



## CDOs Containing Obligors Rated Below CCC+

( 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 CDOs containing obligors rated below CCC+. The rating methodology explained in this report updates and revises the CDO rating methodology R&I previously released ("Securitization Criteria: R&I's CDO Rating Methodology") (Note 1), regarding CDOs that contain obligors whose Issuer Rating is below CCC+.

The revision of the CDO rating methodology does not result in changes in R&I Tranche Pad Version 1.0 (Note 2), a CDO evaluation model.

Since September 2009, there have been a growing number of CDOs that contain obligors who are assigned an Issuer Rating of below CCC+ but have not experienced a credit event, such as companies that have applied for consensual business revitalization alternative dispute resolution (ADR) procedures. In principle, R&I used to place these CDOs on the Rating Monitor and then take appropriate rating actions after confirming the occurrence of a credit event. Because in some cases this process may not allow R&I to promptly incorporate the creditworthiness of such obligors into the ratings for the relevant CDOs, R&I has reexamined this process and revised its rating methodology.

### 1. Obligors rated below CCC+

The CDO rating methodology explains the probability of default (PD) of obligors in each rating group from AAA to CCC+ (Note 1). The PD of obligors rated below CCC+ is not mentioned in the CDO rating methodology. This is because before September 2009, the recovery rate from obligors rated below CCC+ was determined within a reasonable period of time after R&I placed the relevant CDO on the Rating Monitor, and R&I was able to evaluate the CDO by subtracting the amount of the loss from the credit enhancement amount. Recently, however, there have been an increasing number of obligors who are assigned an Issuer Rating of below CCC+ but may not necessarily end up defaulting. R&I has therefore reexamined its rating review process for CDOs containing obligors rated below CCC+.

### 2. Assessment of obligors rated below CCC+

#### 2.1 Probability of default of obligors rated below CCC+

For obligors who are rated below CCC+ and have not experienced a credit event, R&I will use the PD (by the number of years passed) of obligors rated CCC+.

#### 2.2 Recovery rate from obligors rated below CCC+

If there is a significant possibility of an obligor rated below CCC+ experiencing a credit event, estimating a recovery rate from the obligor after the occurrence of the credit event may be possible in some cases. In such cases, the estimated recovery rate will be applied to the obligor.

### 3. Assessment of CDOs containing obligors rated below CCC+

CDOs containing obligors rated below CCC+ are subject to the monitoring process explained in R&I's rating methodology "R&I Tranche Pad Version 1.0 Technical Document." However, in principle, R&I will not upgrade ratings for CDOs containing obligors rated below CCC+. This is because if an obligor rated below CCC+ experiences a credit event, the CDO that includes such obligor in the portfolio may be downgraded.

Also, because of this possibility of downgrade, even if only one of the obligors in the CDO's portfolio is rated below CCC+, the CDO will be placed on the Rating Monitor as a general rule. When the CDO comes to no longer include an obligor rated below CCC+, R&I will, in principle, remove the CDO from the Rating Monitor.

- (Note 1) For details, refer to R&I's rating methodology, "Securitization Criteria: R&I's CDO Rating Methodology."  
(<http://www.r-i.co.jp/eng/rating/st/detail/C20070131.pdf>)
- (Note 2) For details of R&I Tranche Pad Version 1.0, refer to R&I's rating methodology, "R&I Tranche Pad Version 1.0 Technical Document."  
(<http://www.r-i.co.jp/jpn/rating/st/detail/j07-a-041-rm.pdf>) (Japanese only)
- (Note 3) Refer to "R&I View: Synthetic CDO Reference Entity Uses ADR," dated September 24, 2009.  
([http://www.r-i.co.jp/eng/news\\_topics/detail/200909/e09-a-089.pdf](http://www.r-i.co.jp/eng/news_topics/detail/200909/e09-a-089.pdf))

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