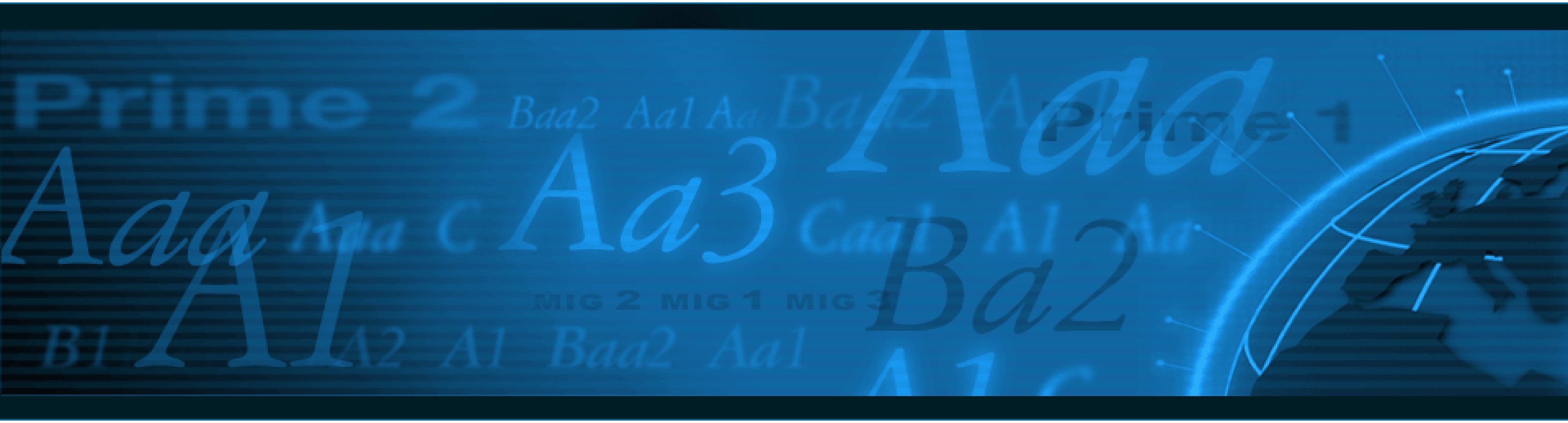
# A Brief Introduction to MERIS Rating Services – Structured Finance Ratings




MERIS

Middle East Rating & Investors Service

# About MERIS

- **MERIS (Middle East Rating & Investors Service)** was established as a joint venture between **Moody's Investors Service** (among the world's foremost credit rating agencies) and **FinBi** (Finance & Banking Consultants International).

- **MERIS** is supported by the technical assistance and expertise of **Moody's**. **MERIS** focuses on issuing independent credit ratings, opinions of the relative creditworthiness of issuers or issues, research and analysis to various corporate and banking market participants at the national level.

- **MERIS** is currently focused on providing credit rating service, extensive credit rating analysis and credit research in Egypt. **MERIS** territory also extends to cover other countries in the Middle East.

*Additional information about **MERIS** is available at*
*www.merisratings.com*

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# What Does a Credit Rating Mean?

- Credit rating provides an **independent** and **rigorous** credit opinion about an entity or about a fixed-income security. It is an assessment of the ability and willingness of an entity or an issuer to honor full and timely payments on its financial commitments.
- Credit rating provides a clear and easily understood **ranking** of the credit quality of a security across different markets which can help facilitate **comparability**.

# What Does a Credit Rating Mean?

- Credit ratings can enhance **transparency** and **efficiency** in the debt capital markets. Transparency is a key issue that **investors** are looking for in today's world.
- Applying for a credit rating signals a willingness by the issuer to be transparent.

# National Scale Ratings (NSRs)

- A NSR is **an opinion of the relative creditworthiness** of entities and issues in a **particular country**.
- NSRs are not designed to be compared between countries, rather they address relative risk within a given country.

***NSR Criteria:***

- NSRs take into account the intrinsic financial strength of the obligor.
- External support factors to the issue may be taken into consideration.
- Balance between qualitative and quantitative analysis.

# MERIS National Rating Scale

| Quality of credit | long term | short term | |
|---|---|---|---|
| Highest Credit | AAA | Prime-1 | Investment Grade |
| Very High | AA+<br>AA<br>AA- | | |
| Upper-Medium | A+<br>A<br>A- | Prime-2 | |
| Medium Grade | BBB+<br>BBB<br>BBB- | Prime-3 | |
| Weak Quality | BB+<br>BB<br>BB- | Not Prime | Speculative Grade |
| Poor Quality | B+<br>B<br>B- | | |
| Very Poor | CCC+<br>CCC<br>CCC-<br>CC<br>C | | |

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# Principal Benefits of NSR - Issuers

- Can enhance transparency, which is a major requirement for today's capital markets and for investors.
- Facilitates wider access to the local & global capital markets and investors.
- Can offer means of communicating opinion on creditworthiness to key counterparties from an internationally recognized neutral and independent body.
- Can provide means of comparison to other institutions in the same country.
- May be useful to facilitate repeat issuance.
- Provides issuers with an independent assessment against which to benchmark their own creditworthiness.
- Rating may expand your investor base and decrease your cost of borrowing.
- May help issuers to formulate internal capital plans and funding strategy.

## Benefits Specific to Structured Finance NSR - Issuers

- Structured Finance ratings are focused on **specific assets** – not the borrower. This is important for firms that do not want the scrutiny of a full corporate rating.
- This asset focus allows even **young and smaller companies** to achieve the highest ratings if they have good strong assets.
- Structured Finance ratings are usually **higher** than the borrower corporate rating.

# Principal Benefits of NSR - Investors

- Can enhance transparency and reduce uncertainty.
- Reduces information gap between issuers and investors, giving investors greater confidence.
- Can widen investment horizons beyond state boundaries.
- Independent indicator of credit quality.
- Can help understanding and managing credit risk.
- Strategic tool for portfolio management techniques.
- May facilitate secondary market liquidity.

# What a Rating Will Not Tell You?

- Rating agencies do not make recommendations to buy or sell.
- Credit ratings are a measure of relative risk and not a measure of relative value.
- Rating agencies do not "price" debt.
- Rating agencies are not auditors or investigators. They depend on audited financial statements as well as on the information provided by the rated entity in the rating process.
- Rating is not a guarantee against loss. It is an opinion about the relative probability of default and loss.

# Rating process

## Typical Time Frame for a First-Time Rating

| Week 1 | Week 2 | Week 3 | Week 4 | Week 5 | Week 6 | Week 7 | Week 8 |
|---|---|---|---|---|---|---|---|

**Processing Initial Information**

**Operational Review Meetings**

**Credit Rating Analysis**

**Rating Committee Discussion**

**Rating Committee Discussion**

**Press Release & Final Rating Report**

Note: This time frame applies as of the date of availability of information.

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## Rating Process

- Initial Meeting – possible first glance???
- Execution of a Rating Agreement.
- Analytical team assigned consisting of minimum two analysts (lead and a backup).
- Preliminary Information Requirement List sent to customer.
- Processing Initial Information.
- Management Meetings.
- Preparation of the Report.
- Rating Committee.
- Communication of the Rating.

*Not a black box exercise, it is an open dialogue process.*

# Deliverables

- Credit Rating Report
- Rating Certificates
- Press Release
- Responses to inquiries from institutional investors, research needs, questions and/or information requirements

# Once a Rating is Assigned….

- Rating and key credit opinion is made widely available.
- On-going monitoring of published ratings and annual review meetings with the company.
- Change the rating or confirm it whenever appropriate (i.e. issues such as M&A activity, debt issuance, etc. should always be discussed with the rating company).
- We promote continuous communication between **MERIS** analysts and rated companies.

# Standards of MERIS Professional Conduct

- Protection of Confidential Information
- Independence and Objectivity
- Integrity
- Compliance with Applicable Laws and Regulations
- Real and Apparent Conflicts of Interest

# Structured Finance Ratings....

- **Asset Backed Securities:**

  A variety of financial and non-financial assets that are packaged together into securities and are then sold to investors. The cash flows generated by the underlying assets are used to pay principal and interest on the securities in addition to transaction expenses. The securities themselves are “backed” (or supported) by the assets and are collectively known as asset-backed securities (ABS).

- **Types of ABS**

  ✓Residential mortgage backed securities (RMBS)
  ✓Commercial mortgage backed securities (CMBS)
  ✓Auto loans
  ✓Credit card receivables
  ✓Equipment leases.

# Overview: Rating of ABS

- A comprehensive approach, including both quantitative techniques and qualitative judgment.

- Ratings of ABS are ultimately based on the ***Expected Loss*** concept. When assigning a rating, we attempt to identify all outcomes or paths which might lead to investors suffering losses, to quantify those losses, and to assign probabilities to each such path occurring. The rating is then based on the ***probability weighted loss*** to the investor.

- Assumptions used in the quantitative modeling of the cash flows are derived and conditioned by the analyst’s qualitative analysis of the underlying assets credit risk as well as a careful examination of the transaction’s structural and legal aspects.

# Structured Finance Rating Process

**Qualitative**

- Origination sources
- Underwriting quality
- Servicing
- Management level
- General risk factors
- Economic trends

- Deal structure
- Parties involved
- Legal/tax issues
- Parties' incentives

- Review of all factors
- Checking models:
  - reasonableness
  - sensitivity
- Benchmarking vs. similar deals
- Final vote

**Loan/Pool Analysis** → **Deal & Bond Structural Analysis** → **Rating Committee**

**Quantitative**

- Loan-by-loan analysis
- Statistical & quantitative modeling
- Rigorous scrutiny of pool various characteristics

- Pool's cash flow
- Default frequency and timing, loss severity
- Payment priorities
- Spread analysis
- Hedging mechanism (if any)
- Liquidity facility (if any)
- Performance triggers
- Tranching & credit enhancement

- Review of models
- Final tranching and enhancement

# The Importance of Qualitative Analysis

- Operational review
  - Offers a first-hand impression of the Originator's credit procedures.
  - Provides an opportunity to assess the credibility of data provided by the Originator, through a physical demonstration of data-related systems in connection with the originator's credit scoring, underwriting, collection mechanism, etc.
  - Benchmarking of originators – used to assess the adequacy of the recommended CE to the transaction.

| The Building Blocks of MERIS Operational Review |
|---|
| ▪Business strategy |
| ▪Company's management |
| ▪Origination goals |
| ▪Origination channels |
| ▪Underwriting/selection criteria |
| ▪Quality control |
| ▪IT Systems |
| ▪Servicing |

## The Importance of Qualitative Analysis

- Legal and Structural Analysis - an Add-On to Quantitative Analysis
  - Review of the viability of the proposed transaction via an examination of various legal issues, i.e. true sale, bankruptcy remoteness, enforceability, etc.
  - Attempt to ascertain that the probabilities of loss calculated through the various models are not underestimated due to an oversight of certain legalities that might interfere with the projected cash flow.
  - Adjust the modeled levels of stress or volatility applied to the projected cash flows if legal issues raise significant concerns regarding the viability of the transaction.

# Do ABS Transactions Need A Credit Rating?

- Rating is a **mandatory** requirement for any bond issuance according to the Egyptian law. In most countries, credit rating is also a legal requirement for bond issuance.
- Credit Rating, both locally and internationally, provides **Transparency** to the outside world from an independently recognized body.
- A rating can **facilitate access** to a wider pool of debt capital market.
- Investors use credit ratings as **benchmarks** to compare between the creditworthiness of various assets.

# Contacts

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