EthiFinance Ratings

# Structured Finance Rating Methodology - SME CLOs

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# 1. Summary

## 1.1 Scope

The methodology described in this document applies to SME CLOs backed by granular and well diversified portfolios of loans to small and medium sized enterprises. EthiFinance Ratings (Agency indistinctly) evaluates qualitative and quantitative factors, to determine the final rating of the transaction.

The methodology applies to European SME CLOs transaction, with the application of the given assumptions based on the idiosyncrasies of the country and particular assets. If required, the methodology may be adjusted by introducing any ad-hoc variables that are determined to be essential to analyse specific risk factors of the transaction.

## 1.2 Analytical Rating Process

The steps in the analytical rating process include:

- Historical information
- EthiFinance Rating's credit risk information
- Loan data tape analysis
- Estimation of the probability of default and the loss distribution
- Cash flow analysis of assets and liabilities
- Adjustments of qualitative factors
- Review of legal documentation
- Final rating

The quality of the notes will depend on the collateral type, the cash flows analysis, the structural features and the assessment of the qualitative risks. The criteria contemplate other risks beyond credit risk that may have an impact on the notes, these are described in the section 2.4 of the document.

Once the rating for the notes has been determined, it will be validated through a series of sensitivity exercises to test the stability of the ratings. The rating is considered to be dynamic in an ongoing review and it is based on expected future performance.

This methodology cannot be considered static as economic and/or regulatory aspects may result in modifications.

This document contains a final section that summarizes the monitoring procedures of the credit quality of the notes.

# 2. Main elements of the analysis

## 2.1 Collateral

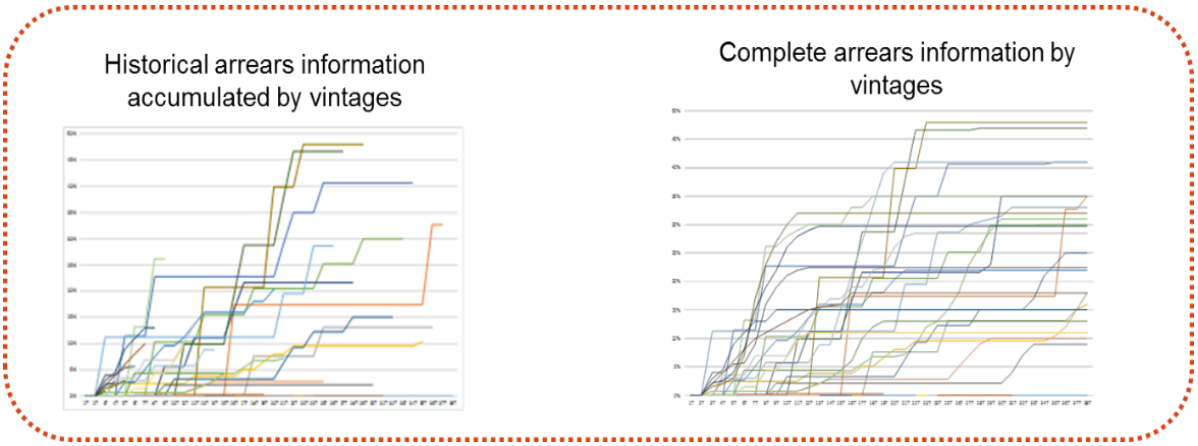
### 2.1.1 Probability of Default

Historical information & EthiFinance credit risk information

EthiFinance Ratings relies on the historical performance provided by the originator as a key input to determine a probability of default (PD) and to form a view regarding future performance.

Generally, the originator is expected to provide from five to ten years of historical data that is representative of the originators SME loan book data, which provides a good reference for the transaction and that covers a full economic period. The Agency will evaluate the criteria used to select the portfolio. The expected default rate may be higher than that indicated by the historical information observed, when the data supplied does not cover a period of significant stress.

EthiFinance Ratings expects to receive the historical performance information in the form of static and dynamic defaults, delinquencies, recoveries and prepayment ratios by vintage of origination/default, usually on a monthly or quarterly basis. The vintages should be broken down into different categories such as asset type, debtor type…




EthiFinance Ratings has a proprietary database, to complement and enrich the historical and the current information provided. EthiFinance Ratings will utilize this database and its own PD models, to estimate the debtors' PD, for back testing purposes.

In case, the information provided will be enriched with variables within EthiFinance Rating's database on a loan-by-loan basis, in cases where there are gaps in the data provided. The Agency would assume an expected one-year PD or annualised default rate for each debtor rather than to derive an expected one-year PD or annualised default rate for the underlying portfolio.

**PD Calculation**

- Internal EthiFinance Ratings PD for SME / Corporates with similar characteristics of the portfolio. Historical data with adequate depth.

- Debtor features (self-employed):
  - CNAE: National Classification of Economic Activities
  - Years of which has carried on business
  - Status on CIRBE
  - Purpose of the loan
  - Forborne loan?
  - Other specific factors which may affect the credit quality

- Other information for SMEs, companies or freelance on credit status:
  - Status on CIRBE
  - Loan range
  - Information on prior default of the debtor
  - Existence of loan guarantees or insurance
  - Months up to date with payments
  - Loan scoring

**PD Distribution**

- Information arrears (+90 days in default) by vintage origination (quarterly) and breakdown of assets if necessary (i.e., freelance vs corporate; specific CNAE as in real estate development and construction).

- Delinquency in originator's "population" portfolio in each moment of time.

EthiFinance Ratings may from time to time use other public market information or from other transactions rated by EthiFinance Ratings as a source of information to calibrate the initial estimations.

In cases where the information provided is deemed to be insufficient, the Agency may apply a rating cap or decline to rate the transaction.

### 3.1.2 Loan Data Tape Analysis

EthiFinance Ratings analyses the risk characteristics may vary depending on the type of product or overall composition of the underlying portfolio. To have accurate information, EthiFinance Ratings will perform a detailed analysis of the underlying portfolio in its most relevant characteristics and segregate the portfolio into several groups which facilitates the analysis of common risks and helps to form an opinion on the credit quality of the securitised collateral.

The loan data tape analysis will allow EthiFinance Ratings to estimate the cash flows of the underlying assets as well as other relevant aspects such as debtor and industry concentration levels and variability of the loan characteristics (amortisation type, interest, and principal frequency payments, weighted average interest rate, weighted average life…) amongst others.

For each loan, EthiFinance Ratings derives a proprietary industrial classification from the established NACE industry codes (Statistical Classification of Economic Activities in the

European Community) in order to assess the industry concentration levels.

### 3.1.3 Portfolio Composition and Asset Characteristics

Once the current individual loan data and historical information have been analysed, EthiFinance Ratings may adjust the expected default for the underlying portfolio to take into consideration variables such as the performance trends, the portfolio composition, the underwriting and servicing quality of the originator/servicer as well as macroeconomic factors.

Collateral performance is unknown and can differ significantly from expectations. The volatility of expected default rates depends on the portfolio composition.

Diversified portfolios are expected to exhibit lower volatility and default rates that are closer to the expected case. On the other hand, concentrated portfolios are expected to exhibit higher volatility of expected default rates. All these factors will be considered when modelling correlations.

EthiFinance Ratings uses a simplified form of the so-called firm's value models to Vasicek (1987). This approach is also used in Finger (1999) and Belkin et al. (1998) and extended in Lucas et al. (2001).

The default of each debtor is triggered by the change in value of the assets of the firm. The value of the assets of the nth debtor at time t is denoted by Vn(t) and is normally distributed.

The model considers Vi, t as a latent stochastic variable that captures the asset value of a company i = 1;,N at time t = 1;.., T. Let Vi,t follow a standard normal distribution. If Vi,t falls below a predetermined threshold ui;t (related to the level of debt) then a particular event is triggered. This event refers to a transition between states defined under some rating level. With this in mind, a 2-factor is considered as the underlying structure behind the dynamics and dependence structure of the asset value for the firms that belong in the portfolio.

$$V_{i,t} := \sqrt{\rho} b_t + \sqrt{\rho_g - \rho} b_{g,t} + \sqrt{1 - \rho_g} e_{i,t}, \forall i \in g$$

Where bt represents a global systemic factor and bt,g,g = 1;..,G, represent local systemic factors that jointly determine the default process. The model used by EthiFinance Ratings is one step forward from the one factor model which is used in the Basel II framework and is considered to be an over simplified representation of the factor structure underlying default dependence, particularly for internationally active banks (McNeil et al., 2005).

Characteristics that will be considered includes; the individual portfolio risk characteristics derived from the loan data tape, the weighted average life, the PD assumption based on historical and EthiFinance Rating's credit risk information and the two-correlation factor to capture concentrations in debtors and/or industries.

| | AAA | AA | A | BBB | BB | B or Below |
|---|---|---|---|---|---|---|
| **Correlation Intra-Industry** | **28%** | **26%** | **25%** | **22%** | **20%** | **18%** |
| **Correlation Inter-Industry** | **12%** | **11%** | **10%** | **9%** | **8%** | **6%** |

The agency relies on a Monte Carlo simulation and the portfolio default rate for each rating level is determined as percentiles of the loss distribution based on EthiFinance Ratings idealised corporate default rates.

### 3.1.3 Recovery Rates

SMEs loans can be secured or unsecured depending on the guarantees which will be available in case of the debtor defaults.

This information must contain, at least:

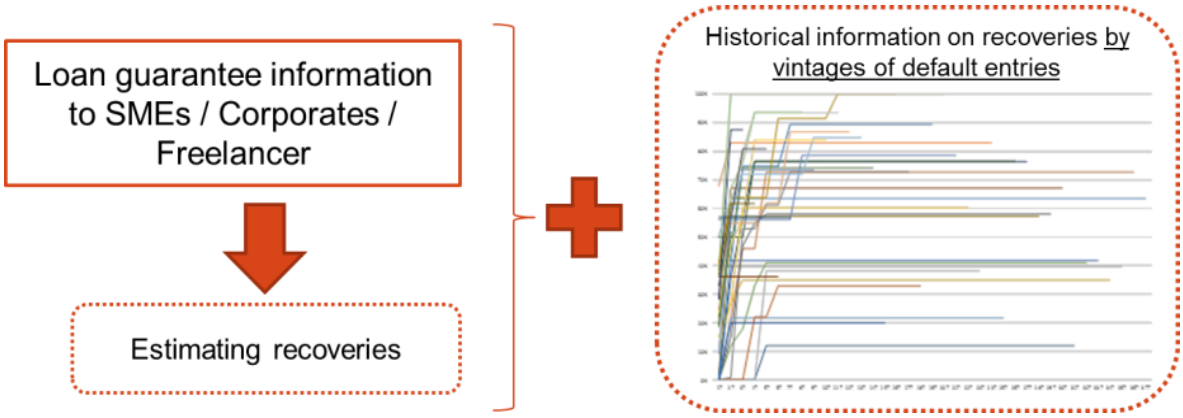
**Guarantee Information**

- Number of guarantors
- Guarantor / guarantee
- Guarantee type
- Initial value of the guarantee
- Current value of the guarantee
- Valuation type of the collateral
- Last valuation
- Zip code of the guarantee
- Shared guarantee?
- Construction year of the guarantee

**Recoveries distribution:**

- Recovery information by vintages of default entries (quarterly) and breakdown of assets if necessary (i.e., freelance vs corporates or personal loans vs collateralized loans, specific CNAE as in real estate development and construction).

The recovery value depends on collateral types (secured, unsecured or subordinated), its seniority (first or second) and macroeconomic factors. It is estimated applying different haircuts levels for each rating level.




For secured assets (residential and commercial real estate loans).

(i) The appraisal value of the guarantee may be adjusted to indicate possible drops or increases based on its collateral type and geographical location. EthiFinance Ratings would rely on a published home price index within the relevant jurisdiction to estimate the expected appraisal value.

(ii) Legal elements across each jurisdiction that affect the foreclosure process and potential regulatory changes may have an impact on the guarantees.

(iii) The guarantee is adjusted to the market value decline (MVD) assumptions for each

rating level to capture sales discount.

Expected recovery rate:

Min (Max (Stressed value - Foreclosure costs Prior ranking balance;0)/ Outstanding balance; 100%) Stressed value = Appraisal value adjusted * (1-MVD)

| | AAA | AA | A | BBB | BB | B or Below |
|---|---|---|---|---|---|---|
| **Residential MVDs** | **70%** | **66%** | **60%** | **56%** | **49%** | **45%** |
| **Commercial MVDs** | **80%** | **76%** | **70%** | **66%** | **59%** | **55%** |

MVD assumed for commercial properties are higher to reflect the lower liquidity, the higher price volatility and larger average size among other factors.

For unsecured assets, the recovery rates will generally be capped at the levels shown in the table below.

| | AAA | AA | A | BBB | BB | B or Below |
|---|---|---|---|---|---|---|
| **Unsecured RR** | **10%** | **13%** | **15%** | **17.5%** | **22%** | **25%** |

Finally, the resulting recovery assumption for the portfolio will be compared to the historical recovery data from the originator with adjustments in some cases.

## 2.2 3.2 Structure

The structural features will be analysed and incorporated into the model on a case-by-case basis. They will be a key determinant of the allocation cash flows within the structure to pay interest and principal of the notes according to the specific priority of payments established in the documentation.

Common structural features are as follows:

- **Subordination:** The existence of tranches with a different priority, reduces the risk for senior tranches and provide credit enhancement to the notes with higher priority.
- **Triggers:** Securitised transactions might incorporate several triggers related to the counterparties and/or the portfolio performance such as stopping the revolving period, altering the priority of payments, deferring interest payments…
- **Amortisation triggers**: Restricting the pro-rata amortisation of the notes, altering the priority of payments.
- **Reserve fund trigger:** The amortisation can usually start only, if a sufficient reserve has built up and/or certain conditions on the portfolio and on the structural performance are met.
- **Deferral triggers**: Protect the payment of principal payment with higher priority over the interest payments for subordinated notes.
- **Artificial Mechanism (Write-off):** This provision mechanism protects the notes by accelerating the amortisation of defaulted loans. Generally, a defaulted loan is classified when the loan has been in arrears for a certain number of months in accordance with the documentation.
- **Excess Spread:** The difference between the weighted average interest rate of the assets and the weighted average interest rate of the notes plus senior expenses. The level of excess spread varies across transactions and depends on the underlying

portfolio but might also be subject to changes during the life of the transaction.

- **Cash Reserve/Reserve Fund:** Structural mechanism usually funded by an equity tranche or by a subordinated loan at closing in order to provide credit support. It also acts as a mechanism to mitigate liquidity shortfalls.
- **Liquidity Facility:** In some instances, the liquidity facility agreement results in credit enhancement to the notes. In practice, typically transactions may rely on liquidity facility to cover potential liquidity shortfalls but in other cases, may act to absorb part of the losses.
- **Hedge Instruments:** Interest rate swaps or exchange rate swaps to cover interest rate and currency mismatches. The potential credit enhancement is incorporated by modelling both side payments of the swap, taking into account the result as more (or less) available funds on each payment date. In the absence of these hedge instruments, the transaction may be exposed to interest and currency risks.
- The counterparty's quality and the triggers in the documentation will be verified, in order to accomplish the counterparty criteria described in point 3.5.

## 2.3 3.3 Cash Flow & Sensitivity

This section summaries our assumptions for modelling SME CLOs transactions.

The analysis performed will focus on current portfolio information but also consider potential variations that may take place in the future composition.

In case of a revolving transaction, adding new loans can result in portfolio credit deterioration if riskier assets are added. It is expected to be partially mitigated by tight eligibility asset criteria, concentration limits and early amortisation triggers. On this specific case, the Agency would assume the worst-case scenario for loans added to the portfolio.

Modelling the transaction, we aim to capture the main structural features described in the transaction documentation. Cash flow analysis reflects how principal and interest collections are allocated according to the priority of payments established throughout the life of a transaction under different stress scenarios. For this purpose, EthiFinance Ratings relies on the scheduled amortisation, the default rates, the default timing distribution, the recovery rates, the recovery lag, prepayment rates and interest rates scenarios to estimate the cash flows for each rating level.

Cash flow analysis lets the Agency test the ability of the issuer to make timely interest and principal payments on the notes. Elements such as payment frequency, reference rate and structural features would be essential to determine the default risk of the notes.

### 3.3.1 Scheduled Amortisation

The starting point is to calculate the scheduled amortisation defined as the expected payments under the contractual terms of each loan. EthiFinance Ratings relies on the following information to derive the amortisation profile.

**Loan information**

- Initial loan amount
- Current loan amount
- Fix /floating interest rate
- Initial interest rate
- Current interest rate
- Method of resetting interest rate
- Loan spread
- Loan reference
- Date of origination
- Date of maturity
- Frequency of interest payments
- Frequency of principal payments
- Last date of actual payment
- Next payment date
- Amortization method
- Grace periods
- Months at default

**Early redemption**

- Historical information about amortization. Static monthly measurements: total monthly prepayments on total portfolio at each date.

Monthly amortisation schedule is calculated as a separate flow of principal and interest. Key variables such as payment dates, interest rate reset, interest rate reference, amortisation type and grace periods…are taken into account.

### 3.3.2 Default Timing Distribution

Most transaction structures are more vulnerable to being front loaded due to the negative impact of defaults on the excess spread. A back loaded distribution may be more vulnerable in transactions where the most senior notes are protected by very tight performance triggers linked to defaults. EthiFinance Ratings may adjust its default distribution assumptions depending on the characteristics of the transaction.

### 3.3.3 Recovery Lag

The timing of the recovery lag manly depends on the asset type, servicer procedures and also varies across each jurisdiction. Normally, longer recovery lag cause higher negative carry cost in the absence of structural mitigants such as artificial write off mechanisms.

Historical recovery information and the loan data tape supplied by the originator will be used as proxy. For secured assets (residential and commercial loans), EthiFinance Ratings assumes a recovery lag of 3-5 years and 1-3 years for unsecured assets.

### 3.3.4 Prepayment Rates

Three prepayment scenarios are modelled, slow, average and fast in order to establish different stress scenarios. The prepayment rate is a key variable in determining the volume of excess spread.

Generally, a high prepayment scenario may be more stressful as it results in a faster amortisation of the portfolio and a reduction of the excess spread available for repayment of the notes. However, a low prepayment scenario could also prove to be stressful if the structure includes excess spread trapping mechanisms to accelerate the amortisation of the notes or if the most senior notes are pass-through but have a shorter maturity than the other notes. Stressing a low prepayment scenario is particularly important where senior notes have already fully amortised and junior notes carry a high funding cost.

### 3.3.5 Interest Rates Trend

The Agency tests the structure in rising, falling and flat interest rate scenarios with the purpose of addressing any potential mismatches. The stresses consist of vectors of monthly increases/decreases.

### 3.3.6 Senior Expenses

We model senior expenses introducing stresses into the transaction for counterparty replacements (servicer for example). The stress will vary depending on the complexity of the tasks required and the availability of substitute providers.

### 3.3.7 Spread Compression

Permitted variations allow the originator to renegotiate the loans conditions, once they have been originated to provide higher flexibility. The most common features are linked to changes in the interest rate and/or the maturity profile of the loans. Based on this, permitted variations according to the documentation may be stressed since closing date.

### 3.3.8 Spread Compression

We would generally expect that the tranches of the notes would be able to withstand all of the relevant stress combinations applicable to that particular rating level, without defaulting,

Ratings are finally assigned through the exercise of a qualitative assessment by the Rating Committee alongside the consideration of model results.

The rating report will disclose what the rating addresses (i.e., timely interest payment and ultimate principal payment…).

In this sense, the following default’s probabilities are taken into account for each rating:

| | 1 year | 2 years | 3 years | 4 years | 5 years | 6 years | 7 years | 8 years | 9 years | 10 years |
|---|---|---|---|---|---|---|---|---|---|---|
| AAA | 0,012% | 0,021% | 0,034% | 0,061% | 0,100% | 0,146% | 0,189% | 0,227% | 0,263% | 0,304% |
| AA+ | 0,016% | 0,031% | 0,057% | 0,096% | 0,151% | 0,215% | 0,282% | 0,350% | 0,419% | 0,490% |
| AA | 0,019% | 0,044% | 0,084% | 0,138% | 0,209% | 0,296% | 0,393% | 0,502% | 0,623% | 0,739% |
| AA- | 0,024% | 0,063% | 0,120% | 0,197% | 0,296% | 0,412% | 0,540% | 0,683% | 0,840% | 0,991% |
| A+ | 0,043% | 0,112% | 0,202% | 0,317% | 0,456% | 0,620% | 0,797% | 0,989% | 1,198% | 1,409% |
| A | 0,064% | 0,151% | 0,266% | 0,414% | 0,589% | 0,788% | 1,005% | 1,242% | 1,495% | 1,753% |
| A- | 0,092% | 0,227% | 0,402% | 0,621% | 0,881% | 1,172% | 1,481% | 1,807% | 2,149% | 2,489% |
| BBB+ | 0,172% | 0,404% | 0,704% | 1,058% | 1,461% | 1,903% | 2,364% | 2,827% | 3,296% | 3,749% |
| BBB | 0,241% | 0,590% | 1,018% | 1,515% | 2,070% | 2,668% | 3,274% | 3,865% | 4,441% | 4,988% |
| BBB- | 0,499% | 1,128% | 1,842% | 2,605% | 3,398% | 4,193% | 4,955% | 5,670% | 6,342% | 6,958% |
| BB+ | 1,111% | 2,508% | 4,017% | 5,547% | 7,035% | 8,442% | 9,730% | 10,885% | 11,923% | 12,844% |
| BB | 1,576% | 3,522% | 5,581% | 7,622% | 9,575% | 11,387% | 13,023% | 14,472% | 15,753% | 16,869% |
| BB- | 2,382% | 5,038% | 7,724% | 10,310% | 12,734% | 14,952% | 16,942% | 18,700% | 20,244% | 21,594% |
| B+ | 3,598% | 7,615% | 11,241% | 14,486% | 17,428% | 20,067% | 22,394% | 24,420% | 26,180% | 27,699% |
| B | 5,171% | 10,485% | 14,893% | 18,689% | 22,047% | 25,010% | 27,583% | 29,797% | 31,702% | 33,330% |
| B- | 9,018% | 17,631% | 23,350% | 27,489% | 30,934% | 33,911% | 36,495% | 38,745% | 40,720% | 42,451% |
| CCC | 23,751% | 36,732% | 44,396% | 49,271% | 52,975% | 55,968% | 58,403% | 60,389% | 62,020% | 63,344% |
| CC | 48,780% | 59,075% | 67,034% | 74,101% | 80,714% | 87,065% | 93,250% | 96,250% | 99,250% | 100,000% |
| C | 87,750% | 90,750% | 93,750% | 96,750% | 99,750% | 99,999% | 100,000% | 100,000% | 100,000% | 100,000% |

### 3.3.9 Sensitivity

Once the securitised notes are rated, sensitivity analysis is performed, to make sure that a small change in the main parameters does not result in a rating downgrade.

## 2.4 3.4 Qualitative Factors

Although the quantitative analysis is the starting point to determine the rating of the notes under each scenario and its distribution, there are elements of risk associated to qualitative factors that may have an impact on the notes, therefore the final rating may differ from the modelling results.

The performance of a securitisation transaction does not only depend on the credit quality of the underlying portfolio, but also on other factors such as the requirement for timely and effective action from the parties involved.

The main qualitative risks considered to assign the rating include:

### 3.4.1 Sensitivity

Originator and Servicer review

EthiFinance Rating's operational review is designed to understand policies, process and practices and to reach an opinion regarding the quality of the originator and the servicer.

If EthiFinance Ratings believes that the originator or/and servicer quality and their capabilities are not adequate, issuers may be required to incorporate certain structural features such as a commingling reserve, backup servicing agreements or specific triggers to address the operational risk within the respective jurisdiction.

EthiFinance Ratings considers important the following factors:

- Company structure, financial stability and strategy
- Management and staffing
- Origination and underwriting policies
- Administration and recovery process
- Quality controls and compliance procedures
- Technology and Reporting

In the event that operational risks are not managed, evaluated and mitigated adequately and materialise in the transaction, it could have a negative impact on the credit quality of the notes. The capabilities of each of the parties of the fund shall be assessed.

Particularly, weak variables detected in the origination, underwriting monitoring and recovery process may be included in the quantitative analysis (probability of default and recoveries parameters).

The Agency believes that operational risks as a result of servicer interruption may lead to liquidity risk.

Additionally, with respect to operational risk, the performance of the transaction can be impacted by the performance of parties involved, such as calculation agents, trustees and cash managers.

### 3.4.2 Commingling Risk

The commingling risk arises whenever cash belonging to the fund is deposited in a third-party account or is mixed with cash belonging to a third party.

In the event of bankruptcy, the cash belonging to the fund but not transferred would be in risk. Temporary commingling could lead to liquidity risk and when permanent, can lead to credit risk.

The most common structural features, to mitigate this, are the reduction of the days between the debtor’s payment and the allocation of that amount into the issuer account bank (daily sweep collections), replacement of triggers in place to ensure a minimum credit quality throughout the life of the notes, additional credit enhancement, liquidity facility to cover delays…

The Agency may model this risk by assuming that asset flows up to one month will be lost at the beginning of the transaction. This stress is assumed early, and its aim is to test the impact due to the delay on the notification of the debtors.

### 3.4.3 Counterparty Risk

Counterparties in the transaction shall be assessed to determine the risk exposure, the materiality and the remedies in place.

The Agency believes that counterparty risk may result in a potential loss for the

transaction. The agency expects that remedial actions or structural mechanisms would have to be included in the prospectus to mitigate or reduce the potential exposure.

In particular, a downgrade language definition in the form of replacement triggers shall be required to be included in the documentation of the fund. The rating required to be eligible applies to financial counterparties involved in the transaction such as the paying agent, swap provider, liquidity facility provider and the issuer account provider.

| Transaction Rating | Eligible Counterparty |
|---|---|
| AAA(sf) | BBB- |
| AA+(sf) | BBB- |
| AA(sf) | BBB- |
| AA-(sf) | BBB- |
| A+(sf) | BB+ |
| A(sf) | BB+ |
| A-(sf) | BB+ |
| BBB+(sf) | BB |
| BBB(sf) | BB |
| BBB-(sf) | BB |

As detailed in the table above, a financial counterparty with credit quality of at least BBB- in the long term and a replacement commitment in place, would be able to support a maximum rating of AAA(sf).

Remedial actions would have to be considered within 30 business days:

- Obtain a first demand, unconditional and irrevocable
- Guarantee from a third-party entity rated at least BBB-.
- Replacement by another eligible entity rated at least BBB-.

For derivative counterparties, until the replacement is fully completed, they would have to post sufficient collateral (collateralisation). The rationale for posting collateral is based on covering the replacement cost and to encourage the counterparty affected to be replaced or provide liquidity facilities. Counterparties would have the commitment to deposit cash.

Additionally, when the remedy period has expired, and the remedial actions haven't taken place, the ratings of the notes may be lowered. Without prejudice of the aforementioned, linkage to the counterparty rating may be considered when the risk exposure is very high and is not mitigated.

### 3.4.4 Legal Risk

Legal risk refers the risk derived from the transfer of assets to the fund or "true sale", the isolation of the assets from the credit risk of the counterparties and the bankruptcy-remoteness of the special purpose vehicle. The legal opinions of the transaction will be reviewed.

Other regulatory risks to be analysed ad-hoc for each transaction and jurisdiction may exist.

### 3.4.5 Set-Off Risk

The set-off risk appears when the originator/seller or the debtor becomes insolvent. The debtors under the securitised loan have two different contractual relationships with the originator (deposits, notes, derivatives or any other financial product). This risk varies depending on each jurisdiction, asset class and structures.

### 3.4.6 Sovereign Risk Set-Off Risk

Sovereign risk will not be treated as an independent qualitative risk to rate the transaction. Specific macroeconomic conditions that can deteriorate the collateral quality in each country will be analysed although EthiFinance Ratings will not apply a country ceiling across the European countries.

### 3.4.7 Other Qualitative Elements

In the event that it is determined that there are additional qualitative factors, they will be analysed.

Depending on the jurisdiction, the transaction can be influenced by many factors, not all related to the mitigation of bankruptcy risks. Tax considerations, in the form of both potential benefits and liabilities or in relation to collections received on the assets.

# 3. Surveillance

Continuous monitoring from the date of issuance is performed on aspects like of the quality of the counterparties, the quality of the notes and the performance of the underlying portfolio, information provided by the management company, the originator, and any other participant as well as public information sources.

- Collateral quality: Default, delinquency and recovery rates are evaluated to check if they are in line with the initial assumptions applied. The composition of the underlying portfolio is monitored, amongst others on changes to industry concentration, geographic concentration, debtor concentration, asset type concentration, weight average interest rate and weight average life.
- Credit enhancement levels: Credit enhancement can come in the form of subordination, liquidity facilities, reserve funds and excess spread, among others. Credit enhancements are monitored to test their ability to cover projected losses.
- Counterparties: If any of these counterparties suffer deterioration and cannot meet their contractual obligations, the Agency may initiate a review process in relation to thresholds or triggers.
- Triggers: Transactions may have triggers based on portfolio performance or changes in ratings for transaction participants. Breaches of triggers can lead

changes in terms of increasing the credit enhancement or replacement of transaction parties. These triggers are typically linked to default rates and delinquency rates but can also be linked to certain concentration levels.

An analysis will be carried out to verify that the outstanding credit enhancement is commensurate to the rating assigned.

This document updates the previous version while preserving its original methodological criteria; therefore, all existing ratings remain unchanged. In this version, the format has been updated and includes a higher level of detail.