Article Title: ARCHIVE | Legal Criteria: Behind the Ratings: Multiple-Use SPE Criteria for U.S. Transactions; Exceptions to Limitations on SPEs' Ability to Issue Additional Debt Data: (EDITOR'S NOTE: —This criteria article is no longer current. It has been superseded by the article titled, "Legal Criteria For U.S. Structured Finance Transactions: Special-Purpose Entities," published Oct. 1, 2006. This article supersedes "Global Synthetic Securities Criteria: Structural Considerations," published June 1, 1999.) Under Standard & Poor's existing criteria for special-purpose entities (SPEs), an SPE may not issue additional debt unless that debt is either fully subordinated to the outstanding debt, or has been given the same rating by Standard & Poor's as the outstanding debt (at the time of issuance and at all times thereafter). In either case, the additional debt, like all debt issued by the SPE, should be nonrecourse to the SPE or any of its assets other than cash flow in excess of amounts necessary to pay holders of the rated securities, and should not constitute a claim against the SPE in excess of the pledged cash flow for such debt. Accordingly, under this criteria, all forms of indebtedness of the SPE, e.g., asset-backed term notes, warehouse lines of credit, conduit financings, unless expressly subordinated, should, at issuance and at all times thereafter, be given the same rating by Standard & Poor's. The purpose of the SPE additional debt limitation is to minimize the likelihood that the SPE will be filed into bankruptcy by its creditors. Standard & Poor's concern is that to the extent that additional debt obligations of the SPE are rated lower than its outstanding debt, the additional debtholders may have an incentive to file a bankruptcy petition against the SPE and seek repayment on such debt from the SPE's other assets, such as overcollateralization supporting the higher rated debt. Once a bankruptcy petition is filed against an SPE, the automatic stay makes the timely payment of principal and interest on any of its outstanding debt obligations (regardless of the rating) highly unlikely. Therefore, under existing SPE criteria, Standard & Poor's rating on the initial debt issuance may be adversely affected if the SPE issues additional debt that is either not subordinated to the existing debt or is not rated the same as the existing debt. Consequently, if there were no limitation on additional debt, a default on lower rated debt could bring about a default on higher rated existing debt. This article is prompted by the desire of the structured finance market to use a single SPE to issue multiple series of debt collateralized by discrete pools of assets that carry independent ratings (or may be unrated). For example, an originator of commercial lease receivables may wish to use the same SPE to issue various series of term debt obligations, collateralized by different pools of leases, which are not rated the same at issuance (or even if rated the same at issuance, such ratings would not be linked, as described above). Or, an originator of retail auto loan receivables may wish to use the same SPE to issue an 'AAA' term series and enter into a conduit financing or a bank line of credit, each of which is collateralized by a discrete pool of loan contracts. Standard & Poor's believes that by implementing the following disincentives to filing a bankruptcy petition against the SPE, a single SPE can be used for multiple debt transactions collateralized by discrete pools of assets, the ratings of which will not be linked. 1. As is currently required under Standard & Poor's SPE criteria, the operative documents for each series of debt should provide that each series of debt is nonrecourse to the SPE and does not constitute a claim against the SPE if cash flow from the designated pledged assets is insufficient to repay the debt in full. In addition, the debtholders should agree that they have no rights in any other assets of the SPE, including, but not limited to, any assets collateralizing other debt obligations of the SPE. 2. As is currently required under Standard & Poor's SPE criteria, the operative documents for each series of debt should prohibit the filing or joining in a filing of any bankruptcy petition against the SPE prior to the end of the period that is one year and one day after all of the debt is paid in full. In addition, the debtholders should agree that they will not cooperate with, or encourage others to file, a bankruptcy petition against the SPE during the same period. 3. The operative documents for each series of debt should provide that, notwithstanding the agreements described in section 1, to the extent that the debtholders are deemed to have any interest in any assets of the SPE dedicated to other debt obligations of the SPE, the debtholders agree that their interest in those assets is subordinate to claims or rights of such other debtholders to those other assets. Further, the debtholders should agree that such agreement constitutes a subordination agreement for purposes of Section 510(a) of the Bankruptcy Code. Again, the purpose of these provisions is to minimize the incentive of the SPE's creditors to file a bankruptcy petition against the SPE. 4. Each series of debt should have distinct bank accounts or trust accounts, as applicable, in which cash and investments allocable to each series are held. However, in accordance with Standard & Poor's commingling criteria, the servicer may maintain a commingled account for collections allocable to multiple series. After the applicable commingling period, funds in this account should be transferred to the specific accounts for each series. 5. The organizational documents for the SPE should reflect that the SPE may be used for multiple debt issuances, however, the traditional restrictions on objects and powers remain applicable. If desired, the SPE may retain one or more subordinated classes of its various series, whether or not such retained pieces are subsequently pledged as collateral for another transaction. However, the SPE should not acquire subordinated debt obligations of other entities. 6. Each series of debt should bear its own trustee fees and servicer fees. Each transaction involving a transfer (e.g., sale, pledge) of assets to or from the SPE, including the issuance of pass-through certificates or other equity interests in the assets of the SPE, should be reviewed by Standard & Poor's prior to its closing. If a rating of the transaction from Standard & Poor's is not being sought, the review of the transaction generally will be of a limited scope so that Standard & Poor's can evaluate compliance with the SPE criteria, including the safe harbor for multiple-use SPEs described herein. Such review will be on a fee basis, and will also include an evaluation of the extent to which tax liabilities arising from one series could affect another series. Depending upon the circumstances of the particular transaction, Standard & Poor's may request certain legal opinions regarding the treatment of the transaction under the Bankruptcy Code. Compliance with the foregoing requirements will enable Standard & Poor's to rate multiple issuances of debt by an SPE collateralized by discrete pools of assets without linking the ratings of each issuance. Issuers who intend to rely on this exception to the SPE additional debt limitation, and implement a multiple-use SPE structure, should establish a new SPE for that purpose. While existing SPEs with multiple series of debt outstanding as of the date hereof are grandfathered, Standard & Poor's will permit the use of such existing SPEs for new transactions on a case-by-case basis in compliance with the safe harbor described herein. How does Standard & Poor's additional debt limitation for SPEs apply to master trust structure? The master trust structure, in which multiple series of securities (whose senior classes are not necessarily rated the same) are issued by the trust and backed by a single revolving pool of assets, is consistent with existing criteria because Standard & Poor's views the asset allocation provisions contained in the pooling and servicing agreement (and the supplement governing each series) as constituting an enforceable subordination agreement under Section 510 of the Bankruptcy Code.