



R&I's Rating Methodology for Single-Asset Securitized Products

(This report is an English translation of the original report in Japanese.)

Rating and Investment Information, Inc. (R&I) has released its rating methodology for Single-Asset Securitized Products. This report summarizes the methodology used by R&I for assignment of ratings to Single-Asset Securitized Products.

R&I will apply the rating methodology if this securitized product can be determined to be a "Single-Asset Securitized Product". However, this report goes only so far as providing a description on the concept of the rating methodology for "Single-Asset Securitized Products." Actual ratings analysis requires analysis of legal issues and attributes concerning the underlying assets. In addition, the product origination will take the needs of the originators and investors into consideration. Therefore, whether or not such issues are compatible with R&I's rating methodology (not necessarily limited to this report) must be confirmed.

1 . Single-Asset Securitized Products

The "Single-Asset" in "Single-Asset Securitized Product" as defined by R&I in this report refers to, among the securitized products, an asset with a condition that the obligor of the original contract can be regarded as a single entity even if there are multiple original contracts that constitute the underlying asset (or, same is applied if the guarantor to the obligation is a single entity even if there are multiple obligors). There are several types of monetary claims that may be regarded as the underlying assets: principal and interest of bonds, principal and interest of loans, funds, installment credits, lease receivables, account receivables and repayment rights to tenancy deposits. Product overview and structure of Single-Asset Securitized Products are stated below.

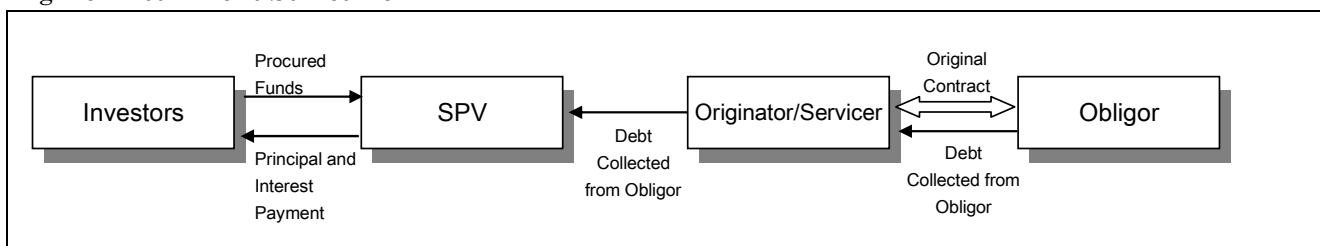
1.1. Product Overview

Securitized products are products where the entity considering financing (the "Originator") assigns monetary claims it owns ("Underlying Assets") to an SPV (Special Purpose Vehicle, such as Cayman SPC, trust company, or special purpose company) with superior bankruptcy remoteness, and the SPV becomes liable for the debt (financed through corporate bond, beneficiary rights, loan credits, etc.) based on the creditworthiness of the Underlying Assets thus transferred, thereby procuring funds for the Originator.

1.2 . Product Structure

Let us now review the structure of the Single-Asset Securitized Product. "Instrument" refers to "Single-Asset Securitized Products" in this report.

Figure: Instrument Structure



Basic cash flow for the Instrument is as described in (1) and (2) below:

- (1) SPV purchases the underlying asset from the Originator using the funds procured through issuance of the Instrument.
- (2) During the term of the Instrument, the Originator will act as the servicer to collect the debt from the obligor, and deliver the collected amount to the SPV on the delivery date. SPV will manage the collected amount, and pay the amount owed to the investors on the date of principal and interest payment of the Instrument.

2 . R&I's Evaluation

When evaluating the Instrument, R&I believes that whether or not the “assigned claim” which becomes the underlying asset for the Instrument is suitable for securitization is important. There are several types of monetary claims that may be used as underlying assets of securitized products, such as principal and interest of bonds, principal and interest of loans, funds, installment credits, lease receivables, account receivables and repayment rights to tenancy deposits. However, depending on the assigned claim, the contents of the original contract executed between the Originator and the obligor may become an issue. For example, a lease contract involves a contract with respect to the use of the leased property, and the obligor pays lease fees to the Originator in return for the right to use the property. Because the underlying asset of the securitized product is the latter's claim on the leasing fee, issues such as the treatment of the securitized claim on the lease fee if there is a defect in the leased property must be resolved at the time of the securitized product origination. Discussion of rating analysis is possible only after such issues have been resolved.

In this section, it shall be assumed that the above stated issues have been resolved, and discuss points to note in performing actual ratings analysis from perspectives of “creditworthiness of the obligor” and “cash flow management.” If no specific measures are taken with respect to these two perspectives, the rating for the Instrument shall be the rating of the entity with lowest creditworthiness among the obligor, servicer, investment destination of the collected amount, and the swap counterparty.

2.1. Creditworthiness of the Obligor

Payment of the principal and interest for the Instrument depends on the repayment to the SPV by the obligor of the underlying asset. Therefore, creditworthiness of the obligor becomes a significant credit risk from the perspective of whether or not the obligor can make repayments prescribed in the original contract.

2.2. Cash Flow Management

The repayment of the debt by the SPV to the investors of the Instrument on the promised payment date depends on appropriate delivery of the monies derived from the underlying assets to the SPV. As securitized products are artificial products created by controlling the cash flow of the underlying assets and the Instrument, these cash flows must be managed safely. Due to the involvement of multiple parties controlling these cash flows, various structures are prepared to minimize the effect of their creditworthiness on the Instrument. If effective measures are implemented for the Instrument, there may be cases where such parties' creditworthiness will not be reflected on the Instrument. Following paragraphs will summarize the important points with respect to the rating analysis from the perspectives of servicer, investment destination of the collected amount, and the swap counterparty.

2.2.1 Servicer

Collection of the debt from the obligor may be performed by the servicer commissioned by the SPV, rather than directly by the SPV (where servicer is used, in general, the Originator becomes the servicer). In such instance, if the “date when the servicer collects the debt from the obligor” differs from the “date when the servicer delivers the collected amount to the SPV,” the collected amount will be temporarily managed by the servicer. In case of failure of the servicer, there is a risk that the collected amount that should belong to the SPV may be commingled with the servicer's existing assets (commingling risk). In addition, if the servicer fails, there is also a risk that appropriate collection of the debt may not be possible after its failure. Therefore, measures to minimize such risks are taken in some cases (Note 1).

2.2.2. Investment Destination of the collected amount

Where the “date when the servicer delivers the collected amount to the SPV” and “the date when the SPV performs payment of principal and interest of the Instrument to the investors” differs, or depending on the redemption method of the Instrument, some collected amount may accumulate in the SPV. In such instance, the SPV may deposit the collected amount in a bank account opened under its name, or invest such amount in a different asset. Where this is the case, there is a risk that the collected amount that should belong to the SPV may not be collected as originally scheduled in case the bank where the amount have been deposited or the asset that the collected amount was invested in defaults. Therefore, measures to minimize such risks are taken in some cases (Note 2).

2.2.3. Swap Counterparty

Swaps may be used as hedging transactions to adjust the “underlying asset's cash flow” and the “Instrument's cash flow”. If the swap counterparty defaults, adjustment of the cash flows may be delayed, creating a risk that the SPV may not be able to make principal and interest payments for the Instrument as scheduled. As the main object of securitized products is to transfer the underlying assets' cash flows to the investors, the credit risk of the swap counterparty in the hedging transaction is a secondary risk. Measures to minimize risks related to the swap counterparties are taken in some cases (Note 3). Therefore, the Instruments are generally structured in a way that the default by the swap counterparty will not constitute an early redemption event.

R&I's rating method for Single-Asset Securitized Products are as stated above; however, the final rating will be determined pursuant to consideration of other factors such as the bankruptcy remoteness of the SPV, and the legal risks related to the underlying assets and the structure.

(Note 1) For rating methods on this issue, refer to the reports on specific products in the URL below.

(Note 2) For rating methods on this issue, refer to the “Eligible Deposit Accounts and Eligible Investment Instruments” report.

(Note 3) For rating methods on this issue, refer to the “R&I Eligibility Criteria of Swap Counterparties for Securitized Products” report.

Reports mentioned in Notes 1, 2, and 3 above are posted on the below URL:

<http://www.r-i.co.jp/eng/rating/st/methodology.html>

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