

## Securitization

This methodology applies for securitization or asset-backed securities transactions with the underlying assets of loans originated by single or multiple creditors (originators), such as pool of mortgage loans, automotive financing loans, or corporate loans. It also applies for securitization with underlying future cash flow from the originator's business activities with the examples of future cash flow from toll road revenue or airline ticket sales revenue.

Currently there are two available schemes for asset securitization: Collective Investment Contract (Kontrak Investasi Kolektif or KIK) and Participation Certificate (Surat Partisipasi or SP).

There are some key characteristics to both schemes, including differences and similarities.

For KIK:

- There is the role of Investment Manager (Manajer Investasi or MI) as monitoring agent after instrument is issued
- The scheme is able to accommodate securitization of any type of asset classes
- The KIK serves a role as the issuer of the instrument
- The instrument, called KIK-EBA, is independent of the originator, or off-balance sheet

For SP:

- There is no role of Investment Manager as monitoring agent; it will be replaced by the issuer.
- Based on OJK regulation no 23/POJK.04/2014, the scheme can only be issued by a secondary mortgage financing provider and the asset is only specific to mortgage loan.
- The instrument, called EBA-SP, is also independent of the issuer and originator, or off-balance sheet.

An outline of the analysis:

- Industry analysis
- Underlying asset risk analysis
- Service Provider evaluation (Servicer)
- Analysis of the structure of the securitization
- Cash flow analysis

### Industry Analysis

Objective: To assess the characteristics and risk profile of the industry associated with the securitized asset from various aspects. The result of this analysis will be used as a reference in determining the benchmark pool and multiplication factor as the basis for the underlying asset risk analysis. For the industry with higher risk profile, PEFINDO may apply more stringent benchmark and multiplication factor, and vice versa.

As an illustration, in the case of mortgage securitization, PEFINDO analyzes the mortgage industry by reviewing the historical growth of mortgage and its sustainability in the near to medium term. PEFINDO will also assesses the mortgage product development, lending rate trend, as well as number of players in the mortgage segment and its competitive landscape. Assessment on the mortgage quality will also become an important part of the analysis, including the historical trend of non-performing loans (NPL), and its segmentation such as based on type of residential (landed houses, high rise apartment, or shop houses), mortgage value, debtors' profile, etc.

After conducting the industry risk analysis, PEFINDO will determine the benchmark pool, particularly for the new type of securitization. Benchmark pool are some criteria used as the reference by PEFINDO in measuring risk factors of the securitized asset. For the new securitization transaction but with similar asset class as the previously rated issuance, it can use the existing and relevant benchmark pool.

Criteria used in the Benchmark Pool is generally accepted criteria considered in the industry (not the best/worst). Each criterion in the "Benchmark Pool" has a value of 1.0x risk factor. Next PEFINDO sets the value of risk factors for different parameters. As an illustration, PEFINDO considers the common debt to income (DTI) ratio is at the range of 21%-30%, and therefore if a debtor has DTI ratio within that range, its risk profile would be 1.0x or neutral. For DTI ratio above 30% would be considered as riskier with risk profile above 1.0x and DTI ratio below 20% as less risky with risk profile below 1.0x.

After determining the benchmark pool, PEFINDO will measure the base default frequency calculation, reflecting the level of expected loss for each rating category. On the other words, it indicates the portion of credit enhancement required to meet a certain rating. The higher the desired rating, an ABS will require a higher credit enhancement levels. In most cases, PEFINDO will use the highest non-performing loans (NPL) ratio in the past few years for the relevant industry sector of the underlying assets as the reference, and multiply this to reach the certain comfortable level to achieve the targeted rating. If NPL ratio data for the specific sector is not available, PEFINDO may refer to the NPL ratio for the overall banking industry.

As an example, if the industry's maximum NPL ratio in the past 5 years is at 3.33%, then for AAA rating PEFINDO may add multiplication factor of 3x, resulting a base default frequency of 10%. It means that if all the parameters of the underlying assets meet the criteria in the Benchmark Pool, and without incorporating other factors such as servicer quality, structural risk analysis or cash flow analysis, then it will need 10% of credit enhancement in the form of the junior tranche to achieve the AAA rating.

### **Underlying assets risk analysis**

**Objective:** To calculate the credit enhancement of the securitized asset portfolio based on existing criteria in the benchmark pool & Base Default Frequency.

Deviation from benchmark pool will affect the credit enhancement needed to achieve a particular rating category. PEFINDO will also analyze securitized assets based on its diversification risk profile.

If applicable, PEFINDO will also separately assess the overall risk profile of the parties where the cash flow of the underlying assets are sourced from. This obligor or counterparty risk may play an important role in the overall rating assessment, considering that the risk profile of the obligor may strongly affect the capability of the underlying assets in generating cash flow to fulfill its financial obligations. For securitization with single or few obligors, PEFINDO may use the obligors' credit rating to determine their credit profile.

In addition to the obligor's creditworthiness, the analysis will also cover the strength of the legal framework binding the obligor in fulfilling its financial obligations to the originator which will be used as the underlying cash flow to repay the securitized debt.

If the underlying assets are low ticket size loans such as mortgage or consumer loans, there may not be credit rating available, but PEFINDO may use loan-by-loan information, such as debt-to-income ratio, type of employment, and borrower's age to measure their risk profile.

For the type of underlying asset in the form of revolving loans, even though the risk analysis of obligors in the pool can be measured, the pool will have a high likelihood to change over time or be very dynamic in nature. In this case, PEFINDO will evaluate the entire revolving loan portfolio at the originator with the view that the dynamic pool will have a set of characteristics that is not much different from the overall revolving loan portfolio with further enhancement in the form of selection criterias for new loans or receivables that can be purchased and included to the pool later to substitute the maturing ones. PEFINDO also views at how long the track record or historical data of revolving loan program as a risk factor.

In some cases such as in toll road or airline ticket future revenue securitization, the counterparty risk profile are difficult to assess. In that case, PEFINDO will consider the obligor risk profile to have a neutral impact to the overall rating, as long as the counterparties are well-diversified due to the retail transaction nature and small ticket size. A concentrated profile of obligors without adequate information to assess their risk profile may adversely affect the underlying asset risk profile and accordingly the securitization overall credit profile.

### **Service Provider (Servicer) Evaluation**

Objective: To measure the ability Servicer in managing the securitized assets. PEFINDO will evaluate the procedures for asset management, IT system, disaster recovery plan, as well as business and financial profile. PEFINDO will consider track record of operation, market position in its respective industry, and management & human resource capabilities. PEFINDO will also use the servicer's corporate rating as a reference in determining servicer quality profile.

### **Analysis of the securitization structure**

Objective: To assess the risk profile of the structure of securitization transactions, by evaluating:

- Securitization scheme, including scheme being used such as Collective Investment Contract (Kontrak Investasi Kolektif), Participation Certificate (Surat Partisipasi), or others
- Securitization agreements analysis
- Analysis of protection against credit risk of the parties involved in the transaction
- Analysis of legal aspects (with an opinion of legal expert)-bankruptcy remote, true sales, etc.
- Analysis of the audit results of the securitized asset compared with asset selection criteria, when applicable

### **Cash flow analysis**

Objective: To calculate the adequacy of cash flows from the securitized asset generation against EBA's financial obligations, including senior expenses and principal and coupon payments to EBA holders.

PEFINDO will combine all above analysis to come up with minimum subordination level required and apply it in the cash flow model. If it does not satisfy to fulfill future cash flow requirement under worst-case scenario, then PEFINDO will determine the junior portion required based on the cash flow model.

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