

ABCP Programs

1. Overview of the products

ABCP (asset-backed commercial paper) is a type of CP issued by SPCs (special purpose companies), which is backed by assets that are typically monetary claims. In general, many of the ABCP programs issued in Japan are established by banks and other financial institutions for the purpose of purchasing monetary claims and other assets held by their client companies.

2. General scheme

ABCP programs in which a financial institution becomes a sponsor and many client companies become asset sellers are called multi-seller programs. In contrast, there is a form called single-seller program, in which a specific company founds an SPC only for the purpose of transferring its assets and issues ABCP.

Assets to be purchased by SPCs vary depending on the programs and are wide-ranging. As ABCP issued by SPCs is a means to finance a purchase of such assets, they are often short-term financial assets that include accounts receivable, notes receivable including electronically recorded monetary claims, lease payments receivable, healthcare receivables and a proxy right to receive loans from the Japan Housing Finance Agency. In some cases, an SPC purchases the asset in the form of beneficial interest of trust.

Like in other cases of securitization, the SPC itself is established to be “bankruptcy remote” from the sponsor and sellers. While, in general, a Cayman-Islands company or its Tokyo branch often becomes the issuer, in some cases, a *Godō Kaisha* or a limited liability company or a joint-stock company in Japan is an issuer.

Currently, most ABCP issued in Japan are provided with credit enhancement and liquidity support for the entire amount by sponsors (fully supported). There are ABCP programs backed by monetary claims, of which creditworthiness is enhanced internally by senior-subordinated structure.

3. Key analytical points

(1) Fully supported

The rating on fully supported ABCP that is 100% backed by sponsor’s credit enhancement and liquidity support is basically linked to the rating of the sponsor that provides the backup line. The key analytical points center on carefully examining the bankruptcy remoteness of the SPC itself and the contractual terms that facilitate efficient and timely supply of liquidity and credit enhancement necessary for the redemption of ABCP.

Summary of documents required for rating is the following:

- (i) Term sheet for ABCP
- (ii) Documents related to foundation of SPC
- (iii) Contracts for liquidity and credit enhancement facilities for ABCP (backup line agreement, etc.)

(2) ABCP with internal credit enhancement¹

The rating on ABCP with internal credit enhancement of senior-subordinated structure is basically linked to creditworthiness of the senior part of the asset pool, and in such cases, JCR checks whether an appropriate subordination level is set to meet the rating of the ABCP based on rating methodologies for asset types.

Taking monthly clear receivables of card shopping as underlying assets as an example, JCR shows the outline of the rating analysis as below. Please refer to Installment Receivables and Card Shopping Receivables.

(i) Expected risks and evaluation on them

(a) Credit risk/ cancellation risk

Collection of securitized receivables may not be conducted as scheduled due to an underlying debtor's credit deterioration or an insufficient balance on its deduction account. In cases where an underlying debtor cancels credit agreement, there is a risk that the receivable can cease to exist (dilution risk).

(b) Commingling risk

In cases where the originator to whom trustee or other party entrusts servicing operation goes bankrupt, loss on the collected money (commingling loss) will be the full collection amount over the collection period at a maximum, because monthly clear receivables are receivables with single payment and usually the payment dates concentrate on specific dates.

(ii) Calculation of required subordination Amount

As monthly clear receivables are in general well diversified into many small claims by their nature, expected amount of loss owing to defaults on the underlying claims is calculated by a stress test based on approach of many small lots (large numbers approach) using the law of large numbers.

(a) JCR calculates credit loss rate and cancellation rate from historical data of the population receivables.

(b) JCR understands characteristics of the population receivables/ securitized receivables

¹ JCR may apply rating methodology for ABCP with internal credit enhancement to a partially supported ABCP, to which the sponsor provides less than 100% credit enhancement and liquidity support, in accordance with characteristics of structure.

pools from these data by composition ratio and refers to the data when determining stress multiplying factor by comparing these two types of data.

(c) JCR determines a base case for analysis by confirming movements of credit loss rate and others from historical data of the population receivables.

(d) JCR calculates next required subordination amount after generating stressed credit loss rate and other variables for the expected cash flows during the securitization period. There are multiple cases for levels after the addition of stress, including a level of the base case multiplied by a constant, or the one with the standard deviation of historical data multiplied by a constant being added to the base case. JCR adopts an appropriate level for each case. JCR determines a stress multiplying factor in consideration of qualitative factors such as attributes of the population/ securitized receivables, based on the same level as normal installment receivables. In cases of monthly clear receivables, in particular, a sharp reduction in collected amount for a month can lead to failure of timely payment, because certainty of principal repayment of the securitization products at the repayment date is a thing to be rated. Under this securitization scheme, stress multiplying factor should be set at a stronger level than that for a long-term securitization product, in which a sharp reduction in collected amount for a month does not lead to an impairment of principal if the collected amount recovers next month following the month, in which collected amount is reduced sharply.

(e) JCR checks whether subordination for commingling risk is arranged, and if not, JCR checks restrictions to its rating on the securitization product. In cases of monthly clear receivables, commingling loss will be the full collection amount over the collection period for the receivables at a maximum. In general, rating on originator is a ceiling of rating on the ABCP program. However, measures including those for bankruptcy remoteness from the parties to the structure and setup of backup servicer can reduce this risk.

(f) JCR checks whether funds required for transfer of the initial servicer's collection activities to the backup servicer are saved as cash reserve for cases where it can no longer conduct its collection activities as usual due to its default or other reasons.

In addition to the above, JCR examines carefully bankruptcy remoteness of SPC itself, appropriateness of various triggers including a worsening of performance of underlying assets, and sufficiency of liquidity facilities such as cash reserve for matching of maturities of underlying assets and ABCP and for various costs of SPC.

Summary of documents required for rating is the following:

- (i) Term sheet for ABCP
- (ii) Documents related to foundation of SPC
- (iii) Materials related to underlying assets' credit, management and collection process

- (iv) Historical data and attribution data of population receivables
- (v) Documents related to transfer or entrustment of securitized receivables

4. Key monitoring points

JCR monitors the sponsor's creditworthiness and changes to the structure for the fully supported ABCP, and reviews the rating on the ABCP program after rating change of the sponsor without delay.

For ABCP with internal credit enhancement, JCR constantly monitors in principle performance of underlying assets such as monthly credit loss rate, moves of subordination ratio and ability of the parties to the structure to perform their tasks. In addition, when making a periodical or an extraordinary rating review, JCR re-examines a base rate and others, which are prerequisite conditions for rating, in light of performance of underlying assets or economic conditions, if necessary, and then makes a cash flow analysis based on these prerequisite conditions, taking into consideration the remaining period of the securitization product.

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