Article Title: ARCHIVE | Guidance | Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology Data: (EDITOR'S NOTE: —This article is no longer current. It has been superseded by "Financial Institutions Rating Methodology," published Dec. 9, 2021.) Overview And Scope 1. This document provides additional information and guidance related to the application of S&P; Global Ratings' "Nonbank Financial Institutions Rating Methodology," published Dec. 9, 2014. It is intended to be read in conjunction with those criteria. For further explanation of guidance documents, please see the description at the end of this article. Key Publication Information Originally published March 22, 2018. Related to "Nonbank Financial Institutions Rating Methodology" published on Dec. 9, 2014. We may revise this guidance from time to time when market dynamics warrant reevaluating the variables and assumptions we generally use in our analysis. Guidance Finance companies: Use of the RAC or leverage ratio in assessing capital, leverage, and earnings This section provides guidance on how we typically choose between the risk-adjusted capital (RAC) ratio and the leverage ratio in our assessment of a finance company's capital, leverage, and earnings (CLE). 2. For fincos, the initial capital and earnings score reflects our expectation for either the entity's expected RAC ratio or leverage ratio. The RAC risk weightings are calibrated using historical data for banks. Although fincos often do not underwrite the same assets as banks, we may still use the RAC ratio where we can address relevant differences in risk position. Additionally, we could use the RAC ratio when a finco is subject to prudential regulation, or has: Historical net charge-offs broadly in line with the normalized losses of the entity-specific portfolio under the RAC framework (RACF); Significant off-balance-sheet exposures, such as provisions of guarantees or unutilized committed lines; or Material size of investments in public and private equity, including junior positions of securitized assets. 3. We may also use the RAC ratio when a significant portion of a finco's loans are credit enhanced by highly rated guarantors. 4. We may use the leverage ratio in other cases, typically when we view a finco's assets as materially riskier than a typical bank's assets in its jurisdiction. Examples of when we may use the leverage ratio include when a significant proportion of a finco's exposures include: Nonprime consumer loans (such as unsecured personal loans and deep-subprime auto loans to subprime borrowers); Second-lien, subordinated, or mezzanine loans; Unsecured commercial and industrial loans, particularly leveraged loans; Development, transitional, and construction real estate loans; Nonlending assets, such as equity and real estate investments; or Other nontraditional or esoteric assets that are not addressed directly in the RACF. 5. We typically use the leverage ratio when the majority of the finco's exposures include these items. The choice of RAC or leverage ratio will typically be consistent for fincos in the same market subsector with similar business models and exposures. 6. Regardless of which measure we apply for our initial capital and earnings score, we use the risk position assessment to refine our view of a financial institution's actual and specific risks, including lending and underwriting standards of fincos relative to banks in their markets. 7. For business development companies (BDCs), we use leverage because they mainly invest in leveraged loans, and in some cases second-lien loans or equity. Finance companies: Liquidity stress test assumptions This section focuses on assumptions we typically make when we generate a finance company's liquidity stress test, including but not limited to refinancing assumptions, principal and interest income reductions, advance rates with regard to secured facilities, asset value liquidation haircuts, undrawn commitment drawdown contingent obligations, and business origination decline. We make these assumptions when we calculate a stress case cash flow forecast, as described in the funding and liquidity section of the methodology applicable to finance companies. 8. We conduct company-specific stress tests to consider a firm's sensitivity to short-term liquidity needs and liquidity resources. Given the wide breadth of business models, assets, and funding platforms applied by nonbank financial institutions, we consider the assumptions listed below in creating company specific stress scenarios as a baseline, but they may not all apply to a specific issuer and may not be exhaustive. Divergence from the baseline can be expected and not all of the following assumptions may be applicable. Rather, we analyze only those most relevant or sensitive under a stress scenario. Specific assumptions, such as access to funding sources and declines in principal and interest received may vary by country, business segment, credit quality of obligors, or the presence of government ownership. We also consider the expected timing of cash flows in our analysis. The stress scenario adopted is typically a low-probability (but still possible) scenario customized for the company. Ultimately, debt stability, asset encumbrance, and asset amortization are key factors in the stress case.

9. We typically assume a company has reduced capacity to rollover unsecured debt maturities for 12 months. If the company primarily funds itself through the securitization markets, we typically assume restricted access to the securitized markets. Consistent with NBFI criteria (¶176), we may expect the company to lose access to short-term funding sources, particularly unstable wholesale funding markets. Nevertheless, we would generally expect firms to rollover unsecured bank facilities at a reduced level, depending on the country, market conditions and credit quality of the company. In general, we would expect the following rank ordering in terms of loss of access to funding sources: a. Unsecured short-term (wholesale) b. Unsecured long-term (wholesale) c. Securitized funding (wholesale) d. Unsecured bank facility e. Secured debt and repo facilities f. Related party funding g. Special funding for certain government-related entities 10. We typically assume a deposit-taking finance company will experience faster deposit withdrawals under stress, at rates that could differ depending on the counterparty, country, market conditions and credit quality of the company. In general, we would expect counterparties to withdraw their deposits in the following order, with the most sensitive counterparty at the top: a. Institutional deposits b. Corporate deposits c. Heavily rate driven deposits d. Uninsured deposits e. Insured deposits f. Transactional deposits 11. We typically assume a decline in principal and interest received (interest income) due to borrower distress. The decline may vary, and is typically relative to recent levels of nonperforming assets, scaled up to reflect the expected stress conditions over the forecast period. This can be based on a combination of the historical experience of the company, past stresses experienced by similar peers, and our expectations of future market conditions. For higher risk assets, this decline could be up to 25%. 12. Company- and facility-specific information drives our assumption for the advance rate that companies can expect on their secured facilities. If the company has margin call exposure, we typically assume up to a 25% decrease in collateral value. a. If it triggers a margin call, we would typically expect the borrower to i. Post available cash; or ii. Post eligible unencumbered assets (assuming up to a 25% decrease in value); or iii. Sell unencumbered assets at a haircut (which typically varies based on asset type and quality, but could be up to 25%) to raise cash to post as collateral. 13. We typically assume a decline in origination volume of 10% to 50%. Even in a stressful scenario, it is unlikely a company will completely stop originating new loans, though we would expect the company to be highly selective in new loans originated. We would expect a company to first attempt to satisfy draws against undrawn commitments. We would not assume a company would go insolvent because of new originations. Under such a scenario, we would expect the company to completely stop originating new loans if necessary and preserve cash from existing amortizing loans to fulfil its obligations. 14. We may assume the company would sell assets to raise cash, if necessary, but typically at a discount of up to 25%, depending on asset type and quality. Revisions And Updates This article was originally published on March 22, 2018. Changes introduced after original publication: On Feb. 10, 2021, we republished this guidance document to add the section titled "Finance companies: Use of the RAC or leverage ratio in assessing capital, leverage, and earnings" to provide more details on the selection of ratio when assessing capital, leverage, and earnings for finance companies. We also added the heading "Finance companies: liquidity stress test assumptions" for the existing guidance addressing this topic. We updated the "Overview And Scope" section to reflect the described changes and to be consistent with other guidance articles. We also updated the contact details. Related Criteria Key Credit Factors For U.S. Business Development Companies, Dec. 9, 2014 Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014 Related Research Criteria And Guidance: Understanding The Difference, Dec. 15, 2017