Structured Finance and Covered Bonds Counterparty Rating Criteria

Cross-Sector

Scope

This criteria report describes Fitch Ratings' approach to counterparty risk in all new and existing structured finance (SF) transactions and covered bond (CVB) programmes, for both international and national scale ratings globally. Any reference to SF includes CVB ratings, unless otherwise noted. Certain general concepts of this report may apply outside of SF and CVBs, which will be referenced in the relevant analytical team's criteria.

Each of the key rating drivers below is of equal importance for the analysis.

Key Rating Drivers

Rating Framework: Fitch's approach to assessing counterparty risk breaks down to three steps that ultimately determine the extent to which the rating of the SF bonds can be delinked from that of the related counterparty (see *Counterparty Risk Levels*). The three steps are:

1. determining the source of the counterparty risk exposure as either credit risk or operational risk;
2. categorizing each risk, considering legal and structural mitigants, into one of four risk levels: excessive, primary, secondary or immaterial; and
3. assessing any available counterparty's rating and documented remedial actions upon the loss of that rating, to determine the maximum achievable rating on the SF bonds.

Key Counterparty Risks: The provisions of this criteria report apply to any counterparty exposure in a SF transaction. Typical SF exposures and risks discussed in this report include:

Exposure	Risk	Source of Risk
Transaction Account Bank	Loss of Deposited Amounts	Operational and Credit
Qualified Investments	Loss on Invested Amounts	Credit
Servicer/Collection Account Bank	Payment Interruption Risk	Operational and Credit
—	Commingling Risk	Credit
Servicer	Servicing Disruption Risk	Operational
Liquidity Facility Providers/ Advancing Agents	Failure to Provide Liquidity Support	Credit
Derivative Provider	Failure to Hedge Interest or FX Risk	Credit

Criteria versus Transaction Documents: Transaction parties determine remedies, if any, to mitigate counterparty risk, which are then detailed in the transaction documents. Fitch is not responsible for the structuring of transactions and determines rating opinions based on provided structures. Differences between the criteria and transaction documents are addressed in the *When Documents Differ from Fitch Criteria* section. Fitch assumes all counterparties will uphold their contractual obligations; any failure to do so is reviewed in the *When Counterparties Fail to Comply with Documents* section.

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This report replaces "Structured Finance and Covered Bonds Counterparty Rating Criteria," published on July 29, 2022.

Click Here for Rating Criteria Synopsis Video

Disclaimer: This synopsis video is a summary of the criteria report made for information purposes only. It does not replace any part of the criteria report and is to be used only as complimentary material.

Related Criteria and Addenda

Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum (August 2022)

Covered Bonds Rating Criteria (November 2022)

Global Structured Finance Rating Criteria (March 2023)

Criteria Framework

Criteria Background

One of the core principles in SF, excluding CVBs, is to achieve structural isolation of a SF issuer — the special-purpose vehicle or trust — and its assets from any credit deterioration of the transaction counterparties. The intended result is that the SF transaction's performance primarily reflects that of the underlying asset pool and is isolated from the specific risks that affect any counterparty.

Fitch does not believe it is possible to fully structure away counterparty risk. However, risk can be minimized, and this criteria report outlines the key principles Fitch uses to determine counterparty risk in a SF transaction, and its subsequent effect on the maximum rating level that may be assigned to SF bonds. If sufficient isolation from any material credit or operational risk introduced by a counterparty is not achieved, the SF bond's rating may not exceed that of the counterparty introducing such risk.

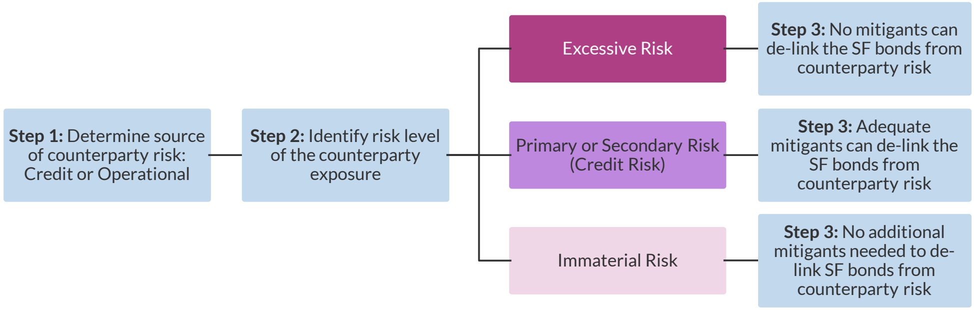
Fitch's analysis also relies on all SF counterparties having the operational knowledge and capability to perform the functions that they are contractually obligated to perform.

Under these criteria, counterparty risk refers to any risk resulting from a counterparty exposure that could ultimately affect transaction performance, both in the form of operational reliance (operational risk) and existing or potential financial reliance (credit risk).

Key Counterparty Risks in SF

Fitch's three-step approach to assessing counterparty risk, illustrated in Figure 1, ultimately determines the extent to which SF ratings can be delinked from that of the related counterparty.

Figure 1



Source: Fitch Ratings

Fitch applies this approach to all counterparties that could have a sizable impact on the SF transaction's performance. This typically includes counterparty risks associated with roles described in Figure 2. Counterparty exposures substantially equivalent to those in Figure 2 will be analyzed accordingly, regardless of naming conventions used in the transaction documents.

Figure 2

Key Counterparties in Typical SF Transaction

Counterparty Category	Role
Transaction Account Bank (TAB)	Any entity holding funds in the name of the SF issuer.
Servicer	Any entity tasked, among other things, with the periodic collection of payments from the asset pool, holding such collections in the servicer's accounts until their transfer to the TAB, and management of asset pool delinquencies and defaults.
Collection Account Bank	Any entity holding collected funds in the name of the servicer until their transfer to the TAB.
Liquidity Facility Providers/ Advancing Agents	Any entity providing liquidity support to the SF transaction, via an external facility or by advancing collections from the asset pool.
Derivative Provider	Any derivative provider, including currency or interest rate hedges.

SF – Structured finance
Source: Fitch Ratings

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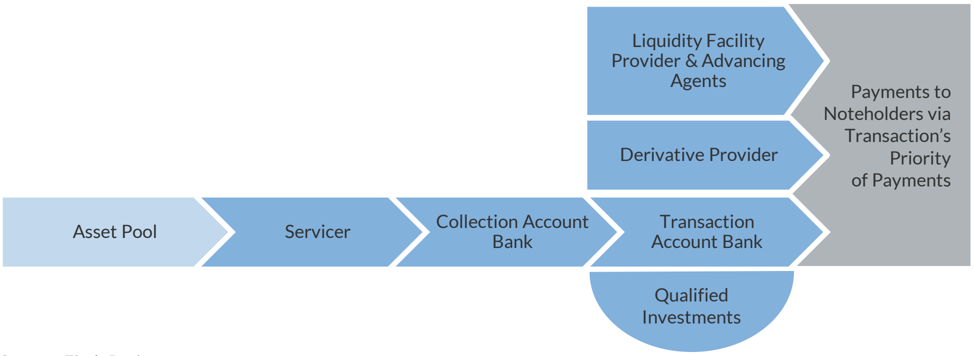
Figure 3 illustrates a typical flow of funds in a SF transaction. First, the servicer collects and holds periodic payments from the asset pool; second, in some structures, funds may be credited to a collection account bank (CAB). Third, funds are moved to a transaction account bank (TAB), where they may be invested in qualified investments. Lastly, available funds are paid out to noteholders through a payment waterfall. Inflows from liquidity and derivative providers may complement funds collected from the asset pool.

Figure 3

Flow of Funds in Typical SF Transaction



Source: Fitch Ratings

Counterparty Risk Levels

Risk Sources: Credit and Operational

Fitch classifies exposures to SF counterparties as operational risk, credit risk or a combination of both, based on the nature of the risk.

Operational risks are a direct result of the counterparty's ability to perform specific operational functions, and can be vital to ensure timely payments to noteholders. Operational risks include asset pool servicing, transaction administration and ancillary services, asset management and application of available funds through the SF transaction's priority of payments.

Credit risk results from the SF transaction incurring a loss of cash flows due to a counterparty being unable to meet its financial obligations, or the counterparty losing transaction funds at the time of default. Examples of credit exposures include derivatives, liquidity facility providers and any entity holding transaction funds.

Risk Levels: Excessive, Primary, Secondary and Immaterial

Credit and operational risk are continuums, which Fitch classifies into discrete risk levels after reviewing the legal and structural provisions of a SF transaction pertaining to each counterparty role. Credit risks are classified into four risk levels: excessive, primary, secondary and immaterial. Operational risks are associated with two: excessive and immaterial.

- **Excessive Risk**: Performance by the counterparty is considered a key risk driver for the SF ratings, or its default is expected to result in an event of default on the SF bonds.
- **Primary Risk**: A counterparty default would negatively affect a SF transaction's performance, heightening the risk of an event of default on the SF bonds.
- **Secondary Risk**: Mitigating factors limit the negative effects of a counterparty default on the SF transaction; these include asset pool or structural characteristics that limit the horizon or the effects of risk exposure to the SF bonds.
- **Immaterial Risk**: Exposures that are short-lived in nature or do not add credit or operational risk, at least to an extent that would affect the SF bond's rating.

Excessive risk exposures are deemed material such that the SF ratings cannot be delinked from the counterparty rating, even if remedial actions are in place. For immaterial risks, the counterparty rating will not constrain the SF bonds' ratings. For primary and secondary risks, Fitch expects counterparties to maintain certain minimum ratings at all times (see *Eligible*

Counterparties with Multiple Roles

A counterparty can also serve more than one role simultaneously. If mitigants to counterparty risk in line with these criteria are available for each role, Fitch does not view these structures to present more risk than cases where each role is performed by separate entities.

Section Outline

Risk Sources: Credit or Operational
Risk Levels: Excessive, Primary, Secondary and Immaterial

SF Modifier

All ratings referred to in this criteria report are deemed to have the SF modifier attached, except for those transaction types that are not considered by Fitch to be SF.

Counterparties) or that other structural mitigants reduce counterparty risk, in order to support SF ratings above the rating of the counterparty.

Eligible Counterparties

Definition of Eligible Counterparty

A counterparty that meets or exceeds the relevant minimum risk ratings detailed in the *Credit Risk Rating Table* (CRRT) below — or in Figure 28 in the case of a *Derivative Provider* — is referred to as an "eligible counterparty" under these criteria.

For primary and secondary risks, Fitch may delink the SF ratings from the counterparty's rating depending on the remedial action taken if the counterparty's rating falls below the relevant minimum risk rating, as described in *Remedies upon Losing Eligible Counterparty Status*.

Figure 4

Credit Risk Rating Table

Category of Highest Rated SF Bonds	Minimum Primary Risk Ratings	Minimum Secondary Risk Ratings
AAA	A or F1	BBB or F2
AA	A– or F1	BBB or F2
A	BBB or F2	BB–
BBB	BBB– or F3	BB–
BB	Note rating	B–
B	Note rating	B–

Note: Ratings in this table refer to the applicable counterparty's rating (Deposit Rating, Derivative Counterparty Rating or Issuer Default Rating), per Figure 6, and different minimum risk ratings apply to derivative providers. See Figure 28 in *Derivative Provider*. SF – Structured finance.
Source: Fitch Ratings

For example, assuming documented remedial actions in line with the next section are in place, Fitch views a "primary risk" TAB rated 'BBB' or 'F2' as able to support SF bonds rated up to 'A+' but not 'AA–', while an entity rated 'A' or 'F1' can support SF bonds rated up to 'AAA'.

Fitch views the "jump-to-default risk" for eligible counterparties as commensurate to the corresponding SF rating category in the CRRT. Jump to default refers to a counterparty defaulting directly from minimum risk ratings outlined in the CRRT before documented remedial actions following a counterparty downgrade can be executed.

For SF transactions, excluding CVB, Fitch may still limit the ratings of the SF bonds to the counterparty's rating where transaction documents do not include adequate timely remedies upon losing the relevant minimum ratings in the CRRT. This depends on the counterparty's role and materiality to the rating analysis, and adequacy of structural mitigants to address the risk.

Remedies upon Losing Eligible Counterparty Status

Fitch observed the following remedial actions in transaction documents following a counterparty downgrade below the minimum risk ratings in the CRRT:

- Replacement with a different eligible counterparty.
- Obtaining a guarantee from an eligible counterparty.

Fitch also observed risks resulting from specific roles, to be addressed in the transaction documents through the following:

- Collateralization for derivatives.
- Prefunding of committed liquidity amounts for liquidity facility providers.

Section Outline

Definition of Eligible Counterparty
Remedies upon Losing Eligible Counterparty Status
Timing of Remedies upon Losing Eligible Counterparty Status
Highly Rated Counterparties

CVB — CRRT

To achieve the CVB timely payment rating level, CVBs rely on counterparties effectively performing their roles.

When assessing counterparty eligibility in the context of CVBs, the first column of the CRRT represents the CVB timely payment rating level.

Additionally, for CVB programmes, Fitch relies on the ability of the CVB issuer to manage counterparty risk, even if documented remedies are not available. The rating of an eligible counterparty will not limit the CVB rating.

Fitch only credits remedies that can be credibly executed. For example, "replacement" will not be viewed as a credible remedy if no other entities willing or able to take over the role exist in the relevant sector or jurisdiction.

Costs associated with the remedial action, while generally not material in amount, are expected to be met in such a way that they do not result in any loss for the SF transaction, such as payment from the replaced entity. Fitch will incorporate material costs paid with transaction cash flows in the rating analysis.

Timing of Remedies upon Losing Eligible Counterparty Status

Fitch will review the impact on the SF ratings of any documented remedial actions upon losing eligible counterparty status occurring outside the time frames seen in the *Remedial Time Frames* table.

Figure 5

Remedial Time Frames

60 calendar days	• Replacement with a different eligible counterparty. • Obtaining a guarantee from an eligible counterparty. • Posting of a reserve covering commingling or set-off risk, when these risks are considered a secondary risk.
14 calendar days[a]	• Prefunding for liquidity facility providers. • Posting of reserves covering payment interruption risk or any primary risk. • Posting of collateral for derivatives[b].

[a]60 calendar days for highly rated counterparties at the loss of 'AA–' or 'F1+', per the *Highly Rated Counterparties* section below. [b]Liquidity adjustment and volatility cushions can be posted in 60 calendar days if the counterparty maintains the relevant minimum secondary risk ratings in Figure 28. Please see *Derivative Provider* for additional details.
Source: Fitch Ratings

Fitch expects collateralization for derivatives and prefunding for liquidity facility providers to be completed within 14 calendar days from ineligibility, even when the ineligible counterparty will ultimately be replaced or obtains a guarantee within 60 days.

Highly Rated Counterparties

Fitch considers entities with applicable ratings of at least 'AA–' or 'F1+' to present reduced jump-to-default risk than other counterparties. For these counterparties, Fitch therefore views a remedial time frame of 60 calendar days upon downgrade below 'AA–' or 'F1+' to sufficiently address deteriorating counterparty creditworthiness. Fitch considers a documented remedial period of 60 calendar days to be sufficient for all remedies, including those expected in 14 calendar days (Figure 5), given that remedies are implemented at a higher rating level.

Short-Term SF ratings

Unless provided otherwise in the relevant sector criteria, when short-term SF ratings are assigned, Fitch considers counterparty risk to be mitigated when remedial actions are taken upon a counterparty rating falling below either: (i) the lowest long-term rating associated with the assigned short-term SF rating; or (ii) the lowest short-term ratings associated with the long-term rating under (i).

For example, for SF bonds rated 'F1+', an eligible counterparty would be rated at least 'F1' or 'A'.

Which Rating to Apply

Section Outline

Applicable Ratings
Rating Watch Negative (RWN)
Bank Branches
Unrated Subsidiaries
Operational-Continuity Banks in SF

Applicable Ratings

Any reference to "rating" or "ratings" in this report means a public or private Fitch rating. Credit opinions, credit assessments or ratings from other credit rating agencies are not considered sufficient for the purposes of counterparty risk review, if not otherwise specified in this report.

References to counterparty ratings throughout this report refer to the applicable rating in Figure 6. When a Deposit Rating (DR) or Derivative Counterparty Rating (DCR) is not available, the Issuer Default Rating (IDR) is the applicable rating.

Figure 6

Counterparty Risks Associated with:	Applicable Rating (or IDR if not available)
Transaction Account Bank	Deposit Rating (DR)
Servicer	Issuer Default Rating (IDR)
Collection Account Bank	DR
Liquidity Facility Provider/Advancing Agents	IDR
Derivative Provider	Derivative Counterparty Rating

Source: Fitch Ratings

For transaction documents executed prior to the first assignment of DR or DCR ratings to the counterparty, Fitch will assume that references in the transaction documents to counterparty ratings, including to IDR, refer instead to DR or DCR.

Rating Watch Negative (RWN)

If at transaction close, counterparty ratings are on RWN and its applicable ratings are at the relevant minimum levels of Fitch's CRRT — such as 'A' or 'F1' on RWN for SF bonds rated 'AAA' — Fitch looks for advanced preparation for the implementation of documented remedial actions when assigning new SF ratings. However, Fitch only expects advanced preparations for CVB programmes when rating the CVB for the first time. The detail of such remedial plans should ensure a rapid and effective application of the documented remedies and can include finalized collateral posting arrangements or contracted replacement parties.

Bank Branches

For a bank's branch that is the actual counterparty in the SF transaction, Fitch incorporates the parent bank's IDR in its counterparty risk review, unless the branch's host country has a Country Ceiling below the bank rating. In this case, Fitch will consider the bank's rating used for the branch to be capped at the Country Ceiling. The Country Ceiling is not applicable for derivative counterparties if the derivative is entered into under the ISDA master agreement, and section 10 (a) is specified in the schedule as applying. Please see Fitch's "Bank Rating Criteria" for more details on branch ratings.

A bank's assigned DRs and DCR are not automatically considered for branches operating outside the rated bank's country of incorporation. Fitch will analyze the DRs and DCR for branches in other countries on a case-by-case basis.

Unrated Subsidiaries

For unrated subsidiaries of rated entities, Fitch will perform a case-by-case analysis to establish whether the parent's applicable rating can be used as a reference rating for the subsidiary.

The relevant Fitch-rated financial institutions, non-bank financial institutions or corporate rating analysts are consulted as part of this assessment, unless all three conditions outlined below are met, in which case, the SF analyst can determine if the parent's IDR can be used for the counterparty assessment.

1. The subsidiary is at least 75% directly or indirectly — up to the third level in the corporate structure — owned by the rated parent.
2. The subsidiary uses the same branding as the rated parent.

3. A documented commitment from the rated parent to support the unrated subsidiary is available, such as a profit and loss sharing agreement or similar support.

For more details, see Fitch's "Bank Rating Criteria" and "Non-Bank Financial Institutions Rating Criteria."

Triggers on posting collateral, replacement or guarantee are based on the parent company's rating, if Fitch assesses the counterparty's creditworthiness using the parent company's rating. Additional triggers addressing a potential change in the relationship between the parent and the unrated subsidiary are needed. Examples of triggers include a decline in the ownership level to below 75% and discontinuation of any commitment to support.

Operational-Continuity Banks in SF

References throughout this report to operational-continuity banks in SF refer to regulated banks domiciled in or subject to the banking regulations of the following jurisdictions:

- Australia, Canada, Japan, New Zealand, Singapore, South Korea, Switzerland and the United States.
- The European Union, Norway and the United Kingdom — as long as the bank is required to comply by resolution authorities with the minimum requirement for own funds and eligible liabilities required under the Bank Recovery and Resolution Directive, or it falls within the resolution group of a parent bank that is required to comply.
- China — where either the bank's Support Rating Floor is in the 'BB' category or higher, or the local regulator designates the bank as systemically important.
- India or any Latin American jurisdiction, as long as the bank's Support Rating Floor category is at the maximum achievable category for the jurisdiction.

Absent any indication of near-term distress for the bank, Fitch believes these banks present lower risk of disruption in their operations supporting SF transactions, partially mitigating certain counterparty risks, as noted in these criteria.

Additional jurisdictions or banks undergoing distressed or other unique circumstances will be evaluated on a case-by-case basis.

Covered Bonds-Specific Aspects

Section Outline

Issuer Support to CVB
Timely Payment of CVB
Recovery-Given Default Analysis for CVB
External Counterparties Benefits

Issuer Support to CVB

Fitch relies on the fact that CVB programmes are dynamic, and that issuers provide support by maintaining or increasing the enhancement level and by directly managing counterparty exposures to protect investors.

Fitch's assessment of counterparty risk also relies on the willingness of the issuers to protect investors upon a deterioration of the counterparties' creditworthiness. In the absence of documented counterparty provisions or protection under the relevant law, Fitch relies on the counterparty rating when assessing timely payments to CVB holders. Once the counterparty becomes ineligible and it is not replaced, Fitch will quantify the risk and test the ability of the CVB programme to maintain timely payments.

CVB holders have full recourse against the issuing financial institution. When the issuer is solvent, it will pay the CVB when due, irrespective of the performance of counterparties. The resolution reference point, as detailed in "Covered Bonds Rating Criteria," reflects the favorable treatment of CVBs over senior debt in a resolution scenario and determines the rating level at which the issuer can honor its CVB commitments.

The resolution reference point is determined by adding the number of notches of resolution uplift granted to the programme to the issuing institution's IDR. Fitch views counterparty risk as sufficiently mitigated in a stress scenario corresponding to this resolution reference point. When the CVB rating is limited due to counterparty risk, it will be limited to the higher of either the resolution reference point or the counterparty rating.

Timely Payment of CVBs

To meet timely payments on the CVB, once recourse against the cover pool has been enforced, satisfactory liquidity protection mechanisms need to be in place, along with effective hedging of interest rate and currency risks and sufficient cash flows stemming from the cover pool.

Liquidity mechanisms for principal and interest payments are assessed in the Fitch Payment Continuity Uplift analysis, as detailed in "Covered Bonds Rating Criteria." When liquidity mechanisms or interest rate and currency hedging rely on the performance of a counterparty, Fitch will assess the eligibility of the counterparty relative to the CVB timely payment rating level, subject to the minimum rating levels outlined in Fitch's CRRT.

Recovery-Given Default Analysis for CVB

Fitch's CVB ratings incorporate credit to recoveries from the cover pool in the event of a CVB default, reflecting the expectations of above-average recoveries stemming from the cover pool. This step of the analysis is typically not sensitive to counterparty risk, as timely payments are no longer essential.

Fitch considers counterparty risk sufficiently mitigated for CVB programmes when timely payment is not tested, and the CVB rating is determined by adding the recovery uplift to the resolution reference point.

External Counterparty Benefits

CVBs are full recourse obligations of the issuer. Therefore, CVB investors would only be exposed to losses from a defaulting counterparty if the issuer also defaulted. As a consequence, external counterparties not related to the issuer provide additional comfort compared with internal counterparties. Fitch defines an internal counterparty as either the same entity as the issuer or one that is closely related, such as a wholly owned subsidiary.

Fitch will assess both the CVB issuer and the counterparty creditworthiness, relative to the CVB timely payment rating level, to apply less-stringent guidelines to external counterparties. For example, an external derivative counterparty will post a lower collateral amount compared with an internal counterparty, or the exposure to an external transaction account bank will not be considered excessive if the issuer is rated at least 'BBB+' or 'F2'.

Transaction Account Bank

Role

The term "transaction account bank" (TAB) includes all entities that hold funds in the name of the SF issuer, including distribution, collateral and reserve accounts — referred to collectively as transaction accounts in this report. In some jurisdictions, including U.S. and Latin American SF, this role is often performed by either the indenture trustees or trustees, in addition to their other operational capacities.

The key counterparty risk is that transaction funds held with the TAB may be lost upon default of the TAB, resulting in both a credit loss of cash flows and operational challenges in meeting required timely payments on the SF bonds for the next payment date.

Funds held at the TAB are often invested until their periodic release to noteholders. Fitch reviews investment guidelines, per *Qualified Investments*, given these investments may introduce additional credit or market risk.

Risk Classification

Fitch's risk level assessment with respect to the TAB is summarized in Figure 7.

Figure 7

Risk Classification — Transaction Account Bank (TAB)

Risk Level	Examples	Remedies
Excessive	TAB holds funds for more than 12 months and the following conditions apply: CE held with the TAB > 50% total CE; and loss of CE held with the TAB would result in a model-implied downgrade of 10 or more notches.	No remedies can mitigate the exposure. SF ratings are capped at either the applicable TAB rating, or the rating of the prevalent qualified investment, if funds are not held in cash.
Primary	All exposures that are not considered immaterial or excessive.	Eligible counterparty with primary risk ratings in Fitch's CRRT, including remedial actions.
Secondary	Not applicable.	Not applicable.
Immaterial	Specific legal provisions isolate transaction funds from TAB insolvency.	No additional documented remedial actions are expected.

SF – Structured finance. CE – Credit enhancement.
Source: Fitch Ratings

Immaterial Credit Risk — TAB

Fitch views the exposure toward the TAB as immaterial where its default is not expected to result in a cash flow loss or delay in the availability of amounts deposited with this entity. Structures that addressed the exposure to the TAB are detailed below.

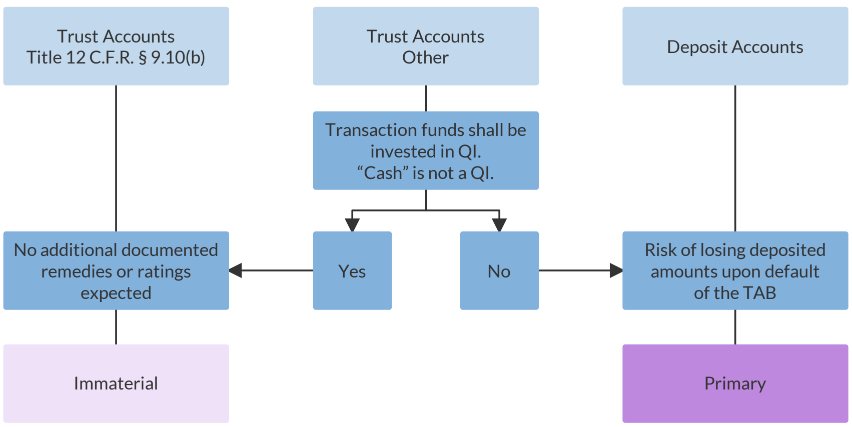
- **Legal Provisions Isolating Transaction Funds:** Fitch reviews transaction documents to determine whether transaction funds — cash, securities or both — are protected from TAB insolvency. Additional mechanisms, such as a liquidity facility or reserve account from a different eligible counterparty typically address the risk, when present, of any potential delay in the availability of the protected funds.
- **U.S. Trust Accounts:** The following accounts represent a special case of legal provisions isolating transaction funds and can take two forms:
    - Trust accounts established in the United States in accordance with Title 12 C.F.R. § 9.10(b), or substantively identical regulations, with the account provider acting in a fiduciary capacity. In these cases, Fitch considers the exposure to the TAB as immaterial, as both securities and cash holdings are protected in the event of the insolvency of the TAB.

Section Outline
Role
Risk Classification
Qualified Investments

- Other forms of U.S. trust accounts, where only funds invested in securities and not held as cash funds are protected. Fitch views the counterparty exposure as immaterial if transaction documents require investments in securities consistent with Fitch's qualified investments and exclude cash holdings (Figure 8). If cash holdings are allowed, Fitch views the TAB exposure as primary risk.

Figure 8

U.S. Trust Accounts



Note: Qualified investments (QIs) include those with definitions in transaction documents that are in line with these criteria (see Qualified Investments section). TAB – Transaction account bank.
Source: Fitch Ratings

Primary and Secondary Credit Risk — TAB

Where the TAB exposure is not deemed an immaterial risk per the prior section, Fitch views it as a primary risk. To mitigate this counterparty risk, Fitch expects the TAB to maintain minimum primary risk ratings at all times, including remedial actions upon losing such ratings, in line with Fitch's CRRT.

When the TAB acts as a paying agent and holds funds for up to two business days immediately prior to a payment date, the exposure is analyzed as outlined in the section *Paying Agents*.

Remedies upon Losing Eligible Counterparty Status

Collateralization is not seen as a practical remedy for TAB exposures, given their operational role in ensuring periodic timely payments on the SF bonds. Fitch views replacement with or obtaining a guarantee from an eligible institution to instead be a viable remedy in these cases (Figure 9). Fitch will review the effect of delayed remedial actions on the SF ratings beyond the time frames set forth below.

Figure 9

TAB — Remedies upon Ineligibility

Remedy	Remedial Time Frame
Replacement with a different eligible counterparty	60 calendar days
Obtaining a guarantee from an eligible counterparty	60 calendar days

Source: Fitch Ratings

Excessive Credit Risk — TAB

SF ratings cannot be delinked from the TAB rating, where the TAB represents a key risk driver of the SF transaction, or its default would disproportionally impair the ability of the SF transaction to repay noteholders.

In Fitch's view, this occurs where the following two sequential steps apply:

1. CE held at the TAB represents more than half of the CE available to the SF bonds at the time of the analysis. For CVB, this refers to the overcollateralization (OC) in Fitch's analysis;
2. If the above applies, assuming a loss of the CE held at the TAB results in a model-implied downgrade of 10 or more notches on the SF bonds. For CVBs, a downgrade on the timely payment rating level disregarding the recourse against the CVB issuer.

CE held at the TAB is described in Figure 10. CE available to SF bonds includes OC and subordination as well as CE held at the TAB, but excludes projected excess spread and derivative payments.

Figure 10

Credit Enhancement at TAB

Credit Enhancement Held at TAB	Excluded from Excessive Risk Assessment
Any cash holding or investments held at the TAB for longer than 12 months, including cash reserves covering credit losses.	Periodic collections from the asset pool as well as cash reserves dedicated to provide liquidity support or address specific risks, such as commingling or set-off risk.
—	Funds held for revolving or ramp-up periods, unless a Fitch credit committee concludes that sufficient contractual triggers to prevent cash accumulation are not available.

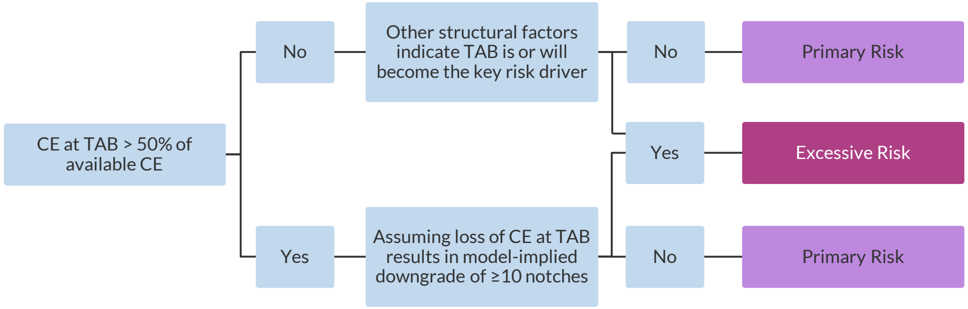
Source: Fitch Ratings

Fitch's credit committees will also review any structural feature or transaction circumstances that indicate excessive risk toward the TAB, even when the two CE conditions above do not apply. Examples may include but are not limited to the following cases: a cash reserve held with the TAB is the only CE available to the SF transaction; or the transaction structure envisages a cash reserve with an absolute floor that is expected to increase the exposure to the TAB later in the life of the SF transaction.

Figure 11 summarizes Fitch's approach to excessive risk for TABs.

Figure 11

When Transaction Account Bank Represents Excessive Risk



Source: Fitch Ratings

Qualified Investments

Some structures allow for funds held in transaction accounts to be invested into qualified investments — also known as permitted, authorized or eligible investments. These investments are used as a short-term repository for cash, usually only until the next payment date.

Transaction documents typically specify a simple set of rules on applicable forms of investment and how they must be managed. When investing is possible, Fitch analyses whether such rules restrict potential investments and maturities to address their market and credit risk.

CVB Excessive Credit Risk — TAB

Fitch will generally consider no excessive exposure if:

1. There is an external eligible counterparty acting as a TAB, and the CVB issuer is rated at least 'BBB+' or 'F2'. This is based on the benefits of the dual recourse to the TAB and the CVB issuer.
2. Where the CVB legal framework defines the maximum amount of cash and liquid assets that can be held in the programme.

If the exposure to the TAB is deemed excessive, the CVB rating will be limited to the higher of resolution reference point or the counterparty rating.

Charged Assets

For synthetic securitization structures with charged assets, further details on how Fitch analyses the exposure to the TAB are available under the section *Charged Assets*.

Market Value Risk

To avoid liquidating investments at a discount, resulting in a market value loss for the SF transaction, qualified investments are typically:

- Held to maturity.
- Expected to return the invested principal in full.
- Due to mature before the SF bonds' next payment date.

The following exceptions may apply to the above items:

- Qualified investments may be sold prior to maturity in order to purchase new assets for the asset pool in actively managed collateralized loan obligation transactions, provided that structural features exist to preserve the total principal amount of the asset pool, including qualified investments.
- Where early liquidation of the investment is possible, a third-party guarantee or repurchase agreement from an eligible counterparty — with primary risk ratings, including relevant remedies — is expected to cover any market losses.

When negative yields prevent par protection, Fitch will account for potential losses resulting from interest payments on investments by applying Fitch's "Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria," which envisages negative rates over the short to medium term for certain jurisdictions and in some rating scenarios.

Credit Risk

Qualified investments expose the SF transaction to the creditworthiness or liquidity of the underlying security, obligor or deposit provider. To minimize this risk, Fitch expects each broad category of investments to have minimum ratings in line with those included in Figure 12.

Figure 12

Fitch's Definition of Qualified Investments

Investment Category	Minimum Fitch Rating	Other Credit Rating Agency (if no Fitch Rating)[a]	Notes
Deposits[b]	Eligible counterparty (primary risk ratings in Fitch's CRRT, including remedies)	Not applicable	—
Securities (with a maturity up to 30 days)	Primary risk ratings in Fitch's CRRT	AA– or F1+	—
Securities (31 days–365 days)	AA– or F1+	Not applicable	—
Money Market Funds	AAAmmf	AAAmmf	Ratings from other credit rating agency need to address preservation of capital and timely liquidity.
U.S. Government Obligations[c]	No minimum rating applies	No minimum rating applies	Only for SF transactions with U.S. assets and SF bonds issued in the U.S.
Canadian Government Obligations[c]	No minimum rating applies	No minimum rating applies	Only for SF transactions with Canadian assets and SF bonds issued in Canada.

[a]Ratings from another credit rating agency are only applicable if a Fitch rating is absent. Ratings refer to the Fitch-equivalent rating assigned by the credit rating agency. [b]Includes time deposits, demand deposits, repurchase agreements and guaranteed investment contracts. [c]Any government obligation guaranteed, backed or issued by the relevant government without specified rating limits. Obligations of public entities or states are excluded if they are not fully backed or guaranteed by the sovereign. CRRT – Credit Risk Rating Table. SF – Structured finance. Note: Fitch's definition of qualified investments is further detailed for national scale ratings under *Criteria Application for National Scale Ratings*.
Source: Fitch Ratings

Servicer

Role

The servicer's role in SF transactions may include the following: periodic collection of interest and principal payments from the asset pool; asset pool delinquency and default management; advancing of next-period expected asset pool collections to the SF transaction; and holding collected funds into servicer accounts until their transfer to the TAB. In Fitch's view, the above tasks can raise the following counterparty risks (Figure 13):

Figure 13

Counterparty Risks Connected to Servicers

Servicer Risk	Description
Payment Interruption Risk	Upon default of the servicer or CAB, the SF transaction withstands a short-term disruption in the collection process, but not a loss of funds. This impairs the SF issuer's ability to meet upcoming required payments on the SF bonds.
Commingling Risk	Upon default of the servicer or CAB, funds deposited with or held in the name of these entities cannot be recovered, resulting in a loss of transaction cash flows.
Servicing Disruption Risk	Risk for the SF transaction that servicing quality will deteriorate over time or no replacement servicers will step in after termination of the servicer.
Default on Advances	Upon default of the servicer, ability to provide liquidity support to the SF transaction is impaired. See *Liquidity Facility Providers and Advancing Agents*.

SF – Structured finance. CAB – Collection account bank.
Source: Fitch Ratings

Section Outline

Role
Risk-Presenting Entities: Payment Interruption Risk and Commingling Risk
Payment Interruption Risk
Commingling Risk
Servicing Disruption Risk

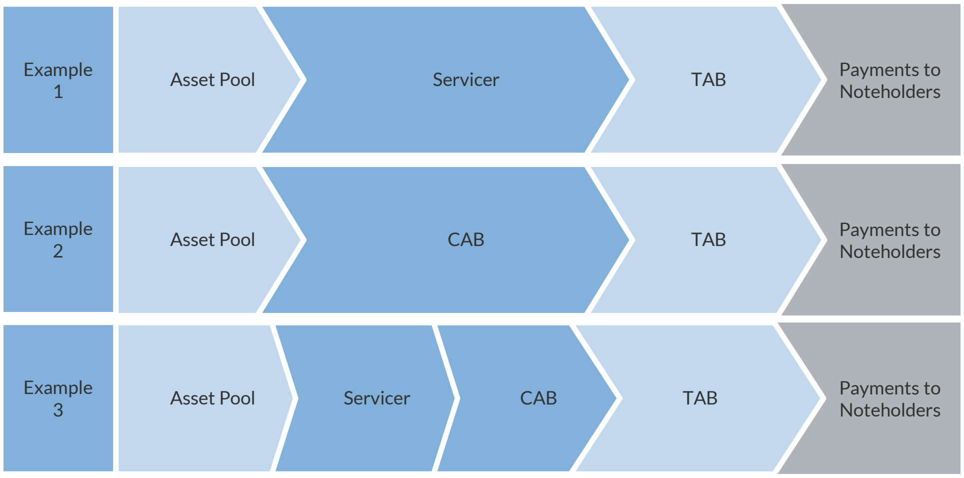
Risk-Presenting Entities: Payment Interruption Risk and Commingling Risk

In a typical SF transaction, the flow of funds at the servicer level — i.e. before collections are transferred to the TAB — follows one of the three examples in Figure 14:

1. The servicer holds asset collections — directly if the servicer is a bank, or via a third-party bank external to the SF transaction. In the latter case, the servicer remains obligated to turn over the funds to the TAB.
2. Collections are directly credited to servicer's accounts held with a CAB appointed in the SF transaction. The servicer may or may not remain obligated to transfer funds to the TAB.
3. The servicer holds collected funds for a period of time, as per case (1) above, before crediting collections from the asset pool to the CAB.

Figure 14

Flow of Funds at Servicer Level



CAB – Collection account bank. TAB – Transaction account bank.
Source: Fitch Ratings

For structures in line with Figure 14, Fitch reviews commingling and payment interruption risk in relation to the servicer and/or CAB — the risk entities — per Figure 15. Should the flow of funds differ from the examples in Figure 14, Fitch will determine whether the default of any other entity could add similar counterparty risks to the SF transaction.

Figure 15

No.	Flow of Funds at Servicer Level	Commingling Risk Entity	PIR Risk Entity
1	Servicer holds collected funds.	Servicer	Servicer
2 & 3	Servicer's accounts are held with the servicer and/or CAB. The servicer remains obligated to turn over the funds to the TAB.	Servicer	Servicer
2 & 3	Servicer's accounts are held with the servicer and/or CAB. The servicer does not remain obligated to cause the transfer of funds to the TAB.	Both	Both
2	Servicer's accounts are held with a CAB. The relevant legal regime protects funds held with the CAB from insolvency of the servicer.	CAB	Both

PIR – Payment interruption risk. CAB – Collection account bank.
Source: Fitch Ratings

Payment Interruption Risk

Definition

Payment interruption risk (PIR) is the risk that a SF transaction may not be able to meet upcoming required payments to noteholders upon a disruption of the collections process.

A disruption can materialize as a result of a default of the servicer or, in some cases, the CAB (see Figure 15), resulting in a delay in access to funds already held in servicer's accounts at the time of default, and the inability of the defaulted servicer to collect and forward to the TAB any additional collections from the asset pool.

Servicing disruption risk focuses on the long-term availability of satisfactory servicing and availability of replacement servicers. PIR looks at the immediate effects to the SF ratings of a default of the servicer or CAB in their obligation to make funds available for payments on the SF bonds. Therefore, Fitch believes that PIR may occur despite the mitigation of servicing disruption risk, and vice versa.

PIR does not address disruptions to collections unrelated to a default of the servicer or the CAB, such as idiosyncratic events related to loan payment holidays or natural disasters. These are addressed in Fitch's "Global Structured Finance Rating Criteria," or each sector-specific criteria.

Risk Classification

Figure 16 summarizes Fitch's risk classification for PIR.

Figure 16

Risk Classification — Payment Interruption Risk (PIR)

Risk Level	Examples	Remedies
Excessive	PIR is not immaterial, and mitigants in line with Figure 17 are not in place.	SF ratings capped at the applicable rating of the lowest-rated risk entity.
Primary	All exposures that are not considered immaterial or excessive.	Fitch expects mitigants in line with Figure 17.
Secondary	Not applicable.	Not applicable.
Immaterial	At least one of the following conditions apply: • Relevant insolvency framework minimizes PIR. • The relevant legal regime isolates transaction funds from the insolvency of a risk entity. • TAB holds cash funds to an extent that SF ratings are capped to the rating of the TAB. • For SF ratings up to A+, when deferring SF bond payments is not an event of default.	No additional documented remedial actions are expected.

Source: Fitch Ratings

CVB — PIR

Liquidity mechanisms for principal and interest payments are assessed in Fitch's Payment Continuity Uplift analysis, as detailed in "Covered Bonds Rating Criteria." When liquidity mechanisms rely on the performance of a counterparty, Fitch expects an eligible counterparty with minimum primary risk ratings.

PIR as described in this section does not apply to CVBs.

PIR — U.S. Structured Finance

Fitch views PIR as an immaterial risk for U.S. SF transactions, as the U.S. insolvency framework is expected to minimize the impact on the collection process of a servicer or CAB default.

As result, Fitch expects no mitigants to address PIR in U.S. SF transactions.

Immaterial Credit Risk — PIR

For each risk entity, Fitch views PIR as an immaterial risk when no disruption in the collection process is expected due to the default of the servicer or CAB. The structures included below fully address PIR.

- **Insolvency Framework Minimizes PIR:** Fitch views PIR as an immaterial risk where the applicable insolvency framework is expected to minimize the impact on the collection process of risk entities' default. Fitch believes the U.S. meets these criteria and therefore expects no additional mitigants to address PIR in U.S. SF transactions.
- **Legal Regime Protects Servicer Accounts:** When the legal regime in the relevant jurisdiction, and provisions in the transaction documents are consistent with that regime, protects the collections held by the CAB from the servicer's default, Fitch will view the servicer's PIR as immaterial if, upon servicer default: (i) the SF issuer can access the protected funds without any delay; and (ii) the borrower's payments continue to be credited to the protected account. Fitch still expects mitigants in line with Figure 17 for the CAB. If item (ii) does not apply, Fitch considers servicer's PIR as immaterial only for SF ratings up to 'A' category.
- **Deferring Payments on SF Bonds is Not an Event of Default:** Fitch does not assess PIR for rating scenarios up to 'A+', when payments on the SF bonds can be deferred without causing an event of default, including subordinated SF bonds when they become the most senior note in the structure.
- **Excessive Cash Funds Held with the TAB:** Where cash holdings with the TAB are considered significant, to the extent that the SF ratings are capped at the applicable rating of the TAB, Fitch assumes this liquidity can also address PIR up to the rating level of the TAB. See *Excessive Credit Risk — TAB*.

Primary and Secondary Credit Risk — PIR

PIR primary risk categorization can be mitigated as set forth in Figure 17 for each risk entity in Figure 15. In these cases, the maximum achievable SF ratings will be the higher of the maximum SF ratings achievable under Figure 17; or the rating of the lowest rated PIR risk entity.

Figure 17

Expected Mitigants to Payment Interruption Risk (PIR)

Max SF Rating Category	Mitigant		Additional Mitigant
AAA	Liquidity covering the PIR exposure amount		—
AAA or lower based on CRRT	Risk entity is an eligible counterparty (primary risk ratings in Fitch's CRRT, including remedial actions)		—
AAA	Liquidity covering one month of PIR exposure amount	and	Risk entity is an Operational-Continuity Bank in SF rated at least BBB or F2, including remedial actions
A	Liquidity covering one month of PIR exposure amount	and	Risk entity is an Operational-Continuity Bank in SF
A	Risk entity holds funds for no longer than two business days	and	Risk entity is an Operational-Continuity Bank in SF
A	Liquidity covering the longer of one month of PIR exposure amount, or Fitch's expected replacement period for the back-up servicer	and	Back-up servicer appointed at closing of the SF transaction
BB	Risk entity holds funds for no longer than two business days	and	Liquidity covering one month of PIR exposure amount

SF – Structured finance. CRRT – Credit Risk Rating Table. Note: Each row is sufficient to achieve the maximum SF rating category.
Source: Fitch Ratings

Interest Deferrals

Consistent with Fitch's "Global Structured Finance Rating Criteria," Fitch will not assign 'AAA' or 'AA' category ratings to SF bonds that are expected to defer interest under stress scenarios associated with those ratings, even if permitted under the documents. For those rating categories, Fitch expects mitigants to PIR in line with Figure 17.

For example, SF transactions with available liquidity covering the estimated PIR exposure amount, as seen in section *PIR Exposure Amount*, can achieve SF ratings up to 'AAA'. Alternatively, if all risk entities are operational-continuity banks and transfer funds within two business days from receipt, the maximum achievable SF rating would be 'A+'.

Under Figure 17, liquidity refers to any readily available cash reserve, liquidity facility or advance mechanism held with or provided by an eligible counterparty with primary risk ratings and including the relevant remedial actions. *Appendix 1 – Cash Reserves Covering PIR* describes how Fitch reviews the ability of different types of cash reserves to mitigate PIR.

PIR Period

Fitch assumes a PIR period of three months — or one month, if certain additional mitigants are available, as per Figure 17 — unless a Fitch credit committee determines that any of the following factors warrants a longer or shorter PIR period:

- Specific and enforceable legal provisions applicable to the SF transaction;
- Transaction-specific arrangements, including frequency of the transfer of funds or borrowers' payment method;
- Servicer and market-specific considerations, including standardization of the asset pool, availability of replacement servicers and precedents of servicing transfers; impact of a servicer's insolvency on collections and forwarding of payments; or borrower notification period.

PIR Exposure Amount

Over the PIR period, Fitch determines the amount of PIR exposure as all payments needed to avoid an event of default under the SF bonds. This usually includes, but may not be limited to, the sum of the following:

- Senior costs;
- Payments made and received under any derivative agreement;
- Senior interest payments for which a failure to pay interest constitutes an event of default; for SF bonds rated 'AAAsf' and/or in the 'AAsf' category regardless of whether interest is deferrable, because Fitch expects timely payment at these ratings;
- Any nondeferrable principal payments falling due during the PIR period.

For PIR periods shorter than a payment date, Fitch can approximate the PIR exposure amount as a fraction of payments due for the payment date. For example, for a PIR period of one month, the PIR exposure amount can be approximated as one-third of above payments due for a quarterly payment date.

Senior costs can be approximated as a servicer's fee, as detailed in the respective sector-specific or bespoke criteria, in a 'Bsf' rating scenario if specified. For floating-rate payments, Fitch uses the equilibrium rate as specified in "Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria."

Excessive Credit Risk — PIR

Where PIR is not immaterial and none of the mitigants in Figure 17 are in place, SF ratings will be capped at the rating of the lowest-rated risk entity.

Commingling Risk

Definition

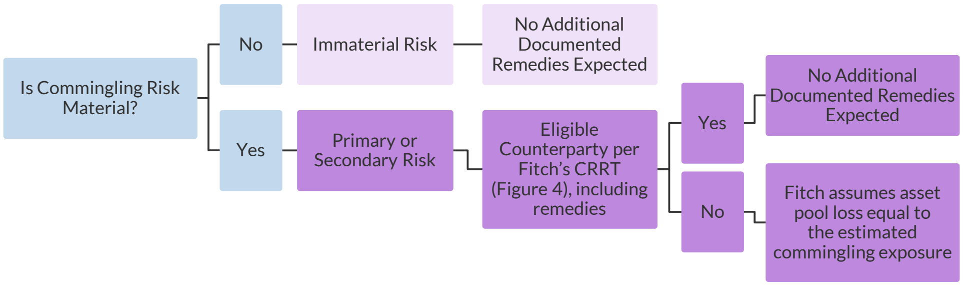
Commingling risk is the risk of losing funds collected from the asset pool, and held with a defaulting servicer or the CAB, that are commingled with other funds of the defaulted entity.

Figure 18 summarizes Fitch's approach to analyzing commingling risk. Unless presenting an immaterial exposure, Fitch expects minimum primary or secondary risk ratings at all times for each risk entity, including remedial actions upon losing such ratings, in line with Fitch's CRRT.

In the absence of sufficient documented mitigants for all risk entities, Fitch will assume an asset pool loss in the SF transaction equal to the estimated commingling exposure amount, net of any cash reserve dedicated to specifically cover the risk. Details on the sizing of this loss are described in *Appendix 2 – Determining a Commingling Loss*.

Figure 18

Application of Documented Remedies to Commingling Risk



Source: Fitch Ratings

Risk Classification

Fitch's risk classification for commingling risk is elaborated in Figure 19.

Figure 19

Risk Classification — Commingling Risk

Risk Level	Examples	Remedies
Excessive	Not applicable.	Not applicable.
Primary	If not immaterial or a secondary risk, Fitch views commingling exposures as a primary risk.	Eligible counterparty (primary risk ratings, including remedies)
Secondary	For SF, when all three conditions below apply. • The servicer transfers collected funds to the TAB at least once a month. • The weighted-average original asset pool term is two years or more. • Payment interruption risk is sufficiently mitigated. For covered bonds, when the length of the commingling exposure is less than one month.	Eligible counterparty (secondary risk ratings, including remedies)
Immaterial	When at least one of the following applies: • The risk entity holds funds for two business days or less. • Borrower payments are made directly to the TAB. • The relevant legal regime or legal provisions isolates transaction funds from the insolvency of a risk entity.	No additional documented remedial actions are expected

SF – Structured finance
Source: Fitch Ratings

CVB — Commingling Risk

Commingling risk designates funds from the cover pool that could be lost when payments switch from the issuing bank to the cover pool. Those losses are typically related to ineffective segregation of cash amounts, or collected amounts not being transferred to the programme account bank.

Immaterial Credit Risk — Commingling Risk

Fitch views commingling risk as immaterial when a default of a risk entity is not expected to result in a loss of transaction funds, either because these amounts are protected or because the horizon of the exposure is negligible. Structures that addressed commingling risk include the following:

- **Transfer of Funds within Two Business Days of Receipt:** For risk entities holding funds for two business days or less, Fitch will consider the risk as immaterial due to the short horizon of the exposure.
- **Borrower Payments Directly to Transaction Accounts:** Where payments from the asset pool are directly credited to the TAB, effectively taking out any credit exposure to the risk entities, Fitch consider commingling risk as immaterial,
- **Legal Regime Protects Servicer Accounts:** Fitch will consider commingling risk as immaterial if the legal regime in the relevant jurisdiction and provisions in the transaction documents are consistent with that regime, and protect the collected funds held by or in the name of the servicer.
    - This is the case in Australia and the UK, with a properly executed declaration of trust; in France, with specially dedicated accounts; and in the Netherlands, where borrower payments are collected in accounts maintained by bankruptcy-remote collection foundations. Under such structures, funds held with the CAB in servicers' accounts are protected from an insolvency of the servicer. In these cases, while exposure to the servicer becomes immaterial, Fitch still expects mitigants to commingling risk for CAB exposure.

Primary and Secondary Credit Risk — Commingling Risk

If not immaterial, Fitch views the commingling exposure as a secondary risk for SF transactions that meet all the following conditions:

1. Transfer collected funds to the TAB at least once per month.
2. Weighted-average original asset pool term of more than two years.
3. Adequate protection for PIR.

If any of the above conditions do not apply, the exposure will be regarded as a primary risk.

Remedies upon Losing Eligible Counterparty Status

To mitigate commingling risk, Fitch expects a risk entity to have the relevant minimum primary or secondary risk ratings at all times, including remedial actions upon losing such ratings, in line with Fitch's CRRT. Remedial actions upon ineligibility are detailed in Figure 20.

Where commingling risk is not sufficiently mitigated for the servicer or CAB, Fitch will review any available reserve covering the risk against the estimated commingling loss, as described in *Appendix 2 – Determining a Commingling Loss.*

Figure 20

Commingling Risk — Remedies upon Ineligibility

Remedy	Remedial Time Frame
Replacement with a different eligible counterparty	60 calendar days
Obtaining a guarantee from an eligible counterparty	60 calendar days
Posting of a commingling reserve	Primary risk: 14 calendar days Secondary risk: 60 calendar days
For CVB programmes, any of the above or provide additional overcollateralization	60 calendar days

CVB – Covered bond
Source: Fitch Ratings

CVB — Commingling Exposure Length

For CVB, the length of the commingling exposure is the shorter of reporting frequency, the frequency of assets being inscribed in the cover pool register, or the transfer frequency of collected funds to the programme account.

Monitored Credit Opinions

For commingling risk, Fitch will consider a monitored credit opinion on a risk entity in line with minimum secondary risk ratings in Fitch's CRRT, and including remedies upon losing such minimum levels, to be a sufficient mitigant to commingling risk, if it is considered a secondary risk and the commingling exposure amount, adjusted for the relevant commingling period, represents less than 50% of the existing CE available (i.e. excluding excess spread) to any SF bonds rated at or above the corresponding category of highest rated SF bonds in the CRRT.

CVB — Commingling Remedies

Where commingling risk is not sufficiently mitigated, Fitch relies on the counterparty rating when assessing timely payments to CVB holders.

Once the counterparty loses eligibility, Fitch assumes the commingling exposure amount as a loss when testing timely payments. The unmitigated commingling exposure will be added to the level of break-even OC obtained in the cash flow model, when the timely payment rating level is above the resolution reference point.

When the CVB rating is derived by adding the recovery uplift to the resolution reference point, no commingling exposure will be sized.

Servicing Disruption Risk

SF issuers rely on servicers to provide continued asset pool servicing. When a disruption in this process occurs, impaired servicing can ultimately affect the performance of the SF transaction.

Servicing disruption risk focuses on the long-term availability of satisfactory asset pool servicing, assessing the operational and financial strength of the current servicer and availability of replacement servicers. This is unlike PIR, which analyses short-term liquidity stress caused by a default of the servicer or CAB.

For SF transactions with standard asset pool characteristics or established servicing markets, Fitch can apply a simplified servicing review, as the risk is deemed limited. Where other factors indicate a heightened risk, such as a significant reliance on servicer's performance — such as in U.S. RMBS, for exotic assets, or for servicers with a limited track record or replacement options, Fitch conducts a full review of servicing disruption risk, in line with this section and as complemented by relevant sector-specific criteria.

Fitch identifies four possible sources of servicing disruption, as described in Figure 21.

Figure 21

Sources of Servicing Disruption Risk

Source of Disruption	Description
Servicer Financial Deterioration	The ability of the servicer to perform its obligations deteriorates over time following a deterioration of its financial condition.
Deteriorating Operational Capacity	The ability of the servicer to perform its obligations deteriorates over time for reasons unrelated to its financial condition.
Servicer Replaceability	Upon servicer termination, no replacement servicer is available or willing to step in to service the asset pool, regardless of the reason.
Inadequate Documentation	Transaction documents do not adequately detail servicing obligations or servicer replacement mechanisms.

Source: Fitch Ratings

Fitch reviews the factors in Figure 22 to assess the SF transaction's overall risk associated with each source of disruption.

Figure 22

Assessment of Servicing Disruption Risk

Source of Disruption	Factors Evaluated to Determine Risk Level
Servicer Financial Condition	• Long-term ability of the servicer to perform its obligations in an adequate manner. Where available, servicer's Issuer Default Rating or Fitch's internal credit view provide a useful indicator of its financial condition/ • The servicer financial condition is not assessed where Fitch determines that other continuity mitigants sufficiently address disruption risk.
Deteriorating Operational Capacity	• Corporate structure, governance and staffing. • Servicing expertise, including experience, tenure and record. • Technological infrastructure of the servicing platform. • If available, Fitch's servicer (operational) rating. • Level of controls, including performance tracking and third-party audits. • Level of information availability, storing and exchange required.
Servicer Replaceability	• Capacity of possible replacement servicers relative to the size of the asset pool. • Adequacy in financial incentives and fees to service the asset pool. • Complexity in servicing the asset pool.
Inadequate Documentation	• Standardization/simplicity of documents to facilitate a servicer transition. • Whether servicer obligations cover actions needed to service the asset pool.

Source: Fitch Ratings

Fitch analyses corresponding available servicing continuity mitigants upon reviewing the overall servicing disruption risk profile for the SF transaction, which evaluates the availability and process for servicing replacement (Figure 23).

Figure 23

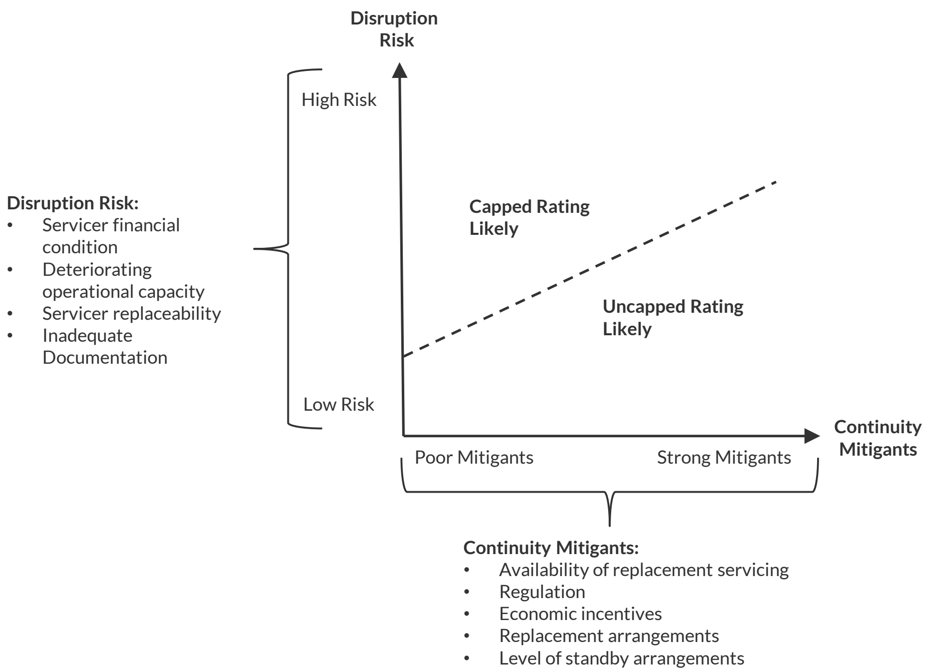
Servicing Continuity Mitigants

Mitigant	Factors Evaluated to Determine the Mitigant
Availability of Replacement Servicing	• Availability of alternative entities that can service the asset pool. • Track record of servicer replacements in the sector or jurisdiction.
Regulation	• Possibility of regulators' intervention to ensure continued servicing.
Economic Incentives	• To what extent economic incentives can ensure the servicer's continued interest in servicing the asset pool and attract high quality replacements.
Replacement Arrangements	• Documented servicer replacement triggers and conditions. • Expected timing to identify and appoint a BUS. • Invocation period, such as the period between the initial notification to the BUS to initiation of the transfer process to the BUS.
Level of Standby Arrangements	• Appointment at closing of a BUS, including its level of commitment. • Any due diligence carried out by the BUS. • Frequency and depth of asset pool data transfers with the BUS. • Committed and expected timing for a servicing transfer.

BUS – Back-up servicer
Source: Fitch Ratings

Figure 24

Disruption Risk versus Continuity Mitigants



Source: Fitch Ratings

Figure 24 above illustrates achievable ratings as a function of disruption risks and continuity mitigants. The SF ratings will be capped to the rating of the servicer if mitigants are deemed insufficient in relation to the risk. However, if mitigants address all potential disruptions, the exposure will be considered immaterial, and no rating cap will apply.

Liquidity Facility Providers and Advancing Agents

Role

SF transactions may include a liquidity facility (LF) or advance mechanisms, primarily aimed at avoiding shortfalls on required timely payments on the SF bonds. The key risk for the SF transaction is that liquidity amounts may not be readily available for timely payments on the SF bonds upon default of the LF provider or advancing agent.

Advance mechanisms usually cover an asset pool's delinquent principal and/or interest payments, and are ultimately recoverable by the advancing agent as part of the asset pool recovery proceeds. Advancing agents can include servicers, master servicers or trustees, among others.

If documented remedies are not in line with this section, Fitch may not consider the liquidity support provided by the LF provider or advancing agent in its rating analysis, and will review the adequacy of transaction cash flows at the relevant SF rating level without the liquidity support.

LF Renewals

For LFs, Fitch reviews the terms under which it is renewed, and any provision to amend charges and fees payable. In the event that the LF is not renewed at maturity, Fitch expects the LF to be prefunded. The LF will not be considered in the rating analysis if Fitch does not have adequate reason to believe that it would be renewed or prefunded at maturity.

Risk Classification

Fitch's risk classification for LF providers and advancing agents is shown in Figure 25.

Figure 25

Risk Classification — LF Providers and Advancing Agents

Risk Level	Examples	Remedies
Excessive	LF or advances are the primary source of required timely payments on the SF bonds.	No remedies can mitigate the exposure. SF ratings will be capped at the entity's Issuer Default Rating.
Primary	LF or advances covering short-term disruptions in payments on the SF bonds.	Eligible counterparty (primary risk ratings, including remedies)
Secondary	U.S. RMBS only: backup advancing agents	Eligible counterparty (secondary risk ratings, including remedies)
Immaterial	For LF, prefunded LF.	No additional documented remedial actions are expected.

LF – Liquidity facility. SF – Structured finance.
Source: Fitch Ratings

Immaterial Credit Risk — LF Providers and Advancing Agents

Fitch views exposures to LF providers or advancing agents as immaterial when their default is not expected to affect timely payments on the SF bonds. For LF providers, this is typically the case when the counterparty prefunds its obligations.

Primary and Secondary Credit Risk — LF Providers and Advancing Agents

To give credit to liquidity support in the analysis, Fitch expects the LF provider or advancing agent to have minimum primary ratings at all times in line with Fitch's CRRT. For U.S. RMBS transactions only, if the servicer acts as advancing agent for the transaction and a backup advancing agent is appointed at closing, Fitch will expect the backup advancing agent to have minimum secondary risk ratings at all times if the servicer does not meet minimum primary ratings expectations (including remedial actions). Remedial actions upon ineligibility are detailed in Figure 26.

CVB — Excessive Credit Risk

For CVB, if the exposure to the liquidity facility provider is deemed excessive, the CVB rating will be limited to the higher of the resolution reference point or the counterparty rating.

Figure 26

LF Providers and Advancing Agents — Remedies upon Ineligibility

Remedy	Remedial Time Frame
LF Provider: Prefunding of the committed liquidity amounts	14 calendar days
Replacement with a different eligible counterparty	60 calendar days
Obtaining a guarantee from an eligible counterparty	60 calendar days

LF – Liquidity facility
Source: Fitch Ratings

Excessive Credit Risk — LF Providers and Advancing Agents

If the counterparty is the primary source for required timely payments on the SF bonds, Fitch views the exposure as excessive risk, and the SF ratings will be capped at its IDR.

Derivative Provider

Section Outline
Role
Termination Payments and Flip Cause
Risk Classification

Role

Fitch divides derivatives into termination or hedging derivatives as follows:

- **Termination derivative:** The default of the derivative provider triggers the early termination of the SF transaction — for example, credit default swaps. Fitch's analysis focuses on the full repayment of the SF bonds, including accrued interest up to the termination.
- **Hedging derivative:** These derivatives typically provide foreign exchange (FX) currency or interest rate hedging to the SF transaction, such as currency swaps, basis swaps and fixed-to-floating swaps. An early termination of these derivatives does not end the SF transaction.

The remainder of this section focuses on hedging derivatives, which are more commonly used in most SF sectors. Full details on Fitch's analysis of derivative exposures, including termination derivatives, is available in "Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum."

Hedging derivatives pose two key risks to the SF transaction:

1. Upon default of a derivative provider, particularly for swaps, the SF transaction may be required to make certain termination payments if the derivative is 'out of the money'. To address this risk, transaction documents usually provide that these termination payments are junior to payments on the SF bonds in the priority of payments;
2. Upon termination of the derivative, typically due to a default of the counterparty, the rated bonds may remain exposed to FX or interest rate risk. To mitigate this risk, the derivative agreements typically include provisions for collateral posting in an amount that is expected to be sufficient to finance counterparty replacement (see *Risk Classification*).

Termination Payments and Flip Clause

Transaction documents typically provide that amounts payable by the SF issuer to a swap counterparty take priority in the transaction's waterfall over amounts payable to noteholders. One exception is termination payments owed to a defaulted swap counterparty; these are usually moved to a junior item on the payments waterfall, this change in payment priority is commonly known as the "flip clause." The flip clause protects note holders from the loss of cash flows resulting from the default of the swap counterparty.

In jurisdictions where the enforceability of flip clauses was challenged, such as those governed by U.S. laws, Fitch applies higher minimum ratings to reduce the risk that the counterparty defaults in advance of implementing a documented remedy, unless sufficient legal comfort on enforceability is provided. In all other cases, Fitch applies lower minimum rating expectations (see 'Valid Flip Clause' in Figure 28).

Additionally, due to rapidly evolving market conditions, Fitch does not estimate possible termination payments. Should termination payments owed to a defaulted swap counterparty rank senior or *pari passu* to interest or principal payments on the SF bonds, Fitch may cap the SF ratings to the applicable rating of the swap counterparty.

CVB — Termination Payments

Fitch views termination payments due by the cover pool to a derivative provider as liquidity risk, as they rank senior or pari passu to CVB payments.

For external derivative providers, Fitch views this risk as immaterial, as it would concurrently require a counterparty default, the swap being "out of the money" for the CVB issuer, and inability of the CVB issuer to fund the payment.

For internal derivative counterparties, Fitch expects a counterparty in line with minimum secondary risk ratings, as seen in "No Valid Flip Clause" in Figure 28.

Risk Classification

Fitch's risk classification for hedging derivatives is shown in *Figure 27*.

Figure 27

Risk Classification — Derivative Provider

Risk Level	Examples	Remedies
Excessive	Derivatives with nonstandard features or providing nonstandard credit support, to an extent that limits their replaceability under similar terms.	No remedies can address these exposures. The SF ratings will be capped at the higher of the counterparty rating and the maximum achievable rating assuming a standard replaceable derivative.
Primary	Standard and replaceable derivatives. No collateral is being posted.	Eligible counterparty — primary risk ratings in Figure 28, including remedial actions.
Secondary	Standard and replaceable derivatives; the derivative provider has started posting collateral in line with Fitch's criteria.	Eligible counterparty — secondary risk ratings in Figure 28, including remedial actions.
Immaterial	Not applicable.	Not applicable.

Source: Fitch Ratings

Immaterial Credit Risk — Derivative Provider

Unless Fitch does not incorporate the derivative in its rating analysis, and a default of the derivative counterparty is not expected to negatively affect the SF transaction, derivative provider exposures are considered a primary, secondary or excessive risk, depending on the derivative and documented remedies.

Primary and Secondary Credit Risk — Derivative Provider

Fitch considers uncollateralized exposures as a primary risk — upon insolvency of the counterparty, the SF transaction could more easily remain exposed to FX or interest rate risk. However, when the derivative provider has started posting collateral in line with Fitch's derivative addendum, Fitch views the exposure as a secondary risk. Available collateral is expected to be sufficient to finance the cost of appointing a replacement derivative provider, if needed.

Figure 28 provides expected minimum ratings by risk level. The column 'Valid Flip Clause' refers to transactions where there is sufficient legal comfort regarding the enforceability of flip clause. The minimum ratings shown in the column 'No Valid Flip Clause' apply where sufficient legal comfort has not been received regarding the enforceability of flip clauses.

Figure 28

Derivative Risk Rating Table

Category of Highest Rated Note	Minimum Primary Risk Ratings (No Collateral)	Minimum Secondary Risk Ratings (with Collateral)	
		Valid Flip Clause	No Valid Flip Clause
AAA	A or F1	BBB– or F3	BBB+ or F2
AA	A– or F1	BBB– or F3	BBB+ or F2
A	BBB or F2	BB+	BBB or F2
BBB	BBB– or F3	BB–	BBB– or F3
BB	Note rating	B+	BB–
B	Note rating	B–	B–

Note: Ratings refer to the applicable counterparty's rating — Derivative Rating or Issuer Default Rating — per Figure 6. Different minimum ratings apply to counterparties that are not derivative providers, per Fitch's Credit Risk Rating Table (Figure 4).
Source: Fitch Ratings

CVB — Derivatives

CVBs are full recourse obligations of the CVB issuer; thus, CVB bondholders would only be exposed to losses from a defaulting derivative counterparty if the CVB issuer defaulted as well.

Fitch's collateral posting expectations are lower for CVBs with external derivative providers, compared to those for CVBs with internal derivative counterparties or SF transactions.

Remedies upon Losing Eligible Counterparty Status

Figure 29 details expected remedial actions upon a counterparty downgrade below minimum ratings necessary to maintain the note ratings. Different time frames may apply for certain counterparties, per the section *Highly Rated Counterparties*. The specific aspects of collateralization for derivatives are detailed in "Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum."

Figure 29

Derivative Provider — Remedies upon Ineligibility

Action upon downgrade below primary risk ratings (Figure 28)	Remedial time frame
Collateralization for mark-to-market collateral amount	14 calendar days
Collateralization for liquidity adjustment and volatility cushion	60 calendar days
Replacement with a different eligible counterparty, per Figure 28	60 calendar days
Obtaining a guarantee from an eligible counterparty, per Figure 28	60 calendar days
Action upon downgrade below secondary risk ratings (Figure 28)	**Remedial time frame**
Collateralization while completing replacement/guarantee, including liquidity adjustment and volatility cushion	14 calendar days
Replacement with a different eligible counterparty, per Figure 28	60 calendar days
Obtaining a guarantee from an eligible counterparty, per Figure 28	60 calendar days

Source: Fitch Ratings

To avoid a note rating downgrade, Fitch expects collateral to be posted within 14 calendar days from counterparty ineligibility, per Figure 29, even when the ineligible entity will be ultimately be replaced, or obtains a guarantee, within 60 days.

Fitch notes that covenants in the transaction documents requiring a replacement/guarantor within a short time frame — such as 14 days — in place of collateral posting, are rarely complied with, and therefore provide limited additional comfort. Replacement or guarantor appointment for ineligible derivative counterparties can sometimes take several months, such that collateralization is likely to be the only viable short-term remedy.

Additionally, Fitch's analysis relies on a credit support annex or similar documentation to be executed at transaction closing in order to facilitate collateral posting within 14 calendar days.

Excessive Credit Risk — Derivative Provider

Fitch views the derivative exposure as excessive if the derivative agreement provides credit support via nonstandard features, or generally provides nonstandard levels of credit support to the SF transaction, to an extent that the derivative provider is unlikely to be replaced under similar terms in the relevant market, even if collateral is available, per Fitch criteria.

For example, Fitch would consider risk derivatives excessive if there is a significant imbalance in the swap payments, or if the derivative references nonmarket interest rate indices.

When the derivative exposure is considered excessive, Fitch models the SF transaction using a derivative with standard features that can be credibly replaced in the market, disregarding nonstandard features or support. If no such replacement is available, Fitch will model the SF transaction with no hedging. Ultimately, the SF ratings will be the higher of the maximum achievable SF rating — assuming a standard and replaceable derivative, or no derivative at all if Fitch deems the derivative irreplaceable in the market — and the rating of the entity providing the derivative considered excessive risk.

Additional SF Counterparties and Risks

Set-Off Risk (Originator/Seller or Service Providers)

In some jurisdictions, obligors may have a right to "set off" their debt service payments against deposits or other obligations owed to them by a defaulted originator/seller. The amounts subject to set-off can result in a loss for the SF transaction.

For example, an obligor who is owed deposits for $5,000 upon default of the bank originator, and has a mortgage loan for $20,000 sold to a SF transaction by the same bank originator, may attempt to offset the two amounts and only repay $15,000 to the SF transaction.

Set-off risk may also arise when complementary services under linked contracts or lease agreements are owed but not provided to the obligors by a defaulting service provider.

Fitch's risk classification for set-off risk, if present, is shown in Figure 30. Sector-specific criteria or a Fitch credit committee can define different analytical approaches to set-off risk, as noted in the transaction-specific reporting, including the sizing of the exposure and risk classification, in order to consider all transaction- and jurisdiction-specific circumstances. The applicable rating (e.g. DR, IDR or other rating type, see *Which Rating to Apply*) for eligible counterparties under Figure 30 will depend on the nature of the set-off risk; for example, for set-off risk arising from obligor deposits, Fitch looks at the DR of the deposit-taking institution (or its IDR, if a DR is not available).

Figure 30

Risk Classification — Set-Off Risk

Risk Level	Examples	Remedies
Excessive	Not applicable.	Not applicable.
Primary	Set-off exposure represents half or more of the CE available to the SF bonds.	Eligible counterparty (primary risk ratings in Fitch's CRRT, including remedies)
Secondary	Set-off exposure represents less than half of the CE available to the SF bonds.	Eligible counterparty (secondary risk ratings in Fitch's CRRT, including remedies)
Immaterial	Case-by-case analysis based on how the following factors mitigate the risk: • The jurisdiction specific legal regime. • Transaction specific legal provisions. • Deposit guarantee schemes.	No additional documented remedial actions are expected.

CE – Credit enhancement. SF – Structured finance.
Source: Fitch Ratings

Immaterial Credit Risk — Set-Off Risk

Fitch views set-off risk as inherently jurisdiction-specific. A case-by-case analysis of the relevant legal regime, the transaction specific provisions and the effectiveness of any available deposit guarantee schemes may determine that the occurrence of a set-off loss is sufficiently remote, ultimately resulting in an immaterial risk for the SF transaction.

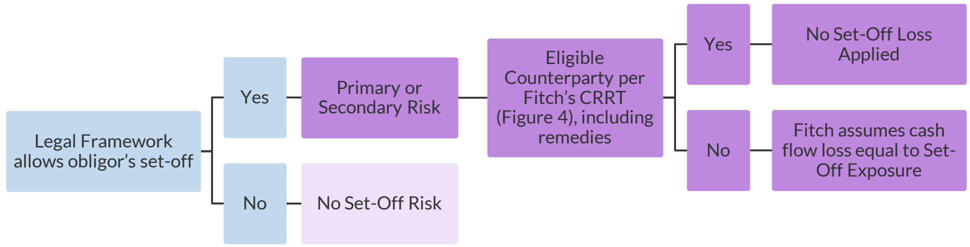
Primary and Secondary Credit Risk — Set-Off Risk

Figure 31 summarizes Fitch's approach to set-off risk. Where set-off risk is present and not viewed as immaterial, Fitch considers the exposure to the originator/seller as the following:

- Primary risk, if the set-off exposure is 50% or more of CE available to the SF bonds;
- Secondary risk, if the set-off exposure is less than 50% of CE available to the SF bonds.

For these exposures, Fitch expects minimum primary or secondary risk ratings at all times — i.e., including remedial actions upon a counterparty downgrade, consistent with Fitch's CRRT. In the absence of sufficient documented mitigants, Fitch will assume an asset pool loss in the SF transaction equal to the estimated set-off exposure amount, net of any dedicated set-off reserve and relevant coverage from any deposit guarantee schemes.

Figure 31



Source: Fitch Ratings

Paying Agents

Paying agents are responsible for distributing available funds to noteholders. When the paying agent: (i) executes payments via a major clearing house, such as those used in the eurozone; and (ii) holds funds for no more than two business days, Fitch assesses this entity in line with other operational counterparties (see *Other Operational Counterparties* below), and does not apply any minimum counterparty rating. If the holding period is longer than two business days, Fitch regards the exposure as a primary risk, and would expect the paying agent to have minimum primary risk ratings at all times, including remedial actions upon downgrade below those ratings, in line with Fitch's CRRT.

Only if the holding period is two business days or less immediately preceding a payment date, when the paying agent does not execute payments through major clearing house (typical for U.S. entities) effectively acting as an additional TAB, Fitch expects minimum secondary risk ratings at all times, including remedial actions upon downgrade below those ratings, in line with Fitch's CRRT. For longer holding periods, or for two-day periods not immediately prior to a payment date, Fitch reviews these exposures in line with the section *Transaction Account Bank*.

Custodians and Security Trustees

The role of a custodian or security trustee is to hold the SF transaction's asset pool on trust for the use and benefit of all present and future debt holders and other secured parties. The exact duties of the custodian or security trustee can vary by transaction. Fitch assumes the custodial and security agreements will be enforceable in the event of an insolvency of the custodian or security trustee without a disruption, moratorium or stay, and that the corresponding agreements specify that the asset pool is the property of the SF issuer or security holders and not of the custodian or security trustee.

In cases where such legal comfort supporting this assumption cannot be provided, Fitch will view the custodian or security trustee as a primary risk, and expect adherence to the minimum primary risk ratings in Fitch's CRRT at all times, including remedial actions upon losing such ratings.

Other Operational Counterparties

SF transactions may rely on various other counterparties to perform several tasks needed for its optimal functioning, including parties responsible for calculating the distributions on payment dates — the calculation agent — and/or managing short-term cash investments between payment periods — the cash administrator. These may include trust managers, trustees or indenture trustees to the extent they don't hold transaction funds.

There is no actual credit exposure for most of these roles, and Fitch does not expect any minimum counterparty rating for such support agent roles. However, when Fitch believes that any operational counterparty lacks the necessary experience or proven track record in the functions they are undertaking, to an extent that can negatively affect the SF transaction, Fitch may cap the SF ratings or decline to rate the SF bonds.

Charged Assets

Charged assets typically exist within funded synthetic securitization structures, where the entire note proceeds are invested in charged assets for the purposes of funding protection payments under credit default swaps, or returning principal upon termination. Charged assets typically take the form of securities or cash deposits.

In the case of cash deposits with a TAB, the SF bonds' rating will be capped at the rating of the TAB, given the magnitude of the exposure, per the section *Excessive Credit Risk – TAB*. In the case of investments in securities, Fitch will analyze the credit risks and market value risks. Credit risks will usually be addressed by capping the SF bonds' rating at the securities' rating.

Market value risks can be mitigated by structures with sufficient charged assets maturing directly before liabilities are due, or structures that envisage payment in kind. Market value risk can also be mitigated using derivative or repurchase agreements with an eligible counterparty with primary risk ratings, including corresponding remedies upon downgrade. Fitch expects the derivative or repurchase agreement offers a commitment for the transaction's life. Fitch can decide not to assign a SF rating if market value risk is not adequately addressed.

Cash Collateral Accounts

In U.S. RMBS, synthetic SF transactions rely on cash collateral accounts for depositing and investing the note proceeds for funding losses and principal payments to the issued notes.

The terms "Eligible" and "Qualified Investments" are used to dictate investments rather than charged assets; however, the applicability of these criteria for eligible investments is the same.

When Documents Differ from Fitch Criteria

Materiality Assessment

If counterparty exposures and structural remedies differ from the principles outlined in these criteria, Fitch assesses the materiality of the exposure with the following questions:

- Is the counterparty exposure material to the SF bonds' rating?
- Where the documentation partially follows the criteria, how material is the deviation in light of the overall transaction structure and documentation?
- Are there other structural mitigants that sufficiently address counterparty risk?

A Fitch credit committee will view the exposure as material to the SF ratings if it would assign ratings that are three or more notches below the SF rating it would have assigned, absent such counterparty risks, based on the above analysis.

If the exposure is not considered material to the rating, the SF bonds' rating will not be limited by the counterparty rating. If the exposure is viewed as material, the SF ratings will be capped at the higher of the applicable rating of the counterparty, or the SF rating achievable by the SF bonds, giving no credit to the counterparty's role in the structure.

CVB — Rating Cap

For CVB, if the exposure is considered material, the CVB rating will be limited to the higher of the resolution reference point or the counterparty rating.

The following sections indicate examples and factors Fitch would assess when contractual provisions to mitigate counterparty risk are not in line with these criteria. They are meant to be indicative only, as the final rating decision is ultimately made by a Fitch credit committee, which incorporates all the transaction-specific circumstances in addition to those described below.

All Key Counterparties

Remedies Are Set at Higher Standard than Fitch Criteria

In some cases, transaction documents may define more stringent standards than those outlined in these criteria. For example, a counterparty replacement trigger for a primary risk on 'AAA'-rated SF bonds could be set at a counterparty rating of 'AA', which is above Fitch's expectation of a 'A' rating. In such cases, Fitch would still expect transaction parties to comply with the transaction documents and complete remedial actions as provided by the transaction documents. Should the counterparty fail to comply with the contractual remedies, Fitch will review the exposure in line with section *When Counterparties Fail to Comply with Documents*.

Triggers Cease to Apply upon Fitch's Withdrawal of SF Ratings

Transaction documents may provide for contractual rating triggers that cease to apply if Fitch withdraws its rating on the SF bonds after transaction closing. Fitch views such provisions as not material for its rating opinion on the SF bonds.

Triggers Cease to Apply upon Fitch's Withdrawal of Counterparty Ratings

Transaction documents may provide for contractual rating triggers that cease to apply if Fitch withdraws the existing rating on the counterparty, which is subject to the contractual trigger, after transaction closing. Fitch views such provisions as not material for its rating opinion on the SF bonds, as a withdrawal of the counterparty rating is not assumed. However, should the counterparty rating eventually be withdrawn, Fitch will review the exposure to a now-unrated counterparty in line with the section *Materiality Assessment*.

Longer Remedial Time Frame than Fitch Criteria

Fitch believes that an extension of remedial periods beyond those specified in these criteria will be credit negative, as an extended period exposes the SF transaction to possible further counterparty credit deterioration and increases the exposure to the counterparty. In these cases, Fitch will review the exposure in line with the section *Materiality Assessment*.

TAB

U.S. Surveillance and Trust Accounts

In the surveillance of U.S. SF transactions, where transaction funds are currently held in trust accounts in line with section *Immaterial Credit Risk – TAB*, and the documents allow the option, upon ineligibility of the TAB to transfer funds from the transaction accounts to nontrust deposit accounts without rating triggers and/or remedial actions in line with these criteria, Fitch may cap the SF ratings to the applicable rating of the TAB, should funds be actually moved from the trust accounts to the nontrust deposit accounts.

Qualified Investments

In the surveillance of SF transactions, where the related documentation is not in line with the section *Qualified Investments*, Fitch will inquire whether the transaction funds are being invested in a manner that meets criteria. If Fitch believes the investment strategy is also likely to remain in line with the qualified investment criteria, this inconsistency will be considered as immaterial.

Additionally, when the maximum term of the investment is 90 days or one quarter, and a credit rating from at least one other credit rating agency is equivalent to Fitch's Short-Term IDR of 'F1+' or Long-Term IDR of 'AA–' is required per the transaction documents, Fitch will view inconsistencies in the definition of qualified investment between these criteria and transaction document as immaterial.

Derivative Provider

Absence of Collateral Posting as a Remedial Action

If collateral posting is not envisaged in the transaction documentation, Fitch will assess the materiality of the derivative on the SF ratings. The following examples summarize the most frequent rating analysis outcomes when the SF transaction arrangements differ from the expectations described in these criteria.

- **Basis Swaps**: If the asset pool and the interest on the SF bonds are indexed to different but correlated indices, such as one-month Euribor versus three-month Euribor, or have a similar but not exact reset frequency, such as monthly versus quarterly, the resulting risk is generally not a key driver in an SF transaction. As such, even if Fitch assumes the basis swap cannot be easily replaced, the SF ratings would generally not be constrained by the counterparty's applicable rating, if collateral posting provisions are not envisioned.
- **Interest Rate Swaps**: Interest rate risk is typically a more substantial risk driver than basis risk. Therefore, the lack of posting collateral is credit negative, but the resulting credit profile can still be better than the direct linkage to the counterparty rating. As a result, a committee might conclude that SF bonds could be rated a few notches above the counterparty's applicable rating.
- **Cross-Currency Swaps**: Unhedged foreign-currency risk in SF transactions is rarely a marginal rating driver. The absence of collateral posting provisions for derivatives hedging significant portions of the rated notional and covering prepayment risk and/or default risk on the asset pool, are therefore likely to lead to a cap to the applicable rating of the counterparty, or to a very limited uplift from the counterparty's applicable rating.

Insufficient Collateral

In cases where the documented collateral provisions would lead to less posted collateral than what is in line with Fitch's current criteria, Fitch can still rate SF bonds above the counterparty's applicable rating if Fitch concludes that the resulting credit profile is better than an uncollateralized exposure to the counterparty or sufficient CE has built up since the transaction's inception.

When Counterparties Fail to Comply with Documents

Background

A key assumption underlying these criteria is that transaction parties will take remedial action as contractually obligated. This holds true even when remedies are set per the section *Remedies Are Set at a Higher Standard than Fitch Criteria*.

In some cases, transaction parties may ignore or only partially follow prescribed documented remedies. Failing to take remedial action as contractually agreed raises questions over the extent to which the SF bond's rating can be isolated from the counterparty's rating, and future compliance by such counterparties. It is also possible that no additional remedies protecting the SF transaction from further deterioration in the counterparty's credit profile are incorporated in the documents. In these cases, Fitch will place potentially affected SF bonds on RWN while the effect on the ratings are fully analyzed.

Should a counterparty subsequently be upgraded to a level in line with the previously noncompliant documented rating level, Fitch will assume future remedial actions will also be noncompliant, absent support to the contrary. As a result, SF ratings that were capped or downgraded due to the counterparty inaction will not be upgraded to their original level.

TAB

To support SF ratings above the applicable rating of the TAB, Fitch expects the credit exposure to be immaterial or that adequate documented remedies are in line with these criteria.

Should the TAB fail to take remedial action as contractually agreed, Fitch may view the SF ratings to be no longer sufficiently isolated from those of the counterparty. Under these circumstances, if the TAB is an Operational-Continuity Bank in SF, Fitch will cap the rating of each SF bond at the higher of the following:

- The TAB's applicable rating; and
- The lower of 'A+sf'; or five notches above the TAB's applicable rating; or model-implied SF rating derived assuming a loss of the amounts at risk held with the TAB.

When the TAB is not an Operational-Continuity Bank in SF, the SF rating will be capped at the counterparty's applicable rating.

Derivative Provider

Where the derivative provider fails to comply with documented remedies and the exposure is material to the rating analysis, the rating of each SF bond will be capped at the higher of the counterparty's applicable rating; or the SF rating that can be supported by transaction cash flows on an unhedged basis.

In the case of a SF transaction with a relatively limited derivative exposure, such as a basis rate swap and/or significant CE levels, the exposure could be deemed immaterial. However, in other cases, such as fixed/floating interest rate or cross-currency swaps, the derivative is likely to be material to the SF rating.

Transaction Restructuring Replacing Documented Remedies

If transaction parties restructure a transaction with lower threshold levels for a remedial action upon a counterparty downgrade below a contractual threshold, Fitch will assess the extent to which these levels will be credibly respected in the future, assessing the motivation for the restructure and the incentives of transaction parties.

If Fitch concludes that the amended remedial thresholds are expected to be followed, then the SF bonds' ratings will consider the lower threshold levels for Fitch's CRRT, or Figure 28 for derivative providers, for relevant exposures. The SF transaction will be analyzed as if the original or restructured documented remedial requirements were not in place if Fitch does not expect such revised provisions to be respected or future remedial action to be taken.

Criteria Application for National Scale Ratings

Background

The principles of these criteria apply to both international and national scale ratings. Ratings referenced in Fitch's CRRT will be converted into the national scale by using the same letter scale. For example, an eligible counterparty for a primary risk for a 'AAA(national scale)'-rated SF transaction would usually be rated at least 'A (national scale)' or 'F1 (national scale)'.

However, owing to the specific nature of some local national scale markets, the definition of an eligible counterparty may be different from this principle, as disclosed in relevant criteria relating to the country involved. Thus, an exact mapping between national scale and international scale ratings is not achievable for SF ratings. For example, a counterparty will be in line with the rating criteria for the national scale, but not with the criteria for the international scale. As a result, the international scale note ratings could be capped at the international scale rating of the counterparty, while the national scale note ratings could exceed the counterparty's national scale rating.

Any SF rating cap resulting from a counterparty exposure discussed in these criteria also applies to national scale ratings. However, for national scale rating cap levels, Fitch will consider the maximum achievable international scale ratings, the specific circumstances of the individual country, and its national rating scale, which may differ in nature to the international rating scale.

Qualified Investments for National Scale Ratings

For qualified investments, the following special considerations apply to national scale ratings:

Government Bonds

For national scale ratings only, qualified investments include any government obligation guaranteed, backed or issued by the relevant government, without specified rating limits. Obligations of public entities or local states are excluded if they are not fully backed or guaranteed by the sovereign. Investments are expected to mature consistently with the provisions of these criteria (see *Qualified Investments*), with the exception of Brazilian *Letras Financeiras do Tesouro* (LFT), given their floating-rate nature with daily reset that minimizes the exposure to market risk.

Cash Management Funds

The use of cash management mutual funds is common across many jurisdictions. Typically, those funds are backed by high credit-quality, short-term government bonds. However, Money Market Fund (mmf) ratings are often not available.

The analysis will assess if the instrument available to the SF transaction meets the principle of preservation of capital and timely liquidity in regions where Fitch or other credit rating agency do not assign mmf ratings. In the absence of a mmf rating, the analysis may rely on Fitch's bond fund ratings as long as these funds carry a 'S1 (national)' Market Risk Sensitivity Rating, as defined in Fitch's "Bond Fund Rating Criteria" along with its capital preservation assessment.

Funds such as "Fundos de Investimentos em Renda Fixa, ativos governamentais, Referenciado DI, liquidez diária" in Brazil; "Fondos a la vista" in Colombia; "Fondos de Inversión en Instrumento de Deuda de Corto Plazo Gubernamental (Fondos de Liquidez)" in Mexico; or "Fondos mutuos de deuda de corto plazo" with duration of no more than 90 days, in Chile will not require a rating as these funds generally meet the principles of capital preservation and high liquidity. The inclusion of any other unrated fund not listed above will be considered as a criteria variation.

Paying Agents

Only if the holding period is two business days or less immediately preceding a payment date, Fitch assesses paying agents in line with other operational counterparties and does not apply any minimum counterparty rating. If the holding period is longer than two business days, Fitch regards the exposure as a primary risk, and would expect the paying agent to have minimum primary risk ratings at all times, including remedial actions upon downgrade below those ratings, in line with Fitch's CRRT.

Criteria Application in Surveillance

During the surveillance of existing ratings, Fitch will monitor changes in counterparty ratings and implementation of remedial actions. An updated analysis of counterparty risk will be completed if a material change is identified related to counterparties, the legislative environment, transaction documents or these criteria.

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 basis, and full disclosure via rating commentary strengthens Fitch's rating process while assisting market participants in understanding the rating analysis.

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

A variation can be approved by a ratings committee if the risk, feature or other factor relevant to the rating assignment and the methodology applied 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.

Limitations

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

Ratings within the scope of these criteria are also subject to the following specific limitations:

- Counterparty risk is analyzed on a transaction–by-transaction basis. A transaction that does not reflect all of the elements of these criteria can still be rated, if Fitch determines that sufficient structural mitigants are in place to address counterparty risk.
- Fitch's analysis of counterparty risk is influenced by the credit strength of a particular counterparty, in addition to the clarity and strength of the contractual documentation binding the counterparty to a transaction. Without the necessary documentation, per Fitch criteria, including clear counterparty replacement mechanisms, well-documented collateralization procedures and realistic replacement time frames, among others, Fitch can elect not to rate the SF bonds, or constrain the SF bonds at the rating of the counterparty.

Criteria Updates

Fitch's criteria can change following further analysis, and incorporate new data or reflect new market developments.

If transaction documentation reflects Fitch's criteria, such documents will generally reflect criteria that were applicable at the time the transaction closed. This means there is generally no contractual obligation on the part of the counterparty to act consistently with future revised criteria, unless transaction parties have chosen to update their documentation. As a consequence, there is a risk that transactions will be subject to adverse rating action in the event revised criteria become more conservative, unless counterparties choose to reflect revised criteria. Fitch reviews documentation for consistency with criteria and assesses whether transaction documentation is specific and self-supporting. Documentation should not rely on references to Fitch criteria or third-party input.

Data Sources

Fitch's analysis is based on information provided by the issuer or the arranger, if any. The rating process can also incorporate publicly available information or information provided by other third-party sources. Fitch will disclose other relevant sources if material to the rating.

Appendix 1 — Cash Reserves Covering PIR

Non-Amortizing Liquidity Reserves/Reserves with Fixed Percentage Target Amount

For non-amortizing liquidity reserves or with a target that remains stable as a percentage of the outstanding SF bonds balance, Fitch will perform a point-in-time assessment to test for full coverage of the PIR exposure amount. This assessment will be applied for new ratings, when the approach in the criteria is first applied, and will not be repeated at future reviews unless the ratings are considered for an upgrade or the liquidity position of the transaction has significantly changed.

Liquidity Reserves with Decreasing Relative Target Amount

For amortizing liquidity reserves, where the target amount decreases as a percentage of the outstanding SF bonds balance, or where the availability of the reserve can be eroded, Fitch will perform a case-by-case assessment, depending on the amortization and replenishment features of the reserve, testing for full coverage over the lifetime of the transaction in its cash flow model or other relevant tool.

Dynamic Liquidity Reserves

For dynamic reserves — reserves that are periodically adjusted to reflect the expected asset pool payments — calculating interest payments based on the current reference interest rate is sufficient, given a rising interest rate environment is protected by the ongoing top-up provisions under the reserve agreement. Fitch expects the top-up counterparty to have minimum primary risk ratings at all times, including remedial actions upon losing such ratings, in line with Fitch's CRRT.

Liquidity Reserves Covering Asset Pool Losses

If a cash reserve can also be drawn to cover for credit losses— meaning the cash reserve is not solely dedicated to providing liquidity support — it may not be available to cover for PIR if it has previously been depleted by poor asset pool performance.

For the assignment of new ratings, Fitch will assess the full coverage of the PIR exposure at any time during the projected life of the transaction by running the cash flow model. If no cash flow modelling is performed, the analysis will test that the available excess spread is sufficient to cover the credit loss that would deplete the reserve. In both cases, this PIR assessment is conducted under stressed assumptions at the rating level of the SF bond — including, if applicable, stressed default levels, default timing, interest rates and prepayment scenarios driving the SF rating.

For the surveillance of existing ratings:

- Fitch will assess full coverage of the PIR exposure amount under rating stress scenarios deemed relevant by a Fitch credit committee, against the current reserve amount along with an assessment of its continued coverage in the short to medium term — in most cases two to three years — in light of SF transaction performance, available excess spread and other sources of liquidity.
- A long-term coverage analysis is needed before SF bonds can be upgraded to avoid possible rating fluctuation stemming from short-term performance changes. For SF transactions with a long performance history of five years or more, a reserve that has consistently provided full coverage of the PIR exposure and no medium- to long-term expectation that the reserve coverage will fall below the PIR exposure, Fitch may not view the nondedicated nature of the reserve to limit the ratings of the SF bonds providing full coverage.

Liquidity Reserves/Facilities Covering Other Junior Payments

When the liquidity reserve/facility can also be used for other payments in the waterfall beyond those needed to avoid an event of default on the SF bonds, such as a coupon on subordinated notes even where deferrable, these will be included in the PIR exposure amount if the PIR period is longer than one payment period.

Appendix 2 — Determining a Commingling Loss

When sizing for a commingling loss, Fitch first determines the monthly commingling exposure amount. This is then adjusted for the actual commingling period of the SF transaction. The resulting adjusted exposure is applied as a loss in the SF transaction's analysis.

Commingling Exposure Amount

For new ratings, Fitch calculates the monthly commingling exposure amount as the average of the first 12 months of the following items:

1. Scheduled principal collections from the asset pool; plus
2. Expected voluntary principal prepayments based on historical prepayment data. For CVBs, absent historical data, Fitch will use the average between the 'high' and 'low' prepayment modelling scenarios, under the 'B' assumptions; plus
3. Scheduled interest payments, haircut by expected prepayments. For floating-rate interest payments, Fitch will apply the higher of its equilibrium rate and the current rate received on the portfolio; minus
4. Rating category-specific asset pool losses; for example, estimated commingling exposure of 5% can be adjusted by asset pool losses of 20% to 4%.

Months with one-off holdings or payments, such as balloon or bullet payments, are excluded from (a) above, and the period for the average calculation should be increased by the number of months excluded to maintain an average of 12 months. For example, the average of the first 13 months is used if one month is excluded.

For the surveillance of ratings, Fitch will use the exposure amount as calculated for new ratings or the commingling exposure calculated for the last transaction review rescaled to reflect asset pool amortization. In both cases, the plausibility of the amount may be checked against the servicer report if significantly different — usually, deviations of 20% or more adjusted to reflect observed collections. One-off payment spikes are excluded when benchmarking the calculated commingling exposure amounts to the collections against the servicer report.

CVB — Commingling Exposure

When sizing the commingling exposure for CVBs, the elements a), b) and c) will be calculated on the first period following the pool cutoff date, and they will be based on a cover pool notional, scaled down so the OC matches the break-even OC for the assigned rating.

Commingling Period

Once Fitch determines the monthly commingling exposure, it is adjusted to the actual period of time the funds are at risk of commingling in the SF transaction. This typically equals the time the collections remain with the risk entities (see Figure 15) before they are transferred to the TAB.

The fractions of the month are calculated as the number of days of exposure divided by 30.5. If a commingling exposure period exceeds one month by less than one week, only a one-month exposure is considered.

Commingling Loss

Fitch will incorporate one of the following calculated commingling loss in in its analysis:

- In cash flow modelling, usually by deducting the principal and prepayment component of the commingling exposure (items 'a' and 'b' above) from the asset balance at the start of the period being analyzed in the cash flow modelling;
- In asset classes where no cash flow model is used, the entire commingling exposure amount (items 'a' through 'd' above) will be accounted as an additional loss in the asset modelling.

When the nature of the model makes the first approach unfeasible, or when Fitch determines the structure of SF transaction warrants a different timing or application of this loss, a Fitch credit committee may decide to adjust this approach.

The commingling loss equals the exposure amount adjusted for the relevant commingling period, net of any reserve dedicated to cover the risk. For cash reserves not dedicated exclusively for commingling loss, Fitch will model them to test if they are available to cover the commingling loss.

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