Dominion
Bond
Rating
Service

Rating Securitizations

DBRS Rating Approach

DBRS Rating Approaches

Rating Securitizations

DBRS's rating of securitizations involves an evaluation of the seller, the collateral and the structure of the transaction. Such evaluation is performed through due diligence, stress testing and credit evaluation, which is followed up by an appropriate legal review of opinions that provide confidence of true sale, enforceability, tax neutrality and bankruptcy remoteness.

The Seller

Securitization involves the separation of the credit risk of the seller from that of the assets, but an evaluation of the seller is also important because of the potential impact on ability and likelihood of performing covenants and on the new asset underwriting process and standards. Furthermore, for some asset types there is a strong correlation between asset quality and seller financial health (such as franchise receivables). Through due diligence efforts, DBRS evaluates the financial health, underwriting process, management and strategic/competitive elements of the seller to determine the level of reliance that is appropriate in setting structural parameters for the securitization. In addition, a review of the capabilities of the seller, as servicer, is an important consideration in assessing the ongoing quality of the cash flow streams generated from the asset pool.

The Collateral

The quality and quantity of collateral is key to the level of credit risk that is absorbed by investors (and consequently reflected in the ultimate DBRS rating). The quantity of collateral is a variable that is dictated by DBRS based on a total evaluation of the credit risk associated with a transaction; or more appropriately, a desired credit rating is achieved based on an indicated level of enhancement being provided (either by the seller and/or third parties). The focus, therefore, is an evaluation of collateral quality. The evaluation of collateral quality considers several elements such as underlying credit risk (to the extent the asset is dependent upon obligors to pay obligations), potential for set-off and/or dilutions, underlying value of the asset (tradable assets primarily), historical loss and delinquency levels and volatility, the nature and character of any spread, payment options available to obligors (prepayable for example) and the inherent liquidity of the asset. To further assure a consistent level of quality, DBRS imposes fairly standard eligibility criteria for purchased assets. From a legal perspective, we ensure that ownership and/or the rights of ownership are appropriately transferred to the Purchaser/Trustee.

The Structure

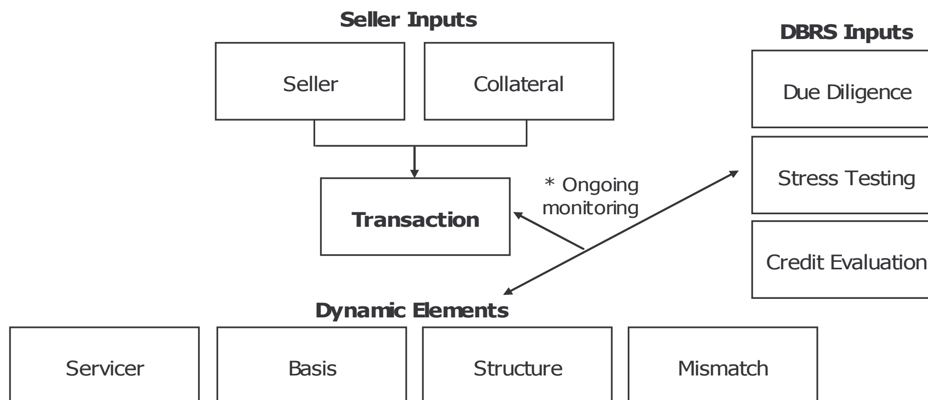
The most important structural element of a transaction is the level of enhancement or credit protection that is provided. The provision of the extra level of protection is one element of securitization that allows the credit rating of Asset-Backed Securities ("ABS") to exceed that of the seller. Of significant importance, and in some instances of overriding importance, is the composition of such enhancement. Enhancement can take several forms, each with distinctive advantages and disadvantages. They include cash, securities, letter of credit, guarantees, overcollateralization, excess spread, triggered cash flow stoppages, etc. Other elements that DBRS pays considerable attention to include the period of any cash commingling that will be allowed, i.e., the extent that cash collected by the seller/servicer can be held by the seller before being required to remit such funds to the securitization vehicle. Concentration limits are placed on exposure to single obligors to ensure that risk is not unduly concentrated with individual sources. Diversification of risk provides a higher level of comfort that asset performance will remain consistent with historical levels. DBRS also imposes liquidity requirements for all short-term ABS issues in the form of committed bank lines from top quality financial institutions.

The Evaluation

In addition to all the qualitative elements that are part of DBRS's rating approach for securitizations, stress testing is used to determine the appropriate levels of enhancement necessary for desired rating levels. These computer models simulate extreme (in the case of AAA rating securities) situations that a securitization must endure without any loss to investors.

Introduction

The rating approach that DBRS uses in evaluating and providing feed-back on securitizations (and for structured transactions as well) may be broadly considered to consist of three inputs or elements. They include seller inputs (basically given parameters established by the underlying character of the seller and assets they wish to securitize), dynamic elements (those factors which can be changed to provide higher or lower levels of protection or to change the characteristics of certain aspects of a transaction) and DBRS's inputs (the value added and parameters established during the rating process). The following schematic maps out these elements as well as their major sub-components. Most of this paper will discuss these elements, what importance they have, how risks can be mitigated and how DBRS evaluates or considers these factors in our overall rating of any ABS.



While it is important to consider the detailed elements that affect our rating of an ABS, it is also useful to discuss the process that this entails.

Typically, a seller has initial discussions with ourselves and/or an investment banker to determine the basic requirements in rating any potential securitization. These requirements would include a long enough track history to evaluate asset performance, adequate systems to properly track assets and cash flows that are segregated from company assets, an established credit and collection policy, a record of financial stability, demonstration that adequate alternative sources of funds would be available if a securitization were to wind down, absence of significant legal contingencies and capable professional advisors (to name only the most major requirements).

Provided the seller can meet these minimum standards and provided other internal considerations have been met, the seller would typically retain an investment banker to put together a more formal proposal for our consideration. General discussion of the business, asset performance, broad legal issues, proposed enhancement levels and structure, as well as desired rating, would be undertaken to ensure that the transaction is feasible. Should feasibility not be an issue and presuming the seller still wishes to proceed, DBRS would then be retained to rate the proposed issue.

Once formally retained, DBRS would work closely with the seller and investment banker in designing an appropriate structure for the transaction. We would perform due diligence on the company as well as rely on due diligence performed by the investment banker, credit enhancers and lawyers (as applicable). The results of our reviews, due diligence and stress testing would be utilized to finalize the structure and parameters of the transaction.

Legal documentation would be reviewed by ourselves and legal opinions would be reviewed by our counsel to ensure that the substance of the transaction is properly documented to our satisfaction. Our legal counsel would ensure that the opinions and structure of the transaction are sound from a legal perspective (particularly bankruptcy remoteness, tax neutrality of the SPV, true sale and registration and/or perfection of security). Providing we are satisfied with the legal documentation and all the previously discussed elements, we will issue a rating letter and also produce a rating report for the transaction.

After a transaction has been executed and rated, DBRS continues to monitor the financial performance of the vehicle, related parties to the transaction (credit enhancers, liquidity providers et al) and significant obligors (if applicable). Monitoring is generally via monthly servicer reports and to the extent that any trends are of concern or become worrisome, DBRS steps up its level of review. DBRS would initiate discussions with the underwriters and seller (and any other procedures we deem necessary - such as audits, site visit, discussion with management, etc.) to determine the underlying causes of performance changes. To the extent that these causes can be managed, we try to ensure that appropriate action is taken. DBRS's involvement in a transaction does not end until all rated securities have been repaid in full.

Seller Inputs

Seller inputs are, basically, given elements to a transaction - they cannot be altered. They are, nonetheless, important and must be evaluated in setting the proper parameters and structure for the transaction. The inputs are the Seller itself and the Seller's collateral.

Seller

Financial Health

Securitizations are executed in order to separate the credit risk of the seller from the assets (amongst other reasons), and it is because of this, that it is possible for the rating of an ABS issue to be higher than the seller. However, despite this separation of seller credit risk from the assets/securitization, we cannot ignore the financial health of the seller completely. In fact, there are circumstances where the financial health of the seller is the overriding consideration in determining the maximum possible rating for a securitization (to be discussed later).

The health of the seller has a number of potential implications for a securitization depending on the asset type securitized. First, even if the financial health of the seller has absolutely no impact on the securitization directly, it does have an impact on our review of the transaction from a credit perspective. For example, if in our judgment a company is non-investment grade, we assume for stress testing and/or review of the viability of the securitization that the seller will go bankrupt during the term of the transaction (for AAA rated transactions). While it is not our expectation that a company would go bankrupt (if we deemed this likely we would not currently allow the company to securitize via a conduit nor by single seller program), we deem it prudent to assume so for evaluating the stability of a transaction rated at the AAA level. It is, however, conceivable that the financial health of the seller could be completely ignored if no reliance in any fashion were placed on the seller. This would be the case where, for example, a bankrupt seller had a marketable asset that could maintain its value separate and independent of the seller. Also, any servicing and collection risk would have been eliminated by the use of a third party servicer and elimination of any commingling. To date, we have not experienced such a unique situation.

Second, the ongoing viability of the seller is critical in situations where a revolving set of assets is securitized such as accounts receivable or credit card receivables. In these situations, new assets are purchased as old assets are repaid. Because there is a continual replacement of old assets with new assets, an element of seller risk is introduced. Obviously, if a company's viability is diminished, the ability to generate new assets can be impaired. If a fixed amount of funding has been advanced, there may be insufficient new assets generated to fully invest such advance, and this leads to a situation where cash is not invested in earning assets but is invested in permitted investments that most likely will earn at a rate significantly lower than the indicated rate of the ABS. This effectively eats into any credit enhancement the vehicle may have had or results in an early payout to investors with the consequent cost of reinvestment. Non-investment grade transactions consider the potential impact of reduced asset generation, if appropriate, and are structured with either higher enhancement levels and/or tighter early amortization triggers to ensure full payout to investors in AAA rated ABS.

With a revolving structure, reliance is placed on the seller to maintain underwriting standards, legal safeguards and collection procedures (to name only the most important factors). When the financial health of a seller deteriorates, there may be an incentive to loosen underwriting standards to generate new business, ignore underwriting standards completely and solicit high margin business (with the associated higher risk) or to fraudulently generate phantom assets. All of these have the result of increasing the risk profile of the pool and/or misstating the composition of the assets. Furthermore, with increased financial stress, the servicing function may take on less and less importance relative to survival of the company. Decisions such as cutting administrative costs, eliminating financial controls and procedures (or ignoring them), cutting legal corners (such as registrations, perfection, checking liens, etc.) or cutting credit reviews and/or documentation can have serious consequences for understanding the true circumstances associated with a securitization (because of late, inaccurate, misleading or fraudulent reporting).

The most worrisome and least controllable risk is that of fraud. The potential for fraud would be expected to increase as the credit quality of the seller decreases. This, however, is only part of the picture. U.S. experience also suggests that the risk of fraud is higher for entrepreneurial companies, younger companies and smaller companies. The risk of fraud can be reduced through structural engineering, controls and increased surveillance and audit, but cannot be eliminated.

For certain asset classes (such as franchise asset securitization) there exists a relationship between seller quality and asset quality. In the franchise asset example, notwithstanding any legal bankruptcy remoteness, the practical result is that the value of the franchisee loans and assets are highly related to the viability of the franchisor and the franchise concept. As such, the financial health of the franchisor has a significant bearing on the rating of the securitization. In these situations, the existing DBRS rating and/or periodic reviews of the financial health of the company are part of the ongoing review and monitoring of the transaction.

Underwriting

How the seller generates the assets (whether the transaction is executed as a single sale or as revolving sales) has a profound impact on our assessment of the quality of the assets independent of previous historical performance. For example, if we were to review two companies that have identical pools of assets and that have identical historical performance, but where one of the companies has a more conservative underwriting approach to asset generation, the level of credit enhancement that would be required would be different notwithstanding the identical historical performance. Historical performance is a good indicator of underwriting standards but not conclusively so. During periods of economic prosperity the level of losses for both companies might be quite low, but when the economy slows the level of losses would be expected to increase for both companies. However, with more conservative underwriting standards the number of obligors experiencing problems and the severity of problem with each obligor would be expected to be less. As such, the volatility and magnitude of losses for the conservative company should be better than for the more aggressive company. Since enhancement is designed to protect investors from losses, the lower the levels of losses and the more predictable the losses of the conservative company would require less protection.

To the extent that a formalized approach (suitably documented) to credit granting or asset generation is in place and utilized, the more likely a consistent quality of assets is generated. This does not imply that the assets are subject to low losses, it only implies that the quality of such assets is more likely to be consistent. Consistency gives us more confidence in developing an appropriate structure for a transaction and in setting enhancement levels, amortization triggers and other numerical parameters as required for a transaction, whether losses are 0.1% of 10% per annum. Also, with a formalized approach, any changes in standards are approved and documented, which provides us with a better understanding of the future impact of such changes (as well as our approval for such changes in the first place). Without this, it is difficult to have any meaningful control over underwriting standards - and consequently structural parameters must be tightened up to mitigate this risk.

The use of credit scoring systems is viewed positively because these systems are based on objective criteria that remain relatively consistent through time (though they are often managed within a range of acceptable performance and migrate between the lower and higher bands depending on the point in an economic cycle). The level of subjectivity is diminished and a higher level of deliberation is often involved in the setting of underwriting standards. Changing of standards is a more involved and deliberate process than the changing of subjective criteria, therefore, the probability of unrecognized declines in underwriting standards is diminished. DBRS also reviews credit approval rates over time - increased approval rates may indicate a relaxing of credit standards and the potential for a deterioration in portfolio performance in the future.

Management

While it is extremely difficult to capture an accurate assessment of management, and the impact of such assessment on the transaction is indirect at best, we believe that an informal assessment of management should have an impact on our analysis of a transaction. There are several aspects of management that we consider, but they may be broadly labeled as ability, integrity and motivation. The higher our assessment of the abilities of management the higher our comfort that the complexities of initiating and managing a securitization can be adequately handled. Furthermore, capable management is expected to be able to operate the business more successfully and has implications in areas such as asset generation, financial health and overall stability of operations. All of which are considered positives in assessing the merits of a securitization. In certain types of transactions, there is a direct tie between the quality of the seller and the rating of securitized assets. For example, where franchise assets are securitized, the rating of the franchisor often sets a ceiling for the assets securitized because the value of the assets is directly related to the viability of the franchisor and the concept. In this situation, an assessment of management deserves an even higher emphasis.

Integrity must be present with any management group. Without it, any representations, data or commitments are suspect. Should there be any lack of faith in management integrity, DBRS would not rate such a transaction.

Motivation of the seller also has some bearing - to the extent that management, for example, is only interested in removing normal loss risks from its balance sheet, that would suggest continuing confidence in the performance of the assets is suspect. Such a fundamental motivation would suggest that extreme caution in structuring such a deal would be imperative. In fact, given that normal loss levels would be absorbed by the first loss security, such a motivation may be totally inconsistent with securitization.

Strategic/Competitive

A review of the strategic and competitive environment of the seller provides a background for the assessment of the future health and growth of the company. Beyond consideration of the company’s future health (discussed above), the competitive environment can have other implications for the securitization. For example, when stress testing a credit card receivable securitization, one of the key variables is gross yield (yield on the credit card balances after allowing for any interest-free grace period). The level to which gross yield will be stressed is partially dependent on the competitive environment that may exist for this company. Department store credit cards typically have nominal interest rates of about 29% per annum and about 22 - 26% gross yield after allowing for interest-free grace periods. Bank credit cards typically have gross yields in the region of 18 - 22%. When stressing gross yields for department store credit cards, the size of drop (in absolute terms and in relative terms) would be larger than for bank credit cards because the ability of department stores to maintain this gap in interest charges is uncertain due to the competitive pressures from various bank card issuers as well as department stores that are adopting bank card programs (at least on a trial basis). Furthermore, because there are periodic political salvos at “unreasonably high credit card rates”, the impact of any legislative changes is likely to be more profound for department store cards than it is for bank credit cards.

Growth opportunities of a company also affect an assessment of early amortization. Where an issuance of term securities is placed in the market, a certain minimum level of assets is required to provide coverage (basically the size of the debt issuance plus enhancement and dilution protection). Seasonality and growth factors are considered when determining the maximum size of such debt issuance (if the seller is interested in raising the maximum amount of funds). To the extent competitive pressures limit or may reverse growth opportunities for the company, an increased level of assurance is required that asset levels will not drop below required minimums. This necessarily limits the size of ABS term issuance. On an ongoing basis, assessment of growth opportunities or risks provide insight into potential early amortization should asset levels drop (provided no other structural elements have been designed to mitigate this risk), or increased comfort if growth should continue unabated.

Collateral

Simplistically, the rating of any asset-backed security is based on the quality of the underlying collateral. It is precisely because of the quality of the assets and their isolation from the credit risk of the seller, that an ABS can be rated higher than the seller and sometimes significantly so (for example, in the U.S.A. there have been bankrupt companies "D" rated which have issued or have had outstanding ABS that remained in the top investment grade category).

The understanding of the characteristics of the collateral is key to understanding how a securitization might fare in certain circumstances (such as bankruptcy of the seller). For example, retail auto loan and wholesale auto loan securitizations routinely are rated AAA. However, the default of the original equipment manufacturer ("OEM") has quite different impact on each of these securitizations. Because there is a secondary market for used automobiles, extensive third party auto parts and service and the credit quality of the diverse base of obligors, the expected levels of losses for a retail auto loan securitization would not be expected to be high. This is due to the diversification of risk across a wide range of obligors and the limited decline in the value of resale cars. For a wholesale "floor plan" transaction, however, there is concentration of risk amongst the OEM's dealers. They are dependent on the OEM for a steady supply of product to sell to customers. Without the OEM, dealers' equity would be eroded and a significant number of them would be expected to fail. Assuming the same level of decline in resale auto prices (notwithstanding a larger bulk sale of dealer inventory that would be expected to depress prices even further), losses would be expected to be significantly higher than for a retail auto loan portfolio from the same OEM. But, when times are stable, the loss and delinquency performance of a floor plan transaction typically is much better than a retail auto loan transaction. The smaller dealer base that is closely monitored by the OEM and the sizable equity base of the dealers cushion investors from losses associated with the smaller bumps in economic performance.

<u>Valuation</u>
Any accounting or notional value an asset pool may have is irrelevant as we must be satisfied that the fair market value of such assets are sufficient to repay any outstanding debt, interest costs, administrative costs of the special purpose vehicle ("SPV"), collection and servicing costs. Otherwise, the rating of such securities would have to be "D" - an assumed default.

Valuation of an asset pool encompasses two elements. The value of the specific assets over time and the expected losses/dilution associated with such assets.

Valuation of financial assets is primarily a function of interest terms and credit quality. Market benchmarks are used to value the assets in determining their adequacy. Non-interest bearing assets are discounted at market rates. Assets that have liquid secondary markets are valued using market indices or benchmarks (adjusted as necessary for differences in specification, transportation, quality, etc.). Unique assets or non-tradable non-financial assets are more problematic. If feasible, the value of such assets is determined by discounting cash flows associated with the asset after allowing for the credit risk associated with the payer of such cash flows. Notwithstanding any value that may be ascribed to such asset, careful consideration of the implications of any default by the seller on the level and stability of such cash flows is considered. Further, the ability of the holders to receive the benefits of such cash flow (from a legal perspective) are also explored. For example, if a private hydro project were to securitize the cash flows associated with power sales from a project, the only real way of valuing this asset would be to look at the terms and conditions associated with the power sales. The rating of the purchaser(s) of the power would be an important consideration as would the fact that, even if such purchaser(s) should fail in their obligation to pay for such power, there would still be

an ongoing demand by end users that would have to be satisfied at some price. Consideration of all these elements would be required to adequately assess the level of protection that would be associated with any ABS issuance.
The ongoing relationship between the outstanding obligations and the value of the assets must be considered, particularly for depreciable assets. For example, leased assets would be reviewed to ensure there is an adequate level of comfort during the full course of the lease. Deposit levels, amortization and lease terms are reviewed for major asset classes (if more than one) to determine the periods when risk is at its highest (start of the lease, during the middle of the lease or near the end). Considering this assessment of risk, structural parameters can be adjusted to cover this period of higher exposure (such as the use of seeded reserve accounts, account floors and/or non-seeded reserve accounts).

Liquidity

Liquidity of assets has an important implication for any wind-down scenario. If the performance of a vehicle is below expectations and amortization triggers are breached, the quicker and more efficiently assets can be disposed of, the less likely an investor will be subject to a loss. Because performance tends to deteriorate over time, quickly resolving a situation is beneficial to the investors as a whole. Quick liquidation of illiquid assets at a large discount or liquid assets that would have a downward effect on prices is not considered to have high liquidity by DBRS. In fact, where liquid assets are being securitized (such as traded commodities), DBRS imposes restrictions on positions to ensure that they remain highly liquid. If a position gets too large, it may be disposed of quickly, but the underlying assumption of price stability would be violated.

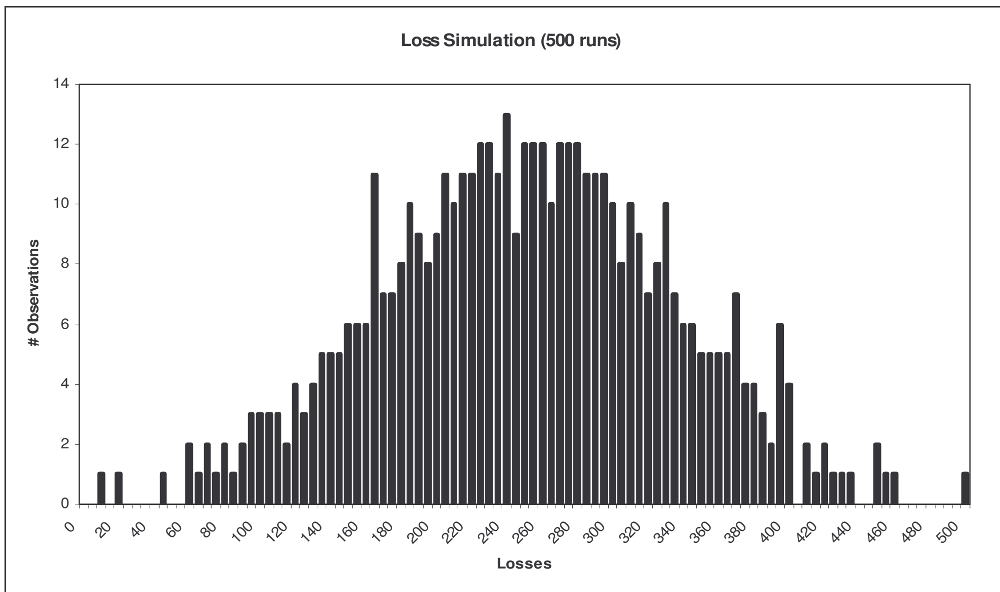
To the extent that assets require a period of time to liquidate in an orderly fashion, stress tests would incorporate the associated carrying costs and marketing costs associated with such sales. If the asset is highly liquid, no carrying or marketing costs would be required. In fact, it is conceivable that for certain very liquid assets (those that could be liquidated on a same day basis with only nominal costs and no market impact), liquidity lines would not be required. This is so because the assets have inherent liquidity. To date, however, no asset group has had this level of liquidity that would justify dropping our additional liquidity requirements for ABS commercial paper ("ABS CP").

Volatility

Volatility of the characteristics of the collateral (such as value, losses, prepayments, etc.) can have a profound impact on our comfort level with (say) a level of enhancement. Two asset pools with identical average loss rates may require significantly different enhancement levels due to volatility in the performance characteristics of each. Volatility implies uncertainty and without added assurance that this volatility can be dealt with adequately, enhancement levels must be higher, ratings lower or no rating at all if volatility is too extreme.

Volatility is incorporated into stress models in one of two ways. Either a multiple of (say) losses are used or a statistically significant confidence interval is determined (the number of standard deviations being dependent on the required rating - AAA requires a wider confidence interval than a BBB rating) and is then used in the stress scenario. The second method is to incorporate the parameters of the variable into the model directly (mean and standard deviation) and to run the financial model hundreds of times to produce a distribution of results. This distribution should be representative of expected outcomes associated with the transaction - credit enhancement (for example) is then set at an appropriate level to eliminate the appropriate percentage of observations. In the following hypothetical distribution of losses associated with a modeling of the proposed ABS issuance, a AAA rating would (say) correspond with no more than 0.2% chance of a loss. This is equal to one observation in 500. The largest loss in the chart is $500 (occurring only once), with the next largest loss being $460 (also only occurring once). Therefore, we would need to set enhancement so that the $460 loss would be covered, but would not be sufficient to cover the 1 in 500 chance of a $500 loss. Enhancement would, therefore, be a minimum of $465.

Prepayment volatility can also be considered in a similar fashion. While prepayment considerations are not relevant in pass-through structures, they are relevant in pay-through structures as cash must be sufficient to pay the scheduled cash payments as securities either mature or as interest payments are due. Historical prepayment levels must be stressed to ensure that accumulated cash is more than adequate - the risk is that prepayments will be too low. Excessive prepayment rates also pose a risk that must be evaluated - if spread between the APR (annual percentage rate) of the assets and the funding is protecting investors from ongoing losses, high prepayment rates could effectively eliminate this positive spread because cash would have to be invested in low risk, liquid assets that presumably would earn less than the assets and the funding. This effectively eliminates some "credit enhancement" associated with the transaction. Also, positive spread is beneficial in resurrecting any cash accounts that have been depleted somewhat - if spreads are flat or negative they will never be replenished.



<u>Eligibility Criteria</u>

Particularly for revolving structures, but also for lump sum purchases, eligibility criteria act as a screen through which assets not satisfying particular criteria should not pass. While this is not always the case (due to inadvertent error or by fraud, ineligible assets may be transferred - see later discussion about remedies), setting appropriate criteria will ensure some consistency in quality and performance of assets. Typical types of eligibility criteria include:

- assets should not be currently in arrears or in default
- obligors should not have defaulted on previous obligations to seller
- asset should not have been extended or restructured in any significant manner
- additional assets from one obligor will not be eligible if obligor concentration has exceeded specified limits
- obligor is resident for tax purposes (to avoid withholding tax considerations)
- asset originated according to credit and collection policy
- valid title to the asset
- no liens/encumbrances associated with asset
- no rights of set-off are permitted
- GST and other taxes are not included
- government receivables are not included (assignments require the consent of the government)
- …. other terms and conditions as required

To the extent that DBRS considers some assets to be of higher risk, uncertain risk, or is uncomfortable as to the potential for lack of diversification, we would require additional restrictions to be imposed on the eligibility of assets. For example, for a residential mortgage pool, if we were uncomfortable with (say) condominiums or the Vancouver market, we may limit exposure to the Vancouver market to a certain percentage of the portfolio, limit condominiums to a specified percentage of the portfolio or may not allow Vancouver condominiums at all.

Associated with these criteria are a representation and warranty (and often an officer's certificate) that the transfer satisfies the eligibility criteria. If by error (or fraud), an asset is subsequently determined to not be eligible, then the seller would typically substitute an eligible asset and reimburse any associated costs or expenses, if any. In the case of fraud, such liability of the company under the representation and warranty is also valid, but the value of that representation is suspect.

Perfection/Registration

Having adequate assets for the protection of investors in the ABS is not sufficient if inadequate legal protection is provided. Security is only effective if (i) security holders have a legal right to enforce that security and (ii) the security interest represents a first charge that will not be compromised in any meaningful fashion. The first claim to the security must be legally registered in all the appropriate jurisdictions to ensure that any other creditors may not "jump the queue" by registering a senior claim and to ensure that, if the security must be realized upon, it may be realized upon without undue legal delays and/or challenges. When registering security, it is necessary to ensure that there are no prior and/or competing claims against the same assets. Failure to ensure a "clean" asset may result in a compromised ability to realize on such assets.

For one-time purchases of assets, it is possible to search title and register all security agreements as necessary (including all appropriate legal opinions on searches and registration). However, for revolving asset classes, reliance must be made on the process the seller uses to register and search title. Positive covenants by the seller will indicate that registrations will be made for assets purchased, but as part of our due diligence we will review the approach and procedures used by seller's counsel in doing so. To the extent that losses occur due to faulty registration, the SPV would have recourse against the seller under the legal covenants; however, where a company is of very weak credit standing, such recourse may be of limited or no value.

In PPSA provinces (B.C., Alberta, Saskatchewan, Manitoba, Ontario and N.B.), registration/perfection is relatively straightforward, with clear procedures and guidelines. Non-PPSA provinces are more problematic, particularly Québec. The provinces of N.S., P.E.I. and Nfld. can present some issues that are potentially difficult to deal with, but because of the small portion they typically represent in pools, this is not normally a significant concern. Where the portion is a little bit higher, the province of N.S., in particular, is often excluded. Québec represents a much larger portion of most pools, therefore exclusion is generally not a viable alternative. Local counsel is retained to ensure that registration/perfection is properly performed. Any ongoing issues of registration are dealt with at the beginning of the transaction to ensure appropriate procedures are in place to limit exposure where it is not possible to eliminate those risks. Periodic legal opinions may be provided to confirm appropriate registrations have been filed.

Legal

As with most aspects of life, choices are inevitable and each has its strengths and weaknesses. This is also true of legal considerations in structuring transactions. In addition, there are seldom "truths" in case law, only reasoned opinions - some of which are not universally accepted within the profession. Where there are legal considerations that are new and/or unique, DBRS relies on its counsel to adequately understand the potential benefits and pitfalls of various legal avenues or structures. Only after DBRS has considered the practical risks associated with legal issues, including discussions with counsel, does it indicate whether they are appropriate for the transaction. Notwithstanding such review, the vagaries of new case law, aberrant decisions, potential delays and challenges to such carefully crafted legal structures are always a potential concern that cannot be eliminated.

Dynamic Elements

Servicing

Typically, but not necessarily so, the seller is also the servicer of the portfolio of securitized assets. There are economic and practical considerations that suggest that the servicer be the seller. From an economic perspective, using an alternative servicer imposes costs on the seller for services that have historically been performed by the seller. There are also transitional costs associated with the transfer of computer files, software, training etc. The SPV also benefits because, typically, no charge is made to the SPV for the cost of servicing as it would attract GST. If a third-party servicer were to be used, expenses of the SPV would be higher and less cash would be available to satisfy the claims on the assets and associated cash flows.

From a practical perspective, any transition from one servicer to another entails costs, but also disruption in service to the customers of the seller. These are unnecessary costs if the seller is capable of servicing the portfolio. Further, there are a limited number of choices for an alternative servicer, with the most logical usually being a competitor of the company. Since this information is very valuable to the competition, an extreme reluctance to allow access to customer files and information is only reasonable.

The following discussion will, unless specifically indicated otherwise, assume that the seller is the servicer.

Collections

Collection systems and procedures (including repossession and resale of collateral) are an important element in the servicing function - ultimately it is the collections that repay the outstanding ABS. While ongoing servicing is a consideration, DBRS focuses on the efficiency and effectiveness of the collection efforts associated with problem accounts. It is during a deterioration of portfolio quality that the collections efforts become one of the key determinants of loss levels (the other being underwriting standards).

While the level of sophistication associated with the collection efforts will vary by industry, number of obligors and size of obligations, it is the effectiveness of those efforts that are important. The effectiveness is partly determined by the resources that the seller devotes to those efforts as well as the priority such efforts receive from management. Procedures that include tracking and monitoring of collection efforts as well as ties to performance based incentives are viewed positively by DBRS in evaluating the effectiveness of collection systems. Where there are informal collection efforts, a lack of monitoring and/or reporting of such efforts, unclear lines of responsibility or a lack of management awareness of collection efforts, decreased confidence is warranted.

Resources (both people and otherwise) that are devoted to legal recourse, recovery and remarketing are important considerations as well. Historical recovery rates on repossessed property are an element in our determination of appropriate stress levels for our models. High recovery rates are a function, not only of the remarketing efforts but also of the asset type - therefore, a low recovery rate is not necessarily indicative of poor recovery efforts. For example, recovery rates for credit card receivables are low because they are unsecured obligations - no tangible assets back the receivable and any right to receive any disposition on a bankruptcy filing is junior to any secured creditors. Recovery rates for residential first mortgages are very close to 100%, because of their secured nature and strong legal standing. Variations in collection rates for residential first mortgages as little as 0.1% can have a significant impact on portfolio performance while a 10% change in recovery rates for credit card receivables would generally be normal (provided it is declining when economic conditions are improving).

Termination Events

Termination Events are triggers incorporated into the legal documentation that give the Trustee the right to replace Servicer. Termination Events are important for the servicing function primarily because (1) the Servicer is generally the Seller and there is a potential for a conflict of interest between the Seller's interests and the role as Servicer, (2) under the section 95.1 of the Bankruptcy and Insolvency Act (the "BIA"), a contract cannot be terminated solely for the reason of a party to the contract entering bankruptcy - as such, it would be impossible to terminate the servicing function based on an insolvency/bankruptcy provision, and (3) the triggers need to be preemptive to avoid the possibility of poor servicing of the assets rather than dealing with the "problem" after it has occurred.

Replacement of the servicer imposes the cost of a replacement collector upon the structure (and ultimately the Seller to the extent of any enhancement provided). It is necessary, therefore, to have objective limits to avoid the uncertainty associated with discretionary judgments. The discretion, however, must be broad enough to ensure that in all foreseeable circumstances, the trustee has the right to replace the servicer prior to any filing under the BIA (because 95.1 could effectively preclude exercise of such right after such filing). The approach to the design of Termination Events is similar to that used for Amortization Triggers - sufficiently weak that they are unlikely to occur but strong enough to ensure that problems are avoided before they occur.

Backup Servicer

It is DBRS's policy to require a standby backup servicer be appointed for non-investment grade companies unless it can be demonstrated that a suitable servicer could be obtained on very short notice and with little or no disruption in the servicing function (i.e., to demonstrate that the costs of appointing a standby servicer at the time of the transaction outweighs the potential benefits of such appointment). In cases where companies are borderline investment grade (generally BBB(low) but also higher rated companies that have had a negative trend attached to their rating or where the rating status is Under Review), DBRS may require that a standby backup servicer be appointed as well.

For non-investment grade companies, we assume in our stress scenario that the company goes bankrupt or files under the Companies' Creditors Arrangement Act ("CCAA"). Given this assumption, it is imperative that we deal with potential servicing disruption at the time the transaction has been initiated rather than at the time of such crisis. The appointment of a standby servicer will help ease any transitional problems associated with a new servicer handling the administration of collection and reporting (although there is inevitable collection disruption because obligors are generally less inclined to make payments in a bankruptcy situation). Appropriate legal language is included in the servicing agreement to ensure that records, software and other critical resources of the seller/servicer can be transferred to the backup servicer if required (software licensing issues, however, sometimes limit the ability to do a wholesale transfer of all systems to the backup servicer).

The replacement servicer must be able to demonstrate that the delay in collections due to the transition will be minimized. This extends to the records transfer and systems compatibility. The standby servicer's ability to use its own systems and/or utilize the seller's systems are evaluated by DBRS and the underwriters of the transaction to attempt to eliminate any roadblocks to a smooth transition. Murphy's Law, however, cannot be entirely eliminated as a possibility.

Usually the ideal candidate as a backup servicer is a competitor in the industry. However, due to the sensitivities of customer information, this is generally an unworkable situation. DBRS, therefore, tends to rely on accounting firms, banks, service bureaus, non-bank financial companies etc. to serve this role. While they may not be the ideal candidate, we believe that obstacles, if any, are not unmanageable.

Servicing Fees

Because any fees charged by the seller/servicer would be subject to GST, a servicing fee is not usually charged by the seller. However, allowances must be made for a servicing fee when stress testing a structure to ensure that a changeover to a new servicer will not adversely affect the level of protection provided to investors. DBRS takes a very conservative view of the estimated servicing fees especially when the asset class or type is unique. Certain asset classes have a number of active participants that are quite willing and capable of servicing the assets in question. For example, servicing of residential mortgages is quite competitive, with a number of participants potentially bidding for the rights to service a portfolio. It is conceivable that servicing fees could be as low as 10 basis points (though we generally would require 25 - 55 bp be set aside in stress testing).

The advantage of appointing a standby servicer at the beginning of the transaction is that the servicing fee is predetermined. It also avoids the situation where a company has gone into bankruptcy and is forced to negotiate a servicing fee with a possible servicer. In such a case, there is little bargaining power for the company and there is potential that fees may be significantly higher than if negotiated in advance. If such fees are in excess of what DBRS had conservatively estimated, such excess is effectively cutting into the level of credit enhancement designed to protect investors.

<u>Systems</u>
In addition to a consideration for disaster recovery (discussed below), DBRS considers several aspects of sellers systems as it relates to the servicing function. The first factor is the level of professionalism that the systems exhibit - while it is difficult to point to particular aspects of a sellers systems and approach, it is an important amalgam of impressions as compared to other servicers that have been reviewed in previous transactions. Other specific considerations are the software utilized (standardized or customized, age and/or frequency of upgrade), hardware utilized (mainframe vs. mini vs. PC, open or closed architecture, archival media), management (dedicated MIS manager, responsibility level of MIS functions, experience of MIS staff), and general access issues (segregated area, passwords, fire control systems, etc.).

<u>Disaster Recovery</u>
DBRS reviews the computer and manual systems to ensure that, should disaster strike, the company has the ability to recreate records and restart systems on a timely basis. Physical record storage (particularly original contracts), backup procedures, off-site software and hardware capabilities, type of software and password protection are all issues that are investigated during any due diligence session. DBRS must be satisfied with the feasibility of any disaster recovery plan before the seller/servicing role is approved.

Structure

The structural elements of a transaction are the essence of securitization or structured financial transactions. They are the variable elements of the transaction that are combined in various permutations and combinations to achieve the desired effect - usually a combination of tax, legal, accounting and economic considerations. DBRS works closely with the underwriter(s) and the seller to ensure that the motivations of the seller do not compromise the level of protection afforded to investors (given the rating desired). Unlike typical corporate ratings where a company is a “given” and DBRS rates the situation, structured financial transactions are developed with some givens (essentially the seller inputs discussed above), but also a number of parameters and tools that can be combined in an infinite number of ways to achieve various results. It is not always possible to achieve all the desired (and conflicting) goals of the seller, the underwriter and investors, but securitization does hold the opportunity for significant advantages to be had by all parties.

<u>Enhancement</u>
The level of enhancement is perhaps the most important focus of attention in securitizations and ultimately is set as a result of consideration of the following conflicting needs or desires: total cost of funding, off-balance sheet considerations and desired rating. The total cost of funding for a seller is composed of two basic elements: the cost of the actual funds raised and the cost of various forms of enhancement. By providing overcollateralization, cash or other reserves, retained subordinated financing, locking up cash flows within the SPV, or whatever enhancement mechanism is used, there is an implicit cost associated with this enhancement either as a result of foregone investment opportunities (cash, for example, could have been used to reduce debt levels rather than being held in the SPV and invested in low yielding treasury bills) or as a result of actual incurred costs of financing such contributions. A company has a natural desire to reduce these costs but also to reduce the total level of recourse associated with a transaction. This, however, is contrary to the interests of investors (unless, of course, such enhancement was excessive to start with). DBRS ensures that the desire of the seller to reduce enhancement levels does not compromise the level of protection afforded to investors - if it does, the rating assigned will be lower than requested.

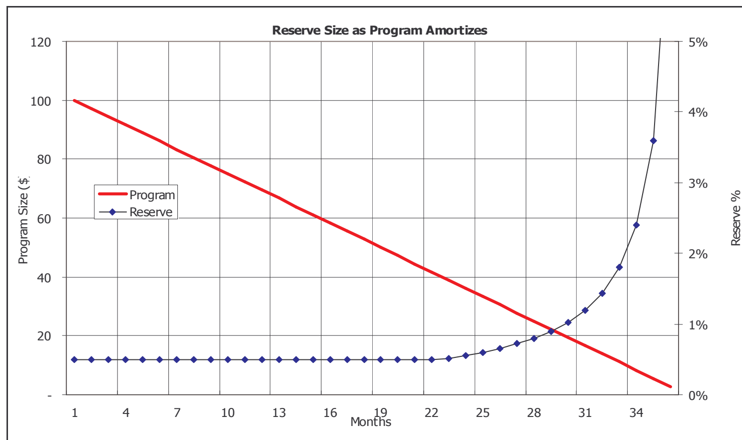
The other motivation of the seller (to reduce the actual cost of funds raised) coincides with DBRS’s interests in properly reflecting the risks of a transaction (as indicated by our rating). A seller realizes that, if it puts too much emphasis on reducing the cost of enhancement, the rating that DBRS assigns will be lower, and as a result, the actual cost of funding will be higher. Because the actual cost of funds is a much larger component of total cost of funds than is the cost of enhancement, the seller is much more interested in obtaining the desired rating than taking a risk associated with providing insufficient enhancement. Ultimately, this is the stick that DBRS wields in discussions with sellers.

Accounting regulations in Canada limit the total level of recourse that a seller can provide and still get off-balance sheet treatment. Recourse levels must be reasonable and must, generally, be below 10%. Our requirements for recourse levels above 10% would conflict with the seller's motivation to achieve off-balance sheet treatment. In some instances, this may effectively defeat the possibility of the transaction being completed due to irreconcilable differences. However, in most instances, the transaction is restructured so that total enhancement is split between the seller and a third party so that total recourse to the seller is limited to 10%.

Reserve/Cash Accounts

Of the various forms of enhancement, DBRS prefers reserve/cash accounts to all others. Cash is extremely liquid, has a known value, is not generally subject to any legal ambiguity and has no associated credit risk. Other forms of credit enhancement have lower liquidity, have an undefined or variable value, and may be subject to some minimal level of legal ambiguity (such ambiguity is inherent in a case law system based on legal precedent) and have a credit risk component. The cost, however, to the seller of providing cash is generally higher than any other form of credit enhancement. As a result, sellers are reluctant to provide credit enhancement in this form.

Reserve/Cash Accounts are, therefore, generally limited to small percentages of transactions and are used when liquidity requirements are paramount. Liquidity requirements for transactions, particularly those of a term nature, are generally lower at the inception and much more important at the tail end. As a result, a fixed cash account is set at the beginning (sometimes even zero and accumulated from excess cash flows over a short period of time at the start of the programme) that tracks a percentage of the total pool (of assets or funding) but will not be allowed to drop below a fixed percentage of the original transaction size. This effectively allows the reserve account to decline as the programme amortizes, but then stops reserve payouts as the programme gets near the tail - effectively increasing liquidity when it is most needed (see graph for possible example).



The types of liquid investments held in reserve accounts is restricted by DBRS. Only securities of little default risk are permitted for investment purposes. DBRS typically restricts investments in non Government of Canada securities to those with a rating of AA(low) or higher and also restricts the amount invested in any particular issuer to no more than 10% of the investment portfolio. DBRS sometimes permits investment in lower rated securities but only because, from a logistical perspective, it is difficult to invest small amounts - the amount invested in lower rated securities is restricted to no more than $1 million. Some conduits may also have some short-term flexibility (only a few days) to exceed investment restrictions noted above, where specific funding commitments have been made and where market conditions make prefunding advantageous.

Revolving/Amortizing

With an amortizing pool the composition of the assets is fixed and subject to only collection of contractual cash flows. A revolving pool, however, is dynamic with new assets replacing other assets that have been repaid. With a revolving pool, there is the added complexity of dealing with origination of new assets. This origination can have serious implications on the performance of the pool either due to changing origination standards and/or differing characteristics of the new assets.

Origination standards are closely reviewed during our due diligence process to ensure that they are consistently applied. The extent and level of review of the credit process by senior management and internal audit are also important considerations. The process for changing the existing credit and collection policy is also reviewed. Legal documentation reinforces our reliance on the credit policies by (i) requiring that eligible receivables have been originated in a manner consistent with the credit and collection policy and (ii) the credit and collection policy has not been changed in any material respect without the consent of the Trust.

Fraud is a risk that is inherently difficult to control and/or detect. With revolving pools, the poenial for fraud is higher because there is no explicit check on the assets with each purchase (which may occur on a daily basis). Amortizing pools, on the other hand, do have an explicit check on the assets with each purchase. The only truly effective mechanism to minimize this risk is to deal with reputable companies and management. U.S. experience suggests that the risk of fraud is highest with (i) entrepreneurial companies, (ii) young companies, (iii) inexperienced management, and (iv) less financially strong companies. If DBRS has any significant misgivings about the potential for fraud, we would not allow the transaction to proceed through a DBRS rated vehicle, notwithstanding any quantitative factors that may suggest otherwise.

Even without any change in origination standards, there is the potential for changes in the underlying characteristics of the new assets generated. Market conditions may dictate differing rate structures, terms, clients, geographic concentration, collateral requirements, etc. For example, a revolving residential mortgage pool may change over a period of time from one with predominantly 5 year fixed rate mortgages to one with predominantly 6 month adjustable rate mortgages due to changing customer demands. Obviously the risk profile associated with these two extremes also changes. Where there is potential for significant changes in a pool profile, particularly due to new marketing initiatives, DBRS may place restrictions on the proportion of assets that may be added or impose other structural elements that serve to protect against actual or potential changes in the pool composition.

Commingling

It is DBRS's general policy to allow reasonable commingling of funds for investment grade companies (for the purposes of commingling we usually consider this to be BBB or better; BBB(low) situations are evaluated on a case by case basis). The period of reasonable commingling would generally be the time-frame between settlement periods (generally one month). Where DBRS has some concerns about a company that is investment grade, a shorter commingling period would be imposed (typically 2 to 3 days depending on the company's capability of remitting on such a short time frame).

Non-investment grade companies (or investment grade companies that become non-investment grade companies) require no commingling of cash flows. There are two concerns associated with commingling. The first is the possibility that commingled cash may end up in a bankruptcy or CCAA situation that may entail either a prolonged period before return of such funds and/or such cash being used to satisfy other creditors and potentially being wholly or partially unrecoverable. Obviously, the shorter the commingling period the less exposure there is - for this aspect only. The second and more important consideration is the ongoing cash flow mechanics associated with the transaction. A filing under CCAA or the Bankruptcy and Insolvency Act ("BIA") has implications for ongoing cash flows as well.

While commingled cash is caught up in any CCAA or BIA filing, we do not want further cash flows to be caught. However, under a CCAA filing, for example, the cash flow mechanics cannot be changed **after** the filing. It is, therefore, necessary to avoid the problem in the first place. Once a company becomes non-investment grade, the cash flow mechanics are changed to ensure that cash does not commingle. Either all funds are deposited directly into a trust account or obligors send the funds direct to the SPV. In either case, any cash not belonging to the SPV would then be released to the Seller. Should the Seller then make a filing under CCAA, these cash flow mechanics could continue without worry that cash might be held up in the company pending appropriate review by the appropriate parties (the trustee, receiver, court, etc.).

Set-Off

Set-off risk is the potential for non-payment by an obligor as a result of an available claim for non-performance of a term of the contract giving rise to the receivable or any other cause of action involving the seller, that can or is asserted prior to the obligor being notified of the receivable sale (generally only at the time of an Event of Default). This risk can be mitigated by reviewing the form of the contract to ensure no other creditor performance obligations exists and to see if an express disclaimer of set-off rights exists. A review of the sellers performance history as well as performance to the date of the receivable sale can help characterize the level of set-off risk that may exist.

Liquidity

For asset-backed commercial paper ("ABCP"), DBRS requires that liquidity lines be provided covering 100% of the outstanding securities. Generally, the term of any liquidity lines are 364 days (which corresponds to the longest period for which ABCP can be issued) with varying renewal periods. DBRS ensures that all paper is covered by existing liquidity lines by either limiting the maximum term of the ABCP or by having a covenant that paper cannot be issued beyond the expiry date of the existing liquidity lines. For example, if a 364 day liquidity facility is in place that requires renewal of the lines 90 days before expiry, either DBRS would require the maximum term of the ABCP be 90 days or that a covenant be included in the Trust Indenture requiring liquidity lines be in place for the term of the ABCP. In the latter case, the maximum term of ABCP would initially be 364 days and would decline to a minimum of 90 days as the liquidity line's remaining term decreased. Upon renewal the maximum term would again rise to 364 days.
The liquidity lines must either be provided by a minimum AA(low)/R-1(middle) credit or be cash collateralized. Liquidity lines are designed to protect investors from market disruption risk - i.e., where the ABCP market is generally unavailable such that it is not possible to roll existing ABCP. Liquidity lines are not credit enhancement and under the Office of the Superintendent for Financial Institutions ("OSFI") regulations, cannot be used for credit purposes. Liquidity lines are occasionally used for bridging temporary mismatching of cash flows (generally a period of only a few days).

Any draws under liquidity lines generally are treated as if the liquidity lender were a holder of ABCP. Thus, the liquidity lender would rank pari passu with any existing ABCP investors.

Concentration

Securitization of assets is reliant on a diversified pool of assets so that historical performance is statistically meaningful for predicting future results. Where the number of obligors is large, the level of assurance that significant changes in performance will not occur can be predicted reasonably well. However, if there are a few large obligors that compose a significant portion of a portfolio, this level of assurance can be significantly diminished because the risk of poor performance is more directly related to the performance of these few large obligors. As such, the credit risk profile for the pool is similar to the credit profile of these large obligors. Even with enhancement, the overall credit risk of the pool may not be changed substantially.

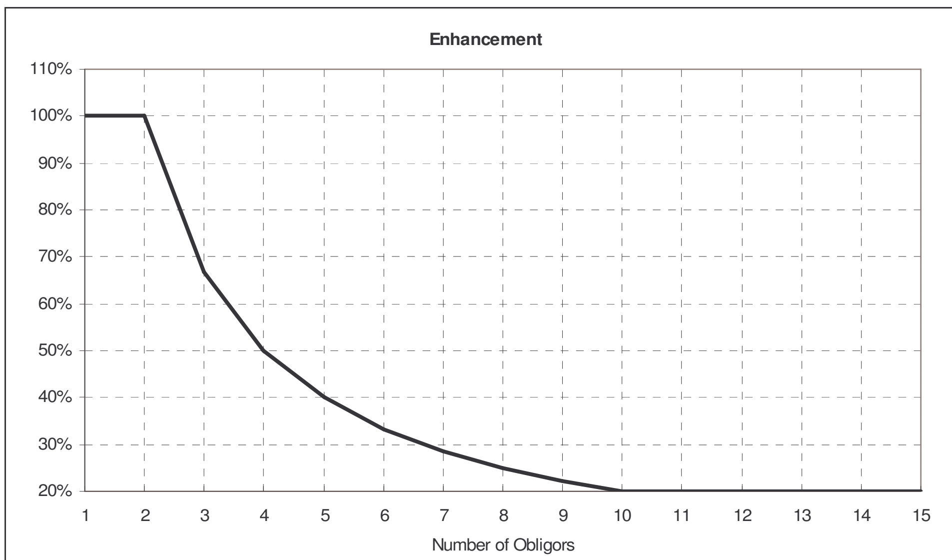
For example, if a pool consists of several thousand unrated obligors with a good period of historical performance, the level of credit enhancement to effectively eliminate the credit risk can be determined statistically with little margin of error. However, if one large unrated obligor were added to this pool so that it composed 20% of the portfolio and the previous enhancement level remained unchanged (say 10%), the credit rating would drop from AAA to a non-investment rating. This is because the probability of the pool failing is tied directly to the likelihood of the large obligor failing (assuming no recoveries). Therefore, to ensure that the pool is diversified sufficiently, DBRS imposes limits on the maximum size of obligors in a pool. These limits vary depending on the type of asset (trade receivables have more restrictive concentration limits because they are essentially unsecured obligations while fleet lease transactions may have more liberal concentration limits because the obligations are backed by readily saleable automobiles).

Maximum Obligor Concentration Limits (for Trade Receivables as a % of Enhancement)		
Obligor Rating	Total Enhancement	Seller Enhancement
AAA	100.0%	200.0%
AA	50.0%	100.0%
A	33.3%	50.0%
BBB	25.0%	33.3%
BB & unrated	16.7%	33.3%

The concentration limits utilized by DBRS (as indicated in the box below for trade receivables) are guidelines only and are tailored to the individual circumstances associated with each transaction - this is particularly so when dealing with AAA rated obligors. The "Total Enhancement" column would reflect the normal concentration limits based on the total level of credit enhancement (excluding excess spread, dilution reserves and any other form of collateralization not designed specifically for covering credit risk). In conduit transactions, there are typically two levels of credit enhancement (seller and third party) with the seller taking the first loss position. Given the vested interest of the seller and the third party credit enhancer, DBRS feels that this increased level of oversight may allow some slightly increased level of concentration. An additional concentration limit based solely on the seller enhancement provided, can be used if it is greater than the standard concentration limits based on total enhancement. Where there are large discrepancies between the two bases, DBRS will review the situation and set an appropriate limit. In no instances will the concentration of any non-AAA obligor exceed the total amount of credit enhancement.

Normally, concentration limits determine the maximum possible purchase from a single obligor. However, for certain asset classes involving larger obligors (such as corporate loans) and/or where growth of a pool is lumpy, credit enhancement is driven by concentration levels (as well as the credit quality of the assets). For example, DBRS's enhancement requirements for corporate loans are based both on the credit rating of the obligor as well as the size of the loan to the obligor. If we had a pool of equal-sized single A rated obligors, credit enhancement would be equal to the two largest obligors if the total number of obligors were 10 or less. Beyond 10 obligors the credit enhancement would be equal to 20%. A graphical view of enhancement levels as the number of equal-sized obligors increased (and therefore provided increased diversification) is shown below. Note that, as a practical matter, since obligors are most likely of differing size, actual enhancement levels would be higher than indicated in the graph.

Material Adverse Change ("MAC")



The MAC clause is a clause included in the termination events that gives the Agent or Trustee the power to terminate the program if there has been a material adverse change in the affairs of the company that may affect the performance of the purchased assets. The clause is very valuable in that it gives discretion in the determination of events that will terminate the program (it also gives DBRS a say via the Agent or Trustee). Such discretion is valuable because it is hard to quantify and/or describe every conceivable set of circumstances (or combination of circumstances) where it would be appropriate to terminate the program. DBRS generally requires a MAC clause for every non-investment grade transaction. For investment grade sellers, the financial strength of the Seller as well as the underlying characteristics of the assets are evaluated to determine the need for a MAC clause. Generally, the closer a company is to non-investment grade, the more volatile the company's performance, the more complicated the asset class or program structure and the newer the asset type, the higher is our determination to require a MAC clause.

Amortization Events

Amortization events are conditions and triggers incorporated into the transaction that will terminate purchases of new assets and/or stop payments to the seller. Amortization events are particularly critical for revolving pools of assets (new assets are purchased on an ongoing basis) and for pay through structures (cash is accumulated within the SPV during the intervals between fixed payments to investors). For some structures, amortization events are irrelevant because no commitment is made to purchase additional assets and cash payments are paid to investors upon receipt (pass-through). For example, if a one-time purchase were made of a pool of lease assets with the purchase funded using a senior/subordinated structure in which the senior tranche was a pass-through certificate and the subordinate note was held by the seller, then the use of any amortization events would be of no benefit to investors. No new purchases of assets have been committed to, so any termination of purchases would be unnecessary. Because all cash receipts would be passed through to the senior certificate holders (presumably on a monthly basis), there is no possibility of accelerating cash flow to investors. The only possible situation where an amortization event would be of relevance (in this type of structure) would be if there were some sharing of cash flows with the subordinated tranche (in which case the subordinated tranche is not strictly subordinated), such as repayment of subordinated tranche interest prior to principal amounts on the senior tranche. What is more relevant would be servicer termination events (as discussed previously).

Amortization events are designed to be triggered prior to any investors' losses. In fact, in an ideal situation they would be triggered sufficiently early so that the situation could be managed to leave investors without any loss. The downside, however, is that such triggers are imperfect. DBRS desires triggers that have a sufficiently high threshold to prevent unnecessary wind down of programs (with the potential cost of reinvesting the early receipt of funds being borne by the investor and with potentially significant costs to the seller associated with refinancing such obligations elsewhere) but not so high that triggers are too late to act as a warning to prevent losses to investors.
Amortization triggers can be tied to loss levels, delinquency levels, prepayment rates, seller credit rating, bankruptcy/CCAA and other creditor filings, payment or other obligation defaults, level of remaining credit enhancement, etc. The numeric ratios can be "spot" ratios or averaged ratios, and the triggers can be fixed or dynamic. Historical performance data is studied carefully in setting appropriate trigger levels. Results of stress testing are also incorporated in setting the trigger levels. Stress testing can provide an indication of the level of comfort that trigger levels provide in preventing losses to investors. For example, the results of stress tests may indicate that loss levels of four times the highest historical loss rate can be withstood on a sustained basis before there are losses to investors. Setting an amortization trigger at (say) two times this historical high loss rate provides two levels of comfort: (1) Because this is twice the previous historical high, the chances of an inadvertent trigger are extremely low (particularly if a short averaging period is used), and (2) Since this trigger is still only 50% of the required level of losses that would cause a loss to investors, there is an extremely low possibility that investors would suffer a loss after the trigger was breached. It is finding this middle ground that is the key to having workable and relevant amortization triggers.

Legal - Bankruptcy Remote

While bankruptcy remoteness is a poenial variable in these structures, as a practical matter it is a **given**. Securitization involves the separation of asset risk from the originator's risk profile. In order to effectively separate these risks, it is necessary that any SPV be bankruptcy remote. By bankruptcy remoteness, we mean that we eliminate the potential for a transaction to be recharacterized as a financing and not as a sale, and that would subject the assets of the SPV to the risk of the bankruptcy of the originator.

In order to achieve bankruptcy remoteness of the SPV, we take a number of steps to ensure a true sale

- Obtain a legal sale opinion (reviewed by DBRS counsel)
- Perfection/registration of an absolute assignment of the assets sold
- Delivery of secured creditors' consents and releases (if applicable)
- Obtain evidence and Officers Certificate of the originator's solvency at closing (if insolvent at closing a transaction can be unwound by the courts under the BIA)
- Isolation of cash flows from the seller insolvency proceedings (i.e., maintenance of cash flow streams, funding from spread, and commingling of funds)

Because of the pivotal role that bankruptcy remoteness plays in securitization, DBRS has its counsel review all true sale opinions except in situations where opinions provided follow an established template.

Basis Risk

Basis risk is not credit risk. Basis risk entails potential exposure as a result of differences in the pricing of assets and liabilities. Generally this risk entails a fixed floating exposure, but can also be floating exposure, foreign exchange exposure, differing grade exposure for commodities or even exposure to differing repricing sensitivity of derivative transactions. The risk is associated with the fundamental characteristics of the assets and liabilities and is present regardless of good credit performance. For example, if fixed rate leases were financed with ABCP, subsequent rollovers of the CP could be at significantly higher rates. At these higher rates, a negative spread may result, and the cost of this negative spread effectively eats into the credit enhancement available and worsens the longer such a situation persists. This is an extreme example, but basis risk can alter the level of credit enhancement even if such exposure is significantly smaller. For example, with assets priced at BA's + spread and financed with ABCP, both assets and liabilities reprice on a daily basis. The difference between ABCP and BA rates changes over time and, to the extent that this difference deteriorates, it could affect the level of credit enhancement if such spread were considered in setting enhancement levels. Swapping is not a feasible alternative because CP does not have a benchmark upon which to set such swap rates. Therefore, consideration of mechanisms to protect against potential (but remote) changes in the relationship between these two rates must be incorporated into the structure of the transaction.

<u>Hedging</u>
DBRS's view is that basis risk should not be borne by the programme in question. This may entail hedging arrangements (futures, swaps, options, collars, etc.) entered into with third parties. Such hedging attempts to minimize (though seldom does it actually eliminate it) the exposure the programme has to this basis risk. In some instances non-market hedging arrangements are made with the sponsoring institution to eliminate any basis risk where either the feasibility of hedging the risk in the marketplace or the cost associated with such hedging arrangements is prohibitive. Customized swapping of cash flows can be accommodated in such situations. In other situations, hedging is not entered into but collateral or additional reserves are provided which are sufficient (as determined by DBRS) to reduce the risk to a level appropriate for the rating given.

To date DBRS has required programs to minimize the basis risk. However, should sponsors wish to proceed with programs rated lower than the typical AAA or R-1(high) rating (and probably significantly below these ratings), DBRS would consider unhedged transactions where the total evaluation of risks (including basis risk) was appropriate for such a rating. For example, a programme rated single A or R-1(low) may not require hedging of BA versus ABCP basis risk because the magnitude of the risk (combined with an evaluation of all other risks of the programme) would be sufficiently low to warrant such a rating. In fact, such a programme would experience most of the risk associated with the level of credit enhancement and the quality of the assets. Basis risk would be relatively minor. For higher rated programs, all risks must be minimized to warrant a AAA or R-1(high) rating.

<u>Counterparties</u>
To ensure adequately that basis risk has been eliminated, appropriate hedging arrangements must have been executed. However, if the counterparties to such hedging arrangements are not of high credit quality, the level of assurance that basis risk has been minimized is not sufficiently high to warrant DBRS's highest investment grade rating. DBRS requires that hedging counterparties have a minimum rating of AA(low) or R-1(middle) for a short-term hedging arrangement. Lower rated counterparties will be considered where appropriate collateral or security is provided.

Mismatch

Mismatch risk is the risk that the cash flows associated with the underlying assets, while adequate to repay fully the principal and interest associated with the asset-backed securities, would not be available to repay scheduled principal and interest payments at the time required. Mismatch risk is not relevant for pass-through structures because, by definition, pass-through structures only distribute cash when it is available.

<u>Cashflow Timing</u>
For pay-through structures, DBRS stress tests the cash flows in a similar manner to that used for setting enhancement levels. Financial models that incorporate prepayment and reinvestment parameters (in addition to normal loss and delinquency considerations) are utilized to ensure that sufficient cash is generated to repay securities as and when they mature. Excess actual cash associated with these transactions were accumulated in reserve accounts (older structures) or were paid out to money market and/or pass-through tranches if not required. Because of the inefficiency of these structures (cash is accumulated and reinvested at rates typically below the opportunity cost of the seller), these structures are becoming less and less appealing for issuers. Reduced or no mismatch risk for the structure, however, means increased reinvestment or mismatch risk for investors. These risks to invesors are no incorporated into the ratings.

<u>Reserve Accounts</u>
Cash accumulation or reserve accounts are incorporated into the structure to act as "sponges" - they absorb excess cash not required for payments of principal and interest. When insufficient cash is available from program flows, then cash is removed from the reserve account to ensure full payment to investors. Stress testing, currently, incorporates a reinvestment assumption of a maximum of 3% for any accumulated cash. Given that most ABS trades in the 6 - 8% range (at the time of this report), this effectively results in a negative carry of between 300 and 500 basis points.

DBRS Inputs

DBRS exists because it provides an independent assessment of credit risk (as do rating agencies in general) that is not affected by actual or potential conflicts (i.e., no vested interest in the transaction). Ratings, like beauty, are not a question of fact but opinion. Opinions, likewise, are only valuable if based on a knowledgeable assessment of a situation. DBRS provides this through due diligence, credit assessment, stress testing (a special type of credit assessment) and ongoing monitoring of transactions, all built upon a base of knowledge developed through the most extensive coverage of structured and ABS transactions in Canada by any rating agency.

Due Diligence

The credit risk of ABS is directly tied to the structure of the transaction and the quality of the assets backing the securities. Due diligence attempts to ensure the integrity of the asset generation process (either historical for a non-revolving structure or historical and future for revolving structures). With revolving structures, in particular, it is impossible to review additions to the pool as they are being done on a continuing basis. We must, therefore, rely on the process that generates the new assets. Due diligence reviews and analyzes that process.

Computer Systems
The quality, capability, versatility and reliability of computer systems provide the backbone to the asset origination and management process. Without systems that adequately serve the day-to-day processing and management functions, any asset origination process becomes futile. Given the level of reliance that must be placed on the systems and the potentially complex reporting requirements, DBRS is looking for a well designed, managed and maintained computer system, not just one that is "adequate".

DBRS looks at several elements in the computer systems. Particular attention is paid to the software in terms of its capabilities for managing day-to-day processing, but more importantly, the versatility and flexibility of the software to allow proactive management of the portfolio. This is particularly so for financial assets (mortgages, leases, loans, credit cards, etc.) but is also relevant for other assets such as trade receivables. The ongoing management of information flows from the systems is a critical element of our assessment of the seller's credit and collection capabilities (discussed below under Management).

Software updates and/or transitions to new systems are looked at carefully to ensure that the process that manages this will minimize disruption to the management of the portfolio of securitized assets. Basic software protection such as passwords, backups, disaster recovery and redundant systems are reviewed as well.

Collections
Assets are only assets if the contractual cash flows that should be generated are actually collected, and the value of the assets are directly dependent upon the extent of collections. Collection processes and methods are, therefore, a significant focus of DBRS's due diligence efforts particularly for high-volume low-dollar assets. The collection efforts (as well as their effectiveness) are reviewed for differing levels of delinquency. The nature and extent of communication with obligors is also reviewed for adequacy. Staffing levels as well as support systems are also important considerations in the assessment of the Seller's ability to collect - particularly when economic conditions make collections more difficult.

Reporting
Part of the requirements to adequately complete a securitization is the ability to properly report the ongoing performance of the purchased portfolio. Given the need to be able to track the performance of the pool separate from any non-purchased assets, the ability of the Seller to generate such information reliably is far from a "given". DBRS reviews the capabilities of the Seller to adequately produce reports as required for the programme.

Management
The quality, experience and capabilities of management are an important qualitative consideration in the overall assessment of a company's operations - numerous references of which are in other specific sections.
Asset Generation
The whole process of how assets are generated is important in determining the future consistency of asset quality and characteristics. DBRS looks at a number of elements, but the most important are:

- Authority - Approval authority is important because it indicates the level of review that various sizes of credits require as well as the level of review required in non-typical circumstances or appeals. The experience level of credit analysts is compared to the requisite discretion they have in approving credits. Special attention is paid to the larger credits to ensure that a high level of review (either senior management or a dedicated credit committee) takes place. The main conclusion that DBRS wishes to achieve is that an appropriate level of review by adequately trained/experienced credit analysts has been made for all credits. While personnel can and do change, a policy that is in place to route size and quality of credits to differing levels of review, should ensure that adequate review does take place at all times.

- Change in policies - Any change in the credit and collection policy that has a material impact on the collectability of the assets must be approved in advance by the Trustee/DBRS, but small incremental changes do not have to go through this third party approval phase. The process by which changes in the credit and collection policy are approved is reviewed by DBRS to ensure that an adequate level of study, review and/or senior review has taken place before changes can be implemented.

- Exceptions - A credit policy cannot anticipate all circumstances nor deal with temporary aberrations. Exceptions to the credit policy (or any appeals of decisions already taken within the parameters of the existing policy) must have a defined mechanism for resolution. If exceptions are too numerous and/or are dealt with at a too junior level, the effectiveness of the stated credit and collection policy is diluted. DBRS attempts to ensure that this is not the case.

- Credit sources - Information used in evaluating the credit worthiness of a customer are only as useful as the reliability and accuracy of the information used. Highest reliance is placed on third party generated or corroborated sources such as audited financial statements, credit bureaus, bank letters, rating reports (preferably DBRS), etc. Less reliance can be placed on non-corroborated information such as internal management reports, interim financial statements, management representations. The mix of information used in establishing credit is reviewed for appropriateness in the circumstances.

- Credit Scoring - Credit scoring is a computerized method of evaluating credit quality based on the data associated with a potential customer. Generally, credit scoring is used in high-volume low-dollar transaction environments where manual reviews of credit applications is time consuming and laborious. These credit scoring systems are developed based on historical information that relates to actual credit performance (delinquency and losses), usually with the help of specialized consultants with expertise in this area. The advantage of credit scoring systems is that they are relatively fixed in form and are consistent. Actual performance histories of asset pools generated using credit scoring systems are less volatile than pools generated through only manual review of credits (biases of human credit evaluators are eliminated). An additional benefit of credit scoring systems is that changes in credit underwriting standards necessitate an active review and updating of the computerized scoring system. Such changes are more visible than subjective human standards and changes necessarily are of higher profile in an organization and, therefore, subject to a higher level of management scrutiny (including senior management). The disadvantage of credit scoring mechanisms is that if poorly set up, credit quality may actually be worse. DBRS ensures a sufficient break-in period has been allowed to develop a track history of the credit scoring model's capability.

- Standardized contracts - The granting of credit entails more than just an approval of a lending limit. It also encompasses how credit is extended and on what terms. Without standardization there is no consistency in character of the assets, let alone the legal standing of such assets. Standardized contracts are particularly important for interest bearing assets such as leases, credit card receivables, loans, etc. because it is important that the legal basis for such assets be clear. Homogeneity makes for cleaner and more efficient securitization of assets. A lack of homogeneity may make it impossible to securitize assets (especially in a revolving pool, in high volume transactions or where there are potential legal or tax pitfalls) or may involve considerably more work. For example, a securitization of bank loan assets that involve customized loan agreements would be difficult to securitize without a review of each and every loan document - clearly this is impossible if there are thousands of loans, but may be manageable if less than one hundred.

- Management Focus (growth, credit quality, profitability, etc.) - While not an explicit part of our due diligence, DBRS nonetheless considers the motivations and priorities of management. A culture and management philosophy that emphasizes credit quality is obviously of more comfort than a volume/market share oriented culture where negative credit decisions are not received favourably. This assessment of the corporate culture and its priorities does form part of the qualitative factors that necessarily are part of the rating process.

- Review - Credit is not a static endeavour of only approving new credits. Of at least equal importance, and probably considerably more, is the ongoing evaluation of existing credits. A good credit does not always remain a good credit (nor does a bad credit always remain a bad credit). Credit policies need to have a formal periodic review of existing credits weighted towards problem or marginal credits. Also of importance is the intelligence network the company has developed to anticipate problem credits separate from the formal review. A company that (say) is tapped into its sales/marketing base to ferret out rumour/facts about customers may be able to reduce or eliminate exposure to a client that is approaching bankruptcy or CCAA filing. DBRS views positively industry groups that meet on credit related issues to exchange information on approaches and problematic credit issues common to the industry - they are a fertile ground for avoiding problems before they occur.

Control Procedures
Well planned and documented procedures are useless unless there exists an appropriate level of supervision and verification of compliance. These control procedures ensure that compliance is maintained. They can be as simple as a supervisor's initials on a document (after review) to full fledged internal and external audits performed on a rotating surprise basis. Reliance is placed upon external auditors in general (assuming there have been no significant issues raised in management letters or in the auditor's report). Specific consideration of control producers is part of our review of credit and collections.

Industry and Competitive Review
Peculiarities of an industry or the nature/extent of competition can have implications on the risk profile of a securitization. For example, securitization of Canada Wheat Board receivables associated with the delivery of grain to a grain company's elevators is subject to a delivery risk rather than a credit risk (the Wheat Board is a body of the Government of Canada and, therefore, rated AAA). Availability of rail cars, therefore, is critical to the assessment of delivery risk. Regulatory changes both in the regulation of the grain industry and in the transportation sector (CN and CP rail systems) are of significant importance. DBRS draws on its knowledge of these industries to adequately assess the risk profile of the transaction.

Credit Evaluation

While securitization involves the separation of asset risk from the credit risk of the Seller, it is nonetheless important to evaluate the credit quality of the Seller. Credit risk of the Seller is relevant because:

- Some structural elements (such as period of cash commingling) are tied to the credit quality of the Seller. The higher the credit quality of the Seller the lower the probability of default and, consequently, the less value certain features of a transaction may have and may be disproportionate with the costs involved.

- Some structural elements are contingent on maintenance of a certain level of credit quality. For example, a backup servicer generally need not be appointed unless the Seller is considered to be non-investment grade. If the Seller is a solid investment grade company, no backup servicer will be appointed at the time the transaction is consummated, but a trigger may be placed in the transaction documentation to either terminate the program if the Seller becomes non-investment grade or to require the appointment of a "hot" backup servicer that would be able to step into the shoes of the Seller, as servicer, should circumstances so warrant.

- While programs are structured against theoretical bankruptcy of the Seller, as a practical matter certain aspects of bankruptcy are uncontrollable (such as lengths of legal challenges or stays) and the probability that the structure will be tested and/or challenged will be higher. As the credit quality of a Seller declines, DBRS gets "harder nosed" about any legal issues that have potential or theoretical impacts on structures (for example, ambiguities about registration/perfection issues in each province are less contentious for higher rated sellers but, for non-investment grade sellers, DBRS imposes a higher standard such as opinions from each province confirming that registrations are not required under conflict of laws legislation).

- While fraud cannot be protected against on an explicit basis, it can be avoided by not entering into transactions that have an unacceptable level of potential risk. Low credit quality is only one of numerous qualitative factors that are considered in assessing the potential for fraud.

Existing Rating of Company
An existing DBRS rating is a significant indication of credit quality. Other credit rating agencies' reports may be used by DBRS to improve our knowledge of the company (though some may be discounted where we feel that potential over rating may have occurred) with a more limited DBRS review. A "shadow" rating may be done by DBRS where there is currently no rating for the Company.

Review of Industry
A general review of the company and the industry it is in (associated with the assessment of the asset quality and characteristics), and DBRS's general outlook for industries (associated with the assessment of rated companies in the industry) provide a context for the evaluation of the credit quality of the Seller as well as the inherent risks associated with the industry.

Stress Testing

Stress testing is a process of evaluating an ABS issuance by using a mathematical model that represents the major characteristics of the financial structure and associated cash flows, including major operating characteristics (such as losses, interest rates, dilution, seasonality, prepayment, etc.) and triggers (amortization and default triggers). The model is developed as a representation of operating characteristics of the structure with flexibility to consider numerous different scenarios. Certain information is hard coded (such as the opening position of the assets that are securitized) while others are variable (such as enhancement levels, losses, interest rates, dilution, prepayment rates, etc.). Stress testing is just one tool that is used to better understand the various relationships and structural elements of a transaction. When used wisely in conjunction with the numerous sources of qualitative and quantitative information that have been gathered during the rating process, stress testing is an extremely valuable tool.

DBRS has, in the past, relied upon underwriters' stress models to evaluate ABS issuance. We have audited the models and tested extreme scenarios to ensure the propriety of such models. However, DBRS is of the view that, notwithstanding the efficiency of such an approach, we will increasingly design and build our own stress models as it may provide a slightly higher level of comfort to ourselves as well as investors. Circumstances may occasionally exist where we will rely on underwriters' models - but only when the circumstances warrant it. DBRS will audit and test such models to ensure they are appropriate for the purpose envisaged.

Approach/Scenario
While any evaluation of credit risk must necessarily reflect losses on the underlying assets, it is necessary to consider both the circumstances and scenario that would potentially contribute to losses to a security holder. For example, in evaluating the credit risk of a credit card pool, stress scenario's include concurrent increases in losses on the underlying assets with lower payment rates and reduced spread. Just using a multiple of historical loss rates would be inappropriate because losses to investors could occur as a result of spread compression (less excess spread is available to provide a cushion against ongoing losses) as well as slower payment rates (less overall cash is available to make contractual payments and assets remain in the pool for a longer period of time and are subject to losses at a later date).

The consideration of key performance characteristics of the assets must also be reviewed to determine the appropriateness of a structure. For example, a residential mortgage portfolio consisting of conventional first mortgages has an inherent level of credit enhancement because the properties are financed at a maximum loan-to-value of 75% (effectively 25% credit enhancement against property declines). Given this level of credit enhancement, the need for additional credit enhancement is generally low (current programs have about 5%), but the need for liquidity may be equally important because of the illiquid nature of the mortgages - we only have monthly payments on the mortgages to repay securities as they fall due. If we were to experience an increase in delinquencies (without any fall in property values) there is no element of credit risk. We do, however, have a cash flow timing issue - there may be insufficient current cash flow to pay securities as they come due. Therefore, the components of the credit enhancement can have as much of an impact on the performance of the securities as does the absolute level of credit enhancement.

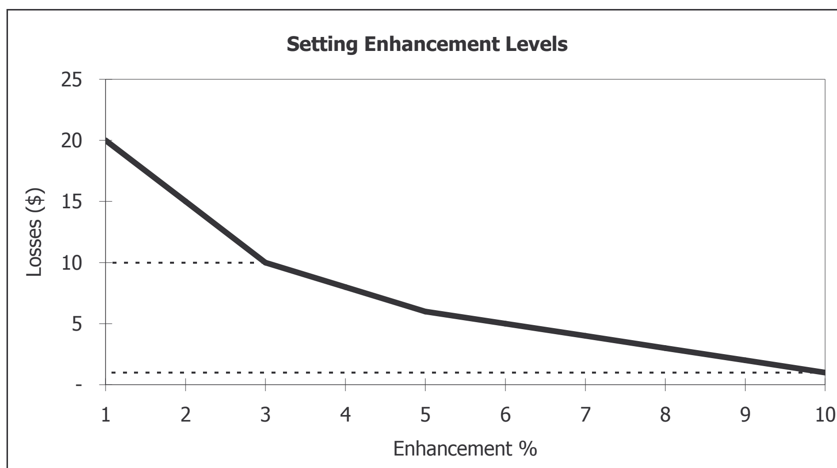
Therefore, careful consideration of the risk elements of a transaction must be given before any number crunching is done.

Default and Loss Rates

In order to assign a rating on any security (other than a AAA security where there is an extremely low risk), some benchmark must be utilized and should be statistically significant to be useful. Because of the limited size of the Canadian marketplace, DBRS utilizes U.S. benchmarks for default rates and recovery percentages in order to characterize properly the rating on an ABS security. The combination of the probability of a default and the expected recovery rate on a rated security yields an expected loss level (for a given rating level, security type and term).

For each rated security, DBRS first determines the expected loss level appropriate for the requested rating. This expected loss level is then used for setting the appropriate enhancement level as well as other parameters of the transaction (subject to other quantitative and numerous qualitative judgments as appropriate).

Based on the results of the stress testing model, an association between levels of enhancement and losses is determined (the solid line in the graph below). The curve shows that as enhancement levels increase, the net loss levels fall and visa versa. Depending on the rating of the securities that may be desired (whether AAA or lower), this relationship will determine (subject to numerous qualitative judgments) the appropriate level of enhancement that would be required, given the maximum allowable loss level for such a rating as previously discussed. Where multiple series of ABS must be rated, this curve will determine the maximum size of each tranche. For example, if the senior security is to be rated AAA, the graph below shows that 10% credit enhancement would be required to keep losses below the indicated level (which in this case is consistent with a AAA rating). If a junior security were also being issued, that required a minimum BBB rating (that is consistent with a loss of no more than $10 in our example), then 3% credit enhancement would be required. This would suggest that a 3% first-loss security of some sort would have to be established, and a 7% (10% - 3%) subordinated security rated BBB would be required for the senior security (90% = 100% - 7% - 3%) to be rated AAA. [Please note that the graph below is for discussion purposes and the magnitude of losses shown for BBB and AAA levels are for illustrative purposes only]



Mismatch/Prepayment & Other Considerations

As indicated previously, DBRS's ratings do not incorporate a timeliness of payment component. Notwithstanding this, mismatching of cash flows and the implications of prepayment levels are tested to ensure a high level of confidence that security holders will be repaid when contractually required.

DBRS attached the letter "m" (market risk) to a rated security where there is the potential for significant volatility in returns as a result of non-credit factors, which are not considered in the evaluation of a rating. Non-credit factors which may or may not influence returns on the security include, for example, derivatives, hybrids and formula returns which can be dependent on the movements in interest rates, foreign currency, equity prices, commodity prices and indices. In addition to the evaluation of credit quality as performed by DBRS, investors need to evaluate fully and comprehend non-credit factors to ensure the suitability of the security. The absence of "m" does not indicate that there will be no volatility of returns related to non-credit factors.

In stress testing of various tranches of securities, it is possible that performance characteristics of the assets may have profound changes on (say) repayment rates. If the potential changes are significant, DBRS would attach the letter "m" as indicated in the previous paragraph.

Ongoing Monitoring

In order for DBRS to maintain its ratings on the ABS, we require ongoing performance data as well as notification of events and circumstances that may have an impact on the transaction in question. Generally, this is provided by servicer reports, officer certificates, periodic legal opinions, copies of communications with the Trustee or a combination thereof.

Servicer Reports

DBRS requires that periodic servicer reports be provided. These reports normally are provided on a monthly or more frequent basis.

Servicer reports would generally include a minimum of the following information:

- Cash account activity and balances
- Prepayments
- Delinquency, default and write-offs
- ABS activity and balances
- Reserve and/or credit enhancement levels
- Performance triggers
- Events of default
- Servicer termination events
- Officers signature attesting to correctness of report

In addition to using the servicer reports for performance review (discussed in the next section) we also use the information to provide investors with summarized statistics on performance for their own review. Statistics are provided only for single-seller programs as the managers of conduits have requested that we not disclose data for competitive reasons. We publish summarized information (generally on a monthly basis) that is mailed to our subscriber base as well as downloaded to Bloomberg. Subscribers can access this data on their Bloomberg terminal by typing: DBRS <Go>, 7 <Go> (for Asset-Backed Securities) and then following the menus.

Performance Review

DBRS looks at all monthly servicer reports and assesses key current performance measures such as losses, delinquency levels, prepayments, reserve levels, cash flows, amortization and termination triggers, etc. DBRS also tracks historical performance and reviews trends both for the individual transaction in question but also against peer group performance. If any worrisome trends or individual month performances are noted, we discuss the situation with the Seller and the Agent for the transaction. Corrective action is taken if possible and as appropriate for the circumstances. Fortunately, to date, we have never had to proceed to the next stage: a downgrade of the securities because of poor performance.

Certificates/Updated Opinions

DBRS may require (generally) annual updates to opinions or Officer Certificates basically to confirm (i) continued registration and perfection of security, (ii) no defaults in any performance related obligations; and (iii) no circumstances have changed that would be expected to have a material adverse effect on the transaction. As a practical matter, increasingly these requirements have been incorporated into the legal documentation as covenants and/or obligations without a need for expensive legal confirmation that these have, in fact, been performed.

Conclusion

The Canadian securitization market has developed considerably in the last five years with a number of significant new asset classes being securitized (auto and other leases, agricultural equipment, credit cards, franchise loans, corporate loans, dealer/floorplan loans, inventories, etc.), including some notable firsts worldwide (mutual fund fees, a multi-seller commodity securitization vehicle, reverse mortgages). We are anticipating significant new asset classes and players in the securitization market such as various bank assets, toll road receivables, power sale receivables, government imposed fees/service charges and may have a significant role in a number of government privatization efforts.

Securitization will become a more important part of the Canadian debt market and will represent a liquid and efficient source of funds for many corporate issuers. DBRS has developed considerable expertise by rating virtually every securitization in Canada over the last seven years, and our on-going involvement should add to the continued growth in the securitization market.