

U.S. Structured Finance Newsletter

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SUBPRIME AUTO ABS STAYS ON TRACK

The current recession has had a negative effect on nearly all subprime auto ABS issuers, resulting in widespread deterioration of collateral performance and an increasingly challenging operating environment. Nevertheless, DBRS has observed that only one outstanding public subprime auto transaction has both drawn on credit enhancement and not yet replenished the draw with excess spread. On all other outstanding subprime auto ABS transactions, any enhancement draws, which are not uncommon for the sector, have been replenished and enhancement has built up over time.

The majority of subprime auto transactions executed in the public and 144A markets have been wrapped by monoline bond insurance policies; very few transactions have been structured as traditional senior-subordinate trusts. Many of the monoline wrapped transactions have been downgraded to reflect the downgrades of the insurance providers. However, in most cases, to date, the credit enhancement structured into the deals below the wraps has been sufficient to protect bondholders from interest or principal shortfalls.

The credit protection below the bond insurance normally consists of cash flows from finance charge collections, a spread account that traps cash, overcollateralization and subordination. Excess spread is derived from the difference between the weighted average yield on the loan receivables and the combined costs of the transaction's note interest rate, servicing fees and insurance premiums. Typically, loan defaults have been sufficiently covered, first by excess spread and then by the other forms of credit protection.

Many subprime auto transaction structures include triggers that force an increase in credit enhancement. These triggers are often based on the performance of a lender's portfolio, as well as on the performance of the particular securitization. The triggers are frequently linked to average three-month delinquency rates and cumulative gross or net loss rates. Of the more than 80 transactions reviewed by DBRS, which include over 1,400 triggers, nearly 88% of the triggers have not been breached, and only roughly 12% had failed.

Further, some subprime ABS issuers are no longer in business and others have scaled back due to a lack of liquidity and implementation of tighter underwriting standards. As a result of lower volume and more selective business practice, DBRS believes that the survivors in the space will benefit from proactive liquidity management and planning and better performing loan pools going forward. This circumstance may lead to improved performance in future pools of subprime auto loans and, possibly, lower credit enhancement relative to past deals. These circumstances may also lead to an increase in subprime auto ABS issuance in the future.

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