

Article Title: ARCHIVE | Legal Criteria: Asset Isolation And Special-Purpose Entity Criteria--Structured Finance Data: (EDITOR'S NOTE: — This article is no longer current. It was superseded by "Structured Finance: Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017. We originally published this criteria article on May 7, 2013, partially superseding the article titled, "Criteria For Rating Synthetic CDO Transactions: Legal Analysis And Surveillance," published on Sept. 1, 2004.)

1. Standard & Poor's Ratings Services is publishing its global criteria for assessing legal risks in structured finance transactions. We are publishing this article to help market participants better understand our approach to reviewing legal risks in structured finance transactions from a global perspective. This article is related to our criteria article "Principles Of Credit Ratings," which we published on Feb. 16, 2011. SCOPE OF THE CRITERIA 2. Other than as noted immediately below, these criteria apply to all structured finance transactions globally that look to incorporate asset isolation and/or the insolvency remoteness of special-purpose entities (SPEs) used in securitization transactions (see Paragraph 12 below for information relating to the meaning of the term "insolvency remoteness"). These criteria do not apply where Standard & Poor's has published jurisdiction or asset-specific criteria that discuss asset isolation or insolvency remoteness of SPEs. In such cases, the relevant jurisdiction- or asset-specific criteria shall be applicable. SUMMARY OF THE CRITERIA UPDATE 3. Standard & Poor's is publishing its global criteria for assessing legal risks in structured finance transactions to provide the market with a description of the criteria it uses to assess legal risks that may affect the creditworthiness of structured finance debt issues. This article focuses on a discussion of: Asset isolation in securitization. The insolvency remoteness of SPEs. 4. This criteria article also discusses related legal issues that may affect insolvency remoteness: clawback risk, set-off risk, and tax risk. In addition, this article discusses challenge risk in securitizations and sources of comfort on legal issues. 5. In the past, we published certain articles discussing methodologies and assumptions related to how we assess legal risks in the context of our structured finance ratings for specific jurisdictions or asset types. The criteria contained herein do not represent a departure from our existing views; rather, this article provides an overarching framework for how Standard & Poor's assesses legal risks in structured finance transactions from a global perspective. Readers are also directed to existing Standard & Poor's articles discussing legal criteria applicable to structured finance transactions in specific jurisdictions or on discrete asset types, where applicable, which may provide greater detail on how the general criteria described in this article may be applied in those contexts. The criteria, as set out in this article, are not intended to be read as being prescriptive but rather as providing general criteria that guide Standard & Poor's when we consider legal issues we view as relevant to the credit analysis of structured finance securities. IMPACT ON OUTSTANDING RATINGS 6. We do not expect any outstanding ratings to be affected by these criteria. EFFECTIVE DATE AND TRANSITION 7. These criteria are effective immediately. METHODOLOGY Asset Isolation 8. We assess, under the applicable legal regime, the extent to which a securitization structure isolates the securitized assets from the insolvency risk of the entities that participate in the transaction. Typically, our analysis focuses on the entity or entities that originated and owned the assets before the securitization transaction. 9. A true sale of assets from the originator/seller to an insolvency-remote issuer is one method commonly used to achieve asset isolation in a securitization. As a general matter, the term true sale is commonly used in a securitization context to refer to a transfer of ownership of the securitized assets from an originator to an SPE. From a legal perspective, a true sale is generally understood to result in the assets ceasing to be part of the seller's bankruptcy or insolvency estate. There may also be other legal mechanisms, apart from true sale, that may achieve analogous isolation. 10. As a general matter, the insolvency and reorganization laws of the particular legal jurisdiction applicable to the originator determine the effect of an insolvency proceeding on the originator's assets (insolvency moratorium, disclaimer or rejection of contracts, treatment of secured creditors, etc.). Certain jurisdictions have legislated securitization regimes that may delineate the conditions and formalities under which a transfer of eligible assets can take place in order to achieve a true sale. In jurisdictions where no specific securitization statutes exist, case law precedents, general laws, accepted market practice, and/or legal or academic commentaries provide guidance to the legal counsel for the transaction parties on the conditions and formalities under which a transfer of securitizable assets can take place in order to achieve a true sale. Comfort as to whether a structure achieves a true sale of assets (whether under a legislated securitization regime or under

general local laws) is often provided in the form of a legal opinion to that effect provided by the transaction parties' outside legal counsel. Insolvency-Remoteness Of SPEs 11. Standard & Poor's has adopted insolvency-remoteness criteria for its analysis of an SPE's insolvency remoteness. SPEs are entities that are typically used in a securitization transaction to house the assets that support the payment obligations usually represented by the securities issued by the SPE. In the context of securitization, the market often refers to these entities as insolvency-remote (or bankruptcy-remote) because they are typically structured to minimize the risk of their insolvency (voluntary or involuntary). The insolvency of an SPE may be caused, for example, by issues relating to the structure or activities of an SPE itself or by issues relating to the bankruptcy of a parent of an SPE. 12. It is important to note that the terms insolvency-remote and bankruptcy-remote are not legal terms--lawyers generally do not provide legal opinions as to whether an SPE is insolvency remote--and these terms are not synonymous with the terms insolvency proof or bankruptcy proof. Insolvency remoteness of an SPE is, in the context of a rating analysis, a matter on which Standard & Poor's forms an opinion based on its evaluation of the specific facts and circumstances it views as applicable to a particular transaction. However, such an opinion by Standard & Poor's does not mean that an SPE is immune to the risk of insolvency, as that risk can never be completely excluded. For the purposes of this article, the terms insolvency-remote and insolvency remoteness are to be used interchangeably with the terms bankruptcy-remote and bankruptcy remoteness, respectively. 13. To assess insolvency remoteness, Standard & Poor's considers: Restrictions on objects and powers. Debt limitations. Independent directors. Restrictions on a merger or reorganization. Limitations on amendments to organizational documents. Separateness. Security interests over assets. 14. Each of these characteristics is, we believe, supportive of the overall concept of insolvency remoteness. Regardless of the specific organizational structure of an SPE (corporation, partnership, trust, etc.), where relevant, our analytic approach considers how and the extent to which these elements are addressed in the relevant organizational and/or transaction documents. 15. We explain the rationale for each characteristic in the sections below. Restrictions on objects and powers 16. One SPE characteristic that we view as relevant to the analysis of insolvency remoteness is whether the entity's objects and powers are restricted to the activities necessary to effect the transaction. We believe that this element, if present, may help reduce the SPE's risk of insolvency by reducing the likelihood of claims created by activities unrelated to the securitized assets and the issuance of the rated securities. 17. Standard & Poor's considers how the transaction documents (to which the securityholders or their representative are party) or the SPE's constituting document of establishment (for example, articles/certificate of incorporation for corporations, deed of partnership/partnership agreement for partnerships, and declaration of trust for trusts) constrain the SPE to those activities needed to carry out the transaction. 18. To the extent the SPE proposes to engage in unrelated business activities, the rating may be affected by our view of the effect of these activities on the SPE's resources, cash flows, and ability to pay interest and principal on the rated securities. Debt limitations 19. A second SPE characteristic that we view as relevant to the analysis of insolvency remoteness is whether there are restrictions pertaining to an SPE's ability to incur indebtedness in addition to the rated debt. We believe that additional debt limitations, if present, may help to reduce the likelihood that the SPE will be forced into insolvency proceedings by its creditors. 20. When reviewing whether an SPE is restricted from incurring additional indebtedness, we may view certain types of additional debt as not necessarily affecting an SPE's insolvency remoteness. Examples include debt that: Is subordinated to the existing rated debt. Bears the same rating from Standard & Poor's as the rating assigned to the existing rated debt (at the time of issuance and at all times thereafter). Is issued as a series that Standard & Poor's views as being adequately segregated from the existing rated debt, such that additional debtholders would not be expected to be able successfully to pursue remedies against collateral securing the existing rated debt. 21. Standard & Poor's also considers whether: There are agreements between the SPE and its creditors that include nonpetition language pursuant to which the creditors agree not to initiate insolvency proceedings against the SPE and not to join any such proceedings. There are agreements between the SPE and its creditors that include limitation-of-recourse language pursuant to which the creditors agree that their recourse is limited to the assets backing the rated debt in accordance with the relevant order of priority set out in the documentation. Fees, expenses, indemnities, and other

performance obligations of the SPE incurred directly in connection with the underlying assets and the issue of the rated debt are adequately covered or subordinated to payments on the rated debt.

Independent director 22. A third SPE characteristic that we view as relevant to the analysis of insolvency remoteness is the presence of any independent directors (or independent voting entities for those SPE types that do not have boards of directors) appointed to the governing board of an SPE. We believe that this element, if present, may help to reduce the likelihood that the SPE may resolve to commence voluntary insolvency proceedings merely for the convenience of its parent. 23. For corporations, it is often the case that the directors are elected by the shareholders, the corporation's owners. In many jurisdictions, among the decisions that may be made by a board of directors is the decision to initiate voluntary insolvency proceedings. Equityholders, depending on the jurisdiction, may also have the power to initiate voluntary insolvency proceedings for a corporation. In cases where a shareholder of the SPE has the power to voluntarily petition the SPE into bankruptcy proceedings, we may consider how the structure mitigates this risk. For example, we believe that the use of independent shareholding entities--the votes of which would be required along with the vote of a parent shareholder in order to commence voluntary insolvency proceedings--may help to mitigate this risk. 24. Regardless of an SPE's legal form, under this SPE characteristic, we assess what mitigants exist to reduce the likelihood that the SPE will initiate insolvency proceedings. 25. If an SPE has directors or voting entities (where relevant) in common with or under the common control of its parent, there may be an incentive for the parent company to attempt to cause an SPE subsidiary to voluntarily file to initiate insolvency proceedings in order to seek to consolidate the assets of the SPE with those of its parent. However, if, as noted above, the SPE subsidiary has at least one director or voting entity (where relevant) who is independent from the parent, and this director's or voting entity's vote is required in any action seeking to initiate insolvency proceedings for the subsidiary, we believe that such SPEs may be less likely to commence voluntary insolvency proceedings. Restrictions on a merger or reorganization 26. A fourth SPE characteristic that we view as relevant to the analysis of insolvency remoteness is whether the SPE is restricted from participating in a merger or reorganization type activity. We believe that this element, if present, may help reduce the concern that while the rated debt is outstanding, the insolvency-remote status of the SPE may be undermined by any merger or consolidation with a non-SPE; by any reorganization, dissolution, liquidation, or asset sale; or by the purchase of the SPE's shares by another company. Limitations on amendments to organizational documents 27. An SPE's ability to amend its organizational documents is another characteristic we view as relevant to the analysis of insolvency remoteness. In particular, we assess whether the SPE is restricted from amending its organizational documents for as long as the rated debt is outstanding. Separateness 28. We also consider the risk that the courts may use principles of "piercing the corporate veil," "alter ego," or "substantive consolidation" ("consolidation") or equivalent concepts that may exist in the relevant jurisdiction to bring the SPE and its assets into the insolvency proceeding of another entity (e.g., a parent). 29. Consolidation is a remedy that a court may exercise in some jurisdictions when a controlling entity, such as the parent of an SPE, disregards the separate identity of the SPE to such an extent that their enterprises are seen as effectively commingled. This remedy may be sought by creditors with claims against an insolvent parent in the belief that funds owed to such creditors can be properly traced into the subsidiary. 30. We may look to a nonconsolidation opinion to derive comfort regarding these risks when assessing insolvency remoteness. In other cases, however, we will review whether the SPE's organizational documents or transaction documents include covenants designed to provide comfort that the SPE will hold itself out as an independent entity. 31. Examples of separateness covenants that we have observed in securitization transactions include: To maintain books and records separate from any other person or entity. To maintain accounts separate from any other person or entity. To conduct its own business in its own name. To maintain separate financial statements. To observe all corporate or other formalities required by the organic documents. Not to pledge its assets for the benefit of any other entity or make loans or advances to any other entity (except as provided in the transaction documents). To allocate fairly and reasonably any overhead for shared office space. To use separate stationery, invoices, and checks. To hold itself out as a separate entity and to correct any known misunderstanding regarding its separate identity. 32. We have observed that the types of SPE separateness covenants that may appear in securitization transactions may vary depending on SPE

type, whether it is an orphan SPE (for example, an SPE whose shares are not held by an operating company but rather are held in trust for charitable purposes), and the relevant jurisdiction involved.

Security interests over assets 33. Another SPE characteristic we view as relevant to the analysis of insolvency remoteness is whether an SPE has created/established a security interest over its assets in favor of the holders of the rated debt. We believe that this element, if present, may help reduce the practical benefits and, therefore, the incentives of creditors of an equityholder or an unsecured third-party creditor of the SPE, for example, to file the issuer into insolvency proceedings to potentially gain access to the SPE's cash flows and assets. Standard & Poor's also considers whether laws applicable to the SPE or certain structural features of the transaction provide comfort analogous to a security interest. 34. We believe reducing the incentive of such parties to attempt to gain access to the SPE's assets and cash flows may reduce the risk of an involuntary insolvency proceeding for the SPE. 35. Given that insolvency remoteness is a matter of opinion and not a fact, none of the above characteristics is, on its own, determinative of a specific analytic view by Standard & Poor's. For example, the analysis to assess whether an orphan SPE is insolvency remote may differ significantly from an assessment of an SPE whose shares are held by an operating parent as part of a larger complex group of companies. We also recognize (and may factor into our analysis) that local laws may provide comfort on certain of these characteristics and/or provide that certain entities are insolvency-remote as a matter of law without regard to these specific characteristics. Related Legal Issues 36. During our assessment of asset isolation and insolvency remoteness of SPEs, we may identify related legal issues that may affect our assessment. The sections below discuss some of these legal issues. Clawback risk 37. Clawback risk is a term generally used to describe the risk that a transfer of funds or other assets that occurred within a specified period preceding bankruptcy (sometimes referred to as a look-back period or suspect period) would be susceptible to the risk of being reversed or declared void post-bankruptcy. In the context of a securitization, clawback risk may be applicable, for example, if the originator enters insolvency proceedings and a challenge is raised by an insolvency officer or creditor of the originator seeking to unwind the transfers of securitized assets made by an originator prior to its insolvency. 38. Among jurisdictions where there are clawback rules, the terminology used and the circumstances that trigger the applicable clawback rules can vary. For example, variants can include fraudulent conveyance, preference, transfers at an undervalue, non-arms-length transactions, and bad-faith transactions. 39. The question as to whether all of the required elements necessary to succeed under the applicable clawback rules are present for the transfer being challenged is typically a qualitative/fact-based analysis that will be judged by a court with the benefit of hindsight at the time of the challenge. Some jurisdictions' clawback regimes also provide specific safe harbors or defenses for certain types of transactions (i.e., those types that may not be successfully challenged). Although laws vary, examples of such safe harbors or defenses may include transactions in the ordinary course of business, transactions that occurred at a time when a bankrupt entity was solvent, or transactions that occurred well before a bankruptcy filing. When deemed relevant, we consider how a transaction has been structured to address potential clawback risk. Set-off risk 40. Standard & Poor's rating analysis considers whether a transaction's structure addresses potential set-off risk. Set-off risk is the risk that amounts owed by a borrower to a creditor will be reduced by amounts owed by the creditor to the same borrower (i.e., the obligations will be netted against each other). In securitization, for example, set-off risk on a pool of loans may exist if the loan originator provides deposit accounts to the borrowers. If the borrowers seek to set off amounts owed to the loan originator against amounts owed by the originator, reduced or delayed payments on the securitized debt may result. The potential for set-off risk may increase as the number and scope of the relationships between the parties increase. Tax risk 41. Standard & Poor's rating analysis considers the extent to which a transaction's structure addresses potential tax risk. In a securitization, tax risk is the risk that a liability to pay tax may affect an SPE's resources, cash flows, and the ability to pay interest and principal on the rated debt. By way of example, taxes that may affect a structured finance transaction can include, among others, entity-level taxes (as defined below) and taxes withheld from cash flows received by the SPE that are designated to service the rated securities. 42. In a securitization, entity-level taxes are taxes that apply to the SPE itself, such as income taxes. SPEs typically fall into two categories: taxable and nontaxable. Nontaxable SPEs are typically located in

jurisdictions where they are either not subject to tax or subject to income tax at a zero rate. Taxable SPEs are typically located in jurisdictions where they are subject to income tax at more than a nominal rate. In the case of taxable SPEs, given the economic incentives for sponsors to set up tax efficient structures, we have observed that sponsors have typically either used SPEs that are transparent for tax purposes, and whose equity owners pay tax on the SPE's income, or structured the cash flows of the SPE such that the expected net taxable income of the SPE (after having deducted expenses, including interest expense) is zero or minimal. Accordingly, in our analysis of most securitizations, we have observed that the participants typically have structured transactions in such a way that the SPE will not bear any material tax liability. 43. In a securitization, withholding taxes are taxes that may apply to cash flows to be received or paid by the SPE. Whenever funds are transferred across a jurisdictional border, there is a risk that the tax authority in the jurisdiction from which moneys are paid will require part of that amount to be remitted to it in the form of withholding tax. In our analysis, we consider whether withholding tax may be imposed on the cash flows to be received or paid by the SPE that may affect the SPE's ability to pay debt service on the rated debt. Standard & Poor's structured finance rating analysis does not address the applicability of withholding taxes on payments made by an SPE to holders of rated debt because such an analysis would be dependent on the facts and circumstances specific to each individual noteholder. Challenges To Securitization Transactions 44. Standard & Poor's notes that it is not possible to exclude fully the risk of challenge of a securitization structure. This may occur, for example, if a creditor or bankruptcy officer of an insolvent originator seeks to challenge the legal isolation of the transferred assets. This is not a comment on the quality or type of structuring involved in securitization but rather a recognition that in certain circumstances a third party may seek to challenge or question the efficacy of the securitization structure--as they could any other financial transaction. A Standard & Poor's rating of a securitization debt issue does not assess the risks (including potential timing delays) that could arise simply upon a third party (such as a creditor or insolvency officer of the originator) seeking to challenge certain legal aspects of the structure (such as the legal isolation of the transferred assets, for example). Comfort On Legal Issues 45. A Standard & Poor's structured finance rating is a forward-looking credit opinion that is based on, among other things, the information and documentation provided by the transaction participants, their counsel, and other advisors. In applying our global criteria for assessing legal risks in structured finance transactions, Standard & Poor's assesses various legal risks we believe are relevant to our analysis of creditworthiness based on the review of information, documentation, and/or legal opinions we view as relevant for the particular rating. Standard & Poor's assessment of legal issues considered relevant may be informed by its general understanding of the relevant legal issues in a given jurisdiction. We note that legal opinions supporting securitization transactions are views expressed by a lawyer or law firm and are not statements of a conclusive outcome. Legal opinions typically rely on factual assumptions and are limited by qualifications. We also note the risk that a court may always form its own view when considering legal issues. RELATED CRITERIA AND RESEARCH "Principles Of Credit Ratings," Feb. 16, 2011 "Criteria Methodology Applied to Fees, Expenses, And Indemnifications," July 12, 2012 These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.