



STRUCTURED FINANCE RATING CRITERIA

GLOBAL CREDIT-LINKED NOTE AND REPACKAGING VEHICLE RATING CRITERIA

This is an update to the methodology previously published in February 2020.

There are no material changes and as such no rating impact.

February 2021

I. INTRODUCTION

ARC Ratings' ('ARC') Global Summary Credit-Linked Note ('CLN') and Repackaging Vehicle Rating ('Repack') Criteria (the 'Criteria') apply 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. The Criteria do not apply to senior secured securities issued by corporates that benefit from certain structural enhancements. The rating on a CLN/Repack is based on an analysis of the CLN/Repack issuer's underlying securities and liabilities, counterparties, and the transaction's structure. The rating addresses timely payment of interest and principal unless one of the underlying Reference Entities has defaulted. A default is deemed to have occurred when a payment has been missed or the Reference Entity has become subject to insolvency proceedings.

CLNs are typically transactions where an investor purchases a note issued by a bankruptcy remote special purpose vehicle (the 'Issuer'). The note is synthetically credit linked to a Reference Entity or the 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. A single-name CLN 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.

Repacks or Repackaging vehicles can apply to various structured instruments. Typically, a Repack involves the issuance of securities by a special purpose vehicle (SPV) in order to purchase, or provide credit protection for, a bond, note, loan or other financial assets.

II. RELATED RESEARCH

The Criteria apply globally, however, specific transactions may give cause to additional deviations, which will be disclosed in the transaction rating reports.

This report should be read in conjunction with ARC's published 'Global Structured Finance Criteria' and available at www.arcratings.com.

III. CREDIT QUALITY OF REFERENCE ENTITIES

The credit quality of the Reference Entities is critical within the analysis of CLNs or Repacks. Reliance is placed upon the credit rating 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 ('weakest link approach'). ARC expects all Reference Entities to have a long-term and/or short-term Issuer Default Rating accorded. Ideally whilst these entities should be rated by ARC, ARC does accept ratings from other ESMA/FCA recognised Credit Rating Agencies ('CRAs'); however, in some instances notching may apply (up or down) where ARC may have a different view on a certain entity. ARC also expects that any entity that performs any supportive role within the transaction, such as account bank or swap counterparty amongst others, is highly rated enough as to not constrain the rating of the notes issued by the Issuer. ARC expects the transaction to incorporate downgrade language in respect to the supporting counterparties such that counterparties are replaced, whose credit ratings are downgraded to below the required ratings.

For single name CLNs, the rating is accorded by a straight look-through to the underlying Reference Entity's credit rating. 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, ARC will use a weakest link approach. Where there is more than one Reference Entity, ARC will use the rating of the lowest rated entity as its base for the analysis. However, ARC will deviate from this in cases where there are multiple Reference Entities which are severally, but not jointly, liable; in such cases ARC will utilise its CLO methodology or a multiplicative probability of default approach. Where an underlying security issued by the Reference Entity has the benefit of a put option from a higher rated put provider, ARC will use the rating of the put provider in place of the rating of the Reference Entity in its analysis. In the event that the Reference Entity is fully guaranteed by a higher rated entity, the rating of the Referenced Entity would benefit from an uplift of the higher rating of the guarantor, but not necessarily be assigned the same rating.

Counterparties that belong to the same corporate group will be regarded as one Reference Entity. If the company is an operating entity then the weakest link approach will apply.

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.

For CLNS/Repacks ARC's analysis addresses probability of default. Typically, the Reference Entities are the main risk driver for CLNs/Repacks as other risk-presenting entities such as swap counterparties can be delinked through rating triggers.

IV. EARLY TERMINATION

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.

V. LEGAL OPINION

ARC 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. ARC may request independent external counsel to review the legal opinion.

VI. PERFORMANCE MONITORING

Ongoing monitoring of performance of transactions and the underlying receivables is key to the rating process and maintaining current ratings. ARC expects sufficient performance information to be provided on a monthly or quarterly basis. This data will be captured and presented in ARC's transaction specific monthly surveillance reports. ARC also expects to be notified of any changes to the transaction such as amendments to concentration limits etc that may impact the current rating and its analysis. In addition, a formal rating review will be held annually at a minimum, or as events warrant.

VII. RATING MODIFIERS

Indicative Rating - evidenced by the suffix (ind) - is a rating assigned by ARC to an issuer or an instrument (most commonly structured or project finance debt issues) when the assignment of a final rating is dependent upon the fulfilment of specific contingencies. Any material deviation in the fulfilment of these contingencies from the assumptions underlying the Indicative Rating can have a material impact on the final rating accorded, which accordingly may be fundamentally different to the initial Indicative Rating. Moreover, ARC reserves the right not to issue a final rating. Potential investors are advised to bear this in mind when considering any indicative rating.

As with all other structured finance ratings, CLN ratings are required to include the suffix (sf) following the rating assigned.

VIII. QUALIFICATION

Note that ARC 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, ARC is not a party to the transaction documents, nor does it provide legal, tax or structuring advice.

DISCLAIMERS

ARC Ratings, S.A. is registered as a Credit Rating Agency with the European Securities and Markets Authority (ESMA), within the scope of the Regulation (EC) N° 1060/2009 of the European Parliament and of the Council, of 16 September, and recognised as External Credit Assessment Institution (ECAI).

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Ratings do not constitute a recommendation or offer or solicitation to buy or sell any investments that may be mentioned, and are only one of the factors that investors may wish to consider. The use of any rating is entirely at the user's own risk.

In the rating process, ARC Ratings adopts procedures and methodologies aimed at ensuring transparency, credibility and independence, and also that rating classifications are not influenced by conflicts of interest.

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