MOODY'S INVESTORS SERVICE

CROSS-SECTOR RATING METHODOLOGY

Global Approach to the Use of Credit Estimates

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This rating methodology replaces *Moody's Approach to Using Credit Estimates in Its Rating Analysis* published in March 2020. In the update, we clarified the application of the criteria to use credit estimates for single-name exposures in structured finance, and we explain more clearly how we apply the jump to a Caa2 equivalent stress test to credit estimates on pool exposures when evaluating the ratings of securities issued by a structured finance transaction. We also made editorial changes to enhance readability.

Scope

This cross-sector rating methodology describes how we use credit estimates (CEs)[1] in our rating analysis. It is relevant to our ratings on instruments or issuers that are exposed to the credit quality of assets or entities for which we have assigned CEs rather than ratings.

We most commonly apply this methodology in our rating analysis of structured finance instruments, such as certain collateralized loan obligations, asset-backed securities, and covered bonds where the cover pool includes entities with CEs. However, we also apply this methodology in our analysis of instruments and issuers outside of structured finance, such as certain securities backed by public infrastructure projects.

This methodology does not apply when we derive an opinion on the credit quality of an unrated entity from the rating of a related entity, rather than the unrated entity's standalone intrinsic strength, and use that opinion to assess operational, commingling or set-off risks in structured finance transactions.

As with all rating methodologies, in applying this methodology, where appropriate, we consider all factors that we deem relevant to our analysis.

[1] CEs are defined in Moody's *Rating Symbols and Definitions*. A link can be found in the "Moody's Related Publications" section.

Using Credit Estimates

We may use CEs to estimate the credit quality of (1) entities that have contracted with issuers or are expected to support them (single-name exposures), or (2) exposures in asset pools backing rated instruments or issuers (pool exposures).

Since CEs are point-in-time opinions, there could be a time lag between a significant change in credit quality and the next update of the associated CE. In addition, CEs are normally based on less information than ratings and are not assigned by rating committees. For these reasons, we apply the criteria described in the next two sections and typically do not use CEs that are more than 15 months old. When a valid CE is no longer available, we evaluate the relevant asset or entity in the same way as any other credit that has neither a rating nor a CE as described in the relevant rating methodology.

We do not apply the criteria in the next two sections when using CEs:

- that we derive from the rating of a related entity rather than the unrated entity's standalone intrinsic strength;
- to assess (1) the durability of servicers when evaluating operational risk in structured finance transactions, or (2) the stability of the policies and practices of originators or servicers in structured finance transactions; or
- qualitatively rather than (1) as direct inputs to models or scorecards, or (2) for determining rating caps.

In other words, we do not apply the criteria in the next two sections when using CEs in structured finance transactions to determine whether the credit quality of certain single-name exposures is below a rating threshold such that additional analysis of the related risk is required. For example, for commingling or auto balloon loan risk, the criteria in the next two sections will not be required for evaluating whether a quantitative analysis is required. When a quantitative analysis is required, the criteria in the next two sections when using CEs will then be applicable in the quantitative models.

When the rating of an issuer or instrument is highly sensitive to the credit quality of a single asset or entity, we are unlikely to use a CE as a credit quality indicator.

Credit Estimates for Single-Name Exposures

CEs for single-name exposures are subject to a two-notch haircut, i.e., we lower the CEs by two notches. Additionally, we perform a stress test to examine whether the rating of the relevant instrument or security would move by more than two notches should the notched-down CE immediately jump to a Caa2 equivalent ("jump-to-Caa2" stress test).[2]

When necessary to pass this test, we position the rating at a lower level than would otherwise be achieved. For a structured finance transaction, if we position the rating of any tranche at a lower level in order to pass the stress test, we may also position the ratings of more junior tranches for which we do not directly apply the stress test at lower levels in consideration of their relative ranking.

[2] For a structured finance transaction, we apply the stress test separately with respect to the rating of each tranche that, but for the stress test, would have the highest outstanding rating for that transaction. For example, if we assess both a senior tranche and a super-senior tranche as Aaa before applying the stress test, then we apply the test separately with respect to the rating of each tranche.

However, we do not apply the "jump-to-Caa2" test for CEs on contractual support providers that will likely be replaced (with no likely loss to the issuer) if they default.

Credit Estimates for Pool Exposures[3]

When using CEs on exposures that individually represent more than 3% of the current total balance of performing assets (material pool exposures), we:

» apply a two-notch haircut to the largest[4] CEs on material pool exposures that collectively represent up to 30% of the performing assets in the pool; and

» perform the "jump-to-Caa2" stress test to examine whether the relevant rating[5] would move by more than two notches should *either* of the pool's two most significant notched-down CEs (though not both of them together) immediately jump to a Caa2 equivalent and, when necessary to pass this test, we position the rating at a lower level than would otherwise be achieved. The two most significant notched down CEs are typically the two largest CEs but we may consider other cases. For example, we may assess the rating impact of smaller CEs with a better credit quality than the two largest CEs and conclude that the impact is more significant.

Credit Estimates with Low Volatility

Some CEs will likely have relatively low volatility between updates. For these CEs, while we apply the two-notch haircut in accordance with the scenarios described above, we do not apply the "jump-to-Caa2" stress test.

We determine the volatility of each CE on a case-by-case basis. The primary indicators of low CE volatility are (1) low rating volatility of the relevant sector and (2) support from a rated entity. In general, we do not assume that a CE has low volatility unless at least one of these primary indicators applies. In unusual cases, there may be other reasons for viewing a CE as having low volatility, including the frequency of updates.

3 In this subsection, references to CEs do not include opinions on the creditworthiness of (1) tranches in structured finance transactions where other tranches have been publicly rated by Moody's and a rating committee has convened and concluded on such opinions; or (2) "seller additions" in partially supported ABCP programs.

4 For determining which CEs in a pool are subject to the two-notch haircut, if two asset exposures are equal in size, we deem the one with the worst credit quality to be the "largest" (unless the relevant CE maps to a rating below Caa2).

5 For a structured finance transaction, we apply the stress test separately with respect to the rating of each tranche that, but for the stress test, would have the highest outstanding rating for that transaction. For example, if we assess both a senior tranche and a super-senior tranche as Aaa before applying the stress test, then we apply the test separately with respect to the rating of each tranche.

Appendix A: Illustrative Example

This appendix illustrates how we apply the methodology, using a structured finance transaction as example:

» a structured finance transaction has an exposure to an unrated company, X

» X is a subsidiary of a rated company, Y

» the credit analyst for Y provides an opinion on the credit quality of X

» the structured finance rating committee uses this opinion in its rating analysis

The exhibits below depict our criteria for determining:

» whether the opinion on the credit quality of X is a CE so that its use falls within the scope of this methodology

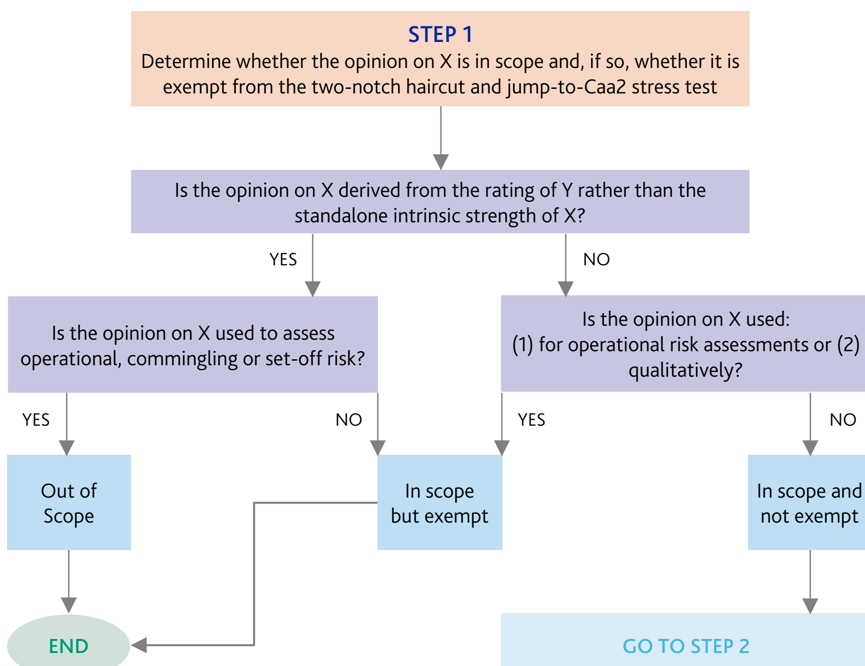
» if it is within scope, whether the CE's use is exempt from the two-notch haircut and jump-to-Caa2 stress

» if it is within scope and not exempt, whether the CE's use is otherwise excluded from the application of the two-notch haircut and/or jump-to-Caa2 stress test

The exhibits below provide a simplified overview of the methodology.

EXHIBIT 1

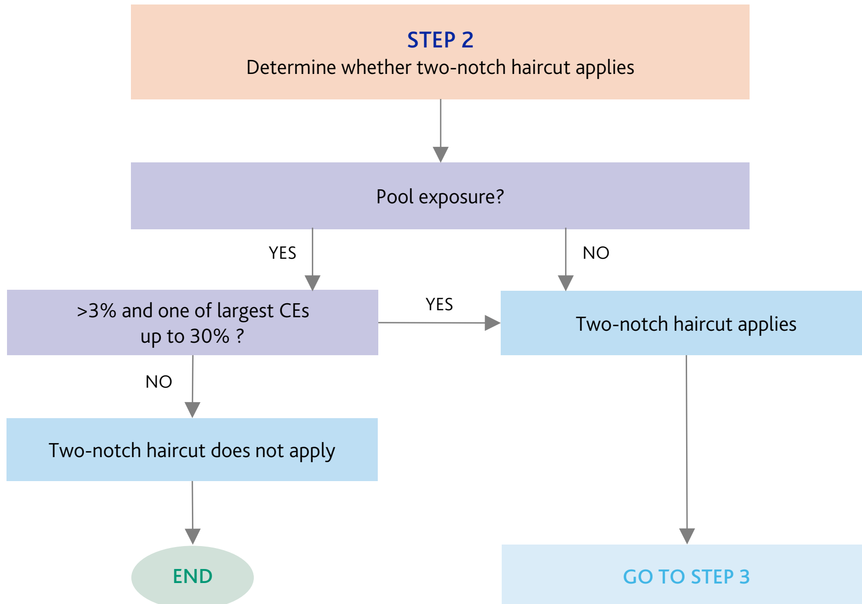
Simplified Overview – Step 1



Source: Moody's Investors Service

EXHIBIT 2

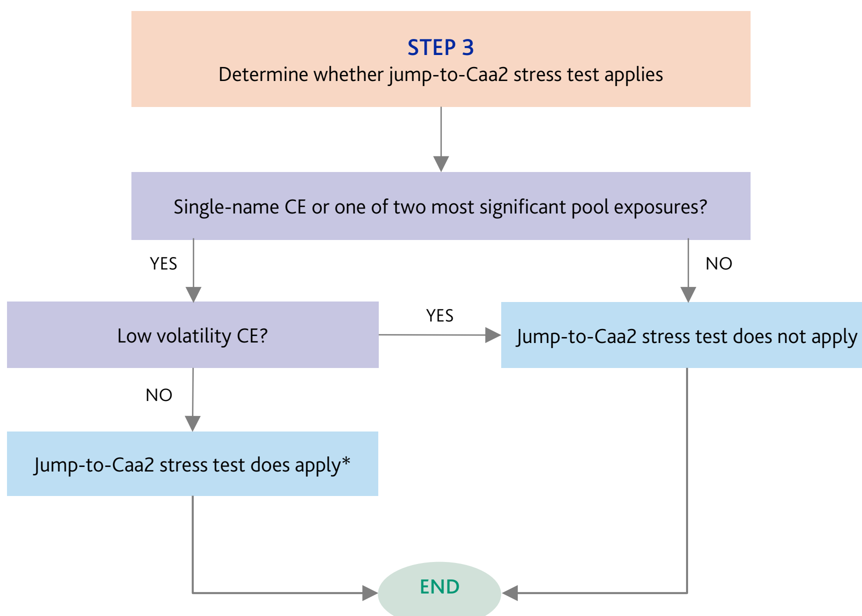
Simplified Overview – Step 2



Source: Moody's Investors Service

EXHIBIT 3

Simplified Overview – Step 3



* The stress test does not apply for CEs on contractual support providers that will likely be replaced (with no likely loss to the issuer) if they default.

Source: Moody's Investors Service

Moody's Related Publications

Cross-sector credit rating methodologies are typically applied in tandem with sector credit rating methodologies, but in certain circumstances may be the basis for assigning credit ratings. A list of sector and cross-sector credit rating methodologies can be found here.

For data summarizing the historical robustness and predictive power of credit ratings, please click here.

For further information, please refer to *Rating Symbols and Definitions*, which includes a discussion of Moody's Idealized Probabilities of Default and Expected Losses, and is available here.

Report Number: 1343392

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