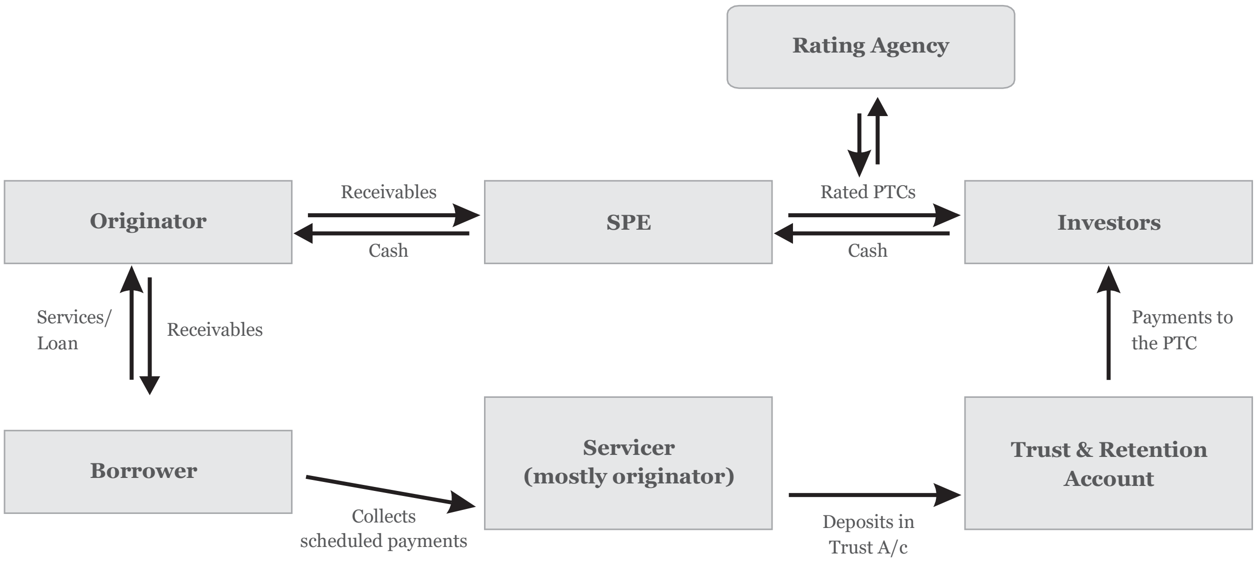
Rating Criteria - Securitisation Transactions

1. Background

Securitisation refers to the sale of assets generated by originator to others such that the ownership of the underlying assets and risks involved with the same is transferred to the buyer. As per regulatory RBI guidelines, only the following assets are eligible for securitisation:

- Underlying assets that represent a homogeneous pool of borrowers
- All on-balance sheet loans and advances except
  - Revolving credit facilities
  - Assets purchased from other entities
  - Securitisation exposures
  - Loans with bullet repayment of both principal and interest (with the exceptions as laid out by the regulatory guidelines)

Securitisation transactions in India can be either through the "PTC" (Pass Through Certificate) route or through a "Direct Assignment/Payout". Assets that are usually sold through such loan transactions include cars and two/three wheelers, Commercial Vehicles (LVCs, MCVs and HCVs), personal loans such as microcredit, and mortgage backed loans. Single loans can also be securitised and such transactions are referred to as "Single Loan Sell Downs".
A typical securitization transaction is structured as shown below:



The "Originator" is the seller of the assets and can be a bank/financial institution/company that had originally lent to the underlying Borrower. The sale is made to a Special Purpose Entity, which is constituted typically as a Trust. The SPE then raises funds from investors by issuing Pass Through Certificates (PTCs) and the proceeds from the same are paid to the Originator (after deduction of fees, charges and statutory dues). Thus, the Originator now has access to a source of funds and transfers the underlying credit risk to the extent of the portfolio sold. The borrowers continue to service their debt to the Originator, which transfers all such payments in a Trust and Retention A/C that is usually assigned to the control of the Trust. The Servicer (in most cases the Originator in India) is responsible for ensuring that the payments received are utilized for payouts to the investor. In the case of Direct Assignments, the transfer of assets is directly to the buyer and is not routed through the trust.

2. Types of Securitisation Transactions

Securitisation transactions differ based on both the structure (PTC/Direct Assignments, Par/Premium, credit enhancement provided etc.) as well as on the underlying assets that are securitized. Brickwork Ratings assigns ratings for the following:

- Residential Mortgage Backed Securities
- Asset Backed Securities including CVs, Tractor Loans etc.
- Personal loans such as Micro credit backed securities

3. Regulations for Securitisation

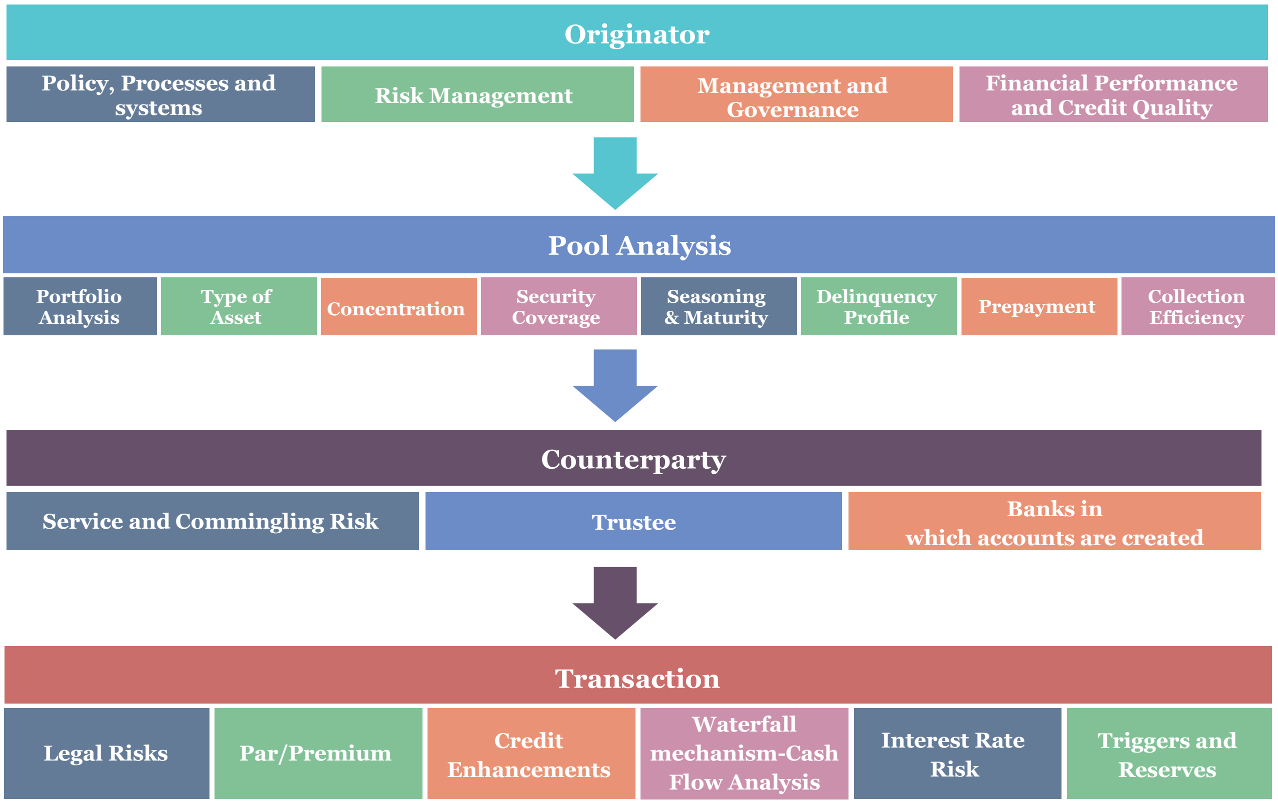
Securitisation transactions are mainly regulated by the Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI).
The latter regulates instruments that are listed in stock exchanges.
The regulations set by RBI include

- Guidelines for securitization – who can be originators, investors, responsibilities of the originator, responsibilities of the investor, type of assets that can be securitised
- Requirements of a Minimum Holding Period (MHP) and a Minimum Retention Requirement (MRR) based on the original maturity of the asset being securitized and the repayment frequency of the underlying borrower
- Credit Enhancement – Type of credit enhancement and guidelines on reset of credit enhancement
- Minimum disclosures to be adhered to when entering a securitization transaction
- Provisioning and capital adequacy norms
- Accounting treatments

The regulations by SEBI pertain to those structured finance instruments proposed to be listed. This includes the functions of an SPE, responsibilities of the SPE, Originator, Trustee and Rating Agency, minimum disclosures to be made. In addition, the securitization transactions could be entered under the SARFESI Act regulations.

4. Rating Criteria at Brickwork Ratings

The criteria used by Brickwork Ratings for securitization transactions are highlighted by the figure below:



4.1 Originator Assessment

The Originator is the company that has issued the loans to Borrowers and is securitizing the same. A review of the Originator is necessary as it impacts the performance of the pool.

The following parameters are considered while conducting an Originator assessment:

- Policies, Processes and Systems – Policies such as Credit Policy, Collateral Management Policy that drive the origination and disbursal standards should be well documented. Systems should be in place to ensure compliance with the policies, and to ensure use of technology to track loans and repayment, recoveries, asset values etc.

- Risk Management – The risk management, sanctioning and underwriting practices (including asset specific practices), write-off and provisioning norms should be in place.

- Management and Governance – The technical and management experience in such a field, the ownership of the Company, presence of independent directors, level of corporate governance etc.

- Financial Performance and Creditworthiness of the Originator – As in India, most of the Originators themselves serve as the Servicer, the creditworthiness of the Originator is analysed and a standalone obligor rating assigned. The credit worthiness of the Originator is analysed as per the criteria used by Brickwork Ratings for assigning ratings to companies in the Industry to which the Originator belongs:

Analysis of the Financial Performance of the Originator includes an analysis of the following parameters:

- Capital – Sources of capital, Tier I and Tier II capital, Capital Adequacy
- Earnings – Net Interest Income, Profitability, Cost of Funds and Return on Assets, Non-Interest Income, Provisioning levels
- Assets – Types of Assets, Growth, and Asset Quality measures such as NPA ratios, delinquency profile,

and incremental growth in NPAs
- Liabilities – Sources of Funds, Asset-Liability Gap Risks, CASA in case of Banks

4.2 Pool Analysis

Brickwork Ratings analyses the total portfolio of the Originator (relevant to the assets being securitized) before conducting a pool analysis.
The following are considered while analyzing the portfolios:

- Total size of the Portfolio (number and amounts)
- Trend in growth
- Geographical spread
- Concentration levels at both geography and customer level
- Type of collateral and typical Loan to Value Ratios
- Trends in Collection, Delinquencies and Prepayment
- Holding Period and Retention period

Collections, delinquencies and prepayments can be understood by conducting a Static Pool analysis (ideal) or a Dynamic Pool analysis (done in cases where sufficient historical data may not be available). The trends in the static pools across different vintages and across the life of the loan financed are understood to arrive at assumptions of prepayments, delinquencies and collections.

The accounts in the pool are analysed to understand.

- Divergence of the pool from the portfolio with respect to geographic distribution, ticket size of the loan, loan to value ratios
- Parameters such as customer concentration (by amount) can be a critical factor in the pool quality
- The type of asset being financed
- Pool seasoning – With seasoning, the equity of the borrower in the asset being financed increases and it is expected that loss rates will reduce with higher seasoning
- Prepayments – Prepayments can increase for assets such as CVs at a higher rate during the life of the loan
- Holding Period and Retention Period
- Delinquency Profiles across Ageing Buckets

In addition, BWR looks at Counter party risk, commingling risk as well as credit enhancements.

4.3 Transaction Risk

Legal Risks:

Brickwork Ratings (BWR) considers legal risk as an important risk in any securitization transaction. The following points are covered while analyzing the same:

- If the transaction is in accordance with the Laws of India
- If the transaction is in accordance with regulations and guidelines of RBI and SEBI
- If the sale of assets constitutes a “true-sale”
- Enforceability of the transaction (credit enhancement) etc.
- If all documentation is in order with the above

It should be noted the BWR does not comment on the legality of the transaction nor does it provide any advice on the structuring of such transactions. Brickwork Ratings relies on an independent legal opinion for the same.

Par/Premium Structure:

A PAR structure is one in which the amount collected from the investor is equal to the Principal amount outstanding on the cut-off date of the pool. In such cases, the Excess Interest Spread (defined as the excess interest collected from borrowers as compared to the coupon rate of the instrument securitized) would be used in cases of shortfalls in collection. However, in cases where the Excess Spread is released to the Originator during every payment period, the same would not be considered during the cash flow analysis. Instruments where the future cash flows are discounted and considered in the value of the transaction are considered to be sold at a "Premium" (Price paid for the same is greater than the pool outstanding as on date of transfer). In the Premium Structure, instead of an Excess Interest Spread, there is Over Collateralization (% of receivables every month kept to meet any short fall).

Credit Enhancement:

Credit Enhancements can be given in the form of Cash Collateral (strongest form of enhancement), Liquidity Support, and Guarantee etc.

- Internal Credit Enhancement – Internal credit enhancement is provided by the Excess Interest Spread (EIS) and Over Collateralisation
- External Credit Enhancement – Cash Collateral, Liquidity Support, Guarantee

The cash collateral when given can be given as First Loss Credit Facility or Second Loss Credit Facility. The Second Loss Credit Facility is topped up after the investor payouts from the pool collections before the First Loss Credit Facility. Liquidity Support is provided only for managing shortfalls due to delinquency buckets and as such, top ups are made before payments to the investors. A guarantee is accepted only if it is unconditional and irrevocable. The guarantor's rating at all times is considered and the ability to fund the amount required is assessed. Brickwork Ratings will consider the availability and nature of credit enhancement while arriving at the rating.

Cash Flow Waterfall:

The cash flow will be considered based on the water fall mechanism in place. The better the performance of the pool to the stress tests, the higher the rating assigned. A typical water fall mechanism of a securitization transaction is as follows:

- Collections of interest and principal from the borrower
- Cash flow used to pay fees and statutory dues
- Cash flow used to top up liquidity support provider/credit enhancement provider
- Cash flow used to repay any arrears to investors
- Cash flow used to pay investors the amount due
- Cash flow to top up any credit enhancement used
- Remaining cash released to the originator/kept by the Trust to be released to the Originator on dissolution of the trust

Brickwork Ratings stresses the base cash flows, prepayments, collection efficiencies and delinquencies, the credit enhancement available etc. while arriving at the rating.

The stress factor for loss rate input is done to determine

- Timing of toss
- Severity of loss

The overall ability of the pool, considering possible support of the credit enhancements provided, to meet the required cash payouts on time is measured under such scenarios and the rating is assigned based on the same.

Interest Rate Risk

Interest Rate risk is an important factor to be considered in the cash flow analysis. While there is the risk involved if any leg of the transaction is at a fixed rate while the other is at a floating rate, the base rate that the floating rates are linked to could also be a risk. The risk of prepayments and timing of cash flows that result in interest rate risk are also factored in.

Triggers and Reserves

In certain cases, the transaction may be structured such that certain triggers are included based on collection efficiencies, prepayments, rating of the Originator etc. Brickwork Ratings accounts for the same by stressing the scenarios to include such triggers.

5. Rating Surveillance

The rated instrument will be subject to a continuous surveillance; the originator/servicer will have to provide details on the collections, ageing and prepayments of the pool that is rated periodically. BWR assesses the same to determine a rating action.

6. Structured Finance Rating Scale

The rating scale for Securitisation transactions/Structured Finance Instruments is given below:

6.1 Long term structured finance instruments- instruments with original maturity exceeding one year

BWR AAA (SO)	Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.
BWR AA (SO)	Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.
BWR A (SO)	Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.
BWR BBB (SO)	Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.
BWR BB (SO)	Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.
BWR B (SO)	Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.
BWR C (SO)	Instruments with this rating are considered to have very high likelihood of default regarding timely payment of financial obligations.
BWR D (SO)	Instruments with this rating are in default or are expected to be in default soon.

Modifier {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories BWR AA (SO) to BWR C (SO). The modifiers reflect the comparative standing within the category.

b. BWR assigns rating "outlook" for ratings from 'AAA' to 'B'. The Rating outlook indicates the direction a rating is likely to move over a period of time and may be classified as Positive, Stable or Negative.

6.2 Short term structured finance instruments- instruments with original maturity of/up to one year

BWR A1 (SO)	Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligation. Such instruments carry lowest credit risk.
BWR A2 (SO)	Instruments with this rating are considered to have strong degree of safety regarding timely payment of financial obligation. Such instruments carry low credit risk.
BWR A3 (SO)	Instruments with this rating are considered to have moderate degree of safety regarding timely payment of financial obligation. Such instruments carry higher credit risk as compared to instruments rated in the two higher categories.
BWR A4 (SO)	Instruments with this rating are considered to have minimal degree of safety regarding timely payment of financial obligation. Such instruments carry very high credit risk and are susceptible to default.
BWR D (SO)	Instruments with this rating are in default or expected to be in default on maturity.

Modifier {"+" (plus)} can be used with the rating symbols for the categories BWR A1 (SO) to BWR A4 (SO). The modifier reflects the comparative standing within the category.

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

About Brickwork Ratings: Brickwork Ratings (BWR), a Securities and Exchange Board of India [SEBI] registered Credit Rating Agency and accredited by Reserve Bank of India [RBI], offers credit ratings of Bank Loan, Non- convertible / convertible / partially convertible debentures and other capital market instruments and bonds, Commercial Paper, perpetual bonds, asset-backed and mortgage-backed securities, partial guarantees and other structured / credit enhanced debt instruments, Security Receipts, Securitisation Products, Municipal Bonds, etc. BWR has rated over 11,400 medium and large corporates and financial institutions' instruments. BWR has also rated NGOs, Educational Institutions, Hospitals, Real Estate Developers, Urban Local Bodies and Municipal Corporations. BWR has Canara Bank, a leading public sector bank, as one of the promoters and strategic partner. BWR has its corporate office in Bengaluru and a country-wide presence with its offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi along with representatives in 150+ locations.

Disclaimer: It must be clearly understood that a Rating opinion is based on various factors/aspects which includes application of certain Rating criteria. The particular criteria applied depends on a number of factors, inter alia, sector/Industry, historical performance, cyclical trends, prevailing economic condition, group support etc. Rating opinions factor many assumptions and the application of any particular criteria or a set of criteria may be full or partial depending upon peculiarity of each case. Application of any Rating criteria should not therefore be considered as rendering finality or completeness to a Rating assessment. A reference to criteria needs to be perceived in broad terms, only as an aid to a rating decision.

Brickwork Ratings India Pvt. Ltd. (BWR), a Securities and Exchange Board of India [SEBI] registered Credit Rating Agency and accredited by the Reserve Bank of India [RBI], offers credit ratings of Bank Loan facilities, Non- convertible /

convertible / partially convertible debentures and other capital market instruments and bonds, Commercial Paper, perpetual bonds, asset-backed and mortgage-backed securities, partial guarantees and other structured / credit enhanced debt instruments, Security Receipts, Securitisation Products, Municipal Bonds, etc. [hereafter referred to as "Instruments"]. BWR also rates NGOs, Educational Institutions, Hospitals, Real Estate Developers, Urban Local Bodies and Municipal Corporations.

BWR wishes to inform all persons who may come across Rating Rationales and Rating Reports provided by BWR that the ratings assigned by BWR are based on information obtained from the issuer of the instrument and other reliable sources, which in BWR's best judgement are considered reliable. The Rating Rationale / Rating Report & other rating communications are intended for the jurisdiction of India only. The reports should not be the sole or primary basis for any investment decision within the meaning of any law or regulation (including the laws and regulations applicable in Europe and also the USA).

BWR also wishes to inform that access or use of the said documents does not create a client relationship between the user and BWR.

The ratings assigned by BWR are only an expression of BWR's opinion on the entity / instrument and should not in any manner be construed as being a recommendation to either, purchase, hold or sell the instrument.

BWR also wishes to abundantly clarify that these ratings are not to be considered as an investment advice in any jurisdiction nor are they to be used as a basis for or as an alternative to independent financial advice and judgement obtained from the user's financial advisors. BWR shall not be liable to any losses incurred by the users of these Rating Rationales, Rating Reports or its contents. BWR reserves the right to vary, modify, suspend or withdraw the ratings at any time without assigning reasons for the same.

BWR's ratings reflect BWR's opinion on the day the ratings are published and are not reflective of factual circumstances that may have arisen on a later date. BWR is not obliged to update its opinion based on any public notification, in any form or format although BWR may disseminate its opinion and analysis when deemed fit.

Neither BWR nor its affiliates, third party providers, as well as the directors, officers, shareholders, employees or agents (collectively, "**BWR Party**") guarantee the accuracy, completeness or adequacy of the Ratings, and no BWR Party shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of the Rating Rationales or Rating Reports. Each BWR Party disclaims all express or implied warranties, including, but not limited to, any warranties of merchantability, suitability or fitness for a particular purpose or use. In no event shall any BWR Party be liable to any one for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Rating Rationales and/or Rating Reports even if advised of the possibility of such damages. However, BWR or its associates may have other commercial transactions with the company/entity. BWR and its affiliates do not act as a fiduciary.

BWR keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of the respective activity. As a result, certain business units of BWR may have information that is not available to other BWR business units. BWR has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

BWR clarifies that it may have been paid a fee by the issuers or underwriters of the instruments, facilities, securities etc., or from obligors. BWR's public ratings and analysis are made available on its web site, www.brickworkratings.com. More detailed information may be provided for a fee. BWR's rating criteria are also generally made available without charge on BWR's website.

This disclaimer forms an integral part of the Ratings Rationales / Rating Reports or other press releases, advisories, communications issued by BWR and circulation of the ratings without this disclaimer is prohibited.

BWR is bound by the Code of Conduct for Credit Rating Agencies issued by the Securities and Exchange Board of India and is governed by the applicable regulations issued by the Securities and Exchange Board of India as amended from time to time.