

Global  
Special Report

## Fitch Proposals for Complementary Ratings and Indicators to Structured Finance Ratings

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### Feedback

Feedback on the proposals is being sought from market participants over the next month – any comments should be sent to [sffeedback@fitchratings.com](mailto:sffeedback@fitchratings.com) by 1 August 2008.

### Executive Summary

- This report examines the case for potential separate complementary indicators and ratings that may be offered in three areas to enhance the meaning and usefulness of existing structured finance ratings; these are outlined below.
- The ideas developed in the report reflect those announced in a Rating Action Commentary dated 29 April 2008 entitled “*Fitch Announces Potential Complementary Rating Scales For Structured Finance*”.

1. **Loss Given Default/Loss Severity** – Fitch’s ratings traditionally address the probability that a security will default prior to its legal final maturity. They do not address the extent of loss that might occur if a security defaults (loss given default or loss severity).

This paper proposes a complementary Loss Severity Rating scale at the security level to accompany traditional ratings. Fitch believes additional disclosure in this area would offer most value-added given the inherent difference in loss given default between traditional corporate debt and most structured finance debt. In structured finance, given different priorities of payment and the relative ‘thickness’ of tranches, the extent of loss given default can vary significantly. It is an important consideration for investors that Fitch’s structured finance ratings do not traditionally address.

2. **Collateral Quality Assessment** – Fitch generally conducts a periodic originator review visit as part of the rating process in order to assess the quality of origination and underwriting processes for the underlying assets. The portfolio profile in terms of borrower and product types, for example, will also be examined to form a view on the collateral. Historical performance data will be analysed to assess collateral performance. The result of this analysis is considered by the rating committee when determining transaction ratings. No separate opinion on collateral quality is generally published, however.

This paper proposes that an opinion scale be adopted for individual asset classes and sub-sectors. At the time of rating a new transaction, the agency would assign the underlying collateral an opinion grade alongside the rating of the transaction securities.

3. **Rating Transition Probability and Volatility** – Fitch believes that meaningful scales giving indications of the potential for a particular security to suffer rating transition or volatility would be difficult to develop in isolation from factors captured by traditional debt ratings. However, the agency agrees that additional transparency regarding the likely medium-term path of a credit rating would be useful information for investors to have.

To address this, Fitch has recently committed to an extension of “Rating Outlooks” to all structured finance areas globally. Rating Outlooks are intended to give a forward-looking opinion about the medium term prospective direction of a tranche rating, generally over the next 12-24 months. Fitch believes this will give the market greater information about prospective future individual tranche performance than an explicit rating volatility indicator.

## Feedback Requested - General

Fitch is seeking industry comment on the following questions.

- Rather than complementary scales and indicators to the existing rating scale, would users prefer to see a separate rating scale for structured finance securities?
- Would a structured finance 'modifier' to the existing rating scale be preferable to devising a separate rating scale for structured finance securities or the proposed complementary scales and indicators?
- Of the three complementary indicator proposals outlined above, which one adds the greatest analytical value?
- Are there other indicators addressing additional risks that could also be considered?
- Are the perceived deficiencies in structured finance ratings best addressed through increased transparency with respect to methodology enhancements or other areas, rather than through additional rating scales?
- Does the provision of more information in addition to ratings increase the risk of 'too much information' and consequently risk causing confusion?
- Should there be greater co-ordination between the major credit rating agencies to produce broadly comparable complementary additional rating scales for structured finance transactions rather than developing disparate non-comparable individual scales?

## Introduction

In recent months there has been increased scrutiny with respect to the nature, integrity and meaning of structured finance ratings. Fitch Ratings has consulted extensively with interested parties - including investors, issuers, bankers and regulators - to assess what changes might be made to enhance existing rating scales, as well as what supplementary measures might be introduced to complement them.

Feedback with respect to changing the structured finance scale - for example, via the addition of a modifier to distinguish the rating as structured finance-specific - has been mixed. Most industry participants that Fitch has consulted are not convinced as to the value of adding an identifying modifier to ratings of structured finance securities. Additional discussion is expected on this issue, particularly with the regulatory community. The US Securities and Exchange Commission (SEC) recently proposed that ratings for structured finance products be differentiated, perhaps by the use of different rating symbols. Fitch continues to examine the merit of individual sector rating scales as part of this discussion, and may make further proposals in this arena as the dialogue progresses. The exclusive focus of this report, however, is to examine what separate complementary indicators may be offered to the financial community which could enhance the meaning and usefulness of existing structured finance ratings. The ideas developed in the report reflect those announced in a Rating Action Commentary dated 29 April 2008 entitled "*Fitch Announces Potential Complementary Rating Scales For Structured Finance*" (available at [www.fitchratings.com](http://www.fitchratings.com)).

The agency is mindful that some of the discussion surrounding structured finance ratings relates to a misunderstanding among some as regards the nature and limitations of ratings themselves. Fitch does not wish to add to any confusion surrounding structured finance ratings by proliferating the number of scales and measures it makes available to the market. However, following internal and external discussion, the agency offers for investors' consideration a number of new, simple additional indicators and scales which it believes can add value in the three

areas outlined. Feedback on the proposals is being sought from market participants over the next month – any comments should be sent to [sffeedback@fitchratings.com](mailto:sffeedback@fitchratings.com) by 1 August 2008.

## Loss Given Default/Loss Severity

### Summary of Issues

Fitch's ratings address the probability that a structured finance security will default prior to its legal final maturity. They are designed such that a security can withstand a given set of adverse assumptions associated with that rating category and without defaulting. While both the loss severity and probability of default of the underlying collateral are a consideration in the formulation of ratings for structured finance securities, the rating of the security itself only addresses the probability of default (and therefore the likelihood of a so-called 'first dollar of loss' being realised). The rating does not go further and address, where a default has already happened, the extent to which a loss might be realised on the defaulted security. Given the nature of tranching within structured finance transactions, with generally 'thick' highly-rated senior tranches supported by 'thinner' mezzanine and junior tranches, this is an important investor consideration which Fitch's existing rating scale has not traditionally addressed. When actual defaults or losses are higher than stressed at initial rating, thinner junior tranches are particularly susceptible to a much higher loss severity given a relatively mild increase in defaults or loss severity of the underlying collateral than would a much thicker senior tranche. However, it is important to note, that a tranche with a given thickness that is highly rated is more likely to experience lower loss given default than a subordinate tranche of equal thickness, as the probability of collateral loss sufficient to wipe out the highly rated class is lower. Thus it is always necessary to consider loss severity in conjunction with probability of default (PD).

### Proposals

Fitch proposes to develop a Loss Severity Rating scale, which will give investors a simple ordinal indicator of the relative risk of loss severity given default. This concept proposal would involve relating the size of the tranche as a percentage of the collateral to the base case cumulative loss percentage expectations for the life of the transaction. A Loss Severity Rating scale could be developed around the resulting tranche loss multiple which would be an ordinal indicator of the extent to which the tranche might withstand increments in collateral loss in the context of the base case.

The Loss Severity Rating proposal could be alternatively developed by taking this calculation further and comparing the tranche loss multiple against the typical distribution of tranche loss multiples for structured finance tranches with the same credit rating. A rating scale built around this comparison would not only be an indicator of the extent to which the tranche could withstand increments of collateral loss, but would also give an indication of the relative "thickness" of the tranche given the typical tranche thickness for that rating category.

Such a rating also provides additional information at the top of the capital structure. Many structured finance transactions in recent years have featured credit tranching among tranches that are rated 'AAA' (with "super" senior and "support" senior tranches). While Fitch does not differentiate between these classes with respect to credit ratings, the proposed Loss Severity Rating does provide a mechanism for commenting on the relative loss severity given these low probability default events occurring. The concept of a Loss Severity Rating would thus give users a simple ordinal indicator of a tranche's risk of loss relative to other tranches with the same credit rating. The combination of the credit rating and the proposed Loss Severity Rating scale would give the investor a better view of the risk of loss than either measure in isolation.

### *Advantages*

The agency notes the following advantages to this proposal:

- it would create a clear, concise and simple indicator;
- it would complement traditional PD based ratings;
- it would give a different scale to traditional ratings allowing for clear distinction between the two;
- it would provide an additional scale exclusive to structured finance securities, thus clearly differentiating them from corporate debt ratings;
- the measure could be applied not only to new transactions, but also to existing transactions with possible movements in the loss severity scale as transactions delever and as expected losses are re-assessed on an ongoing basis as part of the surveillance process;
- it would give an indicator of loss severity relative to peer tranches of the same rating category allowing for direct comparison to investments with a similar rating.

### *Disadvantages*

The agency sees the following disadvantages to this proposal:

- it would provide another indicator scale overlay in addition to existing ratings. This risks giving users ‘too much information’ and requiring them to invest time in analysing and understanding new indicator scales;
- it would create potential confusion with Fitch’s existing scale for loss severity, the Distressed Recovery Ratings (DR) scale (which, for structured finance, are assigned to tranches which become distressed rated in the ‘B’ rating category or below). The provision of two scales addressing recovery given default may be confusing to users.
- The Loss Severity Rating i as proposed would use collateral loss expectations prior to considering excess interest and other structural features, as this simplifies the application and focuses the analysis on leverage and asset quality. However, because of this, it may prove less useful in assessing the risk of some securities.

### **Feedback Requested - Loss Severity**

Fitch is seeking industry comment on the following questions.

- Do respondents believe that a Loss Severity Rating would provide additional analytical value when analysing structured finance securities?
- Do respondents agree that a rating linking loss severity to **both** base case collateral loss expectations and the typical “thickness” of tranches with the same rating would be the best approach ?
- Do respondents feel that other measures of potential tranche loss severity beyond that outlined could prove a better indicator such as a pure measure of expected loss?
- Do respondents feel the exclusion of consideration of excess interest and other transactional features that the proposal would entail would materially impact the usefulness of the Loss Severity Rating? Should time be taken to develop a Loss Severity Rating scale which takes account of these features?

## Collateral Quality Assessment

### Summary of Issues

As part of the rating process, Fitch performs an analysis of the credit quality of the underlying collateral of the assets. This frequently includes periodic originator and underwriter review visits to assess quality of asset underwriting and an analysis of the profile of the assets themselves – for example, for residential mortgage-backed securities, this would include an assessment of the relative concentrations of riskier loan products and borrowers and, in the case of commercial mortgage-backed securities, an assessment of property quality following site visits.

Fitch also assesses the extent and quality of originator historical data available and the picture it paints with regard to past asset performance. The agency uses comparison with industry and sector peers as part of its analysis. The opinion that Fitch forms as a result is factored into its rating analysis and is a significant consideration of the transaction rating committee when it comes to assign ratings to a transaction.

Disclosure of this specific collateral opinion, however, is currently limited and generally restricted to a summary description of underwriting and origination processes and their strengths and weaknesses, product descriptions and concentrations in presale reports (where these are published), and a limited overview of historical performance information used in the rating analysis assessment. Fitch also publishes general non-transaction-specific research on particular asset classes and sectors which will examine these issues on a sector-wide level.

While the rating itself will therefore give some indication of collateral quality, the rating is also influenced by transaction structure (for example, hedging structures, varying cash flow priority of payments) which will influence the levels of credit enhancement and “muddy” the degree to which the rating can be an indicator of underlying collateral quality. To date there has been limited information published by Fitch which indicates the agency’s opinion as to collateral quality between transactions and originators.

### Proposals

Fitch proposes to issue Collateral Quality Opinions based around its assessment of the origination and underwriting processes and procedures under which the collateral was originated, relative loan products, property, borrower or other risk concentrations and quality compared with peers specific to the asset class and historical data available with respect to the originator’s past asset performance compared with peers. The opinions would draw upon those items impacting collateral quality that are already factored into the rating, but concentrates those factors in one opinion pertaining solely to collateral quality (that is absent other features such as transaction structure, third party counterparties and hedging instruments). The opinions would be based around a five-point scale (see Collateral Quality Opinion table).

## Collateral Quality Opinion

**Excellent** – A transaction where the collateral shows an exceptionally high degree of quality by exhibiting substantially lower risk features when compared with transaction peers in the sector.

**Good** – A transaction where the collateral shows a high degree of quality by exhibiting lower risk features when compared with transaction peers in the sector.

**Standard** – A transaction where the collateral shows a degree of quality which is broadly typical of the sector by exhibiting largely representative risk features when compared with transaction peers in the sector

**Below Standard** – A transaction where the collateral shows a lower degree of quality by exhibiting higher risk features when compared with transaction peers in the sector

**Poor** – A transaction where the collateral shows a weak degree of quality by exhibiting substantially higher risk features when compared with transaction peers in the sector

Source: Fitch

Specific Fitch rating groups would develop their own detailed methodology for determining their Collateral Quality Opinions for each major asset class and these would be published as they are rolled out. In addition, separate methodology, which may involve differing emphasis on particular factors, may be developed by each asset class for sub-sectors within that class. An example within RMBS may be differing methodology to determine opinions for subprime and prime collateral. Examples are given below for what considerations might be taken into account in developing Collateral Quality Opinions within the RMBS and CMBS sectors.

The Collateral Quality Opinion would be disclosed in presale reports with accompanying commentary where these are published. In those asset classes or geographical sectors where presale reports are not currently published, Fitch would propose publishing commentary surrounding the Collateral Quality Opinion.

### *Examples*

**RMBS** – Collateral Quality Opinions in RMBS could be formed around the origination and underwriting review process, a comparison of transaction collateral features with a benchmark average determined for that particular sector and an assessment of historical performance data against a benchmark average established for that sector. A scorecard might be developed which would give different weightings to different factors when formulating the agency's opinion.

In formulating opinion with respect to the origination process, factors which might be considered include, but are not limited to:

- controls surrounding broker-originated collateral as opposed to branch-originated collateral – for example, the quality of management information and how it is used to assess broker performance in terms of defaults and losses;
- the quality of product underwriting limits for various products compared with peers in the market;
- the extent, and quality, of procedures surrounding stated underwriting policy rules and exceptions to these rules;
- the quality and tightness of procedures surrounding riskier products – an example might be the quality of procedures to assess stated income for low documentation or self-certified mortgage products;
- the quality of processes on the changing of underwriting guidelines and product limits – for example, in terms of risk assessment (particularly where this results in a loosening of underwriting criteria);
- the procedures surrounding the assessment of a borrower's ability to afford the mortgage;
- the quality of file content and compliance with stated limits and criteria as represented by originators, as assessed during Fitch's sample file review;
- the general lending strategy and business plan – for example, how aggressive expansion targets resulting in expanding loan product ranges are controlled for risk;
- the procedures for ensuring high-quality valuations of collateral – for example, the review process used for panel valuers;
- the procedures for assessing the quality of the performance of automated underwriting based on scorecards and valuation systems;
- staffing adequacy in the underwriting function;
- fraud detection procedures;
- the completeness and quality of responses to Fitch information requests. Limited or poor quality data in a key area will be suggestive of impaired ability to control collateral quality.

Loan profiles might be assessed as follows:

- particular product or borrower concentrations – for example, high concentrations to high risk products, such as mortgages, second liens and low documentation loans. These could be assessed by establishing a benchmark average portfolio for the sector in question (for example US subprime) and developing specific weightings for high risk concentrations in transactions against this benchmark;
- geographical concentrations – high concentrations to particular regions of a country which have a deteriorating economic outlook or may be prone to natural disaster. As above, weightings might be determined compared with benchmark averages determined by analysing the distribution of mortgage lending, housing stock or population;
- the extent to which the portfolio includes loans or assets which incorporate new features which Fitch believes would materially impact performance and which would cause a disconnect to the ability to use historical performance to assess future performance of those assets.

Opinion with respect to historical performance could be assessed as follows:

- by reviewing an analysis of historical performance data, particularly on a static basis, of different product vintages and comparing it to industry peers and industry level performance data;
- by analysing the ability to provide good-quality data regarding past collateral performance on a static basis for several years for well-established originators – this would indicate the ability to control collateral quality adequately;
- by considering policies and procedures with respect to matters which might influence the picture painted by historical performance – examples might include a liberal policy with respect to capitalisation of arrears cases which would massage down historical arrears figures.

**CMBS** – Collateral Quality Opinions in CMBS could similarly be formed around a number of the characteristics associated with both the property and the loan finance attached to the property.

Unlike RMBS, there tends to be more information available about individual loans and properties.

Collateral Quality Opinions could be formed by determining benchmark averages for specific real estate markets, loan structures and sectors and examining the key features of collateral and loans against these benchmarks. Opinion might be determined by applying different respective weighted importance to the various factors described .

- Lease Structures – The structure of leases in terms of break clauses and expiry dates will be a determinant of the stability and quality of cash flows coming from the underlying property.
- Legal Framework – This determines the length of timing of workouts and extent of costs involved, again influencing the stability of cash flow from the underlying property.
- Local Market Strength – The quality of the local geographical market for commercial property and the resulting extent of liquidity. City business districts will generally have a greater degree of liquidity than non-core regional areas.
- Property Quality – The nature of the underlying property in terms of its attractiveness and marketability to tenants.
- Technical Specification – Quality in terms of construction quality, refurbishment or amenities such as parking and air-conditioning.

- Quality of Property Managers – The quality of business plans for property, the track record in re-letting space, vacancy rates compared with peers.
- Loan Quality – The quality of loan features attached to property, including debt service coverage ratios and loan-to-value ratios.

### Feedback Requested - Collateral Quality Opinions

Fitch is seeking industry comment on the following questions.

- Do respondents believe a separate explicit collateral quality opinion regarding underlying collateral has merit?
- Should collateral quality opinion be confined to major asset classes – eg, all residential mortgage-backed securities, or should they be segmented further, for example on a geographic or sub-category basis?
- Would other methods of indicating collateral quality prove more informative or value added to users than that indicated?
- Do respondents have any supplementary issues either generally or specific to particular asset classes or sectors that they think should be factored into collateral quality opinions?

## Rating Transition Probability and Volatility

### Summary of Issues

Fitch has considered the benefit of attempting to measure potential differences in the “volatility” or conversely the “stability” of structured finance ratings. Setting aside the special case of synthetic CDOs, which Fitch has already discussed in its “*Stability Scores For Synthetic CDOs*” report (dated 28 September 2007 and available at [www.fitchratings.com](http://www.fitchratings.com)), a review of structured finance assets that have experienced rapid and/or substantial downward rating migration suggest some common themes that might be incorporated in a volatility indicator.

- Complexity – Transactions which are highly complex present greater opportunity for their multiple “moving parts” to interact in some unexpected way that reveals a weakness in the overall structure. Sources of complexity can be components of collateral risk analysis, or can derive from structural features of the transaction. An example of collateral complexity would be the necessity to estimate recovery on default loans, whereas, for some asset classes, 100% loss is always assumed. Another example for RMBS is analysis of voluntary prepayment rates. Various kinds of transactions have exposure to interest rate risk, basis risk and currency risk. Introducing hedges for these risks may be advisable, but this introduces more complexity with respect to evaluating the effectiveness of the hedge in addition to counterparty risk. Many other examples could be cited, but it appears clear that an enumeration of risk factors could give some insight into the risk of ratings deterioration.
- Market Breadth – It is notable that the structured finance markets which have experienced the most severe problems are those where there was little appetite for the assets outside the securitisation market. Examples include manufactured housing earlier this decade, in addition to subprime mortgages and asset-backed CDOs more recently. In all instances, traditional buyers of assets felt that risk and pricing had become misaligned, and retreated from financing these assets, leaving securitisation as the near sole, if not the sole, source of funding. Complete dependence on securitisation may indicate an unhealthy market where asset risk is not effectively priced for, leading to painful corrections when assets underperform and the securitisation take-out is no longer present. A simple measure of the percentage of an asset-class that is securitised could be a meaningful indicator of changing levels of risk.

- **Depth of Historical Data** – Fitch has always taken a conservative approach to new assets with limited historical data, both through applying high loss expectations, and in some instances, imposing a ceiling on the highest rating that could be achieved. While asset classes with 15-20 years of performance information are clearly deserving of more “fine-tuned” analysis, the benefits can be illusory. US RMBS, for example, is an asset class with over 20 years of collateral history, much of it available at the loan level. However, the migration of the attributes of mortgages in recent years has reduced the effectiveness of the historical data as an indicator of future performance.
- **Assumptions on Assumptions Risk** – Ratings for transactions such as structured finance CDOs which securitise assets which themselves have ratings and have been subject to a separate ratings process inherently rely not only on assumptions applied for the transaction itself, but implicitly on assumptions applied when determining ratings on the underlying assets. As a result, any uncertainties that might exist in assumptions – for example, due to other factors described here – become amplified due to the extent of assumptions relied upon. This amplification goes further for transactions such as CDOs of CDOs.
- **Alignment of Motivations** – Counterparties involved with a transaction will have their own motivations for being involved in it. Some of these motivations may conflict, while others may be aligned. The extent to which there is common alignment of interests may influence the stability of the performance of the transaction. Where there are significant misalignments of parties’ motivations, the extent to which structural mitigants are incorporated will also influence transaction stability.
- **Reactions to Economic Cycle** – While ratings are intended to be ‘through the cycle’, some asset classes or industries may be more prone to entering deeper, longer, more volatile and less predictable cycles in a general economic downturn than experienced in the past. The ability to derive robust forward-looking rating assumptions from historical data – even if extensively available – may therefore be weakened. In such instances, a greater degree of uncertainty is introduced to rating analysis which could influence rating volatility.
- **Linkage to Counterparties** – Transactions which rely on third party counterparties to mitigate particular risk exposures are subject not only to underlying asset performance but also the credit profile of the counterparty concerned. The greater the exposure to counterparties to cover risks, the greater the amplification of potential rating downgrades due not only to transaction performance, but also counterparty risk, thereby increasing the potential rating volatility of the transactions affected. Examples include recent financial guarantor downgrades in which transactions were downgraded even though many had demonstrated stable underlying asset performance. In most cases, the amount of credit protection for an underlying structured finance transaction was less than what would have been necessary to support a ‘AAA’ rating, which was based on the financial guarantor’s previous insurer financial strength rating of ‘AAA’.

## Proposal

While it is possible to engineer some form of indicator scale reflecting volatility, Fitch believes that a meaningful scale that specifically indicates tranche-level probability of rating transition or rating volatility would be difficult to achieve without significantly overlapping key factors already used in determining traditional ratings. While each of the measures described above may provide insight into asset classes, or subsectors or even individual securitisations, they are not easily used to derive precise rating volatility risk scales at the tranche level. In addition, the combination of these considerations may be difficult to synthesise on a predetermined formula, outside the case-by-case consideration applied by a

committee at the individual tranche level. Fitch believes, therefore, that these factors should be considered as part of the rating analysis to decide whether a rating can be assigned at all, and, if so, to which rating category that rating can extend.

In the agency's view, a tranche-level opinion which provides users of credit ratings with a view of the likely future direction of a rating action on that tranche rating in the medium term would be of greater value to investors. For this reason, Fitch has recently decided to assign an Outlook indicator to all structured finance transactions globally. The factors described above in *Summary of Issues* are all considerations which would be taken into account when determining Outlooks. It is Fitch's opinion that any volatility indicator or scale that could be derived would, in any event, be highly correlated with rating Outlooks. Rating Outlooks have been published for corporate, financial institutions, sovereigns and municipal issuers for some time. Outlooks were introduced for European ABS, CMBS and RMBS transactions in June 2007, and they will now be extended to remaining ABS, CMBS and RMBS transactions globally, as well as to transactions in the CDO sector.

An Outlook indicates the likely direction of any rating over a one- to two-year period. Rating Outlooks are assigned to tranches within the existing universe of transactions, as well as new transactions when they close and ratings are assigned. Outlooks are reviewed concurrently as individual ratings are reviewed by credit committee and are accompanied by commentary describing the rationale applied by Fitch in assigning the Outlook.

Since Outlooks are assigned at the tranche level, it is possible that the various tranches within a transaction may carry different Outlooks with respect to their rating. An example may be where there has been a modest deterioration in performance which leads to a Negative Outlook being assigned for junior tranches, while senior tranches retain a Stable Outlook.

While Outlooks give an indication of future rating movement, they do not imply a rating change is inevitable otherwise they would represent nothing more than a delayed rating action. For example, it is not a guarantee that a tranche will actually experience the rating action indicated by the Outlook within the 12- to 24-month timeframe, as deteriorating trends when the Outlook is assigned are not always sustained. Equally, a Stable Outlook does not rule out a positive or negative rating action if circumstances change rapidly – for example in reaction to a specific event. Finally, it does not rule out a rating downgrade for a tranche in a sector with a Positive Outlook – for example, if the underlying collateral exhibits strong performance trends but a financial guarantor with a 'wrap' to the tranche has its Insurer Financial Strength rating downgraded.

The definition of a rating Outlook is as follows: *"An Outlook indicates the direction a rating is likely to move over a one to two-year period. Outlooks may be positive, stable or negative. A positive or negative rating Outlook does not imply a rating change is inevitable. Similarly, ratings for which Outlooks are 'Stable' could be upgraded or downgraded before an Outlook moves to Positive or Negative if circumstances warrant such an action. Occasionally, Fitch Ratings may be unable to identify the fundamental trend. In these cases, the rating Outlook may be described as evolving."*

In assigning a rating Outlook opinion within structured finance, Fitch might take into account, among other factors:

- the latest collateral performance indicators and trends in performance – whether changes in trends are considered temporary or a fundamental change;
- the amount of credit support available to each tranche and amortisation trends of the transaction collateral;

## Rating Outlook

Positive  
Stable  
Negative  
Evolving

Source: Fitch

- prospective developments in national or regional economic or sector outlooks that might influence collateral performance and the extent to which individual sectors might be expected to react;
- the rating and credit Outlooks on any supporting corporate, financial institution or sovereign (for example, in the case of a financial guarantor or swap counterparty) as well as other transaction parties and how this might influence current motivations;
- the degree of historical information factored into initial assumptions and the extent of historical information that has become available since;
- any uncertainty in relation to deriving initial assumptions, how this position has changed since closing and how this influences complex transactions or those relying heavily on assumptions;.
- the profile of investors for the asset class in question and how the depth of the market has changed.

### **Feedback Solicited - Rating Transition Probability and Volatility**

Fitch is seeking industry comment on the following questions.

- Do respondents agree with Fitch's view that the factors that would drive a rating transition or volatility scale at the tranche level should be factored into deriving the tranche level credit rating itself?
- Do respondents agree with Fitch's view that the extension of the existing rating Outlooks that accompany ratings to all structured finance areas provides most value added to investors in capturing potential factors which could see a rating action in the medium term?
- What supplementary factors besides those described in this section do respondents think should be factored into the determination of a rating Outlook?

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