



R&I View on the Use of Standard Deviation When Applying Stress in the Large Pool Approach

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

Rating and Investment Information, Inc. (R&I) has announced "R&I View on the Use of Standard Deviation When Applying Stress in the Large Pool Approach."

If underlying asset is numerously diversified as in the case of auto loan receivables and shopping loan receivables, and the pool's loan loss ratio is expected to perform stably, R&I may use a standard deviation derived from the historical data when applying stress in the Large Pool Approach. R&I has summarized and described below the method and points of consideration upon calculating stress scenario when applying standard deviation on stresses.

1. Method of calculating stress scenario when applying standard deviation on stresses

Credit enhancement for asset backed securities (ABS) backed by a large pool containing assets such as auto loan receivables, is primarily composed of (1) an amount to absorb defaults and (2) an amount to offset commingling loss in the event of servicer bankruptcy.

To analyze the risk amount shown in "(1) an amount to absorb defaults", the stress scenario is generally calculated by multiplying default ratio and the stress multiple corresponding to target rating. When loan loss ratio of the underlying pool is expected to perform stably, however, R&I may calculate stress scenario by applying standard deviation.

The stress scenario when applying standard deviation will be derived by "the standard default ratio + stress multiple x standard deviation."

2. Points of consideration when applying standard deviation in the Large Pool Approach

When applying standard deviation in the stress scenario, R&I takes account of the following points A) to E); and then judges whether the loan loss ratio of the underlying pool can be expected to perform stably.

- A) Underlying pool resembles the mother pool
- B) Historical data is showing a stable performance
- C) Concentration risk is alleviated in order to maintain diversification
- D) Underlying pool has a certain number (5,000 in principle) of obligors
- E) No major changes from ordinary times are expected in the performance of the underlying asset in the event of servicer bankruptcy.

In light of the above, R&I will determine stress scenario by taking account of the performance of a similar instrument in the past, the characteristic of the underlying assets and the trend of the data, and so on.

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