncertainties and variables that may affect future transaction performance. The coverage range in Table 1 is a guideline and may not be applicable in all transactions.

<table>
<thead>
<tr>
<th>Rating Category</th>
<th>Lessee Concentration</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>Top 5–7 Obligors</td>
</tr>
<tr>
<td>AA</td>
<td>Top 4–6 Obligors</td>
</tr>
<tr>
<td>A</td>
<td>Top 3–4 Obligors</td>
</tr>
<tr>
<td>BBB</td>
<td>Top 2–3 Obligors</td>
</tr>
<tr>
<td>BB</td>
<td>Top 1–2 Obligors</td>
</tr>
</tbody>
</table>

For example, if the top concentration was 4.0%, then the total default when evaluating the cash flow results for a AAA rating would be expected to be 20% to 28%. DBRS typically assumes a recovery credit is applied to this default assumption consistent with the Recovery Rate Range Assumptions (Table 3 on page 19) table below.

In addition to the lessee concentrations noted above, DBRS also usually reviews the credit quality of the largest obligors in the portfolio and assesses the level of enhancement in comparison to the credit rating of such obligors. Under this analysis, the risk of default is related to the level of enhancement available in the transaction. For example, a AAA-rated lessee could be afforded a greater concentration limit relative to lower-rated obligors in the same portfolio. Given that fleet portfolios may be comprised of secured (i.e., lease) and unsecured (i.e., fleet management) receivables, it may be necessary to bifurcate the pool when evaluating the proposed level of enhancement. DBRS typically evaluates the proposed level of enhancement and applies the benchmarks noted below (Table 2). Table 2 indicates the typical lessee concentrations as a percent of total credit enhancement for U.S fleet lease securitizations. The lessee concentration analysis is designed to capture uncertainties and variables that may affect future transaction performance. The lessee concentrations in Table 2 are guidelines and may not be applicable in all transactions.
Table 2: Lessee Concentration as a % of Total Hard Credit Enhancement (i.e., excluding excess spread)

<table>
<thead>
<tr>
<th>Lessee Credit Rating</th>
<th>Secured Portfolio</th>
<th>Unsecured Portfolio*</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>200%</td>
<td>100%</td>
</tr>
<tr>
<td>AA (low) or better</td>
<td>100%</td>
<td>50%</td>
</tr>
<tr>
<td>A (low) or better</td>
<td>66.6%</td>
<td>33.3%</td>
</tr>
<tr>
<td>BBB (low) or better</td>
<td>50%</td>
<td>25%</td>
</tr>
<tr>
<td>Less than BBB (low)</td>
<td>34%</td>
<td>17%</td>
</tr>
</tbody>
</table>

* Management fees, if securitized, are treated as unsecured assets, with reduced concentration limits expected.

Once credit enhancement is evaluated, DBRS assesses lessee exposures with the table above. For example, AAA-rated obligors typically have concentration exposures (net of recoveries for the secured receivables) that are equal to not more than 2 times the proposed enhancement. If a transaction had 11% enhancement, a AAA-rated lessee typically could have a concentration exposure in the transaction of 22% (net of recoveries for the secured receivables). If the same transaction had a BBB (high)-rated obligor, that obligor’s concentration level typically would not exceed 5.50% (net of recoveries for the secured receivables).

HISTORICAL PERFORMANCE
The adequacy of the amount of enhancement relative to lessee concentration is evaluated by applying certain cash flow stress assumptions to determine how deterioration in the credit quality of the obligors impacts repayment of the ABS notes.

As part of determining base default-level expectations for analyzing cash flows in a fleet lease transaction, DBRS typically reviews historical performance and lessee concentrations. The historical performance analysis is usually additive to the lessee concentration analysis. DBRS normally reviews the historical performance of the owned and managed pool to determine the expected and potential worst-case default experience. Data capturing for at least one economic cycle is generally a preferred time frame to assess performance.

RECOVERIES
The impact of stressful periods are also typically applied to recoveries, and the timing of recoveries in order to assess the enhancement structure. Recovery expectations are typically assumed for the different components of the portfolio. Table 3 indicates the typical recovery expectation for U.S. fleet lease securitizations. The recovery analysis is designed to capture uncertainties and variables that may affect future transaction performance. DBRS generally assumes that there will be no recoveries on unsecured receivables; however, a recovery credit may be applied to the extent that the originator has demonstrated a consistent track record of recoveries on such receivables. The recoveries in Table 3 are a guideline and may not be applicable in all transactions.

Table 3: Fleet Lease Receivable Recovery Rate Range Assumptions

<table>
<thead>
<tr>
<th>Transaction Rating</th>
<th>Secured Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>55%−65%</td>
</tr>
<tr>
<td>AA</td>
<td>60%−70%</td>
</tr>
<tr>
<td>A</td>
<td>70%−80%</td>
</tr>
<tr>
<td>BBB</td>
<td>80%−90%</td>
</tr>
<tr>
<td>BB</td>
<td>90%−95%</td>
</tr>
</tbody>
</table>
DBRS usually assumes recoveries on leased vehicles are realized one to three months after default. Under normal conditions, the recovery value of the underlying collateral, when remarketed via retail channels, provides a recovery value greater than the depreciated price. Under a distress scenario with waning demand for vehicles, the realized proceeds are typically expected to fall below the book value of the vehicle. The cash flow analysis and recovery rates for the portfolio are normally reviewed on a static basis and used in the assessment of the break-even analysis.

**TRIGGERS**

DBRS's cash flow analysis typically incorporates any triggers that may affect the priority of payments and result in early amortization. Although investors are entitled to the current and future cash flows in a revolving structure, DBRS usually analyzes the performance on an amortizing basis, assuming an immediate termination of the revolving period.

**EXCESS SPREAD AND FEES/EXPENSES**

The yield on the assets is typically stressed based on the review of the lease contracts giving effect to any hedges in place. The adequacy of appropriate indemnity, counterparty fee and/or expenses are usually taken into consideration in the cash flow analysis of the transaction.

**MONEY MARKET TRANCHEs**

It is generally a common practice for ABS transactions to incorporate a money market tranche eligible under Rule 2a-7 of the Investment Company Act of 1940. Under the rule, the money market tranche should be consistent with the maximum amount that can be repaid by the legal final maturity of 13 months after the closing date. The cash flow analysis for related tranches are usually reviewed using a 0.0% to 0.5% ABS speed and with no losses occurring on the portfolio.

**LEGAL FINAL MATURITY DATE**

The legal final maturity date is typically the date that represents the latest date a principal payment can be made under the transaction documents to fully pay an outstanding principal amount without incurring an event of default. Often this represents the scheduled maturity date of the collateral in the securitized pool plus 12 months as dictated by the cash flow scenarios. This can be an important consideration since the servicer may extend or renegotiate contract terms for a lessee as long as such extensions do not cause the final maturity of the underlying leases to extend beyond the legal final maturity of the transaction.

**ADDITIONAL ASSUMPTIONS FOR VARIOUS RATING CATEGORIES**

DBRS usually assesses a loss timing curve for the proposed collateral in stressed cash flow scenarios. Additional cash flow analysis may also be reviewed, contemplating the timing of losses under changes to loss timing that could impact the amount of excess spread in the transaction. Fleet lease securitizations may utilize excess spread as one of the forms of credit enhancement; however, if not trapped, excess spread may be released from the transaction and no longer be available to cover losses.

DBRS may vary the timing of losses by using different loss timing vectors (see below). In these scenarios, the amount of losses the transaction is subjected to may remain constant with only the timing of these losses changes. Often front-loaded loss scenarios add stress to the credit enhancement levels of senior securities in the structure, while back-ended losses often cause additional stress on the subordinated notes. Table 4 indicates the typical payment speeds and timing curves for U.S fleet lease securitizations. The payment speeds and timing curves are designed to capture uncertainties and variables that may affect future transaction performance. Table 4 is a guideline and may not be applicable in all transactions.
Table 4: Payment Speeds and Timing Curves for U.S. Fleet Lease Securitizations

<table>
<thead>
<tr>
<th>Stressed ABS Speeds: Month</th>
<th>ABS (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 6</td>
<td>0.15%</td>
</tr>
<tr>
<td>7 to 12</td>
<td>0.25%</td>
</tr>
<tr>
<td>13 to 18</td>
<td>0.50%</td>
</tr>
<tr>
<td>19 to 24</td>
<td>0.90%</td>
</tr>
<tr>
<td>25 to 36</td>
<td>1.40%</td>
</tr>
<tr>
<td>37 and beyond</td>
<td>1.20%</td>
</tr>
</tbody>
</table>

Loss Curve 1: Year % of Cumulative Loss

<table>
<thead>
<tr>
<th>Year</th>
<th>% of Cumulative Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>35.00%</td>
</tr>
<tr>
<td>2</td>
<td>35.00%</td>
</tr>
<tr>
<td>3</td>
<td>20.00%</td>
</tr>
<tr>
<td>4</td>
<td>10.00%</td>
</tr>
</tbody>
</table>

Loss Curve 2: Year % of Cumulative Loss

<table>
<thead>
<tr>
<th>Year</th>
<th>% of Cumulative Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>40.00%</td>
</tr>
<tr>
<td>2</td>
<td>40.00%</td>
</tr>
<tr>
<td>3</td>
<td>15.00%</td>
</tr>
<tr>
<td>4</td>
<td>5.00%</td>
</tr>
</tbody>
</table>

Loss Curve 3: Year % of Cumulative Loss

<table>
<thead>
<tr>
<th>Year</th>
<th>% of Cumulative Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>30.00%</td>
</tr>
<tr>
<td>2</td>
<td>50.00%</td>
</tr>
<tr>
<td>3</td>
<td>15.00%</td>
</tr>
<tr>
<td>4</td>
<td>5.00%</td>
</tr>
</tbody>
</table>

Surveillance

DBRS discusses its surveillance methodology in the DBRS Master U.S. ABS Surveillance Methodology.
Appendix I: Sample U.S. Fleet Lease Originator Review Agenda

The originator risk review typically includes an assessment of the items noted below, as well as any other relevant factors related to the issuer.

**Company and Management**
- Company history, ownership and operating experience.
- Financial condition/profitability.
- Ability to provide representations and warranties.
- Fleet size, composition and age.
- Strategic initiatives.
- Recent or planned mergers or acquisitions.
- Risk management practices.
- Management experience.
- Number of employees and underwriters.
- Staffing, training and retention rates.
- Use of outsourcing, temporary staff and offshore resources.
- Securitization history and future plans.
- Historical performance by origination channel.

**Controls and Compliance**
- Quality control and internal audit procedures.
- Internal and external audit results.
- Efforts to ensure regulatory compliance.
- Have you been or are you now the subject of a regulatory or state investigation? If so, discuss any findings.
- Have you ever been terminated or not in good standing with any federal or state regulatory body? If so, please explain.
- Repurchases due to breaches of representations and warranties ($ and #).
- Material litigation (past, present and expected).
- Controls for managing potential conflicts of interest associated with parties to a transaction.
- Procedures for vendor selection and oversight.
- Storage and updating of policies and procedures.

**Originating and Sourcing**
- Origination strategy and channels.
- Sales and marketing practices.
- Use of dealers and brokers.
- Approval and monitoring processes for lessees.
- Delegated underwriting practices and policies.
- Procedures for ensuring new lease setup accuracy and data integrity.
- Exception and trailing documentation management, i.e., title.
- Post-closing quality reviews.
Underwriting Guidelines
• Underwriting policies and procedures by product and lease type.
• Is underwriting centralized?
• Recent or planned changes to underwriting guidelines.
• Approval process for potential lessees.
• Qualifying rate and ratios.
• Documentation requirements.
• Insurance requirements and verifications.
• Use of credit scoring, automated underwriting and other technology.
• Underwriter compensation structure.
• Authority levels.
• Exception and override process/practices.
• Process for completing data integrity checks.
• Fraud detection procedures and systems.
• Closing and funding process.

Technology
• Core origination system strengths and weaknesses (including reporting capabilities).
• Capacity remaining in the origination system.
• Website availability, usage and security.
• Security measures employed to ensure compliance with regulatory requirements.
• Procedures for vendor selection and oversight.
• Disaster recovery/business continuity plans and success of last test.
• Frequency of full-system backup.
• Future initiatives.