ARC Ratings (UK) Limited accords a public, final 'BBB' rating to the Senior Secured Fixed Rate Note issued by BSCH 2 DAC, with stable outlook

London, 29 June 2021 - ARC Ratings (UK) Limited (ARC) has accorded a final, long-term public rating of 'BBB' to the Senior Secured Fixed Rate Note issued by BSCH 2 Designated Activity Company (DAC), with stable outlook. The rating addresses the ultimate payment of interest and ultimate repayment of principal by the maturity date.

ISSUER	ISSUE	ISSUE AMOUNT	RATING CLASS	RATING	OUTLOOK	NEXT REVIEW DATE
BSCH 2 DAC	Senior Secured Fixed Rate Note	USD 500,000,000	CLO	'BBB'	Stable	29 June 2022

TRANSACTION OVERVIEW

The USD 500m Senior Secured Fixed Rate issuance has a maturity date of 21 June 2023 and is secured against cash and a portfolio of credit assets, with the portfolio having a fair market value ('FMV') of USD 661.6m as at 22 June 2021. The additional cash held translates to a total advance rate of 70%, thereby providing credit enhancement of 30%. The Note pays a fixed margin of 60bps, which results in a significant amount of excess spread for consideration given the underlying pool has a weighted average spread of 4.4%.

ISSUER PROFILE

BSCH 2 DAC (company number: 687926) is a private company limited by shares incorporated under the laws of Ireland, with registered address at 1-2 Victoria Buildings, Haddington Road, Dublin 4, D04 XN32, Ireland. The Note issued by BSCH 2 DAC is being purchased by GLQ International Holdings Ltd ('GLQI' – a private unlimited company incorporated under the laws of England and Wales). In addition, GLQI is providing a guarantee over the Note, however ARC has not considered this as part of its analysis.

Subordination agreements in place provide funding for any fees payable by the Issuer and for any currency movements against the transaction (given 60.7% of the underlying pool is non-US denominated). Note however, these agreements do not determine the distribution of losses and thereby do not constitute credit tranching which would subsequently make this transaction a securitisation. As such, whilst ARC conducted its analysis of this transaction in accordance with its Global Structured Finance Rating Criteria and its Collateralised Loan Obligation Rating Criteria, the rating accorded does not carry an '(sf)' modifier.

RATING RATIONALE

The rating reflects the quality of the underlying collateral and the legal and financial structure of the transaction.

Key Rating Drivers include:

- **Portfolio Credit Quality:** The weighted average credit rating of the portfolio is 'B/B-', implying a relatively weak to moderate credit quality and thus moderate to high risk. This has a direct impact on ARC's base probability of default, and as such the deterioration of the weighted average rating could cause a rating action, though the results of ARC's sensitivity analysis below indicate this would require a substantial level of negative rating migration.

- **Portfolio Diversification:** The portfolio exhibits some diversity with respect to underlying industries and geographies, spread across several respectively with the largest industry, computer and electronics, accounting 20.8% of the total FMV and the largest country, United Kingdom, accounting 48.5% of the total FMV. Any benefit brought on by this, however, is completely negated by the small collateral pool size of 17 assets comprising the USD 661.6m portfolio. This has a strong impact on the asset-level model, which resulted in the 82% default rate assumption ARC modelled in a 'BBB' rating scenario.

- **Recovery Expectations:** ARC has modelled a 45% recovery rate assumption in a 'BBB' rating scenario, a relatively high assumption owing to the fact that all pool assets are senior secured loans. In addition, on a quarterly basis the Issuer must procure that the principal amount of the Note divided by the FMV of the Collateral (cash and assets) is less than or equal to 70%. In the instance where this test fails, it must be remedied by way of a further drawing under the Subordination Agreement, else it would constitute an Event of Default. Effectively this means that any actual recovery of funds relating to the Note is likely to be very strong, a credit positive to the transaction that gives ARC confidence in the conservative nature of its recovery assumption. Due to some assets having a longer maturity date than the Note this introduces market risk, which is largely mitigated by the FMV test. Nonetheless, ARC assessed the maximum additional yield stress that could be applied and found that the short risk horizon, thanks to the weighted average remaining asset life of 2.1 years, translated to a high level of maximum stress applicable.

- **Credit Enhancement:** The key structural enhancement mechanism in place, namely the FMV test, ensures that the advance rate must remain no higher than 70%. This gives a minimum 'hard' credit enhancement of 30%, which, combined with excess spread, is sufficient to protect the Senior Secured Fixed Rate Note at a 'BBB' rating level.

- **Cash Flow Analysis:** ARC's cash flow model assessed the ultimate payment of interest and ultimate repayment of principal by the Maturity Date of 18 June 2023. For the asset portfolio, given each pays a floating rate plus a quoted spread, ARC used the spread only within the model to minimise the cash generated whilst also reflecting the current macroeconomic environment. As aforementioned, ARC also applied a market value stress for any assets that had a maturity date past that of the Note. In doing so ARC determined that the transaction would be able to withstand an increase in asset yields commensurate with a 'BBB' rating scenario, with front loaded and stable default vectors applied.

ARC will perform regular surveillance of the transaction, including monitoring of the underlying portfolio's ratings, and will review the rating accorded should anything that has a material impact be found.

ARC ran sensitivity tests to determine to what extent the performance of the portfolio would need to deteriorate in order for the rating to be downgraded. The table below shows the increase in the weighted average default probability (WAPD) for the underlying assets that would trigger a rating downgrade.

Increase in the base WAPD of:	Rating Change?
10%	No Change
20%	No Change
30%	One Notch Downgrade

KEY TIPPING POINTS

Positive Turning Points

- Significant reduction of the Advance Rate as a proportion of the Asset Pool FMV;
- Positive migration in the weighted average rating of the underlying assets.

Negative Turning Points

- Reduction in Asset Pool FMV triggering a fail in the FMV test without remedy.
- Reduction in the credit quality of the underlying assets.

RELATED CRITERIA AND RESEARCH

ARC Ratings' Global Structured Finance Rating Criteria (September 2020)

ARC Ratings' Collateralised Loan Obligation (CLO) Rating Criteria (February 2021)

The rating(s) were assigned by ARC Ratings (UK) Limited and endorsed by ARC Ratings, S.A. in accordance with Regulation (EC) N° 1060/2009 of the European Parliament and of the Council.

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