Rating Criteria for PCE/PLI/PBI Structures

Partial Credit Enhancement (PCE), Pooled Loan Issuance (PLI) and Pooled Bond Issuance (PBI) structures are used by companies to enhance their standalone rating to enable them to borrow at lower rates. The enhancement is achieved through a combination of partial enhancement (typically through partial guarantee provided by another higher-rated entity) and/or diversification achieved through multiple entities coming together to borrow as a collective vehicle, providing a common enhancement mechanism.

In a PCE structure, a single entity borrows from a lender on the back of a guarantee provided by a third entity. A 100% guarantee provided would lead to an equation of the rating to the guarantor's rating. However, this may be an expensive proposition for the borrower, and hence, borrowers use partial guarantees from higher-rated guarantors to increase their rating over their standalone rating while it may remain below the guarantor's rating. The rating criteria for this structure are provided in this document.

In a PLI structure, multiple entities come together to borrow from a lender using a common partial guarantee from higher-rated guarantors to increase their standalone rating, like in the case of a PCE structure. However, PLI structures are better than PCE structures, where the entities can achieve a higher rating with the same amount of enhancement because of the benefit of diversification across multiple borrowers, thereby reducing the probability of default. The rating, however, continues to get capped to the guarantor's rating. A PBI structure is same as a PLI structure with bonds replacing loans as the instrument used.

What provides a rating enhancement in these structures?

- The guarantee is common to all the borrowers in the structure. Thus, if any borrower misses its debt obligation, the same is serviced by the guarantor up to the amount of the guarantee. This reduces the probability of default, especially in case of a temporary disruption at the borrower's end or if the borrower is able to pay a part of the debt, but not 100%. Furthermore, if the borrower's situation improves at a later date, the guarantee amount gets reinstated, with the instrument not defaulting and the structure remaining intact.
- A percentage of guarantee at the start of the transaction and the terms of guarantee cover as the loan/bond amortises. If the guarantee amount remains fixed, the guarantee cover increases with the amortisation of the loan/bond, providing increasing safety over time. However, if the guarantee amount also reduces to maintain the cover, then the safety net remains the same till maturity. The most common structure is where the guarantee cover increases, but gets capped

to a certain percentage, post which the guarantee also reduces to maintain the cover at the capped percentage.

- The credit risk is diversified by having more borrowers with low correlation among them and with the loan amount well-spread-out between them. The rating increase can be higher for the same amount of enhancement if the number of borrowers is high, with no single borrower taking a large share of the loan and with low correlation among them. Correlation would be higher if the borrowers belong to the same group, have a common geography of operations, same products and are highly dependent on certain regulations that may impact all of them, among others.
- The weighted average rating of the borrowers and the difference between the rating of the guarantor

While these are structured instruments, and there are multiple clauses that can impact the rating of the structure, BWR looks at the following major aspects in assigning ratings for these instruments:

1. Standalone credit profile of the borrowers and guarantor; where BWR does not have a rating on them, an internal view on their credit profile is taken. The criteria applicable to the entities are followed, and these can be accessed from the BWR website.
2. Borrower-wise debt details in the structure, including the quantum of debt and tenor for each borrower, and the monthly/quarterly/yearly debt servicing to be done by each borrower
3. Partial guarantee amount and the number of instalments of any borrower and all borrowers on a cumulative basis that the guarantee is able to cover
4. Correlations between borrowers and hence, the PD of each borrower, the LGD of each borrower and the cumulative PD of the structure, considering the correlations among the borrowers and the number of simultaneous defaults that the guarantee is able to cover
5. Amortisation structure of the repayments, and the guarantee amounts and how the cover changes over time to ascertain how the PD changes as the guarantee cover builds up
6. The guarantee must be unconditional and irrevocable, and the non-payment of fees or any other condition should not lead to the guarantee becoming null and void. The mechanism should have a T-minus structure for the guarantee invocation to ensure timely payments to investors.

The rating of PCE/PLI/PBI instruments carry the suffix CE to indicate that this is a structured rating, different from the standalone rating of the individual borrowers.

The previous version of this document can be found in
https://www.brickworkratings.com/download/Criteria-Partial_Credit_Enhancement.pdf

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