

U.S. Structured Finance Newsletter

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THE DRIVING FORCE FOR AUTO UPGRADES

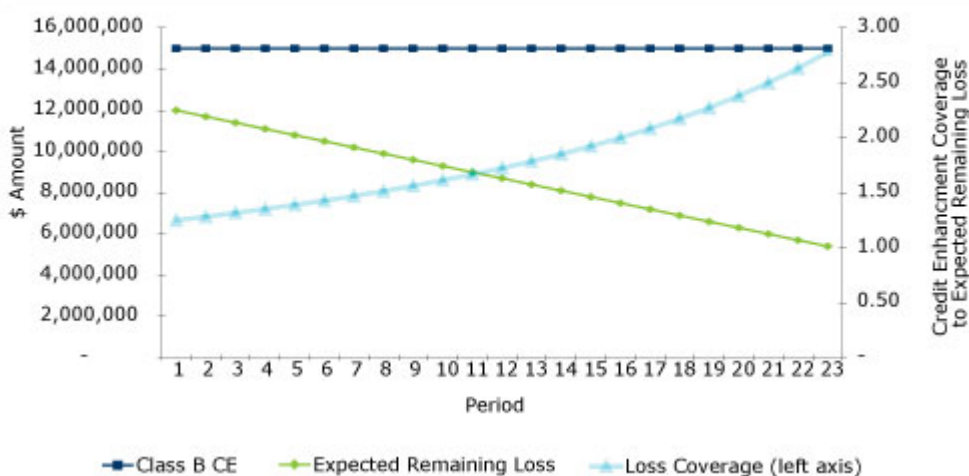
To the extent that collateral performance remains within expectations, non-declining credit enhancement frequently stands out as one of the most common structural features to drive potential rating upgrades. These features typically include (1) a reserve account that is required to maintain a floor amount and/or (2) targeted overcollateralization (OC) levels that must be maintained at a required dollar amount.

For example, DBRS recently upgraded three Capital Auto Receivables Asset Trust (CARAT) auto loan transactions. These structures shared similar credit enhancement features that trap excess spread in order to maintain target OC levels and reserve account floors. Once the target OC is reached, the structure will strive to maintain that dollar amount (trap excess spread as necessary) while the structure amortizes. Similarly, the reserve account is set at a minimum of a given percentage of the original pool balance. This effectively sets a floor amount on the reserve account, regardless of how the structure de-leverages. If the reserve account is drawn upon in any given period, the priority of payments is designed to trap excess spread to replenish the reserve account.

As long as excess spread is sufficient to cover current losses, while the outstanding notes amortize these forms of enhancement grow as a percentage of remaining outstanding note balances. Take for example a subordinate note that has \$15 million in a non-declining reserve account available as credit enhancement. For as long as excess spread is able to cover losses within any given period, the reserve account is maintained and the relative credit enhancement for the note increases. Consequently, over time the loss coverage multiple for the note will increase, assuming losses have occurred within expectations. For example, at closing the subordinate note originally had credit enhancement to cover expected remaining losses 1.2 times; by month 18, available credit enhancement will cover expected remaining losses by 2.2 times.

The chart below illustrates the interaction of loss coverage multiples, losses and non-declining credit enhancement features.

Effect of Non-Declining Credit Enhancement on Loss Coverage Multiples



Non-declining credit enhancement amounts provide longer-term protection against unexpected negative volatility in expected loss. Over time, if collateral performs within expectations, transactions with floor credit enhancement amounts will have greater potential for upward rating migrations relative to transactions without these structural features.

For questions or comments, contact Cherry Allen at callen@dbrs.com