

JCR's Credit Rating Process for Structured Finance Products, etc.

1. Credit Rating Process for Structured Finance Products, etc

In rating of asset securitization products and other financial products, JCR clarifies the instruments to be rated (referred to as structured finance products, etc.¹ hereinafter) and analyzes securitized assets and the cash flow from them.

JCR takes normally 2 months (3 months in cases of real estate) after receiving formal requests (please refer to the Attached), though the required time is different to a certain degree, depending on nature of assets to be transferred, complexity of the product itself and type of assets.

(1) Preliminary Meeting

JCR first discusses at a preliminary meeting with arranger or originator for credit rating of structured finance products how JCR can clarify possible risks of structured finance products, etc. through structure, legal issue and affirmation of required data item for calculation of level of credit enhancement.

(2) Receipt of Application for Credit Rating Request

After the preliminary meeting described above, when arranger or originator decides to make securitization transactions with a credit rating obtained in the process of schedule, it officially applies for a credit rating.

To be more precise, it can apply by filling in required items in an “application form of credit rating request.” Upon receipt of the request, JCR formally starts rating process. Rules on confidentiality are also described in the application form.

(3) Selection of Responsible Rating Analysts

JCR first decides responsible rating analysts to formally start rating process with the credit rating request on hand. The responsible rating analysts contact with persons in charge at the arranger to obtain necessary information for credit rating, and start credit rating analysis.

(4) Receipt of Materials Necessary for Credit Rating

JCR requests the following materials necessary for credit rating. Some of the materials are

¹ JCR defines asset securitization products stipulated under the Article 295 (3) (i) of Cabinet Office Ordinance on Financial Instruments Business, etc. (Ordinance No. 52 of 2007), ABCP program and other financial instruments including repackaged financial instrument as structured finance products, etc.

found to be needed additionally when the JCR conducts the preliminary meeting and credit rating process. In such cases, JCR requests arranger or originator to submit additional materials. Necessary materials differ depending on types of assets, forms of issue for credit rating, whether parties to the structure are entities to which JCR assigned its rating or not, and so on.

- Term Sheet (document outlining material terms and conditions of the transaction)
- Data on Assets/ Receivables
- Transaction Documents
- Information Materials on Originator/ Servicer

(5) Analysis/ Assessment

A credit rating for structured finance products, etc. is an assessment of risks in a structure built for investors to ensure cash flows from underlying assets for interest payment and principal repayment. The analysis therefore is practically made for overall structure from a perspective that in what ways the cash flows can be ensured for investors.

Primary points for the credit rating are described below in sections of 2. and 3. Taking these into consideration as a whole, JCR decides credit rating. In practice, JCR applies different methods to the structured finance products, etc., depending on nature of assets to be securitized. As a typical example, JCR here describes the outline of analysis for structured finance products backed by “monetary claim” and “real estate.”

JCR holds meetings with parties concerned for analysis/ assessment, if necessary. JCR analyzes/ assesses, while getting appropriately advices from experts such as attorneys or CPAs.

- Asset assignment (“Issue of True Sale”)
- SPV (SPC, trust, etc.) (“Issue of Bankruptcy Remoteness”)
- Assets/ Receivables to be securitized
- Servicer
- Other Parties to the Structure

(6) Determination of Credit Rating at Rating Committee

A credit rating proposal derived from the Analysis/ Assessment is determined at Rating Committee, and the applicant is notified of the credit rating result in the form of a notification.

A formal credit rating (final rating) is determined in general after assignment of preliminary rating. It is assigned for requests from securities underwriters for their purpose of selling them on a conditional basis, and is determined at Rating Committee based on information obtained up to the time of the preliminary rating determination. In cases where the structure changes after the determination, a final rating might be different from the preliminary

rating.

(7) Publication of Credit Rating

A credit rating that has been determined is made public without delay. Instrument name, assets, parties, rationale for credit rating, etc. are posted on JCR's home page, etc.

If any material change is to be made in the rating criteria, etc., the fact that the change will be made and the outline will be announced before it is applied to individual credit ratings. In unavoidable instances, however, JCR may announce the cause, the fact that the change has been made, and the outline at the time the publication of an individual credit rating is made.

(8) Review of Credit Rating

JCR monitors investment products to which JCR assigned a rating periodically or if necessary till the products are redeemed. In any cases where an event that can have a material impact on credit rating, JCR reviews the credit rating and makes public the credit rating result at the appropriate time. JCR monitors credit ratings for changes in value of assets/ receivables, cash flow performance, administrative capabilities of parties to the structure, and so on. JCR incorporates all experiences that have been acquired up to that time into the rating review. JCR also reflects any changes to the rating standards or assumptions of credit ratings. If JCR does not review a credit rating that has been made public, JCR will announce the case and necessary information without delay.

2. Monetary Claims Analysis/ Assessment Process

(1) Analysis of Structure

(a) Structure

- Issue Form
- Credit Enhancement Method
- Measures to take when an event such as trigger event occurs

(b) Parties to Structure

- Originator's creditworthiness, credit policy, business operations
- Credit enhancement provider's and Swap counterparty's creditworthiness
- Administrative capabilities of Trustee or Agent
- Measure to shift to backup servicer, etc. (adjusting operational systems)

(For the above, JCR holds due diligence meeting, if necessary)

(c) Legal Issues

- Legal Issues Concerning Securitized Assets
- Transaction Documents

Receivables Assignment/ Trust Agreement, Servicing Agreement, Backup Servicing

Agreement

(2) Cash Flow Analysis and Evaluation of Credit Enhancement Level

(a) Understanding of Assumptions for Analysis

- Receivables to be assigned
- Factors affecting Cash Flow and Attribute of Receivables to be assigned
- Factors affecting Stochastic Variable and Stochastic Model by Attribute
- Estimation of Model Parameters

(b) Cash Flow Analysis

- Stress Test² for many scenarios
- Monte Carlo Simulation³

(3) Based on Analyses (1) and (2),

- (a) Setting of many scenarios and measures for them
- (b) Overall assessment of entire structure (leading to determination of credit rating)

3. Real Estate Analysis/ Assessment Process

(1) Analysis of Structure

(a) Structure

- Issue Form
- Credit Enhancement Method
- Measures to take when an event such as trigger event occurs

(b) Parties to Structure

- Creditworthiness and administrative capabilities of parties concerned such as Master Lessee, Asset Manager and Property Manager

(c) Legal Issues

- Legal Issues specific to Real Estate
 - Ownership Status, Treatment of Security Deposit/ Guarantee (Affirmation by legal opinions, if needed)
- Transaction Documents
 - Building Lease Agreement, Asset Management Agreement, etc.

(d) Exit Strategy for Assets

- Setting of Tail Period

² Stress Test: Stress test for robustness of structure, assuming many-fold value of default rate, etc. obtained from historical data, which is a kind of simulation.

³ Monte Carlo Simulation: Simulation to get probability distribution of stochastic variable by repeating many trials, while generating random numbers, in order to analyze circumstances with uncertainty.

- Exit Strategy such as refinancing and/or property sale

(2) Cash Flow Analysis and Valuation for Assets

- (a) Analysis of Asset Quality
 - Building Deterioration Status
 - Engineering Report, etc.
 - Seismic Performance
 - Earthquake Report, etc.
 - Contamination by Harmful Materials
 - Environmental Report, etc.
- (b) Market and Earnings Analysis
 - Market Competitiveness, Profitability and Profit
 - Appraisal Report, Market Report, etc.
- (c) Management Status by Property Manager
 - Past Performance, Policy and Financial Status
 - Due Diligence Meeting, etc.

(3) Based on Analyses (1) and (2),

- (a) Setting of many scenarios and measures for them
- (b) Overall assessment by entire structure and LTV ratio⁴(leading to determination of credit rating)

⁴ LTV (Loan-To-Value) ratio: Ratio of liabilities to JCR's appraised value of assets

Appendix

(JCR's Credit Rating Process for Structured Finance Products, etc.)

