CRITERIA FOR RATING SERVICER QUALITY

April 2021

Table of Contents

Scope of the Criteria

1. Global Credit Ratings' ("GCR's") servicer ("servicer quality" or "SQ") ratings assess a servicer's structure and management strength, financial profile, systems, controls and reporting capabilities, and its loan/debtor administration and/or collection abilities, in order to determine the quality of the servicing functions performed by the organisation. GCR may require an originator or servicer to be rated as part of a structured finance transaction. This is of particular relevance in transactions where the underlying collateral is extremely granular. Preferably, this should be a GCR rating, to enhance GCR's understanding of the capabilities and financial condition of the company performing the servicer function. However, ratings from an accredited rating agency (per rating agency regulations in each jurisdiction) can also be relied upon. This criteria details GCR's approach to awarding servicer quality ratings to servicers which are primarily supporting structured finance transactions. However, servicer quality ratings are also of relevance where companies provide servicing for bought-in or third-party portfolios, in the absence of a related structured finance transaction.

2. Although servicer quality ratings are country specific, GCR's rating approach and methodology is principle-based, and thus typically appropriate across all jurisdictions. However, the servicing function of particular entities may have unique features, or the servicing environment may differ across countries due to local practices and laws, which may require modifications to the rating criteria or scorecard used in the rating process. In cases where the criteria are amended or supplemented, this will be disclosed in the individual entity rating reports.

Summary of the Criteria Changes

3. This criteria is an update to the version published in May 2017. There are no significant amendments to the criteria. 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.

Introduction

4. GCR's servicer quality rating approach separates a servicer's performance from the credit quality of the loans being serviced, as well as other factors beyond the servicer's control. The intention is to evaluate how effective a servicer is at preventing defaults and maximizing recoveries when defaults do occur. Nevertheless, the quality, stability, and experience of servicers (regardless of asset type) have a direct impact on the asset quality and therefore the performance of the transaction or portfolio.

5. The servicer quality rating considers a servicer's operational and financial stability, as well as its ability to respond to changing market conditions. This assessment is based on a servicer's organisational structure and management strength, its financial profile, information technology and reporting capabilities, as well as its strategic goals.

6. GCR's servicer quality ratings are typically divided into three servicing types (each of which is discussed later in this criteria):
    - *Primary servicer*: Loan or debtor administration (servicing loans throughout an asset's life cycle);
    - *Special servicer*: Arrears management (collection or workout of delinquent/distressed loans, usually post write-off); and
    - *Standby/backup servicer: A* servicer contracted to effectively be 'on call' and to take over the primary servicer's role in the event that this servicer defaults or is unable to continue the servicing function for any reason

Nature and importance of servicer quality ratings

7. GCR's servicer quality ratings differ from its long and short-term credit ratings, which are opinions of the credit quality of a specific instrument or issuer. Servicer quality ratings measure the quality of the servicing operations, not the probability of the servicer's financial default or ability to repay a fixed obligation. However, a servicer's financial stability and performance are taken into account in the servicer quality analysis, as explained in the "Rating criteria" section of this criteria.

8. Although the approach to servicer quality ratings is, by nature, more qualitative than GCR's credit rating approach, quantitative elements are considered through the analysis of the servicer's track record and financial condition.

Servicing types

Primary servicer

9. A primary servicer is typically an entity servicing its own assets (typically loans or debtors) as part of a securitisation, but also includes a specialised servicer, to which this function has been outsourced. A primary servicer handles all aspects of servicing throughout an asset's lifetime. In addition to processing payments and providing customer service, a primary servicer will also manage collections and the resolution of defaulted loans, as well as origination and credit processes.

10. In the jurisdictions where GCR provides servicer ratings, third party servicing is not the norm, with originators generally appointed as the servicer in securitisations of their own assets. Outsourcing of the servicing function to third parties has, however, gained momentum in recent years, although only for certain asset classes.

Special servicer

11. A special servicer is typically differentiated from a primary servicer in that the assets serviced are generally not originated by this company. Furthermore, a special servicer's core business is generally the servicing of already delinquent or defaulted assets. This role will be fulfilled in either an outsourcing relationship or

through the acquisition of delinquent loan books from other companies. Specialised servicers can also fulfil the role of a standby servicer.

Standby/backup servicer

12. The rating approach for a primary or standby servicer is similar, other than the fact that the standby servicer's ability to collect in a particular transaction or portfolio cannot be assessed directly. A backup servicer may be required for securitisation transactions in which the primary or initial servicer is rated below investment grade or is unrated.

13. The requirement for a standby servicer ensures continuity in servicing throughout the life of the transaction/portfolio, with the backup servicer stepping in should the initial servicer default or otherwise be unable to fulfil its servicing obligations. The exact nature of the backup requirement will depend on the nature of the transaction/portfolio and assets being serviced. GCR will assess the capacity of the standby servicer to assume the primary servicing role within a short period.

Rating Criteria

14. GCR's servicer quality ratings are based on a formal review of the servicer. The source of the information is the servicer itself. In general, GCR expects a servicer to have been in operation and actively servicing assets for a minimum of 12 months, before a servicer quality rating may be assigned. An initial servicer review will commence with an examination of the corporate structure, including:
    - Incorporation and history
    - Ownership structure
    - Operational structure and strategy; and
    - Corporate governance.

15. The abovementioned factors are generally only covered in depth in the initial analysis and report, which will also include an assessment of the servicer's financial performance, and its asset administration and servicing functions. Follow up reviews would typically only address significant changes, particularly where these may impact the rating accorded. GCR has developed a scorecard based on five key analytical areas as follows:
    - Management and staff
    - Systems and controls
    - Debtor administration
    - Arrears management; and
    - Financial condition.

16. Each area is separately considered by the analyst and given a score of between one (1) and five (5), with one (1) being the best possible score. The total servicer quality score will be the sum of each area's score, divided by five (5). The final servicer quality score will then be translated into an overall servicer quality rating, based on the table below.

Table 1: GCR Servicer Rating Score		
Servicer Rating	Description	Score
SQ1	Strong	1
SQ2	Above Average	2
SQ3	Average	3
SQ4	Below Average	4
SQ5	Weak	5

17. The aggregate score, as well as the score for each area, will then be discussed by a GCR rating panel, which will consider adjustments, either per area or to the overall evaluation. The rating panel will then vote on the final servicer quality rating. A "+" or "-" modifier may be added based on the relative position of the servicer quality rating within each rating category. Each of the five analytical areas is discussed in more detail below.

Management and staff

18. One of the most important aspects of the rating process is the level of confidence GCR develops in the capability and continued performance of management, and the Board of Directors ("Board"). GCR's assessment of management includes the evaluation of the quality and level of oversight and support of all of the institution's activities. In this process, GCR focuses on the ability of the Board and management, in their respective roles, to plan for and respond to risks that may arise as a result of changing business conditions or the initiation of new activities or products.

19. GCR examines the corporate structure and various divisions and subdivisions within the organisation, determining the level of complexity and depth of the organisation's management and operational systems, and whether the accuracy, timeliness and effectiveness of those management information and risk monitoring systems are appropriate for the institution's size, complexity, and risk profile. The adequacy of audits and internal controls to: (i) promote effective operations and reliable financial and regulatory reporting; (ii) safeguard assets; and (iii) ensure compliance with laws, regulations, and internal policies, is also assessed. Furthermore, appropriate system backup and disaster recovery procedures will be reviewed.

20. The experience and depth of management, its track record, ability to manage through stressful periods, ability to manage new business lines, and the presence of clear and established management succession plans are also evaluated.

21. Staffing plans are assessed in terms of workload and volumes, and potential increases in these. This is significant in terms of standby servicers, where a sizeable loan book can be inherited at reasonably short notice. GCR expects the standby servicer to be able to take over seamlessly and within a specified timeframe. GCR will also look for active examples the standby servicer can provide of this occurring, or detail on how they aim to achieve this. This becomes of particular importance where the firm acts as a standby servicer for several transactions. Although unlikely, transactions that default in similar timeframes

would place the standby servicer under substantial operational pressure. GCR would typically prefer to see standby mandates secured from a variety of industries, avoiding concentration risk.

22. GCR compares staff turnover to the national average for similar firms, with the more highly rated entities usually displaying turnover levels that are below the average. Staff turnover among call centre agents is generally higher than for other functions, due to the high pressure and monotony of the job. The existence of adequate training programmes in the servicing environment is therefore paramount, and highly rated entities typically display comprehensive and industry leading programmes for staff. The initial review may include a review of the qualifications and experience of all senior staff and Board members. Senior staff should have significant experience and be appropriately qualified for their respective roles, particularly in the key areas of asset administration, collections, credit, arrears management, and compliance. Stability among senior management is also a factor.

Systems and Controls

23. Technology provides the backbone for any servicing company. A disaster recovery plan is essential to ensure minimum interruption of operations if a system shuts down. Systems should be sufficiently scalable to accommodate additional clients, particularly where standby mandates are in place.
24. GCR will consider a potential stress scenario with a default of the largest standby portfolio. Sufficient capacity should be demonstrated to absorb these clients. Servicers with a track record of acquiring and successfully running down poorly performing loan books will be viewed favourably.

25. A servicer's ability to provide clear, accurate and timely management reporting on servicing performance is very important. Inaccurate or late reports may indicate a servicing problem or unforeseen difficulties with collateral. Unclear or overly complicated reports make it difficult to track the performance of a transaction or portfolio. Performance metrics are measured against industry best practice.

Debtor administration

26. The primary role of the servicer is to collect payments and prevent performing loans from going into arrears. GCR's analysis focuses on the day to day servicing operations necessary to support this function and capacity to deal with increased volumes of, or problems, relating to collections.

Arrears management

27. The effectiveness of a servicer's default management practices is a key determinant in the ultimate performance of any portfolio. By the time an asset is significantly in arrears (based on the definition selected, but often considered to be 90+ days in arrears), a servicer must determine whether the borrower has both the ability and desire to pay, in determining the appropriate course of action to be taken. Highly rated servicers will have extensive workout and disposition expertise, thorough legal and collateral knowledge, and a proven track record in loss mitigation.

Acquisition of poorly performing loan books

28. GCR's analysis of the performance of a servicer can be distorted due to the acquisition of poorly performing portfolios. Most servicers assessed by GCR, due to their specialised skill in collecting assets, also acquire poorly performing loan books at a discounted price. Since the delinquency rates are typically high at take-on, this may initially distort the performance analysis. This does, however, allow GCR to better analyse the servicer's performance in collecting on these "distressed" books over time, which is a good proxy for the potential position should the company be called to fulfil a standby servicer role.

29. It is also difficult to determine the true factors responsible for good or bad performances, since a good performance could mean that the quality of the underlying borrowers is strong, rather than reflecting the capability of the servicer. This increases the emphasis on a qualitative approach, as well as placing focus on the credit and origination function.

Financial condition and prospects

30. Although the servicer quality analysis is not focused on the ability of the servicer to service its own debt, the group's financial profile and profitability impacts its ability to retain key staff, maintain adequate systems, and fulfil its role in third party collections.

31. If the servicer is already rated by GCR, then the analysis would use the servicer's corporate credit rating for the financial strength component. If it is not rated by GCR, then a fundamental analysis similar to that of a typical corporate credit rating would be performed for the financial component, considering the quality of earnings, cash flows, capitalisation and gearing levels. The future prospects of the company are also considered and contribute to the overall score in this section.

Analytical contacts

Analyst Johannesburg, ZA	Yohan Assous yohan@GCRratings.com	Sector head: Structured Finance Ratings +27 11 784 1771
Analyst Johannesburg, ZA	Matthew Pirnie MatthewP@GCRratings.com	Group Head of Ratings +27 11 784 1771

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 of 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 whist 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.