FitchRatings

Structured Finance
Non-Performing Loans
Global

Non-Performing Loans Securitisations Rating Criteria

Cross-Sector

Scope

This criteria report outlines Fitch Ratings' cross-sector methodology for assigning new and monitoring existing ratings of non-performing loan (NPL) transactions backed by real estate collateral and unsecured loans.

The rating analysis of NPL transactions will be supplemented either (i) by addenda/appendixes to these criteria or sector-specific criteria, where the underlying receivables are within the scope of the sector-specific criteria and/or (ii) by assumptions derived on the basis of Appendix 3 of this criteria report and disclosed in Fitch's initial transaction reports and/or rating action commentaries (RACs). Italian and Portuguese NPL are analysed on the basis of the approach described in Appendix 2.

These criteria are not applicable for the surveillance analysis of non-NPL transactions originally rated under different sector-specific criteria.

Key Rating Drivers

All of the below key rating drivers are of equal importance to the analysis.

Recovery Amounts and Timing: Estimates of recovery levels and recovery timing are the primary basis for loan and property cash flows. A loan-by-loan analysis is used to derive the amount and timing of recoveries, considering the characteristics of the borrower, the loan and any underlying property securing the loan, as well as any jurisdiction-specific circumstances.

Cash Flow Timing Mismatches: Given the non-performing or defaulted nature of the loans, the cash flow timing profiles of NPL assets tend to be irregular. Resulting liquidity shortfalls need to be addressed with liquidity facilities/reserves.

Servicing: Fitch considers the experience of the entity responsible for working out the loans, its business plan/servicing strategy, and the agency's assessment of servicing continuity. Fitch also assesses the alignment of interests between the noteholders and the servicer, as the potential for conflicts of interest can be reduced through certain servicing fee structures, servicer employees' remuneration types and other economic incentives (i.e. a servicer's capital being at stake).

Rating Caps: Fitch identifies several issues that can result in limits being placed on the ratings, or which may cause Fitch to choose not to rate an NPL transaction (see Rating Caps).

Table of Contents

This report replaces *Non-Performing Loan Securitisations Rating Criteria* published on 16 December 2019.

Related Criteria

Non-Performing Loans Securitisations Rating Criteria - Supplementary Data File (December 2022)
Global Structured Finance Rating Criteria (October 2021)
European RMBS Rating Criteria (November 2022)
EMEA CMBS and CRE Loan Rating Criteria (June 2021)
Consumer ABS Rating Criteria (August 2022)
SME Balance Sheet Securitisation Rating Criteria (October 2021)
Exposure Draft: Iberian Recovery Rate Assumptions Rating Criteria (November 2022)
Exposure Draft: EMEA CMBS and CRE Loan Rating Criteria (October 2022)

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Recovery Amounts and Timing

Estimating the amount and timing of recoveries from individual loan resolutions is a primary component of the rating analysis for NPL transactions. A loan-by-loan analysis is used to derive the amount and timing of recoveries, considering, among other things, the claim amount, property value, the loan's recovery stage, the borrower profile, loan characteristics and real estate fundamentals. To perform this, Fitch's analysis is based on receiving detailed loan-by-loan collateral information, servicers' business plans/strategies, including expectations of recovery amounts and timing, and purchase price details of the assets purchased by the issuer (in jurisdictions where applicable). Appendix 1 lists the data fields Fitch uses in its analysis of NPL transactions.

Recovery Amount

For secured NPLs, the maximum recovery amount for any individual loan (i.e. gross recoveries) is typically the lower of the mortgage amount, the gross book value (GBV) and the property value. For unsecured NPL, the maximum recovery amount is generally capped at its GBV. In Fitch's analysis, no recoveries are expected from undeveloped non-agricultural land and incomplete properties, unless separate servicer-specific data are provided.

Mortgage Amount: The mortgage amount is the maximum amount the creditor can claim back from the borrower, which may be higher than the original principal amount. If a securitised NPL ranks junior to other liens on the property, Fitch will consider the amount of the senior claims when determining the recovery amount (see Property Value below).

Gross Book Value: The GBV may differ from the mortgage amount as it represents the sum of principal and interest currently due under the loan agreement in addition to the penalties accrued. The GBV can be a dynamic figure and may increase with time from the initial amount. When analysing an NPL portfolio, it is important to assess the exact nature of the GBV amount in seasoned pools and in the event of bankruptcies, as the interest component of a claim may not always be entirely recoverable or may partially qualify as an unsecured claim.

Property Value: The property value is an estimate of what the property can be sold for during the assumed recovery period, taking into consideration the servicer's business plan/strategy and likely distressed market conditions. The section below details the criteria Fitch uses to estimate distressed property values.

From the gross recovery amount, deductions are made for capital expenditures and for legal, servicing, foreclosure and selling expenses. Additionally, to the extent the claim is not the most senior claim on an asset, adjustments would be made for senior mortgage liens, for tax and mechanic's liens, for any other claims that may take priority under the laws of the relevant jurisdiction, and for any outstanding arrears or servicer advances on the delinquent loans that have not been reimbursed.

Property Value

To determine recoveries for NPL transactions, a fundamental reference value is the market value of the properties backing the claims in current and likely distressed market conditions. As a starting point, Fitch uses market valuations provided by servicers and issuers, which are both up to date and independent and cover the individual properties within the proposed NPL pool. Such valuations should include the asset value, the identity of the appraiser, the scope of the valuation, the period during which the valuation was performed and any conditions attached to the value provided. Fitch may adjust the supplied values where it believes they are analytically warranted as follows.

- **Valuation Source**: Property valuations performed by a professional third-party appraiser or designated appraiser are viewed as a credit positive (i.e. no adjustment to the property values is performed by Fitch). However, property valuations are often provided from various other sources, including (i) appraisals carried out by a court to set the auction reserve price; (ii) valuations performed at the time the loan was originated; or (iii) valuations by the servicer itself, especially in cases where it also has direct exposure to the property market. The treatment of these valuations will be discussed/considered in (i) sector-specific criteria/addenda/appendixes to this criteria; or (ii) transaction rating reports and/or RACs.

- **Valuation Process:** Valuations could be provided that lack the analytical rigor associated with third-party professional appraisers, such as licensed real estate brokers in the US. These include desktop appraisals that lack an inspection of the property, or broker values that may be limited to comparable sales and lack the full analysis typical of a professional appraisal.
- **Valuation Date:** Fitch uses issuer- and servicer-provided updated valuations for each loan in the pool. Where values are outdated and revaluations are not supplied, the agency will write the value of the property forward to account for any property price decreases or not give benefit the properties with outdated valuations. Where market conditions have improved since the last valuation, property price increases will be considered for residential properties.
- Fitch uses publicly available data, such as house price indexation tables or other market data to rebase original property valuations in the calculation of recoveries. In countries where there is a choice of more than one house price index, key factors considered by the agency when making an index selection are accuracy, frequency and coverage of the market. In jurisdictions where indexation data are limited or not sufficiently reliable, the agency will reduce values further.
- **Forced Sale Adjustments:** Valuations are performed on a market value basis where there are willing buyers and sellers for properties. This may not be accurate for all NPLs and Fitch will adjust market values lower for properties or markets in distress or when disposition strategies are predicated on compressed timeframes as may be the case with quick sales, forced sales or non-judicial resolutions (quick sale adjustments (QSAs)/distressed sale adjustments (DSAs)). When a QSA is included in the valuation provided by the servicer to reflect its disposition strategy or the current market environment, it should be noted in the issuer's data file. If distressed property values are provided, this is likely to lead to the use of lower value adjustments, compared to open market values.

On a case-by-case basis, particularly where a property or market faces significant distress, Fitch can make alternative valuation assumptions. In these cases, the agency will review any valuation assumptions provided, servicer business plan/strategy and other market data to estimate market value and stressed recovery amounts.

Recovery Timing

In NPL transactions, the timing of recoveries is as crucial as the assumptions for recovery amounts, as periodic payments required on the rated notes may only be serviced by the cash that the servicer is able to collect from its workout activity. The negative carry that can exist between yield on the notes and yield on the collateral (which may be zero) is addressed in the agency's cash flow analysis to reflect delayed recoveries affecting a transaction's ability to service the issued notes. As such recovery timing assumptions are a critical part of this analysis.

To estimate the recovery timing, Fitch will focus on the current stage of the legal proceedings and the relevant court of jurisdiction of each loan, the estimated time to foreclose, and whether the borrower is in bankruptcy or insolvency (in jurisdictions where applicable). In the absence of information regarding the progress of a loan's workout or legal proceedings, Fitch will make conservative recovery timing assumptions, apply rating caps, or decide not to rate the transaction. Please refer to the Rating Caps section below for further information. Based on the stage of the workout or legal proceedings, recovery timing is then adjusted to reflect Fitch's assessment of the servicer's ability to manage the legal process (see the Servicer Expertise section for more information).

Rating Category Stresses

Once base case recovery levels and recovery timing are estimated, recovery cash flows are estimated by assuming a series of incrementally higher market value declines (MVDs) or stressed income capitalisation assumptions (for commercial properties) as well as stressed recovery periods. These will be derived from sector-specific criteria/addenda/appendixes to this Criteria report or disclosed in transaction rating reports and/or RACs.

Additional Recovery Level Adjustments

Fitch reviews whether downward recovery adjustments are appropriate, depending on the property type and jurisdiction, for less liquid properties, significant geographical concentrations or concentrations of undeveloped land or incomplete properties. Zero recoveries can be assumed in higher rating stresses for particularly weak assets.

In some jurisdictions, higher foreclosure costs and servicing fee assumptions may be reflected in higher rating category stresses.

Judicial vs Non-Judicial Resolutions

Judicial resolutions are typically court supervised workouts that often result in foreclosure by the lien holder and ultimately the sale of the property to a third party. Non-judicial resolutions take different forms, the most common being the lien holder acquiring the deed in lieu of foreclosure, the payment by the borrower of a lump sum or discounted pay-off (DPO) or the agreement of a short-term repayment plan.

In NPL workouts, judicial and non-judicial proceedings often run in parallel. During the foreclosure proceedings, there may be significant contact between the servicer and the borrower and out-of-court settlements are likely to occur on some portion of the loans. Generally speaking, non-judicial resolutions occur more quickly than resolutions that go through the foreclosure process, but may in some jurisdictions yield lower recoveries. Servicers and issuers, however, may advocate non-judicial resolutions if they yield more favourable recoveries on a present value basis.

Fitch will thoroughly analyse the servicer's business plan/strategy, depending on the jurisdiction, and may give credit to its non-judicial resolution strategies provided certain criteria are met (please refer to the section entitled Servicer Expertise below). However, any credit to shorter recovery timing, as a result of servicers' plans to conduct non-judicial resolutions, will be limited in high investment-grade scenarios. When the criteria are missing or limited, no credit will be given to the business plan/strategy and more conservative recovery timing assumptions will be used.

Cash Flow Timing Mismatches

Risks Covered by Liquidity Facilities and Cash Reserves

- Given their non-performing or defaulted nature, the cash flow timing profiles of NPL assets are irregular and difficult to determine with precision, as collections can be delayed for unforeseen reasons (i.e. an increase in a court's workload or government-imposed foreclosure moratoriums). Without sufficient liquidity, interest shortfalls on the notes are likely to occur. This characteristic of the assets raises the importance of the liquidity facilities or reserves in the analysis of NPL transactions.

- Liquidity is also needed to cover any servicer disruption, as unserviced claims produce limited or no cash flow until a new servicer is appointed to take over the portfolio. Assumptions on how long it could take for a new servicer to step in and resume servicing functions are jurisdiction-specific and depend on the availability of replacement or back-up servicers (please refer to Fitch's *Structured Finance and Covered Bonds Counterparty Rating Criteria*).

- Forms of liquidity in NPL deals, in jurisdictions where applicable, have typically included cash reserves, committed liquidity facilities or servicer advancing. Fitch's analysis considers the sufficiency of the liquidity under various stress scenarios, as well as the availability of liquidity, primarily through an analysis of the creditworthiness of the instrument or entities providing the related support.

- Liquidity for some NPL transactions has been structured to amortise in line with the principal amortisation of the notes, provided that certain conditions and performance levels are met. Although Fitch views negatively liquidity that is permitted to amortise, typical conditions the agency sees for amortising liquidity are as follows:

    - there is no outstanding drawn amount under the liquidity facility;

  - the proportion of the liquidity facility over the rated notes after amortisation will not be lower than the same proportion at closing;
  - if the transaction is hedged, the actual amortisation profile of the notes is in line with, or faster than, the hedging amortisation profile, limiting the risk of under-hedging; and
  - the credit enhancement of the most senior class of notes has significantly increased since closing.
- Fitch analyses the minimum liquidity amounts (i.e. amounts not subject to amortisation) necessary to address potential adverse selection, particularly in the latter stages of the transaction, when only few challenging loans remain.

Interest Rate Hedging

For floating-rate notes, Fitch analyses hedging agreements to see if they provide certainty on the rate payable by the issuer under the notes. This is especially true for NPLs because there may be no or limited scheduled interest collections on the underlying loans. Recovery cash flows can be considered fixed in nature (i.e. they do not increase when a referenced based rate such as Libor increases), creating the potential for interest-rate mismatches. Floating-rate transactions with no or limited hedging may be subject to conservative interest-rate risk assumptions, or may not be rated. For more details, see *Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria*.

Servicing

A servicer's expertise is critical to any structured finance transaction, but its role is even more important in NPL transactions. In contrast to performing transactions, each NPL requires extensive and active management for recovery proceeds to be realised. As such, the quality of NPL servicing can directly affect the quantum and timing of recoveries, i.e. deal performance. Fitch's servicer analysis focuses on the servicer expertise and the impact of potential servicer discontinuity.

Servicer's Role

The main role of the servicer is to collect payments from the underlying assets and distribute them to the trustee for the benefit of the noteholders. In NPL transactions, a single servicer performs primary, master and special servicing, although some transactions have been structured with a master servicer and one or more sub-servicers.

Fitch assumes servicers with long-term, proven experience will be more successful, and analytical emphasis is placed on their ability to work with delinquent borrowers, overseeing repossessions, and managing and disposing of assets. In certain jurisdictions, where court procedures are lengthy and/or inefficient, regional/local expertise also plays a key role. Fitch also closely monitors the incentive and fee structures, and how these are aligned with noteholders. Given the dependence on effective servicing, NPL transactions warrant careful review of a servicer's expertise.

Servicer Expertise

The ability of an NPL servicer to maximise the return on assets is directly related to the experience of its asset management teams, its effectiveness at managing third-party resources and its ability to retain local market knowledge as it relates to real estate and enforcement practices. A servicer can have a positive impact on a transaction by ensuring that each phase of the judicial proceedings is closely monitored, facilitating what can be a time-consuming and inefficient procedure. The servicer can speed up the legal proceedings by, for example, limiting the number of errors that could compromise validity of claims or slow down the enforcement procedures.

Fitch pays close attention to the scope of the activity performed by the servicer and to the incentives it is offered to improve returns. The agency views positively transactions that allow servicers an appropriate level of flexibility in exercising a variety of resolution strategies while providing the right incentives to maximise recoveries to noteholders.

Fitch believes the servicer has a key role in determining resolution strategies that are appropriate to the specific circumstances of each loan. This can be achieved through detailed analysis of the portfolio's characteristics. Additionally, the agency will form a view of the reliability of the business plan/strategy prepared by the servicer based, among others, on the criteria below. Where Fitch considers the assumptions made in the business plan/strategy to be plausible, credit will be given by adjusting the agency's base-case recovery assumptions on either a loan-by-loan or a portfolio basis.

Typical aspects considered in the review of a servicer's business plan/strategy are:

- The servicer's experience, and whether it relates to the jurisdiction where the NPLs are located;
- To the extent recoveries are predicated on non-judicial resolutions, whether the servicer has a track record of achieving these types of settlements (effectiveness and efficiency will be factored in the analysis);
- Whether the servicer has a good working knowledge of the portfolio specifics and has articulated a detailed resolution strategy;
- Whether the claims identified by the servicer to be resolved non-judicially are in bankruptcy proceedings (as these are usually accompanied by a multitude of creditors and a lower probability of achieving out-of-court settlements); and
- Proposed work-out type in relation to collateral value (and therefore borrower incentives): where the collateral value is very high or very low, a non-judicial resolution generally avoids the high costs of a judicial procedure. If these considerations are absent in a servicer's business plan/strategy, Fitch will generally assume a judicial resolution to take place. Where the above criteria cannot be applied, limited credit will be given to the business plan/strategy prepared by the servicer and a more conservative stance will be taken: for instance, Fitch will review whether a higher proportion (or all) workouts will be done judicially, or whether a substantial haircut to the recoveries for non-judicial resolutions is appropriate. In the agency's experience, a highly-rated servicer generally possesses the entire set of prerequisites and its business plan/strategy is then taken into account in its analysis. However, a detailed review of the servicer business plan/strategy will be performed, and Fitch will incorporate its view on the extent to which credit will be given on a case-by-case basis. As a result, Fitch's base-case recoveries usually differ from the servicer's business plan/strategy, even where the servicer is highly experienced and meets all of the above criteria.

If Fitch's assessment is that the servicer's business plan/strategy is realistic, the agency will adjust its recovery assumptions by applying portfolio level or loan-by-loan level adjustments, depending on jurisdiction and pool characteristics. On a loan by-loan basis, typical areas in which the agency could limit its stresses are as follows.

- It will assume quicker recovery for non-judicial resolutions, including DPO and loan sales, i.e. cash is received earlier than the assumed timing for completion of judicial proceedings (albeit applying extra discounts to the cumulative base-case collections, as per a typical DPO).
- It will assume quicker tribunal timing to recovery: if the servicer has proved better than its peers at monitoring the different phases of judicial proceedings, the agency will consider reducing its recovery timing assumptions or limit the assumed number of auctions required to sell an asset.

Servicer Incentives

In the agency's opinion, the servicer is most incentivised when its own capital is at stake in the transaction, fully subordinated (structurally and over time) to the rated bonds. Here, the interests of the servicer and those of the noteholders will be most closely aligned. Nevertheless, other structures, such as the payment of performance fees upon debt retirement, also offer significant incentives. By contrast, Fitch is particularly concerned with fee structures envisaging minimum fees, which can divert a considerable amount of collections and provide clear disincentives to quick resolution strategies. Towards the end of a portfolio resolution cycle, the servicer may be incentivised to delay the workout completion, as minimum fees accrue.

Fitch also analyses the remuneration policy for asset managers to understand whether bonus compensation schemes appropriately incentivise staff to achieve maximum recoveries. The agency views positively structures linked to an asset manager's overall performance, rather than those based on a percentage of recoveries for an individual case, as the former avoids cherry picking – and the resulting adverse selection effects – in working out assets.

Disruption and Operational Risks

Although servicing disruption is a risk for all structured finance transactions, the temporary or permanent disruption of the servicer may impair the performance of an NPL transaction more severely, given its direct responsibility for all collections. For the approach Fitch takes in analysing servicer continuity risk, please refer to Fitch's *Structured Finance and Covered Bonds Counterparty Rating Criteria*.

Rating Caps

Fitch has identified several circumstances in NPL transactions where rating caps may apply, or make the transaction non-rateable. Many NPL transactions are likely to be subject to ratings limits; examples of rating caps are summarised below and will vary depending on the asset class and country. For more information on rating caps, please refer to *Global Structured Finance Rating Criteria* and to the *Structured Finance and Covered Bonds Counterparty Rating Criteria*.

- **Lack of replacement servicers and/or servicer experience as determined by Fitch in cases of new, non-specialised or inexperienced servicers.** Proposed NPL servicers should demonstrate their ability to work with distressed borrowers, managing foreclosures, overseeing repossessions, disposing of assets and maximising recoveries.

- **Limited equity in the transaction.** Fitch will review the purchase price (in jurisdictions where applicable) of the loans relative to the amount of the proposed liabilities and estimated recoveries. The agency will likely cap the ratings or decline to rate the transaction if the issued debt exceeds or it is very close to the purchase price of the loans.

- **Inadequate representations and warranties (R&Ws) made by either the seller of the NPL transaction or a third party with respect to the underlying loans.** Such R&Ws would include mortgage validation and enforceability, title insurance ensuring that the lien priority of the loan has been obtained, the status of any payments or charges affecting the property, existence of adequate hazard insurance and other required insurance coverage, and that there are no tax liens, or proper disclosure of other liens on the property. Additional R&Ws should be in place to address the accuracy of the information provided and that the mortgage property is in material compliance with all applicable federal, state and local laws and regulations as well as any laws pertaining to environmental hazards.

- The following could serve as mitigating factors to transaction analysis: the strength of the R&Ws provided in NPL deals and/or the quality and reputation of the R&W provider; a third-party loan file review; other information provided by the servicer; or if the servicer has managed the NPL pool for some time.

- **Financial strength of the R&W provider**. Fitch will consider whether the seller is financially capable of buying back loans or indemnifying the trust in the event that there is a breach of any R&W for any loan.

- **Lack of diligence or third-party loan file review where warranted.** Third-party loan file reviews could play a key role in NPL analysis as many of these assets are distressed and were not owned or serviced by their originator. It is not uncommon to find NPL loans that have missing or misplaced mortgage documentation that could limit or delay the servicer's ability to recover on the property. If the servicer has managed the NPL portfolio for some time before transaction closing, this could serve as a mitigating factor to missing or inaccurate information in the loan files.

  When Fitch relies on third-party loan file reviews, it checks that the review company be an independent entity with no ties to the issuer, the underwriter or the servicer. It should have appropriate company and management experience for the type of loans being reviewed and have the procedures and controls, staff experience levels, technology, and tools to adequately conduct and report on such a review. At the end of the review, Fitch relies on the review company to provide it with a summary report that addresses the accuracy of the information provided in the data tape versus what is in actual loan files, details of any instances where the loan has any missing mortgage documentation, or does not meet the applicable federal, state, or local laws and regulations, and details of any other specific concerns that were raised by Fitch with respect to the loans prior to the review.

- **Risk of extensive loan modifications inconsistent with historical practices.** Modifications include principal forgiveness, capitalisations and term extensions. The ability for loans to be modified can have a significant impact on the level and timing of recoveries.

  Given limited historical data in some jurisdictions, and the lack of a standardised industry approach as it relates to the type, frequency and extent of loan modifications allowed, Fitch will evaluate the potential for future loan modifications in NPL transactions on a case-by-case basis. In instances where loan modification activity is deemed unpredictable, loans are allowed to be modified and are not repurchased from the trust, or where loan modifications could cause extensions beyond the final legal maturity of the notes, Fitch may decline to rate or implement a rating cap on a transaction.

- **Revolving periods.** NPL deals with revolving periods, where the issuer's available funds after payment of interest (and all amounts senior) could be used to purchase new NPLs rather than to repay the notes' principal, are viewed as posing additional risks.

  Notwithstanding structures that may impose a number of conditions that stop subsequent purchases should the portfolio quality deteriorate beyond a certain level, or if the post-purchase portfolio differs dramatically from the initial pool, revolving periods pose significant risk to NPL deals. Given the "blind pool" nature of revolving structures that could allow the portfolio's credit quality to weaken, the volatility and uncertainty of cash flows, and the adverse selection biases that any NPL portfolio is bound to face, particularly in the tail of the transaction, Fitch would not rate NPL transactions with a revolving period without significant mitigating factors.

- **Pro rata principal paydown structures.** Similarly, due to the negative selection biases naturally embedded in NPL transactions and the volatility and uncertainty of cash flows, NPL deals have typically been structured with a sequential principal paydown. Fitch would not rate NPL transactions with pro rata principal paydown structures without significant mitigating factors.

- **Equity release.** An equity release structure (also known as equity leakage) permits interest payments to be made to the junior unrated notes in priority to principal repayment on the senior rated notes. Given the payment uncertainty of the underlying claims, the conditions for equity release in NPL deals are more important than in other asset classes. Fitch analyses transactions with equity release structures to determine if they are conditional on the achievement of strong deal performance and would not likely rate NPL transactions that allow equity leakage without significant mitigating factors.

- **Transactions with limited post-closing property performance reporting.**

Rating Assumption Sensitivity

The ratings assigned to NPL transactions by Fitch are sensitive to the recovery assumptions underlying the ratings and changes in these recovery assumptions may affect the ratings. For rated transactions, the agency will indicate in its presale or new issue reports the model-implied rating actions for all classes of notes from hypothetical changes in the values of predefined variables.

Generally in NPL transactions, sensitivities will be limited to recovery levels and in some cases, recovery timing. Unanticipated decreases in the volume of recoveries and/or increases in the time taken to realise recoveries, would likely result in a decline in the level of credit enhancement and liquidity available to the notes, which make the notes susceptible to negative rating action, depending on the extent of the decline in coverage. It should be noted that rating sensitivity to recovery expectations will vary on a transaction-by-transaction basis depending on the jurisdiction and the initial credit enhancement levels, underlying collateral and structural features.

Further details on rating assumption sensitivity may be included in sector-specific criteria reports/addenda/appendixes to this criteria report or in transaction rating reports and/or RACs.

Surveillance

As part of the surveillance process, observed cumulative and periodic collections will be monitored at each reporting date and compared against the agency's base-case expectation for the equivalent point of seasoning. Furthermore, the average recovery rate achieved on fully closed positions, and consideration of recovery trends, will be evaluated against Fitch's base-case assumption.

Fitch will also review the impact of legal and servicing expenses on gross collections. The agency will also review the amount of cash held by the courts (if any), the reasons for delays and the servicer's strategy to address the issue.

Surveillance of NPL transactions will also include consideration of any trigger breaches and utilisation or potential utilisation of structural mechanisms in place acting as credit enhancement or liquidity for noteholders. Furthermore, if the transaction is not fully hedged or the swaps are not balance guaranteed, the agency will monitor any interest rate exposure and actual note amortisation against the swap notional amortisation profile to identify any under- or over-hedging that could negatively affect cash flows. Fitch will also monitor the ratings of transaction counterparties.

Every transaction will be monitored on an ongoing basis following the receipt of investor and collection reports. A public rating action will be taken on all transactions at least annually. Rating actions for some transactions may occur more frequently, particularly if performance of the underlying pool exhibits rapid deterioration.

Fitch re-estimates its assumptions on the amount and timing of recoveries based on the updated portfolio information. The resulting assumptions are then used in accordance with the applicable sector-specific criteria.

Data Sources

Criteria Development

Fitch's analysis relies on information provided by the issuer, the servicer or the arranger (if any) or which is in the public domain. The rating process can also incorporate information provided by other third-party sources. If material to the rating, the agency will disclose other relevant sources.

More details on the data sources for each specific jurisdiction can be found in addenda/appendixes to this criteria report or in transaction rating reports and/or RACs.

Criteria Application

Sources of Data

For NPL transactions, Fitch's analysis relies on detailed loan-by loan collateral information, servicer business plans, or loan workout and liquidation strategies, where applicable, and loan purchase price information (in jurisdictions where applicable). The agency also requires for its analysis issuer/servicer-specific historical workout and performance data relevant to the securitised asset pool. While loan-level information is necessary to assess recoveries from the pool of assets to be rated, Fitch's analysis is based on receiving sufficient historical data (generally three or more years of such data), including data from prior stressed periods, to form a view on base-case expectations and future performance of certain asset types, as well as to assess servicer effectiveness.

Fitch may determine that its NPL methodology may be inappropriate for pools that do not meet minimum data adequacy parameters due to, for example, limited data availability or the quality of the data provided. The agency will analyse each of these factors separately and will determine the applicability of its NPL criteria for such pools on a case-by-case basis. In such cases, or in the absence of specific data outlined below and in Appendix 1, the agency may decline to rate a transaction, implement a rating cap on a transaction, or otherwise apply more conservative criteria.

Information Needed on Non-Performing Pools

Fitch's analysis relies on information on non-performing pools that includes:

a summary of borrower, property, loan and pool characteristics as detailed in the issuer template (see Appendix 1 for a list of data fields Fitch uses in its analysis of NPLs; note that sector-specific criteria and/or addenda/appendices, as they are developed, may contain additional information relevant to the sector);

- borrower type (individual, corporate, other)
- property valuations;
- for income-producing commercial properties, borrower, tenant, property and loan information that is typically requested for pools of performing loans;
- servicer's business plans for each asset or an understanding of loss mitigation and liquidation strategies;
- estimated servicer recovery amounts and resolution timings on each asset, or liquidation strategies for more granular asset pools, to the extent servicer business plans are not provided;
- servicer background information (to the extent not provided to Fitch in the course of a servicer rating): previous experience in local market, years in operation, management structure, staffing, financial strength, information technology and control procedures, and loan administration;
- historical recovery information on previous loan resolutions for each jurisdiction, including loss severity data, foreclosure/asset sale timing, and legal and servicing fees if not available from market wide data;
- availability of robust historical industry data on recoveries and liquidation timelines; and
- any other information that may be requested on a case-by-case basis.

Data adequacy for maintaining existing ratings depends on the availability of sufficient portfolio information. To maintain its ratings, Fitch requires regular investor and/or collection reports and the servicer's updated business plans/strategy whenever they are updated, but at least annually. Fitch also requires sufficient portfolio information to re-estimate its assumptions on recovery rates and timing.

Criteria Disclosure

Fitch expects to disclose the following items in its initial transaction reports and/or RACs:

- Baseline MVD assumptions for the 'B' and the notes rating scenarios;
- Adjustment, if any, applied to baseline MVD assumptions and the related rationale;
- Recovery base case for unsecured granular claims and rating category haircuts;
- Assumptions derived on the basis of Appendix 3 of these criteria report;
- Rating caps and the related rationale;
- Variations to these criteria.

Fitch uses, or for which more than one-third of the expected recoveries[1] arise from unsecured claims.

[1] Expected recoveries means the net present value (NPV) of Fitch's assumed gross recoveries at 'Bsf', assuming an all-in flat discount rate of 4%.

Limitations

Ratings, including Rating Watches and Outlooks, assigned by Fitch are subject to the limitations specified in Fitch's Ratings Definitions.

These are available at https://www.fitchratings.com/site/definitions.

Variations from Criteria

Fitch's criteria are designed to be used in conjunction with experienced analytical judgment exercised through a committee process. The combination of transparent criteria, analytical judgment applied on a transaction-by-transaction or issuer-by-issuer basis, and full disclosure via rating commentary strengthens Fitch's rating process, while assisting market participants in understanding the analysis behind our ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the rating where appropriate.

A variation can be approved by a ratings committee where the risk, feature, or other factor relevant to the assignment of a rating and the methodology applied to it are both included within the scope of the criteria, but where the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

Appendix 1: Generic Data Template

Data Fields (as Appropriate Based on the Jurisdiction)
Servicer information
Servicer
Originating bank or financial institution
Seller (if not originating bank or financial institution)
Is the seller a securitisation vehicle (yes/no)
Number of times claim transferred prior to being sold to the issuer
Borrower information
Borrower ID
Loan ID
Number of credit lines for the same loan ID
Connected unsecured claim (if credit line is not secured by a property – i.e. the source of collections is the borrower or the guarantor – fill in "yes")
Borrower type (corporate/individual)
Is borrower a real estate developer or building company (yes/no)
Bankruptcy status (yes/no)
Date of bankruptcy
Current delinquency status (30/60/90/120/REO)
24-month delinquency history
Borrower's payment thread over previous 24 months
Loan information
Loan denomination currency
Current loan balance (excluding penalties)
Recoverable principal amount
Recoverable interest amount
Mortgage loan type
Lien position
Senior claims if any
Mortgage amount
Modification flag (yes/no)
Date of modification
Type of modification
Arrears amount of delinquent loans (the sum of principal and interest unpaid amount)
Mortgage insurance (yes/no)
Mortgage insurance coverage amount
Mortgage insurance company
Property information
Property type (residential, retail, office, industrial, mixed residential/office, mixed retail/office, hotel, land, other)
Property location (region, postcode)
For income-producing commercial properties: Occupancy status (owner occupied, vacant, let to a third party)
For income-producing commercial properties: Who is the tenant?
For income-producing commercial properties: Lease break date
For income-producing commercial properties: Lease expiry date
For income-producing commercial properties: Estimated rental value
For income-producing commercial properties: Net operating income
Is the property completed (yes/no)
Servicer valuation

Data Fields (Cont'd)
Date of servicer valuation
Type of servicer valuation (full inspection, desktop, drive-by)
Type of servicer's market value (current, vacant possession value)
Third-party valuation
Name of third-party appraiser
Date of third-party valuation
Type of third-party valuation (full inspection, desktop, drive-by)
Type of third-party market value (current, vacant possession value)
Relevant court/tribunal
Court valuation
Date of court valuation
Claim information
Claim purchase price (can be provided on an aggregate basis, net of recoveries cashed in between purchase date and portfolio cut-off date)
Gross book value (GBV) at pool cut-off date (this typically includes the sum of principal, interest and penalties)
Court admitted claim amount if less than GBV
Date of default
Servicer's business plan/strategy
Status (not contacted, contacted, payment plan arranged, legal proceedings commenced, in possession, sold repossession)
Date servicing commenced
Recovery strategy (payment plan (DPO), legal proceedings, foreclosure)
For payment plan/DPO: Is this a prospect or ongoing?
For payment plan/DPO: Is there a repayment plan or lump sum payment?
For legal proceedings: Date legal proceedings commenced
For legal proceedings: Legal stage
For legal proceedings: Method of sale (estate agent, auction)
For legal proceedings: Estate agent asking price
For legal proceedings: Auction reserve price
For legal proceedings: Next auction reserve price
For legal proceedings: Number of failed auctions
For foreclosure: Sale date
For foreclosure: Gross sale price
For foreclosure: Sale price net of foreclosure, legal and servicing costs
Servicer expected resolution date
Servicer expected total gross resolution amount
Servicer expected total resolution amount net of foreclosure, legal and servicing costs
Cash sitting in account at portfolio cut-off date
For legal proceedings: Legal stage
For legal proceedings: Method of sale (estate agent, auction)
For legal proceedings: Estate agent asking price
For legal proceedings: Auction reserve price
For legal proceedings: Next auction reserve price
For legal proceedings: Number of failed auctions

Source: Fitch Ratings

Appendix 2: Italian and Portuguese NPL

This Appendix outlines Fitch's methodology for analysing Italian and Portuguese NPL transactions backed by mixed portfolios of secured (residential or small commercial properties) and unsecured defaulted claims. The numerical country-specific assumptions are available in the country-assumptions file: *Non-Performing Loans Securitisations Rating Criteria – Supplementary Data File*.

Rating Cap

Italian and Portuguese NPL transactions will not achieve ratings above 'BBBsf' due to: (i) the intrinsic volatility of recovery cash flows; and (ii) high geographic and obligor concentration.

Fitch will assess idiosyncratic and concentration risk in proposed NPL transactions and may decline to rate or apply rating caps below 'BBBsf' when securitised portfolios display an excessive concentration of expected recoveries in terms of obligors, geographical collateral distribution, year of default of the securitised loans, legal stage, tribunals, or for which more than one-third of the expected recoveries[2] arise from unsecured claims.

Data Adequacy

Fitch relies on the data listed in the table below to perform its rating analysis, including updated property valuations. The agency will also schedule an on-site meeting with the servicer's representatives to discuss servicing procedures and the transaction business plan and may also conduct an on-site visit for properties contributing the most to the servicer's expected recoveries.

Fitch will use servicer-specific data to form an expectation of future performance and to validate its baseline residential and commercial MVD assumptions (see *Secured Claims*). In addition, whenever servicer data suggest assumptions, both with respect to recovery rate and recovery timing, that are materially different from Fitch's assumptions described throughout this report, Fitch may apply a criteria variation and adjust its assumptions accordingly.

Data Adequacy for Italian and Portuguese NPLs

Item	Description
Loan-level portfolio information	Loan-level data include, as a minimum, the following: borrower's legal status, relevant tribunal, type of ongoing legal procedures, current legal phase; loan's security type, default date, gross book value (principal and interest components on a separate basis); and asset type, updated property valuation[3], valuation date, valuation type, state of completion, region, lien and amount of any prior liens.
Servicer's repossession data	Fitch will request information on all repossessions carried out by the servicer. Repossession data include, as a minimum, the following: loan's default date, type of legal procedure, relevant tribunal; and real estate type, latest available valuation, latest valuation date, latest valuation type, court appraisal valuation (if applicable), court appraisal valuation date (if applicable), number of auctions required to sell the asset, realised sale price, sale date.
Servicer's updated business plan	By obligor, for both secured and unsecured claims; by property for secured exposures, if available. Further broken down into secured versus unsecured recoveries and judicial versus extra-judicial recoveries.
Servicer's historical recovery data	Fitch expects to receive historical static recovery vintages for both secured and unsecured claims from the transaction servicer covering, typically, the past five years. For Unsecured Granular Claims, recovery vintages are expected to cover at least five years and the entire recovery process.
Servicer's timing on top tribunals	Fitch will request data on observed tribunal timings, broken down into macro-geographical areas as well as for individual tribunals that cover at least half of the business plan's expected recoveries.

Source: Fitch Ratings

[2] Expected recoveries means the net present value (NPV) of Fitch's assumed gross recoveries at 'Bsf', assuming an all-in flat discount rate of 4%.

[3] For new ratings, valuations should not be older than two years from the portfolio's cut-off date; for existing ratings, the most recent available valuation will be used.

Asset Analysis

Seasoning of Mortgage Defaults

Italy: Secured loans defaulted more than 10 years (if the relevant tribunal falls under Category 1 to 7) or 15 years (if Category 8 to 15) before the portfolio's cut-off date will not be assigned any expected recoveries, unless they are at the final stage of the recovery process.

Portugal: Secured loans defaulted more than eight years before the portfolio's cut-off date will not be assigned any expected recoveries, unless they are in the final stage of the recovery process.

Obligor concentration

In Fitch's view, large obligors providing a significant contribution to expected recoveries may have a disproportionate impact on portfolio performance due to idiosyncratic risk and therefore increase the volatility of portfolio recovery rates. Fitch will stress recoveries for obligors representing at least 1% of expected recoveries.

Secured Claims

Fitch uses its *NPL Recovery Model* to derive loan-level expected gross recovery inflows from secured claims based on a MVD approach. Under this methodology, Fitch stresses property values by a rating category-dependent residential or commercial MVD, which is a representation at different rating categories of the assumed stressed drop in property value, from the point of securitisation until an eventual sale following repossession.

Baseline residential MVDs are calculated on the basis of country-specific Foreclosed Sale Adjustments and regional Current-to-Trough House Price Decline (CTT HPD) from Fitch's European RMBS Rating Criteria. In order to calculate national MVDs, national CTT HPDs are derived averaging regional CTT HPDs as published in the country-specific assumption sheet of ResiGlobal Model: Europe.

The residential MVDs are updated when the *NPL Recovery Model* is required to be run (new ratings and/or surveillance of existing deals); an upward-only qualitative adjustment for 'BBBsf' and 'BBsf' rating categories may be determined at each update. The qualitative adjustment will capture specific portfolio characteristics, for example regional concentrations, not already reflected in MVDs calculated using Fitch's European RMBS Rating Criteria. As a result of the qualitative adjustment, baseline residential MVDs used for NPL transactions are floored at Fitch's RMBS MVDs.

Baseline commercial MVDs are property type-specific and derived from Fitch's EMEA CMBS and CRE Loan Rating Criteria, assuming a property score of 4 or 5 depending on sample reviews of property valuations (and subject to obligor concentration considerations). The commercial MVDs are updated when the *NPL Recovery Model* is required to be run (new ratings and/or surveillance of existing deals).

If servicer-specific data suggest materially different baseline MVD values, Fitch will upwardly adjust its assumptions by a maximum of 10%; any higher adjustment will constitute a criteria variation. The adjustment will be applied as a multiple of the baseline MVD: for example, a 10% adjustment will result in a 1.10x multiple applied to the baseline MVD. No MVD lower than baseline MVD can be applied.

The agency will also adjust the provided property values based on haircuts for certain valuation methodologies, as listed in the Property Valuation Type Haircuts table in the supplementary data file.

Distressed Property Value

The result of the MVD approach is a distressed property value (DPV), estimated as follows:

DPV (residential properties) = indexed open market value x (1 – property valuation type haircut) x (1 – residential MVD)

DPV (commercial properties) = open market value x (1 – property valuation type haircut) x (1 – commercial MVD).

The lower of the loan-level gross book value (GBV, the nominal principal due by the borrower, excluding any accrued interest, fees and expenses), the mortgage amount and the loan-level DPVs (reduced by prior liens, if any) represents the final gross recovery value for each secured exposure. In case of interim collections after the cut-off date, these will be deducted from the gross recovery value estimation. The open market value of residential properties will be indexed to bring it to the current estimated open market value, in accordance with the European RMBS methodology. For non-individual borrowers only, Fitch will treat as unsecured the remaining GBV, after deducting recoveries received from mortgage rights over real estate. These additional proceeds are considered as unsecured recoveries when assessing idiosyncratic and concentration risk.

Recovery Timing

Fitch will apply different recovery timings on the basis of tribunals (Italy) and/or property types (Portugal). In addition, recovery timings are broken down into legal phases to assign each loan a remaining share of the overall expected recovery timing, depending on the stage in the legal process on which each position is as of the portfolio's cut-off date. Regardless of the relevant legal phase, a floor of one year on any remaining recovery timing is applied.

For secured exposures and only at investment grade rating categories, Fitch runs two sensitivity analyses assuming:

- 10% longer recovery timing and increased gross recoveries (by reducing the MVD for secured exposures by 5%);
- A 10% shorter recovery timing with lower gross recoveries (by increasing the MVD by 10%).

For investment grade ratings to be assigned, the notes need to be sufficiently resilient to all the scenarios, including the above-mentioned sensitivities.

Unsecured Claims

Fitch will differentiate between Unsecured Non-Granular Claims (UNGCs) and Unsecured Granular Claims (UGCs). UGCs are defaulted claims granted to individual or small-enterprise borrowers below a defined threshold identified on the basis of historical recovery data provided by the servicer. UNGCs are defaulted claims with a GBV above that defined threshold, GBV equals to the threshold will be considered as UGCs. Fitch uses its *NPL Recovery Model* to calculate loan-level expected gross recovery inflows from unsecured claims.

UNGCs

Gross recoveries from UNGCs (usually with exposure to Corporate or SME obligors) are calculated as the lower of: (i) the sum of each loan's GBV (including any accrued interest, fees and expenses), reduced by a haircut for the seasoning from the default date, multiplied by the lower of: (a) Fitch's 'Bsf' recovery cap assumption; and (b) a recovery assumption derived from the servicer-specific historical unsecured recovery data; and (ii) the aggregate unsecured recoveries expected by the servicer in its cumulative business plan from UNGCs for corporate or SME obligors defaulted in the previous four years from the portfolio's cut-off date.

When Fitch's 'Bsf' assumed unsecured recoveries are below the servicer's cumulative business plan and historical unsecured recovery data, recoveries for the other rating categories are derived in accordance with the Unsecured Recovery Caps for SMEs table in the supplementary data file.

In cases where the servicer's expected cumulative collections or historically-achieved recoveries are below Fitch's assumed 'Bsf' unsecured recoveries, the business plan, or the lower observed assumption, replaces Fitch's 'Bsf' assumption. In such instance, 'BBsf' and 'BBBsf' unsecured recoveries are calculated assuming a haircut of 17% and 33% respectively on the business plan or historical recovery value.

In case of interim collections realised after the cut-off date, these will be deducted from each loan's gross recoveries. No recoveries are expected from UNGCs with a seasoning from the default date of more than four years as of the portfolio's cut-off date. If, for UNGCs, servicer-specific information supports recovery activity beyond four years of seasoning, Fitch will estimate a servicer-specific recovery vector and recovery haircut assumptions based on historical recovery data.

UGCs

For UGCs, Fitch will derive a recovery base-case and then apply rating category-specific recovery haircuts to it, as listed in the Unsecured Granular Claims: Recovery Haircuts table in the supplementary data file.

In order to differentiate between UGCs and UNGCs, Fitch expects to receive historical performance data for comparable claims to those securitised, covering a sufficiently long period (typically, at least five years) and in any case covering at least the entire recovery process.

To assess comparability, historical performance data should include: product type; seasoning (months since servicing inception, months since default date); ticket size (i.e. analysis by GBV clusters, for example 0-25,000, 25,000-50,000, 50,000-75,000, 75,000-100,000); borrower type (individual or corporate); geographic region. In the absence of such detail, Fitch may derive UGC recovery proceeds and timing using the UNGC approach listed above.

Recovery Timing

For UNGCs, Fitch assumes recoveries to be collected linearly over the recovery timing horizon, unless the servicer's cumulative business plan provides for lower recoveries than Fitch's 'Bsf' rating scenario, in which case the timing of recoveries reflects the business plan. Giving credit only to recently-defaulted unsecured loans, Fitch may postpone the cash flows generated by UNGCs for a period of six to 18 months, to take into account servicer set-up and portfolio hand-over activities.

For UGCs, Fitch derives a recovery timing vector informed by historical data provided by the servicer. Fitch will assume gross recoveries to be collected linearly over the expected horizon of recovery timing.

Liability Analysis

Fitch uses its Multi-Asset Cash Flow Model to test whether projected recovery cash flows from the asset model are sufficient to make interest and principal payments due under the rated notes. Contractual servicing fees and any other transaction expenses are reflected in Fitch's modelling. Although the *NPL Recovery Model* produces only rating category results, Fitch's credit committees could decide to assign notch-specific ratings if there is a limited shortfall at a given rating category and a substantial cushion at the lower rating category.

Payment Interruption Risk

Due to the absence of scheduled payments and the intrinsic volatility of recovery cash flows in NPL transactions, liquidity coverage of at least 12 months of interest and senior costs is expected to support the ratings.

Appendix 3: Other Countries NPL

This Appendix details how a Fitch rating committee will determine assumptions for NPL transactions in new countries not currently covered under *Appendix 2: Italian and Portuguese NPL*. Fitch expects to disclose all these assumptions in its initial transaction reports and/or RACs. Fitch will use its *NPL Recovery Model* to derive loan-level expected gross recovery inflows from secured and unsecured claims.

Data Adequacy

Fitch expects to receive the same information detailed in *Appendix 2: Italian and Portuguese NPL*.

Rating Cap

Fitch will determine a country-specific rating cap on the basis of the following considerations: (i) macro-economic environment and issuer default rating of the country, (ii) efficiency of the legal and judicial system, (iii) availability, quality and quantity of data provided, (iv) performance of past public NPL transactions (even if unrated), if any, and (v) volatility of recovery cash flows recorded in existing and past public NPL transactions (even if unrated). The presence and the rationale of a rating cap will be communicated as part of Fitch's transaction specific disclosure.

Asset Analysis

Secured Claims

The approach described in *Appendix 2: Italian and Portuguese NPL* will be used to derive MVDs for residential and commercial properties. Fitch will benchmark its derived residential and commercial MVDs with the respective country and asset-class specific criteria assumptions, but can use more conservative assumptions than disclosed in the respective asset class criteria.

Fitch will set recovery timings on the basis of data published in country-specific tribunal timings databases, if available, or provided by special servicers. In addition, for those jurisdictions with a long recovery process, timings will be broken down into legal phases where appropriate.

Unsecured Claims

Fitch will use the same approach described in *Appendix 2: Italian and Portuguese NPL* to determine recovery rates and recovery timings for unsecured claims.