

# GCR

## RATINGS

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CRITERIA FOR RATING CREDIT LINKED NOTES  
AND REPACKAGING VEHICLES

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## Scope of the Criteria

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1. This criteria titled 'Criteria for Rating Credit Linked Notes and Repackaging Vehicles' (the 'Criteria') will be used to rate each credit linked notes ('CLN') and repackaging vehicle ('Repack') transaction and will be accompanied by a transaction specific report that will disclose any additional observations or modifications to the Criteria. The Criteria should be read in conjunction with GCR Ratings' ("GCR") Criteria for Rating Structured Finance Transactions, updated and published in September 2018.

## Summary of the Criteria Changes

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2. This Criteria is an update to the version published in May 2017<sup>1</sup>. The update of this Criteria will not have an impact on any existing transactions that have been rated under it. Going forward, all new transactions will be rated using this Criteria.
3. This Criteria applies globally, although each individual jurisdiction and each specific transaction may give rise to additional observations and/or deviations, which will be disclosed in the transaction-specific reports.

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<sup>1</sup> This version of the criteria, published in September 2019, has been updated for formatting, naming conventions and alignment with GCR's updated Rating Symbols, Scales and Definitions only. This criteria is applicable to all previous publications referring to "Global Credit-Linked Note and Repackaging Vehicle Rating Criteria, November 2018".

## Introduction

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4. GCR's CLN and Repack Criteria applies to notes issued, mainly by corporates or financial institutions, that rely upon the performance of one or more underlying counterparties (the "Reference Entity or Reference Entities"). The main feature of these notes is the absence of credit enhancement, where a failure by any of the Reference Entities to perform its obligations under a transaction can result in a default of the notes. This Criteria should be read in conjunction with GCR's published 'Criteria for Rating Structured Finance Transactions, updated September 2018. The Criteria does not apply to senior secured securities issued by corporates that benefit from certain structural enhancements i.e. Structured Bonds, where GCR's 'Criteria for Rating Secured Bonds', updated November 2018, applies.
5. CLNs are typically transactions where an investor purchases a note issued by a bankruptcy remote SPV (the "Issuer"), although the Issuer can also be an operating entity (such as a bank). The note is synthetically credit linked to a Reference Entity or Reference Entities, which may be achieved by a credit default swap ("CDS") or other means. Proceeds from the issuance of the note are used to purchase a qualified investment or underlying securities issued by the Reference Entities (this may also include loans advanced to Reference Entities where the SPV acquires the loan and loan agreement which may have been advanced by a separate entity). The qualified investment or underlying security acquired by the SPV thus collateralises the note or CDS. Single-name CLNs reference one Reference Entity, whereas multi name CLNs can reference multiple Reference Entities and often form repackaging programmes. CLNs are thus dependent upon the performance of each Reference Entity under its obligations on the qualified investment or underlying security. A default of any Reference Entity or its failure to perform its obligations on the qualified investments or underlying security can lead to a default on the CLN. If no such credit event occurs it is expected that a CLN will be redeemed in full upon its maturity date. Typically, CLNs and Repacks *de facto* include several risk presenting entities/counterparties that perform supportive functions to the transaction such as the account bank or swap counterparties.

## Credit Quality of Reference Entities

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6. The credit quality of the Reference Entities is critical within the analysis of CLNs or Repacks. Reliance is placed upon the credit rating or credit assessment of the Reference Entity as the CLNs do not benefit from credit enhancement or other structural enhancements. For Repack programmes or multi name CLNs, the lowest rated Reference Entity will drive the rating analysis, as it is considered to contribute the most risk to the structure (*'weak link approach'*). GCR expects all Reference Entities to have a long-term and short-term credit rating accorded. Whilst ideally these entities should be rated by GCR, GCR does accept ratings from other licensed Credit Rating Agencies; however, in some instances notching may apply (up or down) where GCR may have a different view on a certain entity. GCR also expects that any entity that performs any supportive role within the transaction, such as account bank or swap counterparty amongst others, has an adequate rating so as not to constrain the rating of the notes issued by the Issuer. GCR expects the transaction to incorporate downgrade language in respect of the

supporting counterparties, such that counterparties whose credit ratings are downgraded to below the required ratings are replaced.

7. For single-name CLNs, the rating is accorded by a straight look-through to the underlying Reference Entity's credit rating or credit assessment. A default of the underlying Reference Entity is likely to lead to a termination of the transaction and default of the issued notes. For Repacks which are not series segregated, or CLNs that rely upon multi-name Reference Entities, GCR will use a weakest link approach. Where there is more than one Reference Entity, GCR will use the rating of the lowest rated entity as its base for the analysis. Where an underlying security issued by the Reference Entity is fully guaranteed by a more highly rated entity or if the underlying security has the benefit of a put option, GCR will use the rating of the guarantor or the put provider in place of the rating of the Reference Entity in its analysis.
8. Counterparties that belong to the same corporate group will be regarded as one Reference Entity. Where the rating of the lowest rated Reference Entity (or the weakest link counterparty) is on Rating Watch or has a Rating Outlook, the rating of the note will also reflect such Rating Watch or Outlook.

### Credit Quality of Issuing Entity

9. In the event the issuing entity of the CLN is considered to be an operating entity (i.e. an entity not regarded as bankruptcy remote), such as a bank, GCR will apply a similar analysis in that a weakest link approach will be applied. In this regard, the lower rating of the bank or the Reference Entity will form the base of the analysis for the rating of the CLN.

### Early Termination

10. CLN/Repack transactions include early termination events, which in turn lead to an automatic unwinding of the transaction and may result in a potential loss to the note investor. 'Standard' early termination events are accounted for in the rating accorded to the notes.
11. For example, 'standard' termination events are considered to be termination upon default of an underlying Reference Entity, if a transaction becomes subject to tax or if it becomes illegal to maintain a transaction. If other termination events exist, GCR will also consider these in its analysis. Such events will be detailed in the individual rating reports. Where early termination risks are not sufficiently mitigated, GCR may decline to rate a transaction. In the event of a default, claims against the Issuer are typically limited to the proceeds from the underlying security and GCR expects that this default will not affect any other notes that may have been issued by the Issuer that are credit linked to different underlying securities.

## Legal Opinion

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12. GCR expects to receive a legal opinion to include capacity language in respect of transaction parties; as well as that transaction documentation is legal, valid, binding and enforceable against the relevant transaction parties and underlying reference counterparties.

## Performance Monitoring

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13. On-going monitoring of the performance of transactions as well as the underlying Reference Entities or other counterparties are key to the rating process and maintaining current ratings.
14. Surveillance panels are held at a minimum annually or as events warrant. Upward or downward rating action on a Reference Entity will trigger a surveillance panel and potential rating action. For public transactions, GCR will publish a performance report at a minimum on an annual basis or as events warrant.

## Disclaimer

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15. Note that GCR is not a legal, tax or financial adviser and will only provide a credit opinion of the rated securities. For example, a rating does not cover a potential change in the applicable laws nor can it be regarded as an audit. Moreover, GCR is not a party to the transaction documents nor does it provide legal, tax or structuring advice.

## Glossary of Terms/Acronyms

Administrator	A transaction appointed agent responsible for the managing of a Conduit or a Special Purpose Vehicle. The responsibilities may include maintaining the bank accounts, making payments and monitoring the transaction performance.
Advance	A lending term, to transfer funds from the creditor to the debtor.
Agent	An agreement where one party (agent) concludes a juristic act on behalf of the other (principal). The agent undertakes to perform a task or mandate on behalf of the principal.
Amortisation	From a liability perspective, the paying off of debt in a series of installments over a period of time. From an asset perspective, the spreading of capital expenses for intangible assets over a specific period of time (usually over the asset's useful life).
Arrears	General term for non-performing obligations, i.e. obligations that are overdue.
Asset	An item with economic value that an entity owns or controls.
Bond	A long term debt instrument issued by either: a company, institution or the government to raise funds.
Borrower	The party indebted or the person making repayments for its borrowings.
Call Option	A provision that allows an Issuer the right, not the obligation, to repurchase a security before its maturity at an agreed price. The seller has the obligation to sell the security if the call option holder exercises the option.
Capital	The sum of money that is used to generate proceeds.
Cash Flow	A financial term for monetary changes in operations, investing and financing activities.
Collateral	An asset pledged as security in event of default.
Commingling	The mixing of various transaction parties' funds in an account.
Coupon	Interest payment on a security.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
Credit	A contractual agreement in which a borrower receives something of value now, and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company
Credit Enhancement	Limited protection to a transaction against losses arising from the assets. The credit enhancement can be either internal or external. Internal credit enhancement may include: Subordination; over-collateralisation; excess spread; security package; arrears reserve; reserve fund and hedging. External credit enhancement may include: Guarantees; Letters of Credit and hedging.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit Risk	The probability or likelihood that a borrower or issuer will not meet its debt obligations. Credit Risk can further be separated between current credit risk (immediate) and potential credit risk (deferred).
Debt	An obligation to repay a sum of money.
Debt Sponsor	Usually as Investment bank that brings a transaction to the capital markets, similar to an Arranger.
Default	A default occurs when: 1.) The Borrower is unable to repay its debt obligations in full; 2.) A credit-loss event such as charge-off, specific provision or distressed restructuring involving the forgiveness or postponement of obligations; 3.) The borrower is past due more than X days on any debt obligations as defined in the transaction documents; 4.) The obligor has filed for bankruptcy or similar protection from creditors.
Desktop	An assessment of the property value, with the value being compared to similar properties in the area.
Downgrade	The assignment of a lower credit rating to a corporate, sovereign or debt instrument by a credit rating agency. Opposite of upgrade.
Enforcement	To make sure people do what is required by a law or rule et cetera.
Environment	The surroundings or conditions in which an entity operates (Economic, Financial, Natural).
Excess Spread	The net weighted average interest rate receivable on a pool of assets being greater than the weighted average interest

	rate payable for the debt securities.
Guarantee	An undertaking for performance of another's obligations in event of default.
Guaranteed Investment Contract	A contract that guarantees the principal and interest repayment over a period of time. Typically GIC are used in relation to a bank account.
Income	Money received, especially on a regular basis, for work or through investments.
Index	An assessment of the property value, with the value being compared to similar properties in the area.
Issuer	The party indebted or the person making repayments for its borrowings.
Junior	A security that has a lower repayment priority than senior securities.
Liability	All financial claims, debts or potential losses incurred by an individual or an organisation.
Liquidity	The ability to repay short-term obligations or short-term availability of liquid assets to a market or entity.
Liquidity Risk	The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market.
Loan	A sum of money borrowed by a debtor that is expected to be paid back with interest to the creditor. A debt instrument where immovable property is the collateral for the loan. A mortgage gives the lender a right to take possession of the property if the borrower fails to repay the loan. Registration is a prerequisite for the existence of any mortgage loan. A mortgage can be registered over either a corporeal or incorporeal property, even if it does not belong to the mortgagee. Also called a Mortgage bond.
Loss	A tangible or intangible, financial or non-financial loss of economic value.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Obligation	The title given to the legal relationship that exists between parties to an agreement when they acquire personal rights against each other for entitlement to perform.
Option	Either a call or a put option. A call option gives the holder the right to buy assets at an agreed price on or before a particular date. A put option gives the holder the right to sell assets at an agreed price on or before a particular date.
Origination	A process of creating assets.
Originator	An entity that created assets and hold on balance sheet for securitisation purposes.
Owner Trust	Owner of a securitisation vehicle that acts in the best interest of the Noteholders.
Payment Date	The date on which the payment of a coupon is made.
Prepayment	Early or excess repayment of an obligation. Partial or full prepayment of the outstanding loan amount.
Prepayment Rate	The rate of prepayment in relation to the pool of obligations. Also called prepayment speed.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Private	An issuance of securities without market participation, however, with a select few investors. Placed on a private basis and not in the open market.
Property	Movable or immovable asset.
Provision	An amount set aside for expected losses to be incurred by a creditor.
Rating Outlook	A Rating Outlook indicates the potential direction of a rated entity's rating over the medium term, typically one to two years. An outlook may be defined as: 'Stable' (nothing to suggest that the rating will change), 'Positive' (the rating symbol may be raised), 'Negative' (the rating symbol may be lowered) or 'Evolving' (the rating symbol may be raised or lowered).
Recovery	The action or process of regaining possession or control of something lost. To recoup losses.
Repayment	Payment made to honour obligations in regards to a credit agreement in the following credited order: 3.) Satisfy the due or unpaid interest charges; 4.) Satisfy the due or unpaid fees or charges; and 5.) To reduce the amount of the principal debt.
Reserves	A portion of funds allocated for an eventuality.
Seasoning	The age of an asset, the time period passed since origination.
Securities	Various instruments used in the capital market to raise funds.

Securitisation	Is a process of repackaging portfolios of cash-flow producing financial instruments into securities for sale to third parties.
Security	An asset deposited or pledged as a guarantee of the fulfilment of an undertaking or the repayment of a loan, to be forfeited in case of default.
Senior	A security that has a higher repayment priority than junior securities.
Servicer	A transaction appointed agent that performs the servicing of mortgage loans, loan or obligations.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Spread	The interest rate that is paid in addition to the reference rate for debt securities.
Stock Code	A unique code allocated to a publicly listed security.
Structured Finance	A method of raising funds in the capital markets. A Structured Finance transaction is established to accomplish certain funding objectives whilst reducing risk.
Subordinated Loan	A loan typically given by the Issuer to the securitisation vehicle that is more junior than a junior tranche.
Surveillance	Process of monitoring a transaction according to triggers, covenants and key performance indicators.
Timely Payment	The principal debt, interest, fees and expenses being repaid promptly in accordance with the contractual obligation.
Tranche	In a structured finance, a slice or portion of debt securities offered that is structured or grouped to resemble the same degree of risk associated with the underlying asset or with a similar degree of risk. A junior tranche has a higher degree of default risk than a senior tranche.
Transaction	A transaction that enables an Issuer to issue debt securities in the capital markets. A debt issuance programme that allows an Issuer the continued and flexible issuance of several types of securities in accordance with the programme terms and conditions.
Trust	A third party that acts in the best interest of another party, according to the trust deed, usually the investors. Owner of a securitisation vehicle that acts in the best interest of the Noteholders.
Trustee	A third party that acts in the best interest of another party, according to the trust deed, usually the investors. Owner of a securitisation vehicle that acts in the best interest of the Noteholders.
Ultimate Payment	A measure of the principal debt, interest, fees and expenses being repaid over a period of time determined by recoveries.
Valuation	An assessment of the property value, with the value being compared to similar properties in the area.
Waterfall	In securitisation, the order in which the cash flows are allocated to the transaction parties.
Weighted	The weight that a single obligation has in relation to the aggregated pool of obligations. For example, a single mortgage principal balance divided by the aggregated mortgage pool principal balance.
Weighted Average	An average resulting from the multiplication of each component by a factor reflecting its importance or, relative size to a pool of assets or liabilities.



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