

Consumer ABS Criteria Report

Rating Criteria for Consumer ABS in Latin America

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- *Counterparty Risk in Structured Finance Transactions: Hedge Criteria, Aug. 1, 2007*
- *Special-Purpose Vehicles in Structured Finance Transactions, June 13, 2006*
- *Commingling Risk in Structured Finance Transactions, June 9, 2004*

Summary

In Latin America, a wide variety of assets may be classified as consumer loans from a broad spectrum of originators ranging from banks, credit unions, financial companies and retail businesses. Securitization of consumer ABS has grown to become an important and stable financing source for many small-to mid-sized banks and financial companies across Latin America.

This report outlines Fitch Ratings' approach to evaluating consumer ABS transactions in Latin America. Although each country's securitization market has evolved differently in form and complexity, this report's goal is to provide comprehensive and consistent parameters for analyzing the inherent risks of consumer ABS in Latin America, which follows in step with Fitch's global criteria set forth for this asset class. To the extent that there are regional variations, Fitch will issue country-specific reports to address unique geographical/economic and legal issues.

While the vast majority of Latin American securitizations are financed in the local markets and are rated on the national scale, this report addresses the issues related to both national scale ratings and international local currency ratings. This report does not elaborate on foreign currency risks and the various rating caps that Fitch employs when assigning international foreign currency ratings. (For more information related to international foreign currency ratings for securitizations in emerging markets please refer to Fitch's criteria report, "Existing Asset Securitizations in Emerging Markets — Sovereign Constraints.")

Consumer ABS Market

Over the past three years, consumer lending by financial institutions has experienced double-digit growth across major Latin American economies. In order for these institutions to meet the demand for capital to fund portfolio growth, these institutions have turned to the local securitization market. Overall, consumer credit in relation to GDP in Latin America remains below that of developed countries. For example, over the past five years, consumer credit to individuals in Brazil doubled from an estimated 5.0% to 10.0% of GDP. While consumer credit across the region continues to be low with tremendous growth, it remains vastly underestimated when considering retail and other consumer financing entities which do not consolidate activities into Central Bank information.

Consumer ABS has become the predominant asset class for local market securitization. In 2007, approximately USD5.0 billion in consumer ABS transactions were issued in Latin America's local capital markets, representing 34% of the total USD14.9 billion in local securitization transaction issuances. These issuances have been diversely spread among vehicle financing, unsecured consumer loans and payroll deductible loans. Furthermore, concentration among originator type varies by country. In Argentina consumer ABS has been predominant with retail companies, meanwhile, in Brazil, small- and mid-sized banks have dominated the market spotlight for this asset class.

Over the past three years, sustained economic stability highlighted by low-level inflation and declining market interest rates have fostered appetite for expanding credit to

individuals in financing consumption. Generally, consumer credit has been characterized by high interest rates and short-term and double-digit charge-off rates. Nonetheless, financial intermediaries have been continuously improving credit origination and collection procedures.

Consumer ABS — Asset Classes

Fitch defines a consumer ABS transaction as a securitization of a portfolio of payments owed by obligors as a result of formalized financing arrangements for the purchase or use of consumer goods or personal use. For the purposes of this report, Fitch identifies consumer ABS in three distinct product types: vehicle financing, consumer/personal loans and payroll deductible loans. Securitization of credit card debt balance is not covered in this methodology.

This criteria piece applies to both secured and unsecured consumer obligations. There is no clear distinction between secured and unsecured obligations, and while an originator may well take some form of security, for example, a guarantee, Fitch may treat the obligation as unsecured. In Fitch's sense, a secured consumer obligation is a claim that is backed by a financed object of sustainable value, which is pledged to the creditor to satisfy its claim upon default of the obligor. The classic secured consumer debt is the financing of a car, with point-of-sale financing of, for example, a purchase of furniture marking the opposite end of the spectrum (i.e. unsecured debt). Nonetheless, credit to security in auto loans will depend upon the quality of the underlying collateral and overall historical information. Payroll deductible loans, which involve direct debit of the loan payment from the borrower's salary by the employer, would also be considered as unsecured debt.

Credit Analysis

To assess the securitized portfolio's expected performance, Fitch establishes base cases on three performance parameters:

- Cumulative defaults over the term of the portfolio.
- Cumulative recoveries on the defaults in the portfolio.
- Cumulative prepayments.

To develop these assumptions, Fitch usually receives three to five years of historical data. This time period ideally depends on the economic environment during this period, the tenor of the underlying assets and the trend predictable by the presented data. Historical performance data should be presented in amounts, such as defaulted amounts, recovered amounts and delinquent amounts.

Dynamic vs. Static Analysis

Unlike an originator's business, which is dynamic due to the continuous introduction of new loans, consumer ABS transactions always ultimately enter into an amortization period where the portfolio becomes static. Relying only on dynamic performance data, such as series of defaults in a given month, over the outstanding portfolio balance in that month would be inconsistent with the static nature of the transaction. It would not only mask the timing of defaults (i.e. the time from origination to default), but also underestimate and overestimate defaults when the underlying portfolio grows or shrinks, respectively.

A static pool is a group of assets generated during a specific calendar period, typically a month, quarter or year, referred to as the "vintage" of the data. By that means, an originator's total book can be divided into subpools based on the calendar period in which each claim was originated or disbursed. Vintage data captured by geographic region,

credit score, loan term or other parameter helps Fitch to understand the default and the other portfolio performance drivers.

Fitch views such presentation of static data to more appropriately capture portfolio performance and eliminate the aforementioned associated with dynamic presentation of data.

Determining Default Probability

The cornerstone of Fitch's credit analysis is the evaluation and interpretation of the historical cumulative default rate provided. The definition of default is typically a date threshold beyond which an asset is delinquent, is classified as defaulted or an asset that has gone straight into enforcement proceedings. For most markets in Latin America, loans in securitization transactions with loans delinquent for more than 90 or 120 days are classified as defaulted. However, some countries' securitization markets classify defaulted loans after 180 days delinquency.

Fitch may use migration analysis between delinquency buckets in order to assess the more appropriate proxy for determining defaulted loans.

To project the performance of the assets in the portfolio to be securitized, expressed in a "base case," Fitch looks at the historical performance of a portfolio with assets of the same quality and composition from the respective originator. Base cases are determined for each individual product type securitized. The base case is determined by analyzing a number of factors including the average default rate over the tenor of the underlying products, seasoning and trending. (Appendix 3: Calculation of Base Case gives a detailed explanation of how Fitch would determine a cumulative base case default rate.)

If historical data is volatile or shows a certain trend, Fitch reviews this further with a view to gaining a better understanding of the historical and likely performance of the pool. Potential reasons may be changes in underwriting or servicing standards or the impact of changed macroeconomic factors on the borrower base.

When interpreting historical defaults, Fitch will also analyze historical delinquency data, as this can provide insight into potential changes in future defaults. Growth in the total loans in the various aging buckets may indicate a potential for increased defaults in future. Fitch has also found that early stage delinquencies may indicate a relaxation in underwriting criteria, while later delinquencies may represent a change in servicing and collection procedures or a decline in economic conditions. Fitch discusses these trends with the originator and will use this information in determining the base-case default assumptions.

Adjustment for Seasoning

An issuer may choose to securitize a pool of loans which is well seasoned. Seasoning is the amount of time that borrowers have already made payments on a loan pool since origination. For a pool of loans in which the majority of defaults and losses historically occur early within the vintage (e.g. characterizing a "front-loaded" loss curve), securitizing these loans after a period of seasoning would result in base case loss estimates for such a pool being potentially lower than for a newly originated loan pool. Conversely, securitizing a seasoned loan pool which portrays a "back-loaded" loss curve over the entire vintage would result in the larger portion of losses being incurred over the remaining term of the loans.

For well-seasoned portfolios which demonstrate consistent quality historical loss curves, Fitch will increase or reduce base case loss assumptions, based upon the remaining losses as a percentage of the outstanding pool amount as is explained in Appendix 3: Calculation of Base Cases. The amount of credit or penalty for seasoning can be influenced by many

factors, which include: loss speed, shape of the default curve and underlying collateral quality, among others. For transactions with a revolving period, no adjustment is made for seasoning unless the eligibility and portfolio criteria state a minimum weighted-average seasoning for the portfolio will be maintained. Nonetheless, a bare minimum level of seasoning (e.g. one to two months) in a transaction may reduce the transaction's exposure to poorly originated loans or cases of fraud.

Determination of Recovery Rate

Once a loan has been classified as defaulted, generally a liquidation procedure is undertaken on the underlying asset (e.g. vehicle, etc.). The recovery rate is defined by the total liquidation proceeds over the outstanding balance of the defaulted loan.

Fitch reviews historical recovery information in order to estimate the net proceeds received from the liquidation of the underlying asset — if any — and the timing of the process. Based upon this information, Fitch will conclude a recovery rate assumption and a time delay for recoveries to be incorporated into Fitch's cash flow model. Given volatile historical recovery data and timing lag for recovery in Latin American markets, base case recovery rates for most unsecured consumer ABS transactions have been near zero.

Some loans classified as defaulted may become current through continued collection efforts past its definition of default. This is common for loans that have no underlying asset as a guarantee (e.g. personal loans, consignment loans, etc.). Fitch does not give credit to this type of recovery unless collection history presents a consistent recovery trend.

Prepayments

Prepayment consists of the liquidation of the loan by the borrower prior to the original final maturity date. In this case, the borrower pays the outstanding principal loan balance to the creditor.

Prepayment is usually motivated by a borrower refinancing the existing loan with a more attractive one or by voluntary repayment by the borrower after a change to their financial circumstances. Fitch will review dynamic and static prepayment data showing the history of average prepayment across the portfolio. Preferably, prepayment data should be dissected by loan type, interest rate, term or other relevant characteristic to understand prepayment motivations. Generally, most prepayments are derived from the higher interest rate loans, shifting the portfolio's average yield downwards. Fitch will also look to identify certain seasonal prepayment trends.

Constant prepayment rates (CPR) are an annualized measure of monthly prepayments received in relation to the given month's initial outstanding loan pool balance. (Appendix 3: Calculation of Base Case provides an example as to deriving base case CPR.)

Stress Scenarios

After developing base case assumptions for gross defaults, recoveries (e.g. net losses) and prepayments, Fitch stresses these variables at levels applicable to each rating.

National vs. International Scale

When assigning international ratings for structured finance transactions in emerging markets, Fitch will use higher stresses to the same international rating to reflect the more volatile environment. Fitch believes a good proxy for the stability of a sovereign environment is the sovereign's local currency rating. As such, for many variables, Fitch will derive stress scenarios as a function of the number of notches between the transaction's rating and the sovereign's local currency rating. As a starting point, for

Gross Default Stress Multiples

Rating Category	Multiple (x)
AAA(nat)	4.50–6.00
AA(nat)	4.00–5.00
A(nat)	2.50–3.50
BBB(nat)	2.00–2.50
BB(nat)	1.25–2.00

Nat – National rating scale.
Source: Fitch Ratings

consumer ABS ratings equivalent to the sovereign’s local currency rating, Fitch will stress the base case scenario using its ‘AAA’ stress levels.

The increased stress is intended to account for the fact that the environment in which the transaction is domiciled is more volatile than a developed market. For more information related to this, please refer to Fitch’s criteria report, “Criteria for Existing Asset Securitizations in Emerging Markets — Sovereign Constraints.”

When rating transactions on the national scale, ‘AAA(nat)’ stress levels are the same as ‘AAA’ stresses, and so on for other national scale ratings, for transactions from developed countries like the U.S., U.K. and Germany. In this way, the ‘AAA(nat)’ national scale transaction can support similar stresses as a transaction within a developed country as well as an internationally-rated transaction equivalent to the rating of that particular country’s sovereign local currency rating.

Example of Gross Default Multiples Approach

As an example, when rating a consumer ABS transaction in Mexico, Fitch will apply the ‘AAA’ gross default multiples (i.e. 5.0x) at the local currency rating of Mexico, which is ‘A-’. As a result an ‘A-’ internationally-rated Mexican transaction can withstand higher stresses than an ‘A-’ transaction within a developed market. The higher stresses and, as a result, the higher credit enhancement are needed to protect against a potentially more volatile environment. Fitch’s approach to national scale ratings is to equate the ‘AAA(nat)’ rating to the local currency rating of the country, which would have the same stresses as an International rating at the local currency rating of the country. In the Mexican example, for an ‘AAA(nat)’ transaction, Fitch would use the same stresses as a transaction, which would achieve an International rating of ‘A-’.

In rating consumer ABS transactions above the relevant country ceiling on a foreign-currency basis, additional stresses and rating caps will be assessed in conjunction with Fitch’ criteria report, “Criteria for Existing Asset Securitizations in Emerging Markets — Sovereign Constraints.”

Gross Default Stress

Stress multiples for each rating category refer to gross defaults, that is losses incurred prior to any consideration for recoveries. The following table is an example of the gross default stresses used for national scale ratings. The stress levels applied for international ratings are available in the criteria report, “Criteria for Existing Asset Securitizations in Emerging Markets — Sovereign Constraints.” Stresses outside the standard multiples may be applied to address risks associated with servicing ability, historical loss volatility, availability and amount of static loss data, portfolio growth, collateral composition, geographic concentrations and denomination of the underlying assets (i.e. fixed rate vs. floating vs. inflation index).

When Fitch analyzes historical gross default data, we consider the specific timeframe and the overall economic environment in which the data were sourced. If the historical data already refers to a stressful time period (i.e. a sovereign crisis), Fitch will reduce the overall stress, as the historical data may be abnormally high. Similarly for subprime collateral, these multiples may be lower, as these portfolios already reflect certain amounts of stress. Sample ‘AAA(nat)’ ranges are 3.5x–4.5x, with ‘AA(nat)’ ranges from 2.75x–3.50x, and ‘A(nat)’ from 2.0x–2.75x.

Recovery Stress

Due to a lack of data, timing delays and relatively low levels, Fitch has historically given little credit to recovery rates for unsecured and secured consumer loans in Latin America. Therefore, Fitch's recovery stress in most transactions is zero. Fitch will give credit to recoveries if the originator/servicer can show sufficient information to substantiate this. Fitch will stress these recovery rates depending on the rating levels. In many cases there will be time delays related to recoveries and Fitch will stress these time lags specific to the jurisdiction.

Prepayment Stress

Fitch will stress base case CPR in accordance to the relevant rating category. The level of stress per rating category will depend on the portfolio's yield, current interest rate environment, competitive landscape and the country's overall economic stability. As examples, stresses above base case CPR for 'AAA(nat)' are 2.0x–2.5x, 'AA(nat)' are 1.5x–2.0x and 'A(nat)' are 1.2x–1.5x. If historical prepayment data indicate an apparent stress, Fitch will adjust its base case CPR assessments in order to avoid potential 'double counting' of CPR stresses. These stresses will be applied and modeled in tandem with the appropriate default stresses.

Fitch will also perform model runs with substantially higher prepayment stresses within a base case default scenario in order to ascertain the prepayment sensitivity on cash flows. In Latin America, it is not uncommon to see substantial prepayment spikes in moments of stable or improving economic backdrop and gross default rates, declining market interest rates, thus, fostering greater lender competition.

As demand for higher yielding securities grows, many issuers are selling down the capital structure. Fitch has been asked to rate down to 'BB(nat)' and 'B(nat)'. While the credit analysis for these securities is similar to that for higher-rated classes, the dependency on excess spread for credit enhancement generally is far greater. In fact, it is not uncommon for a 'B(nat)'-rated class to be supported solely by excess spread and in some cases be undercollateralized at issuance (see Appendix 1: Gain on Sale Effect in Securitization Structures). Hence, Fitch will evaluate how these lower tranches support base case prepayments in tandem with gross defaults.

Structural Analysis

Cash Flow Modeling

Cash flow modeling is a fundamental element in analyzing any consumer ABS transaction. Such modeling has the ultimate goal of linking the cash flows stemming from the assets side with the liability side of a transaction in that it applies the allocation of proceeds generated as per the waterfall set in the transaction's underlying documentation.

Across Latin America, Fitch utilizes proprietary cash flow models in analyzing consumer ABS transactions. While these cash flow models are country-specific to meet each unique market's structural elements, the main variables feeding the models are uniform. These variables are timing of the base case defaults and recoveries, the transaction's capital structure, portfolio yield, prepayments, interest and, if applicable, currency stress. These inputs, except the capital structure, are subject to rating-specific stresses within the cash flow model.

The cash flow model reflects how the various stress scenarios affect principal and interest collections as they are received each period throughout the life of a transaction. The cash flow model then allocates those payments to the various classes of notes based on the transaction structure (e.g. cash flow waterfall) as detailed in the transaction documents.

The priority of payments or ‘waterfall’ of a transaction determines the order in which available funds are allocated at fixed intervals in satisfying the liabilities (interest and principal under the notes) of the issuer. Junior-ranking positions typically receive funds only after amounts due to more senior items for the relevant period have been paid in full.

There may be several priorities of payments in a single transaction, each corresponding to a category of funds (revenue or principal) and/or the status of the deal (e.g. pre- or post-enforcement of the notes).

In combined waterfall structures, principal and interest collected from the loans are merged and distributed according to one priority of payments. Principal payments to each note class are typically subordinated to payment of interest on the related note tranche.

With separate waterfalls, principal and interest funds are kept segregated and applied in their own respective waterfalls. In both cases it is possible to use interest to cover principal shortfalls, and principal may also be used to cover interest. Fitch has also seen structures where underperformance of the assets will trigger a change in the order in which interest is paid on the notes.

Pro Rata vs. Sequential Amortization

Pro rata amortization refers to the allocation of available cash flows to redeem the senior and junior notes proportionally in accordance with their respective outstanding balance. Thus, credit enhancement remains the same as a percentage of notes outstanding and decreases in absolute terms. Pro rata allocation of proceeds and hence a constant capital structure over time.

Under a sequential-pay amortization, as opposed to pro rata, collateral cash flows will be allocated to integrally pay down senior notes outstanding. Upon full redemption, cash flows will be used to retire junior class notes outstanding. As a result of sequential paydown, credit enhancement, as a percentage of senior notes outstanding, increases over time but remains the same in absolute terms.

In a ‘like-for-like’ comparison between a pro rata and sequential-pay amortization capital structures, Fitch will apply the same stress scenarios within the commensurate rating category. Hence, a sequential pay structure with a lower initial credit enhancement than a pro rata amortization structure could support the same stresses within the same rating category.

Furthermore, it is common for pro rata amortization structures to incorporate collateral performance triggers (e.g. delinquency, cumulative loss, etc.), which can alter the amortization of notes from pro rata to sequential. Fitch will incorporate these triggers within its transaction-specific cash flow model to evaluate how credit enhancement is preserved.

Interest Rate, Currency and Basis Risks

Interest rate or currency risk arising from a mismatch between the assets that constitute the ABS collateral and the liabilities may leave the issuer exposed to adverse movements in interest or exchange rates. This is typically hedged to a large extent either through matching both assets and liabilities in their composition of different currencies/interest rates (“natural hedge”) or through derivatives (primarily swaps but also caps, floors, forwards and options).

While currency mismatch is not common in consumer ABS in Latin America, interest rate mismatch is more predominant. The vast majority of consumer loan pools securitized in Latin America carry fixed-rate interest. However, the securitization class issuances

predominantly have a floating rate coupon. In such a case, the transaction may seek to hedge the interest rate risk by swapping: (i) the asset's fixed rate to floating or (ii) the liability's floating-rate coupon to a fixed rate. In the former, the risk of over- or underhedging is apparent as the assets (e.g. loan portfolio) may amortize faster than originally forecasted due to the acceleration of prepayments or defaults. In the latter, an early amortization event of the notes could also affect the hedge's coverage as the securitization's liability amortization is accelerated. In addition to evaluating the financial mechanics of the hedge instruments, Fitch will seek to understand the counterparties involved. This risk will be reviewed in accordance with Fitch's criteria report, "Counterparty Risk in Structured Finance Transactions: Hedge Criteria."

For transactions which do not incorporate interest-rate-risk hedging mechanisms, Fitch will evaluate available excess spread and other credit enhancement features which aim to mitigate interest rate mismatches. Country-specific stress scenarios for a given rating category will be applied to the securitization's cash flows, in addition to prepayment and gross default stresses.

While interest rate mismatch is the most common risk element in securitization transactions, specific consumer loan securitizations may also carry other basis risks such as mismatches in inflation indexes. In many countries, the liabilities are indexed to inflation and the portfolio does not adjust by the same index. Fitch will look to see how these risks are effectively hedged or, alternatively, stress the cash flows at appropriate country-specific stress scenarios consistent with the transaction's rating.

Forms of Credit Enhancement

Subordination/Overcollateralization

Senior/subordinated structures are typical in consumer ABS transactions. Here, one or more classes of notes (the junior notes) are subordinated in favor of the senior notes thereby providing the senior tranches with protection against losses. Depending upon the cash flow structure of the transaction, all of the principal and interest on the junior notes, or just the principal, may be subordinated for the benefit of the senior notes.

Effectively, any losses in the transaction that are not covered by excess spread will be suffered by the junior notes first. Overcollateralization exists where the principal amount of receivables/assets exceeds the principal amount of notes issued. The main difference between subordination and overcollateralization is that all of the available cash flows from overcollateralization will be used to support the senior notes if necessary. Conversely, support from subordination will typically be net of the junior note costs unless the structure allows for junior note interest to be subordinated to senior note interest and principal.

Portfolio Yield and Excess Spread

Fitch reviews the current yield distribution for an amortizing portfolio and the minimum warranted weighted-average (WA) yield for a revolving transaction. The agency then applies a WA coupon compression, which is driven by prepayment and delinquency/default stresses as it assumes that:

- Higher yielding accounts are more likely to be subject to delinquency, as accounts priced with higher interest are assumed to have less creditworthy borrowers and are more likely to default.
- Higher interest paying accounts are more likely to prepay, as these obligors are more likely to find cheaper funding elsewhere.

The pool interest rate distribution is therefore dynamically adjusted, and a new WA interest rate is calculated at each payment date to reflect the assumed change in the interest rate composition of the then-outstanding portfolio. The total WA coupon compression, arising from prepayments, delinquencies and defaults, is stressed under the respective rating scenario as a consequence of the prepayment, delinquency and default rates applied. For transactions where the initial pool amortizes along with the notes, Fitch uses the pool's initial WA yield as a starting point for its cash flow model. For revolving transactions, Fitch normally models yield at the minimum WA yield that the eligibility criteria allows.

For transactions which acquire the loan portfolio at a premium in relation to its WA yield, Fitch will use the portfolio's WA yield based upon the actual outstanding loan portfolio balance transferred to the transaction.

Fitch calculates excess spread as portfolio yield less funding costs, servicing and transaction costs, delinquent yield and defaults. Fitch models the excess spread according to its application in the waterfall, which can be such that it is released to the originator on each payment date when it has not been used to cover defaults or losses ("use it or lose it"). It may fund a reserve account up to a particular level, or it may be used to redeem a particular class of notes. The latter can be such that it redeems a senior note and as such builds additional overcollateralization, or such that it "turbo" a mezzanine note and reduces the WA cost of capital.

Credit given for excess spread in Fitch's cash flow model is dependent on the different prepayment and default assumptions applied under the various target ratings. Trapping of excess spread during the life of the transaction may occur immediately after closing with the purpose of building a reserve amount. Alternatively, trapping may occur after the breach of a performance trigger with the purpose of building a reserve prior to performance deteriorating to an overall loss-making level. Depending on the projected level of spread performance going forward, Fitch may give credit for immediate trapping of excess spread. However, since it has to be assumed that excess spread diminishes quickly in a stressed scenario, Fitch typically only gives credit for trapping of excess spread over an initial period of six months after closing, which is the time horizon the agency deems prudent not to assume the emergence of a severe stress.

Reserve Accounts

Most unsecured loan securitizations use spread or reserve accounts, which are typically funded with a subordinated loan, and/or, as above, trap net excess spread up to a required amount. Reserve accounts are used primarily to provide liquidity.

Most reserve accounts are then established to reach a target level within six months. If the reserve account target is reached, a greater amount of credit enhancement is available to cover remaining losses, and the losses the transaction can withstand are significantly greater than they were at day one. However, under certain stress scenarios applied in cash flow modeling, the reserve account targets may not necessarily be achieved.

Reserve account proceeds should be allocated in accordance to a specified list of investments per transaction documentation, which seek to eliminate market risk and credit risk, which is not commensurate with the transaction debt class ratings. Further details are outlined in "Counterparty Risk in Structured Finance: Qualified Investment Criteria."

Analysis of Revolving Transactions

Many consumer ABS loan and lease transactions contain a revolving period that is typically for a period of between two and five years. During the revolving period, noteholders will receive interest only, and principal is utilized to purchase new receivables. The average life of the transaction is therefore extended. At the end of the revolving period, the amortization period will begin, and principal receipts will be used to amortize the transaction and pay down the noteholders.

During the revolving period, it is key to ensure that the quality of the portfolio is kept as closely in line as possible with the original pool upon which the analysis was based. Certain structural features including eligibility criteria and performance triggers attempt to mitigate any deterioration in the portfolio during the revolving period.

Eligibility and Portfolio Criteria

Eligibility and portfolio criteria are employed by transaction structuring agents to ensure that purchases by the issuer are consistent with the original pool. Typical eligibility criteria for consumer loan and lease ABS transactions will include the following, some of which will only be applicable for auto transactions:

- Originated in line with the originator's underwriting guidelines.
- No delinquent or written off/charged-off contracts.
- Maximum loan/lease tenor.
- Minimum seasoning.
- Compliance with applicable consumer finance legislation and enforceable.
- Maximum single obligor concentration limits.
- Minimum WA interest rate.
- Percentage of new versus used cars.
- Minimum interest weight or spread for each loan in the pool.
- Maximum original maturity for every contract.
- Geographical constraints.
- Maximum residual value (RV) or balloon per contract, by portfolio or subpool.
- RV/Balloon cap for the portfolio or sub-pool.

Fitch will use the minimum portfolio criteria as an input into the cash flow model to make an assumption on how the credit quality of the portfolio could deteriorate towards the end of the revolving period. For instance, Fitch would assume the share of these products to be maximized as per the portfolio criteria for which it assigned the highest base case default rate or the lowest base case recovery rate. The same applies with regard to assumptions being made on the cash flow side such as, for instance, the WA yield on the portfolio.

Triggers

During the revolving period, the performance of the pool must be monitored to review any significant deviation from historical performance seen at the time of rating the transaction. Fitch therefore accompanies performance and other triggers, which if breached will trigger an early amortization of the transaction, to evaluate whether performance is consistent with original assumptions made when calculating credit enhancement levels. Typical triggers include the following:

- A maximum threshold of delinquency and defaults.
- Negative excess spread or a minimum threshold of yield.
- No uncleared entry on the Principal Deficiency Ledger (PDL).
- No drawings on the cash reserve.

When evaluating delinquency and default triggers, Fitch understands that these triggers seek to maintain performance closely in line with that seen at the time of rating the transaction, although recognizing that performance will be subject to some fluctuations. Triggers may be set in line with base case portfolio parameters, which are derived from the historical performance of the portfolio at close. This addresses the concern that if performance deviates too far from the base case, credit enhancement may not be sufficient when the transaction starts to amortize. When evaluating a default trigger, Fitch will also take into account the transaction's capital structure and the forms of credit enhancement available. If the trigger is adjusted on an annual basis, it should be set to follow the default rate determined from historical data. New purchases that occur during the revolving period are taken into account and added into the denominator for the calculation of cumulative defaults. However, additions will be subject to a time lag depending upon the definition of default to take account of the time it takes for new receivables to roll through the delinquency buckets prior to default.

Although triggers may be useful in identifying collateral deterioration, they may not always be a true indicator of performance. These triggers may be "managed" by sellers in transaction structures, which permit repurchasing of underperforming or prepaid collateral. Hence, the seller may choose to take this collateral back onto its balance sheet in order not to jeopardize an important source of funding. Fitch will seek to monitor repurchase activity in complementing these triggers.

Legal Structure and Opinions

Fitch will review the transaction documents in connection with the transaction and, where appropriate, receive for its review legal opinions and memoranda identifying all significant legal risks in the transaction. Without limiting what may be relevant in any particular jurisdiction, typically, these will include the following:

Consumer Finance Contract

In relation to the form of consumer finance contract that generates the receivables, Fitch expects to receive legal opinions that:

- Confirm that (based on appropriate factual assumptions) a contract entered into using this form of contract will be legal, valid, binding and enforceable under the relevant consumer credit and other applicable consumer laws that govern its formation.
- Analyze whether any legal right exists for the consumer to exercise set-off rights against the lender in respect to the consumer finance contract.
- Analyze whether there is any potential lender liability in respect to the consumer finance contract under applicable consumer laws, for example for lender's liability (whether several, or jointly with the supplier) for goods or services purchased under the consumer finance contract or for untrue or incorrect representations made by brokers or suppliers of goods or services financed by the consumer finance contract.
- Identify whether the consumer finance contract can be affected by any applicable usury laws.

Transaction Opinions

In relation to the transaction, Fitch would typically expect the following issues to be addressed in the legal opinions:

- The special purpose vehicle (SPV), or equivalent vehicle, has been duly incorporated (or established) and exists, and, where relevant, it has good standing and it has the power and capacity to enter into and perform its obligations under the transaction documents.
- The transaction documents are legal, valid, binding and enforceable against the SPV and all other transaction parties relevant to the ratings analysis. The opinions should cover both the law chosen to govern the transaction documents and the laws of any other relevant jurisdictions where the transaction documents are to be enforced; for example, jurisdictions where relevant parties are established or where assets are located. In addition, any local legal, regulatory or tax requirements or consequences that affect the SPV in the place where it is established should be identified. For example, in certain legal jurisdictions, the borrower must be duly notified of the asset sale transfer. (See also Fitch's criteria report "Special-Purpose Vehicles in Structured Finance Transactions.")
- There has been a "true sale" or other mechanism to transfer title to the receivables (and all other securitized assets, for example, where the RV of assets is being financed) from the originator/seller to the SPV in a way that mitigates as much as possible the ability of the originator (or any creditor or bankruptcy official appointed to the originator) to overturn the sale and clawback the receivables. Typically, Fitch will expect this analysis to include a bankruptcy analysis of the originator/seller (in respect to the true sale/other mechanism) and the SPV (in respect to the transfer of assets to the transaction creditors). Where the securitized asset is the RV of assets rather than a receivable, Fitch will expect to receive a legal opinion in respect to the transfer of title to the assets whose RV is being securitized, particularly in structures in which transfer of title does not occur at the outset of the securitization, but is triggered at a future date (for example, on expiry of a hire-purchase or lease contract). If the SPV takes title to physical assets, Fitch would also expect the legal opinion to identify and analyze the risks — if any — of the SPV holding legal title to those assets.
- The transaction creditors, through the security trustee, have been granted legal, valid, binding and enforceable first-ranking security by the SPV over the receivables and other assets acquired.
- The existence of any tax liabilities that can affect the cash flows in the transaction have been identified.
- In respect to any trusts in the structure, they are validly established and the trust assets will not be assets available to the general creditors of the trustee in the event of the trustee's insolvency.

Performance Analytics

Upon the closing and issuance of the transaction, Fitch will initiate surveillance. The ongoing performance analysis of transactions forms an essential part of the Fitch rating process. A dedicated team handles the ongoing monitoring and review of Fitch-rated consumer ABS transactions by assessing whether the transactions are performing as expected.

Originator and Servicer Review

As each market has developed in differing forms and pace, Fitch has published several criteria reports for ABS servicers in Argentina, Chile and Mexico. These criteria explore in greater detail the below mentioned issues. The originator and servicer review aims to evaluate qualitative factors, which can provide a positive, neutral or negative adjustment to analyzing available credit enhancement in consumer ABS transactions.

Fitch will conduct a complete review of the originator and servicer associated with each securitization, and the review will typically be done at least once a year in the case of originators issuing multiple transactions per year. The review will focus on various aspects of the company and its overall operations that may impact the quality of the receivables and performance of the securitization including a discussion about the company's origination and servicing activities. The areas evaluated during the operational review include:

- Corporate overview, including financial condition, management experience and corporate risk management.
- Origination, underwriting and scoring models.
- Staffing and training.
- Procedures and controls.
- Servicing.
- Collections and default management.
- Technology.

Corporate Overview

A thorough understanding of the company's history, structure, strategic objectives, management experience and funding capabilities are key to the operational review undertaken by Fitch. An assessment of the financial condition of the originator (and servicer, if separate from the originator) will be carried out if a formal credit rating is not available, and may involve the Financial Institution and Corporate groups to ascertain the organization's financial stability. For repeat issuers of term revolving structures or term multi-tranche programs, the originator will periodically reviewed.

Origination and Underwriting

The quality and consistency of the underwriting process is critical to the future performance of the receivables. Fitch's review includes an understanding of the originator's sourcing practices and how vendors are selected and monitored. In assessing the underwriting practices of the originator, which are becoming increasingly automated, Fitch focuses considerable attention on the application receipt and data verification process, the loan approval process and how credit authority is delegated to underwriters. While centralized or decentralized underwriting by originators has demonstrated success with both approaches, Fitch does review the control mechanisms for decentralization of underwriting authority. However, it is important to evaluate any conflicts of interest between the sales staff and credit approval personnel. Ideally, remuneration of credit analyst personnel should not be commission based. Fitch will evaluate whether such conflicts are evident and incorporated within historical performance data.

Originators may use credit scorecards to assist in the underwriting process. Credit scoring is a method by which a large sample of defaulted loans is analyzed to determine which variables are statistically significant predictors of default, allowing the efficient and accurate credit assessment of numerous applicants. Fitch will analyze the variables

feeding the originator's scorecard and consider how and why these variables have changed over time. Fitch also takes into account how often scorecards are validated and reassessed to ensure the cards maintain predictive validity.

In reviewing the originator, Fitch will also ascertain the effectiveness of the company's fraud detection processes. It is assessed as to how the originator employs money laundering checks, customer identity and address verification procedures and its participation in industry and national fraud detection schemes.

If the transaction is of a revolving nature, there is the risk that origination and underwriting standards deteriorate over time, such that the portfolio at the beginning of the amortization period is not of equal quality to the historical portfolio used to determine the credit enhancement levels at the inception of the transaction. This might be particularly true when the originator's credit quality suffers, and its dependence on funding via securitization increases. If the stop of replenishment upon a significant deterioration of the originator's credit quality is not an option since it would cut essential funding sources, the managing entity to the SPV hire regular pool audits to be carried out by third parties to check whether underwriting standards and eligibility criteria have been maintained, which would be made available to Fitch. Fitch will adjust base case assumptions in accordance to changes in underwriting standards and eligibility criteria and its effects on available credit enhancement.

Staffing and Training

The tenure and experience of the underwriting and servicing personnel is reviewed as is the organizational structure of both departments. Fitch will evaluate the underwriters' consumer finance backgrounds, the servicing staff's experience in administering receivables and the call center personnel's experience in collecting on secured and/or unsecured loans. Fitch also evaluates whether a training program is well documented with specific requirements for new hires. In several Latin American markets, personnel turnover has been quite high, thus, emphasizing the need for a well-structured training program.

Procedures and Controls

Documented policies and procedures for both underwriting and servicing are critical to ensure corporate credit policies are followed, thus minimizing potential defaults and losses. The originator should be able to make adjustments to its policies and procedures based on reviews of performing and nonperforming portfolios. Fitch will also review the relevant reporting and decision making procedures. In some countries, the transaction structuring agent may hire an independent evaluation of the originator's procedures and controls may be carried out by a third party, which would be made available to Fitch.

Quality control is another critical factor in Fitch's review of originators. Fitch reviews the level of exceptions to credit, which are a concern since they may indicate possible portfolio deterioration. Internal audit procedures should be in place as well to ensure compliance with all company procedures and industry guidelines, and that appropriate follow-up action is taken for exceptions.

Servicing

In nearly all consumer transactions in Latin America, the originator and servicer are the same entity. This may be due to the originator's proven collection experience or the difficulty in viably implementing a third party or backup servicer. Given the pivotal role that the servicer plays in every structured finance transaction, attention is paid to a servicer's financial strength and ability to accommodate growth while maintaining collection and repossession procedures.

If the originator outsources the servicing to a third party, a full review is also carried out with this party. If the entity undertaking the servicing lacks a credit rating from Fitch, the appropriate analytical group within Fitch (Financial Institutions or Corporates) may be consulted to ascertain the financial strength and viability of the servicer. Along with discussions about procedures, staffing and training, the review will focus on specific servicing activities such as the setup process for new accounts, ongoing administration of existing receivables and client and/or investor reporting.

If the servicer holds funds belonging to the issuer, Fitch will assess the credit quality of the servicer in applying criteria as set out in "Commingling Risk in Structured Finance Transactions." In Brazil, commingling risk of funds can be dramatically minimized in structured transactions due to the country's financial system, which affords a standard electronic payment, thereby segregating cash flows from that of the originator. Conversely, certain retail consumer loan originators may require borrowers to make payments directly in their own stores, which further heightens potential commingling concerns. Under such a circumstance, the transaction rating can be "capped" by Fitch's assessment of the operational risk of the seller/servicer.

For servicers of a substantially lower credit quality in relation to that of the rated transaction under service, the manager to the SPV may hire a backup servicer. The servicing agreement with the backup entity should specify the scenario in which it becomes involved and what steps will be taken. Depending upon the contractual specifications, a backup servicer may be hired to receive regular data updates on a daily, weekly, monthly or quarterly basis from the originator and be able to take over the servicing functions within a relatively short timeframe.

Given that the originator generally is the servicer for the transaction, the servicing fees charged are generally below market rates. Therefore, transfer of collections to a backup servicer will likely result in increased expenses. In such a case, Fitch will assess these expenses in its cash flow modeling.

Collections and Default Management

During the servicer review, Fitch will evaluate the collection processes and loss mitigation tactics as well as the servicer's procedures surrounding enforcement and repossession of collateral in the case of auto finance transactions. The collections process should be flexible enough to allow the borrower sufficient time to correct the arrears while ensuring that appropriate action is administered in a timely manner when nonpayment becomes inevitable. Along with tracking payment receipts, billings, insurance and monitoring borrower contact, the servicer's systems should also be able to generate information management reports. While many of the processes undertaken by the servicer relating to collections are automated such as delinquency letters and calling schemes using outbound dialers, Fitch will assess the use of these systems and may request demonstrations of the respective applications.

As there are various ways to organize the collections department within a servicing organization, Fitch will review the servicer's specific structure, paying particular attention to how collectors are recruited, trained and organized as well as the tools used to manage each collector's performance. Regardless of how the collections department is structured, Fitch reviews to see how highly qualified collectors are handling the more serious delinquent accounts.

Fitch will also review historical performance within the servicer's existing portfolio as well as for previous securitizations. For all transactions, the agency will review timelines from default to recovery, including the timeframe from actual possession to the sale of the collateral in the case of auto finance transactions. Attention will also be paid to the

write-off process, including timelines, average write-off amounts, collection of shortfalls, if applicable, and the approval process for authorizing write-offs.

Technology

As part of the review of the originator and servicer, either together or as separate entities, Fitch will evaluate the adequacy of IT systems used to support the management of the portfolio, the administration of the receivables and, for revolving structures, the ongoing origination of accounts. The review will include an understanding of the company's IT infrastructure, including its network configuration and how the various applications used for origination, underwriting and servicing interface with one another. Disaster recovery and business contingency is also discussed as well as the company's process for ongoing systems development and plans for upgrading or replacing existing systems.

Appendix 1: Gain on Sale Effect in Securitization Structures

In many Latin American markets, it is common to sell high-yielding consumer loan portfolios at a premium above the collateral's par value (e.g. outstanding principal balance). In such cases, originators generally seek to fund upfront origination costs (e.g. dealership commissions) or even anticipate cash out on future financial revenue. Under such a "gain on sale" tactic, the originating bank receives cash against future financial revenue from the collateral while the securitization, in many cases, will consider the collateral at the purchase price paid rather than using the true collateral balance. Under this circumstance, collateral is overstated and, conversely, credit enhancement to senior tranches is understated. This ultimately results in more subordinate tranches becoming undercollateralized (i.e. negative equity) and becoming solely dependent upon excess spread to cover principal amortization.

Fitch will model cash flows using the collateral's real outstanding principal balance effectively sold to the securitization. (Contrary to the purchase price paid) in order to account for such discrepancies.

Gain on Sale Effect in Securitization

(100% Par Value)

Loan Collateral		Capital Structure		C/E %
WA Original Term (Months)	36	Class A Senior (At 13% APR)	100	20
WA Remaining Term (Months)	36	Class B Subordinate (At 17% APR)	10	12
WA Yield (APR %)	30.00	Class C Subordinate (Residual)	15	0
Purchase Rate (APR %)	30.00	Total Issuance	125	
Collateral Purchase Price	125	Excess Spread		
Gain on Sale	—	WA Portfolio Yield %	30.00	
Collateral Principal Balance	125	Class A Senior Coupon (13% x 100/125) (%)	10.40	
		Class B Coupon (17% x 10%) (%)	1.40	
		Available Excess Spread (%)	18.20	

(119% Par Value)

Loan Collateral		Capital Structure		C/E %
WA Original Term (Months)	36	Class A Senior (at 13% APR)	100	5
WA Remaining Term (Months)	36	Class B Subordinate (at 17% APR)	10	(4)
WA Yield (APR %)	30.00	Class C Subordinate (Residual)	15	0
Purchase Rate (APR %)	15.00	Total Issuance	125	
Collateral Purchase Price	105.4	Excess Spread		
Gain on Sale	19.6	WA Portfolio Yield (%)	30.00	
Collateral Principal Balance	125	Class A Senior Coupon (13% x 100/105.4) (%)	12.30	
		Class B Coupon (17% x 10/105.4) (%)	1.60	
		Available Excess Spread (%)	16.10	

APR – Annual Percentage Rate. WA – Weighted average.

In the same manner that collateral adjustments are made for transactions which purchase loan pools at a premium, excess spread is assessed using the weighted average portfolio yield over the actual collateral balance. In some countries, it is common to see securitizations acquiring collateral at a premium based on a determined purchase rate below the loan interest rate. The securitization will then account for the collateral at the purchase price and will accrue portfolio yield based on the purchase rate rather than the loan interest rate. In respect, portfolio yield is underestimated over an overestimated collateral balance.

Fitch will model true outstanding principle loan balance and available excess spread using the loan interest yield based upon the real collateral balance. Hence, Fitch's ratings are commensurate with credit enhancement levels irrespective of gain on sale amounts or premiums paid.

Source: Fitch Ratings.

Appendix 2: Information Received from Issuers

To analyze a pool of consumer loans, Fitch reviews underwriting and servicing manuals, stratification data for the current portfolio and approximately three to five years' portfolio performance history.

Portfolio Stratification Data

- Total number of accounts and current outstanding balance.
- Weighted average and distribution of original and remaining maturity.
- Weighted average and distribution of yield.
- Demographic information.

Portfolio Historical Data

- Static pool cumulative gross charge-off.
- Static pool recovery of charged-off balances.
- Static pool cumulative prepayment.
- Dynamic delinquencies showing periodic aging by delinquency bucket.
- Dynamic portfolio yield.

Source: Fitch Ratings.

Appendix 3: Calculation of Base Cases

The analysis below describes how Fitch constructs a static cumulative default rate table and the extrapolations of default rates for recently originated vintages. The same methodology is also applicable to the calculation of cumulative base case recovery rate assumptions, except that the agency would not apply extrapolation. How the agency calculates adjustments for seasoning is also described further down in this appendix.

Defaults are defined as the point in time, post-delinquency, when the originator has demanded full repayment of the loan and has classified it as defaulted. This point in time shall be reflected in the definition of default. The default definition will differ from originator to originator.

Cumulative Gross Default Rates

Table 1 below is an example of vintage data provided to the agency by an originator. The table presents defaults as per the chosen default definition for each quarter since the origination of a vintage. For example, the Q403 vintage has actual defaults of 6,384 two quarters after origination.

Table 1: Actual Default Amounts per Quarter

Vintages	Origination Amount	Quarters Since Origination																				
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1Q01	612,000	623	2,853	3,462	4,658	5,200	3,618	1,670	2,780	1,797	1,886	427	599	1,488	671	532	650	103	113	81	306	662
2Q01	700,000	613	3,875	2,440	5,476	5,664	3,117	3,061	1,254	2,603	1,867	273	1,015	1,833	648	1,051	571	161	146	964	586	
3Q01	732,490	937	4,197	6,089	4,034	3,760	3,540	1,478	3,400	573	3,635	393	1,424	986	1,561	470	93	578	355	117		
4Q01	793,984	1,807	4,908	7,017	3,640	4,205	4,724	3,801	1,360	3,451	2,056	970	1,116	1,682	614	1,248	83	946	599			
1Q02	834,563	1,842	4,283	4,546	5,136	7,315	2,867	2,817	3,082	768	3,843	627	1,540	1,825	1,904	223	347	117				
2Q02	904,485	1,277	4,614	7,222	6,555	4,898	4,367	5,542	2,421	2,749	455	957	3,380	1,480	259	390	317					
3Q02	953,534	978	5,797	6,798	5,303	5,408	5,646	5,441	4,204	2,525	2,455	561	1,515	555	811	2,011						
4Q02	980,124	1,249	5,000	4,803	4,679	3,652	2,466	4,726	3,154	2,631	3,680	877	496	505	2,098							
1Q03	1,202,324	2,157	6,105	5,493	9,745	5,652	1,598	5,094	2,048	6,255	69	945	2,914	1,203								
2Q03	1,014,485	1,643	4,296	8,163	5,137	3,378	3,525	3,485	5,447	2,236	626	1,285	1,217									
3Q03	1,171,731	1,751	5,222	6,892	5,528	3,706	5,558	7,791	465	3,013	1,086	3,583										
4Q03	1,312,338	1,674	6,384	6,826	4,039	8,733	2,957	6,840	271	1,790	557											
1Q04	1,509,189	2,342	6,505	8,365	4,728	4,463	3,588	5,650	1,651	2,446												
2Q04	1,569,557	2,013	7,018	8,046	5,775	6,169	5,403	1,365	2,522													
3Q04	1,545,922	2,218	6,763	6,338	6,146	5,201	3,816	3,173														
4Q04	1,514,485	2,690	6,859	4,643	7,972	5,212	431															
1Q05	1,574,685	2,572	6,044	7,784	6,356	4,269																
2Q05	1,578,485	1,526	4,542	5,541	2,602																	
3Q05	1,501,234	924	5,679	3,063																		
4Q05	1,472,187	964	5,091																			
1Q06	1,459,861	1,198																				

Source: Fitch Ratings.

Cumulative defaults for each vintage for each quarter since origination are calculated simply by adding all of the actual defaults up to the quarter. For example, the Q403 vintage has cumulative defaults of 18,923 four quarters after origination, which is the sum of 1,674, 6,384, 6,826 and 4,039. Table 2 below is the cumulative default table based on Table 1 from the previous page.

Table 2: Cumulative Default Amounts per Quarter

(USD)

Vintage	Origin-ation Amount	Quarters Since Origination																				
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1Q01	612,000	623	3,476	6,938	11,596	16,796	20,414	22,084	24,864	26,661	28,547	28,974	29,573	31,061	31,732	32,264	32,914	33,017	33,130	33,211	33,517	34,179
2Q01	700,000	613	4,488	6,928	12,404	18,068	21,185	24,246	25,500	28,103	29,970	30,243	31,258	33,091	33,739	34,790	35,361	35,522	35,668	36,632	37,218	
3Q01	732,490	937	5,134	11,223	15,257	19,017	22,557	24,035	27,435	28,008	31,643	32,036	33,460	34,446	36,007	36,477	36,570	37,148	37,503	37,620		
4Q01	793,984	1,807	6,715	13,732	17,372	21,577	26,301	30,102	31,462	34,913	36,969	37,939	39,055	40,737	41,351	42,599	42,682	43,628	44,227			
1Q02	834,563	1,842	6,125	10,671	15,807	23,122	25,989	28,806	31,888	32,656	36,499	37,126	38,666	40,491	42,395	42,618	42,965	43,082				
2Q02	904,485	1,277	5,891	13,113	19,668	24,566	28,933	34,475	36,896	39,645	40,100	41,057	44,437	45,917	46,176	46,566	46,883					
3Q02	953,534	978	6,775	13,573	18,876	24,284	29,930	35,371	39,575	42,100	44,555	45,116	46,631	47,186	47,997	50,008						
4Q02	980,124	1,249	6,249	11,052	15,731	19,383	21,849	26,575	29,729	32,360	36,040	36,917	37,413	37,918	40,016							
1Q03	1,202,324	2,157	8,262	13,755	23,500	29,152	30,750	35,844	37,892	44,147	44,216	45,161	48,075	49,278								
2Q03	1,014,485	1,643	5,939	14,102	19,239	22,617	26,142	29,627	35,074	37,310	37,936	39,221	40,438									
3Q03	1,171,731	1,751	6,973	13,865	19,393	23,099	28,657	36,448	36,913	39,926	41,012	44,595										
4Q03	1,312,338	1,674	8,058	14,884	18,923	27,656	30,613	37,453	37,724	39,514	40,071											
1Q04	1,509,189	2,342	8,847	17,212	21,940	26,403	29,991	35,641	37,292	39,738												
2Q04	1,569,557	2,013	9,031	17,077	22,852	29,021	34,424	35,789	38,311													
3Q04	1,545,922	2,218	8,981	15,319	21,465	26,666	30,482	33,655														
4Q04	1,514,485	2,690	9,549	14,192	22,164	27,376	27,807															
1Q05	1,574,685	2,572	8,616	16,400	22,756	27,025																
2Q05	1,578,485	1,526	6,068	11,609	14,211																	
3Q05	1,501,234	924	6,603	9,666																		
4Q05	1,472,187	964	6,055																			
1Q06	1,459,861	1,198																				

Source: Fitch Ratings.

The cumulative default rate is calculated by dividing the cumulative defaults by the origination amount for each quarter (see Table 3 below) expressed as a percentage. The resulting rates are plotted in Chart 1 on the next page.

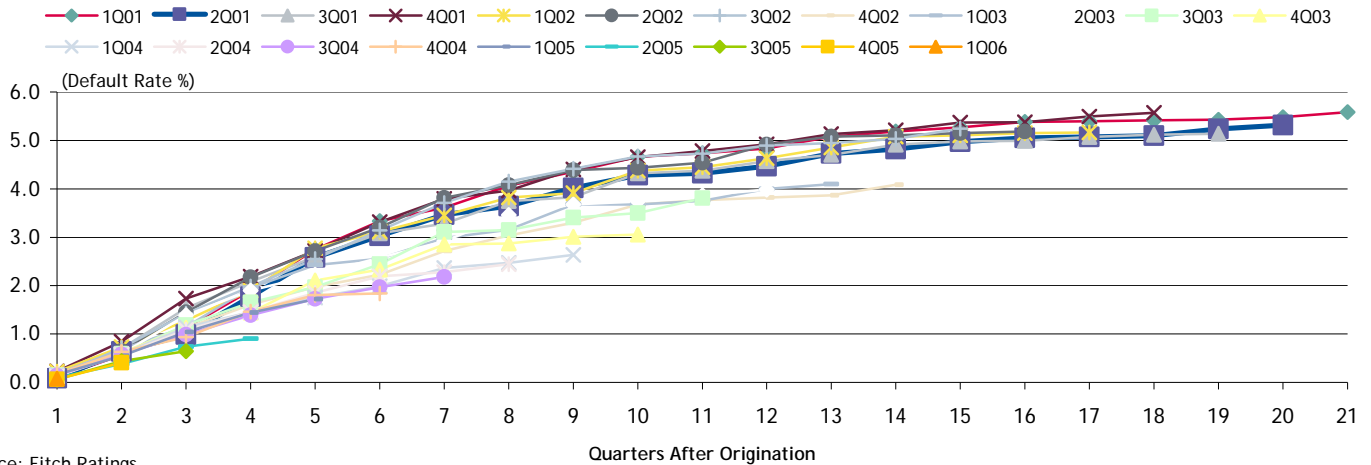
Table 3: Static Cumulative Default Rates

(%)

Vintage	Origination Amount	Quarters Since Origination																				
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1Q01	612,000	0.10	0.57	1.13	1.89	2.74	3.34	3.61	4.06	4.36	4.66	4.73	4.83	5.08	5.18	5.27	5.38	5.39	5.41	5.43	5.48	5.58
2Q01	700,000	0.09	0.64	0.99	1.77	2.58	3.03	3.46	3.64	4.01	4.28	4.32	4.47	4.73	4.82	4.97	5.05	5.07	5.10	5.23	5.32	
3Q01	732,490	0.13	0.70	1.53	2.08	2.60	3.08	3.28	3.75	3.82	4.32	4.37	4.57	4.70	4.92	4.98	4.99	5.07	5.12	5.14		
4Q01	793,984	0.23	0.85	1.73	2.19	2.72	3.31	3.79	3.96	4.40	4.66	4.78	4.92	5.13	5.21	5.37	5.38	5.49	5.57			
1Q02	834,563	0.22	0.73	1.28	1.89	2.77	3.11	3.45	3.82	3.91	4.37	4.45	4.63	4.85	5.08	5.11	5.15	5.16				
2Q02	904,485	0.14	0.65	1.45	2.17	2.72	3.20	3.81	4.08	4.38	4.43	4.54	4.91	5.08	5.11	5.15	5.18					
3Q02	953,534	0.10	0.71	1.42	1.98	2.55	3.14	3.71	4.15	4.42	4.67	4.73	4.89	4.95	5.03	5.24						
4Q02	980,124	0.13	0.64	1.13	1.61	1.98	2.23	2.71	3.03	3.30	3.68	3.77	3.82	3.87	4.08							
1Q03	1,202,324	0.18	0.69	1.14	1.95	2.42	2.56	2.98	3.15	3.67	3.68	3.76	4.00	4.10								
2Q03	1,014,485	0.16	0.59	1.39	1.90	2.23	2.58	2.92	3.46	3.68	3.74	3.87	3.99									
3Q03	1,171,731	0.15	0.60	1.18	1.66	1.97	2.45	3.11	3.15	3.41	3.50	3.81										
4Q03	1,312,338	0.13	0.61	1.13	1.44	2.11	2.33	2.85	2.87	3.01	3.05											
1Q04	1,509,189	0.16	0.59	1.14	1.45	1.75	1.99	2.36	2.47	2.63												
2Q04	1,569,557	0.13	0.58	1.09	1.46	1.85	2.19	2.28	2.44													
3Q04	1,545,922	0.14	0.58	0.99	1.39	1.72	1.97	2.18														
4Q04	1,514,485	0.18	0.63	0.94	1.46	1.81	1.84															
1Q05	1,574,685	0.16	0.55	1.04	1.45	1.72																
2Q05	1,578,485	0.10	0.38	0.74	0.90																	
3Q05	1,501,234	0.06	0.44	0.64																		
4Q05	1,472,187	0.07	0.41																			
1Q06	1,459,861	0.08																				

Source: Fitch Ratings.

Chart 1: Static Cumulative Default Rates



Source: Fitch Ratings.

Extrapolation of Cumulative Default Rates

To extrapolate a default rate for more recently originated vintages, gradient factors are calculated for each vintage and quarter since origination. An average gradient factor is then calculated with which the cumulative default rates are extrapolated.

The gradient factors for Table 4 are depicted below. The gradient factor for each vintage and each quarter since origination is calculated by dividing the subsequent quarter's defaults by the preceding quarter's defaults. For example, the gradient factor for vintage 4Q03 from two quarters after origination to three quarters after origination is $1.13/0.61 = 1.85$. Fitch will apply extrapolation with consideration in situations where the defaults rates observed for the most recent vintages differ significantly from early defaults in previous vintages.

Table 4: Gradient Factors

Vintages	Origination Amount	Quarters Since Origination																				
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1Q01	612,000	—	5.58	2.00	1.67	1.45	1.22	1.08	1.13	1.07	1.07	1.01	1.02	1.05	1.02	1.02	1.02	1.00	1.00	1.00	1.01	1.02
2Q01	700,000	—	7.32	1.54	1.79	1.46	1.17	1.14	1.05	1.10	1.07	1.01	1.03	1.06	1.02	1.03	1.02	1.00	1.00	1.03	1.02	
3Q01	732,490	—	5.48	2.19	1.36	1.25	1.19	1.07	1.14	1.02	1.13	1.01	1.04	1.03	1.05	1.01	1.00	1.02	1.01	1.00		
4Q01	793,984	—	3.72	2.04	1.27	1.24	1.22	1.14	1.05	1.11	1.06	1.03	1.03	1.04	1.02	1.03	1.00	1.02	1.01			
1Q02	834,563	—	3.33	1.74	1.48	1.46	1.12	1.11	1.11	1.02	1.12	1.02	1.04	1.05	1.05	1.01	1.01	1.00				
2Q02	904,485	—	4.61	2.23	1.50	1.25	1.18	1.19	1.07	1.07	1.01	1.02	1.08	1.03	1.01	1.01	1.01					
3Q02	953,534	—	6.93	2.00	1.39	1.29	1.23	1.18	1.12	1.06	1.06	1.01	1.03	1.01	1.02	1.04						
4Q02	980,124	—	5.00	1.77	1.42	1.23	1.13	1.22	1.12	1.09	1.11	1.02	1.01	1.01	1.06							
1Q03	1,202,324	—	3.83	1.66	1.71	1.24	1.05	1.17	1.06	1.17	1.00	1.02	1.06	1.03								
2Q03	1,014,485	—	3.61	2.37	1.36	1.18	1.16	1.13	1.18	1.06	1.02	1.03	1.03									
3Q03	1,171,731	—	3.98	1.99	1.40	1.19	1.24	1.27	1.01	1.08	1.03	1.09										
4Q03	1,312,338	—	4.81	1.85	1.27	1.46	1.11	1.22	1.01	1.05	1.01											
1Q04	1,509,189	—	3.78	1.95	1.27	1.20	1.14	1.19	1.05	1.07												
2Q04	1,569,557	—	4.49	1.89	1.34	1.27	1.19	1.04	1.07													
3Q04	1,545,922	—	4.05	1.71	1.40	1.24	1.14	1.10														
4Q04	1,514,485	—	3.55	1.49	1.56	1.24	1.02															
1Q05	1,574,685	—	3.35	1.90	1.39	1.19																
2Q05	1,578,485	—	3.98	1.91	1.22																	
3Q05	1,501,234	—	7.15	1.46																		
4Q05	1,472,187	—	6.28																			
1Q06	1,459,861	—																				
Average Gradient Factors			4.74	1.88	1.43	1.28	1.16	1.15	1.08	1.08	1.06	1.03	1.04	1.03	1.03	1.02	1.01	1.01	1.01	1.01	1.01	1.02

Source: Fitch Ratings.

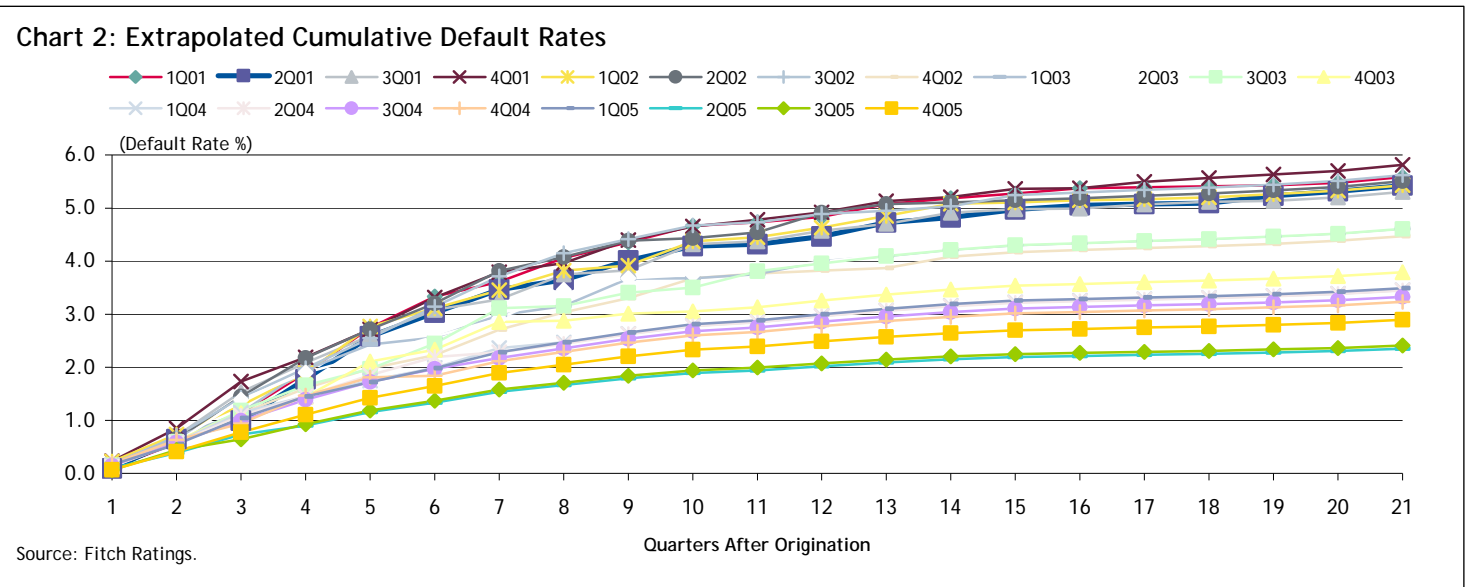
Once all gradient factors have been calculated, they are averaged across all vintages for a specific quarter after origination. In the example above, the average gradient factor for all vintages three quarters after origination is 1.88. The average gradient factors calculated for each quarter after origination is used to extrapolate the cumulative default rates.

Table 5 below presents the results of the extrapolated default rates. The extrapolated default rate for the next quarter is calculated by multiplying this quarter's default rate by the average gradient factor for next quarter. For the 2Q05 vintage, to extrapolate the default rate from four quarters to five quarters after origination, Fitch multiplies 0.9% with the average gradient factor of 1.29 to get 1.16%. Note that for the 1Q06 vintage, the agency could not calculate the extrapolated default rates due to lack of data. Chart 2 below plots the extrapolated cumulative default curves.

Table 5: Extrapolated Cumulative Default Rates

Vintage	Origination Amount	Quarters Since Origination																				
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1Q01	612,000	0.10	0.57	1.13	1.89	2.74	3.34	3.61	4.06	4.36	4.66	4.73	4.83	5.08	5.18	5.27	5.38	5.39	5.41	5.43	5.48	5.58
2Q01	700,000	0.09	0.64	0.99	1.77	2.58	3.03	3.46	3.64	4.01	4.28	4.32	4.47	4.73	4.82	4.97	5.05	5.07	5.10	5.23	5.32	5.42
3Q01	732,490	0.13	0.70	1.53	2.08	2.60	3.08	3.28	3.75	3.82	4.32	4.37	4.57	4.70	4.92	4.98	4.99	5.07	5.12	5.14	5.20	5.30
4Q01	793,984	0.23	0.85	1.73	2.19	2.72	3.31	3.79	3.96	4.40	4.66	4.78	4.92	5.13	5.21	5.37	5.38	5.49	5.57	5.63	5.70	5.81
1Q02	834,563	0.22	0.73	1.28	1.89	2.77	3.11	3.45	3.82	3.91	4.37	4.45	4.63	4.85	5.08	5.11	5.15	5.16	5.20	5.26	5.32	5.43
2Q02	904,485	0.14	0.65	1.45	2.17	2.72	3.20	3.81	4.08	4.38	4.43	4.54	4.91	5.08	5.11	5.15	5.18	5.23	5.27	5.33	5.40	5.50
3Q02	953,534	0.10	0.71	1.42	1.98	2.55	3.14	3.71	4.15	4.42	4.67	4.73	4.89	4.95	5.03	5.24	5.29	5.34	5.39	5.44	5.51	5.62
4Q02	980,124	0.13	0.64	1.13	1.61	1.98	2.23	2.71	3.03	3.30	3.68	3.77	3.82	3.87	4.08	4.17	4.21	4.25	4.28	4.33	4.38	4.47
1Q03	1,202,324	0.18	0.69	1.14	1.95	2.42	2.56	2.98	3.15	3.67	3.68	3.76	4.00	4.10	4.21	4.30	4.34	4.39	4.42	4.47	4.52	4.61
2Q03	1,014,485	0.16	0.59	1.39	1.90	2.23	2.58	2.92	3.46	3.68	3.74	3.87	3.99	4.12	4.24	4.33	4.37	4.41	4.45	4.50	4.55	4.64
3Q03	1,171,731	0.15	0.60	1.18	1.66	1.97	2.45	3.11	3.15	3.41	3.50	3.81	3.96	4.09	4.21	4.30	4.34	4.38	4.41	4.46	4.52	4.61
4Q03	1,312,338	0.13	0.61	1.13	1.44	2.11	2.33	2.85	2.87	3.01	3.05	3.13	3.26	3.37	3.46	3.54	3.57	3.60	3.63	3.67	3.72	3.79
1Q04	1,509,189	0.16	0.59	1.14	1.45	1.75	1.99	2.36	2.47	2.63	2.78	2.86	2.97	3.07	3.16	3.22	3.25	3.29	3.31	3.35	3.39	3.46
2Q04	1,569,557	0.13	0.58	1.09	1.46	1.85	2.19	2.28	2.44	2.62	2.77	2.85	2.96	3.06	3.15	3.21	3.24	3.28	3.30	3.34	3.38	3.45
3Q04	1,545,922	0.14	0.58	0.99	1.39	1.72	1.97	2.18	2.36	2.53	2.68	2.75	2.86	2.96	3.04	3.10	3.13	3.16	3.19	3.22	3.26	3.33
4Q04	1,514,485	0.18	0.63	0.94	1.46	1.81	1.84	2.11	2.29	2.46	2.60	2.67	2.77	2.87	2.95	3.01	3.04	3.07	3.09	3.13	3.17	3.23
1Q05	1,574,685	0.16	0.55	1.04	1.45	1.72	1.98	2.28	2.47	2.66	2.81	2.88	3.00	3.10	3.19	3.25	3.28	3.32	3.34	3.38	3.42	3.49
2Q05	1,578,485	0.10	0.38	0.74	0.90	1.16	1.34	1.54	1.66	1.79	1.89	1.94	2.02	2.09	2.15	2.19	2.21	2.23	2.25	2.28	2.30	2.35
3Q05	1,501,234	0.06	0.44	0.64	0.92	1.19	1.37	1.58	1.71	1.84	1.94	1.99	2.07	2.14	2.20	2.25	2.27	2.29	2.31	2.33	2.36	2.41
4Q05	1,472,187	0.07	0.41	0.77	1.11	1.42	1.64	1.89	2.05	2.20	2.33	2.39	2.48	2.57	2.64	2.70	2.72	2.75	2.77	2.80	2.84	2.89

Source: Fitch Ratings.



Adjustments for Seasoning

If presented with a well-seasoned pool, Fitch may make an adjustment to the default rates based on the remaining losses as a percentage of the outstanding pool. Adjustment is not made where transactions have a revolving period, unless the eligibility criteria include a requirement that receivables are a minimum number of months seasoned. The formula used to make the adjustment is seasoning adjusted base case gross default rate = (unadjusted base case default rate – cumulative default rate to end of seasoning) x (initial amount/outstanding amount).

Specifically, assume that the portfolio has two quarters seasoning and the horizon for Fitch’s analysis is 10 quarters. If the 10Q default rate is approximately 1.75% while the 2Q default rate is approximately 0.2% and if the initial balance of the pool was 100 and is 95 at 2Q, the seasoning adjusted default rate is: $(1.75\% - 0.2\%) \times (100/95) = 1.63\%$.

This reflects the fact that the portfolio amortizes more slowly than the defaults accumulate compared to the cumulative base case. 10% of the losses have been incurred while 5% of the pool has amortized. If, on the other hand, 20% of the pool had amortized the formula would be: $(1.75\% - 0.2\%) \times (100/80) = 1.94\%$.

Constant Prepayment Rates (CPR)

Table 6 reflects quarterly vintage data provided from the originator, presenting the principal outstanding balance of loans in the quarter that are prepaid.

In receiving each vintage’s outstanding principal balance by quarter from the originator, Fitch will deduct the previous quarter’s cumulative loan default amount (Table 2) and the sum of actual prepaid amounts from prior quarters (Table 5) in order to achieve the net outstanding principal balance per quarter as depicted in Table 6.

Table 6: Actual Prepaid Amounts per Quarter

(USD)

Vintages	Origination Amount	Quarters Since Origination																				
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1Q01	612,000	156	713	866	699	780	543	585	695	719	849	854	899	744	336	293	416	515	283	203	612	993
2Q01	700,000	153	969	610	821	850	468	1,071	314	1,041	840	546	1,523	917	324	578	365	805	365	2,410	1,172	
3Q01	732,490	234	1,049	1,522	605	564	531	517	850	229	1,636	786	2,136	493	781	259	60	2,890	888	293		
4Q01	793,984	452	1,227	1,754	546	631	709	1,330	340	1,380	925	1,940	1,674	841	307	686	53	4,730	1,498			
1Q02	834,563	461	1,071	1,137	770	1,097	430	986	771	307	1,729	1,254	2,310	913	952	123	222	585				
2Q02	904,485	319	1,154	1,806	983	735	655	1,940	605	1,100	205	1,914	5,070	740	130	215	203					
3Q02	953,534	245	1,449	1,700	795	811	847	1,904	1,051	1,010	1,105	1,122	2,273	278	406	1,106						
4Q02	980,124	312	1,250	1,201	702	548	370	1,654	789	1,052	1,656	1,754	744	253	1,049							
1Q03	1,202,324	539	1,526	1,373	1,462	848	240	1,783	512	2,502	31	1,890	4,371	602								
2Q03	1,014,485	411	1,074	2,041	771	507	529	1,220	1,362	894	282	2,570	1,826									
3Q03	1,171,731	438	1,306	1,723	829	556	834	2,727	116	1,205	489	7,166										
4Q03	1,312,338	419	1,596	1,707	606	1,310	444	2,394	68	716	251											
1Q04	1,509,189	586	1,626	2,091	709	669	538	1,978	413	978												
2Q04	1,569,557	503	1,755	2,012	866	925	810	478	631													
3Q04	1,545,922	555	1,691	1,585	922	780	572	1,111														
4Q04	1,514,485	673	1,715	1,161	1,196	782	65															
1Q05	1,574,685	643	1,511	1,946	953	640																
2Q05	1,578,485	382	1,136	1,385	390																	
3Q05	1,501,234	231	1,420	766																		
4Q05	1,472,187	241	857																			
1Q06	1,459,861	300																				

Source: Fitch Ratings.

Table 7: Net Outstanding Principal Balance per Quarter

(USD)

Vintage	Origination Amount	Quarters Since Origination																		
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1Q01	612,000	591,546	567,567	542,062	514,732	485,956	458,144	431,351	402,418	373,489	343,351	313,639	282,644	249,808	217,051	183,284	148,041	111,965	74,781	36,329
2Q01	700,000	676,730	648,538	621,265	589,835	557,247	526,611	494,412	463,725	429,870	395,819	362,481	326,204	288,451	251,162	211,855	171,827	130,303	87,714	40,684
3Q01	732,490	707,770	678,092	645,133	614,196	582,587	550,209	518,844	484,124	451,708	413,639	378,431	339,566	301,459	261,115	220,959	179,901	133,993	88,719	
4Q01	793,984	766,200	733,582	697,335	664,643	630,232	594,115	557,145	522,420	483,322	444,788	404,993	363,934	321,708	279,594	234,922	190,446	138,767		
1Q02	834,563	805,430	772,241	737,678	701,809	662,310	626,760	589,495	550,926	513,833	470,891	430,239	386,165	341,694	295,541	250,273	203,098			
2Q02	904,485	873,811	837,875	797,548	757,536	718,212	678,236	634,485	593,837	550,952	509,792	464,902	412,858	365,408	318,094	268,804				
3Q02	953,534	921,657	882,606	841,112	800,779	759,041	715,698	670,121	625,200	580,512	534,256	488,275	438,529	390,015	339,328					
4Q02	980,124	947,053	908,112	868,191	827,621	786,913	746,199	700,521	655,806	609,822	560,599	512,435	463,958	414,186						
1Q03	1,202,324	1,160,975	1,113,241	1,064,768	1,010,395	959,110	910,807	855,723	803,148	742,500	688,564	629,874	564,639							
2Q03	1,014,485	979,817	940,610	895,300	852,965	811,296	768,037	722,656	673,646	626,732	580,399	529,415								
3Q03	1,171,731	1,131,873	1,086,263	1,037,100	988,675	940,767	889,093	831,594	782,271	727,482	673,441									
4Q03	1,312,338	1,268,056	1,216,304	1,162,358	1,110,596	1,051,670	997,553	935,701	880,771	821,626										
1Q04	1,509,189	1,457,743	1,399,274	1,336,592	1,276,971	1,215,623	1,153,173	1,085,034	1,020,191											
2Q04	1,569,557	1,516,582	1,455,458	1,391,086	1,328,093	1,262,535	1,195,664	1,130,890												
3Q04	1,545,922	1,493,450	1,433,434	1,372,014	1,309,444	1,245,879	1,181,747													
4Q04	1,514,485	1,462,434	1,403,346	1,345,133	1,281,591	1,219,185														
1Q05	1,574,685	1,520,846	1,460,769	1,396,547	1,332,702															
2Q05	1,578,485	1,525,831	1,467,505	1,405,955																
3Q05	1,501,234	1,451,816	1,394,645																	
4Q05	1,472,187	1,423,653																		
1Q06	1,459,861	1,411,431																		

Source: Fitch Ratings.

CPR is then calculated by dividing the actual prepaid amounts for the given quarter by the previous quarter's net outstanding principal loan balance. This number is then annualized in simple form to achieve a comparative value. For example, the 2Q03 vintage experienced prepayments of 1,362 in the eighth quarter after origination against a net outstanding principal balance for the prior quarter (e.g. seventh quarter) was 722,656. Therefore, CPR would be calculated for the given quarter as: $(1,362/722,656) \times 4 = 4.7\%$.

Source: Fitch Ratings.

Table 8: Constant Prepayment Rate

(%)

Vintage	Origination Amount	Quarters Since Origination																		
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1Q01	612,000	0.1	0.6	1.3	1.9	2.6	3.3	4.0	5.0	6.2	7.7	9.5	11.8	14.6	17.4	21.2	27.4	38.1	58.5	122.7
2Q01	700,000	0.1	0.7	1.1	1.7	2.4	2.9	4.0	4.5	5.9	7.2	8.5	11.3	14.0	16.6	20.8	26.5	37.4	57.3	147.2
3Q01	732,490	0.1	0.8	1.7	2.2	2.7	3.3	3.9	4.9	5.4	7.5	9.0	12.6	14.8	18.3	22.1	27.2	45.2	72.3	
4Q01	793,984	0.2	0.9	2.0	2.4	2.9	3.6	4.8	5.4	6.9	8.4	11.1	14.2	17.1	20.1	25.1	31.1	56.3		
1Q02	834,563	0.2	0.8	1.4	2.0	2.7	3.2	4.0	4.9	5.5	7.4	9.3	12.8	15.5	19.2	22.9	28.6			
2Q02	904,485	0.1	0.7	1.6	2.3	2.8	3.3	4.8	5.5	6.7	7.5	9.8	16.0	18.9	21.8	26.1				
3Q02	953,534	0.1	0.8	1.6	2.1	2.6	3.3	4.6	5.6	6.8	8.2	9.9	13.1	15.0	17.7					
4Q02	980,124	0.1	0.7	1.3	1.7	2.0	2.3	3.4	4.2	5.2	6.8	8.8	10.4	11.9						
1Q03	1,202,324	0.2	0.7	1.3	1.9	2.4	2.6	3.6	4.1	5.8	6.3	8.1	12.1							
2Q03	1,014,485	0.2	0.6	1.6	2.0	2.4	2.8	3.6	4.7	5.6	6.3	8.8								
3Q03	1,171,731	0.2	0.6	1.3	1.7	2.1	2.6	4.0	4.4	5.4	6.1									
4Q03	1,312,338	0.1	0.7	1.3	1.6	2.1	2.4	3.6	3.9	4.5										
1Q04	1,509,189	0.2	0.6	1.3	1.6	1.9	2.2	3.0	3.4											
2Q04	1,569,557	0.1	0.6	1.2	1.5	1.9	2.3	2.6												
3Q04	1,545,922	0.1	0.6	1.1	1.5	1.8	2.1													
4Q04	1,514,485	0.2	0.7	1.1	1.5	1.8														
1Q05	1,574,685	0.2	0.6	1.2	1.5															
2Q05	1,578,485	0.1	0.4	0.8																
3Q05	1,501,234	0.1	0.5																	
4Q05	1,472,187	0.1																		
1Q06	1,459,861	0.1																		

Source: Fitch Ratings.

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