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METHODOLOGY

Global Methodology for Rating Finance Companies

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DBRS is a full-service credit rating agency established in 1976. Spanning North America, Europe and Asia, DBRS is respected for its independent, third-party evaluations of corporate and government issues. DBRS's extensive coverage of securitizations and structured finance transactions solidifies our standing as a leading provider of comprehensive, in-depth credit analysis.

All DBRS ratings and research are available in hard-copy format and electronically on Bloomberg and at DBRS.com, our lead delivery tool for organized, web-based, up-to-the-minute information. We remain committed to continuously refining our expertise in the analysis of credit quality and are dedicated to maintaining objective and credible opinions within the global financial marketplace.

Scope and Limitations

This methodology represents the current DBRS approach for rating finance companies globally. It describes the DBRS approach to analysis, which includes consideration of historical and expected business and financial risk factors, as well as industry-specific issues, regional nuances and other subjective factors and intangible considerations. Our approach incorporates a combination of both quantitative and qualitative factors. The methods described herein may not be applicable in all cases, the considerations outlined in DBRS methodologies are not exhaustive and the relative importance of any specific consideration can vary by issuer. In certain cases, a major strength can compensate for a weakness and, conversely, a single weakness can override major strengths of the issuer in other areas. DBRS may use, and appropriately weight, several methodologies when rating issuers that are involved in multiple business lines. Further, this methodology is meant to provide guidance regarding the DBRS methods used in the sector and should not be interpreted with formulaic inflexibility, but understood in the context of the dynamic environment in which it is intended to be applied.

Introduction to DBRS Methodologies

- In general terms, DBRS ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. They are opinions based on an analysis of historic trends and forward-looking evaluations that assess an issuer's ability to make timely payments on outstanding obligations (whether principal, interest, preferred share dividends or distributions) with respect to the terms of an obligation.
- In addition to general business, regulatory and financial risk factors, the DBRS rating methodologies include consideration for many subjective factors, nuances and intangible considerations. As such, the approach in this methodology is not based solely on statistical analysis, but includes a combination of both quantitative and qualitative considerations.
- The considerations outlined in DBRS methodologies are not intended to be exhaustive. In certain cases, a major strength can compensate for a weakness, and, conversely, there are cases where one weakness is so critical that it overrides the fact that the entity may be strong in most other areas.
- DBRS rating methodologies are underpinned by a stable rating philosophy; which effectively minimizes rating movement due to economic changes. DBRS strives to factor the impact of a cyclical economic environment into its ratings as applicable. Rating revisions do occur, however, when it is clear that a structural change, either positive or negative, has transpired, or appears likely to transpire in the near future.

I. Global Methodology for Rating Finance Companies – Overview

This methodology principally addresses the determination of the intrinsic strength of a finance company (FinCo), as well as various related issues including support assessments. Where appropriate, this methodology considers the characteristics of the FinCo's operating environment, including such characteristics as industry structure, regulation, legislation, and economic conditions, which generally vary across countries. This methodology also considers the evolving marketplace in which FinCos compete, as well as structural changes amongst FinCos, including the growing role of banking subsidiaries within FinCo organisations. The analysis determines the fundamental credit strength or intrinsic assessment (IA) of a FinCo, which for independent FinCos is also the final rating. For FinCos that are part of larger organisations, the final rating may also incorporate support from within the organisation.

Introduction

This methodology covers a broad range of FinCos that provide commercial and consumer financing across a broad range of sectors. Typically, FinCos are reliant on wholesale funding in various forms and maturities, but are increasingly using bank subsidiaries as a source of retail funding. Among the sectors where FinCos are active include: automobile financing, residential mortgage companies, student lending, credit cards, general consumer finance, commercial finance, commercial leasing including aircraft, railcar, small and large ticket equipment, and container leasing. This list is not all encompassing, but rather illustrates the diverse nature of FinCos. The main body of this methodology provides the core framework for DBRS's approach to rating FinCos. In the appendices to this methodology, additional details are provided on the rating considerations of rating FinCos in two specific sectors, captive FinCos, and business development companies (BDCs). These two sectors differ materially from other FinCos and therefore require a specialized set of rating considerations and factors.

FinCo Organizational Roles

From an organisational perspective, FinCos perform a variety of roles, from independent companies to specialized operations within larger organisations. Some FinCos operate as subsidiaries of manufacturing companies by providing financing for the sale of the company's products. In Europe, and to a lesser extent in the U.S., many FinCos operate within larger banking organisations, as specialized arms leveraging the FinCo's more specialized skills or more extensive geographic reach. Some FinCos have made greater use of banking legal vehicles to provide a source of funding by enabling them to raise deposits by leveraging their brand names and franchise positions, and may benefit from central bank access. This methodology is applicable both to standalone FinCos and to subsidiaries of larger financial institutions or commercial organisations. For FinCos that are subsidiaries of-, or majority owned by banking organisations, DBRS uses the *Global Methodology for Rating Banks and Banking Organisations* in combination with this methodology.

FinCo Ownership

A key element in the analysis is determining the ownership and role of a FinCo, whether on a standalone basis or as part of a larger organisation. When a FinCo is part of a larger non-bank organisation, the final rating is determined by combining the IA of the FinCo with the assessment of support from the FinCo's parent and the broader organisation as warranted by the nature of the organisation. For FinCos that are part of nonfinancial corporations, the approach to support parallels the approach that DBRS utilizes for support provided by corporate parents to their subsidiaries. In some cases, the relationship can be very close, as exists between parents and their captive FinCos. The treatment of captive FinCos is discussed in detail in Appendix A of this methodology.

Application of Methodology(ies)

For FinCos with banking subsidiaries, but whose lending activities are considered monoline and whose banking subsidiary activities are limited to deposit gathering, DBRS applies the *Global Methodology for Rating Finance Companies*. Conversely, for those FinCos with banking subsidiaries that are undertaking more traditional banking activities such as treasury and cash management for customers, or have a diversified lending model, DBRS applies the *Global Methodology for Rating Banks and Banking Organisations*.

The specialty finance industry has changed meaningfully in the past decade. This has been due in part to the challenges that arose for those FinCos that had narrow wholesale funding during the stressed financial markets. These changes have also reflected the growing global competition from banks, as banks have become more willing to enter the higher yielding lending areas that were historically the domain of FinCos. To leverage deposit funding and other attributes of banks, more FinCo organisations now have meaningful banking components, typically through banking subsidiaries. In the U.S., companies with predominantly FinCo business lines are designated as bank holding companies when they own a banking subsidiary.

Rating Constraints

Relative to banks and insurance companies with comparable scale, the ability of independent FinCos to achieve high ratings is typically constrained by three factors:

- Revenues for the typical independent FinCo tend to be more heavily focused on spread income than many banks, which typically have more diverse revenue sources from related fees for services and ancillary activities. Moreover, independent FinCos often focus on a specific industry or lending product, which can result in the FinCo having a monoline nature. This contrasts with the typically broader range of lending, deposit taking and other businesses of most banks.
- Most FinCos have a higher reliance on wholesale funding that makes them more sensitive to market confidence than a typical bank. This reliance reflects their primary focus on lending and related services as the core of their franchise. Wholesale funding is important as a means for FinCos to fund these credit activities and stronger FinCos generally have significant competencies in managing their funding. Nevertheless, this form of funding is not an inherent component of their franchise, unlike banks, where deposits and other liabilities also drive customer relationships and contribute to the stability of deposit funding. To the extent that a FinCo organisation has a banking entity that provides it with sizeable stable deposit funding for its lending activities, its reliance on wholesale funding is reduced, and its funding profile is strengthened.
- FinCos are subject to considerably less formal regulation than banking organisations, although the extent of this regulation varies by country and over time. While regulation does not always prevent problems at banks and represents an additional cost, regulation and supervision do result in more constraints on banks including on leverage, and direction that prevents entry or excessive volume in riskier sectors. This may mean that, when problems do occur, they are identified earlier and dealt with more robustly than would otherwise be the case. This also means with less formal regulation and limited impact on core areas like the payments system, DBRS typically gives no consideration for government support in the case of FinCos.

Business Model Considerations

The extent of a FinCo's risk is contingent upon its leverage. By contrast, banks have to weigh the benefits of being better rated to attract business from customers who value safety, such as depositors and other counterparties, against the benefits of providing financing that attracts borrowers who value a FinCo's willingness to take risk and utilize its skills to provide them with financing.

Inherently, a very highly rated FinCo would either have a very limited base of high risk customers or have abundant capital that yields low returns to its shareholders. As a result, it would be very unusual for a FinCo to attain a rating in the AA range without clear and meaningful support from a strong bank or corporate parent rated in the AA rating category. Better performing independent FinCos tend to be in the lowest investment grade category of BBB, with only the very strongest FinCos that have very sound and resilient funding profiles and robust earnings generation achieving ratings in the 'A' category.

II. The Approach to Rating Finance Companies

This methodology provides an analytical framework for assessing a FinCo's fundamentals and its ability to meet its obligations. Typically, FinCos provide financing in various forms, as well as related services, to commercial and retail customers. Reflecting this financing, the major risk for most FinCos is credit risk. Generally, FinCos rely on wholesale funding in various forms and maturities ranging from unsecured debt to securitizations.

Five Interlocking Building Block Approach

Reflecting the core components of a FinCo, DBRS's approach is to separate the analysis into five interlocking building blocks, which when combined results in the rating of the FinCo. DBRS has identified these building blocks as the essential components for the assessment of the intrinsic strength of a FinCo. This approach enables the many aspects of a FinCo to be separated into manageable components that can be analyzed separately and then combined together. Similar to the approach for rating banks and banking organisations, this approach allows an individual analysis of each one of the main factors, which can thereafter be combined to get to the final rating of a FinCo. For independent FinCos, the analysis generates a final rating. For FinCos that are part of larger organisations, the analysis generates an IA, which is expressed on the DBRS rating scale. This assessment of intrinsic strength is combined with a Support Assessment of potential support from the FinCo's parent or other internal support provider to derive a final rating for the FinCo. The process of combining the building blocks is an assessment of a FinCo's integrated strength.

Business Cycle

The IA takes into account the operating environment within which a FinCo operates, including the conditions in the economy and financial markets. In endeavouring to rate through the cycle, DBRS seeks to understand and incorporate the current phase of the cycle into the assessment of a FinCo's intrinsic strength. In the up-phase of a cycle, this means remaining cautious about the prospects for current trends being sustained and the risks from a build-up in leverage and credit. FinCo capital ratios and balance sheet leverage, for example, can deteriorate, as optimism affects the outlook for losses, especially in a period of sustained low credit losses and muted volatility in financial markets. In the down-phase of the cycle, the analysis seeks to understand the sources of the downturn and identify which FinCos are most impacted. In particular, this investigation seeks to understand, if the current cycle is going to be particularly severe. Downturns may reveal weaknesses in various aspects of some FinCo's fundamentals that were not apparent during a more benign environment, while other FinCos may prove to be more resilient.

Sovereign Rating Considerations

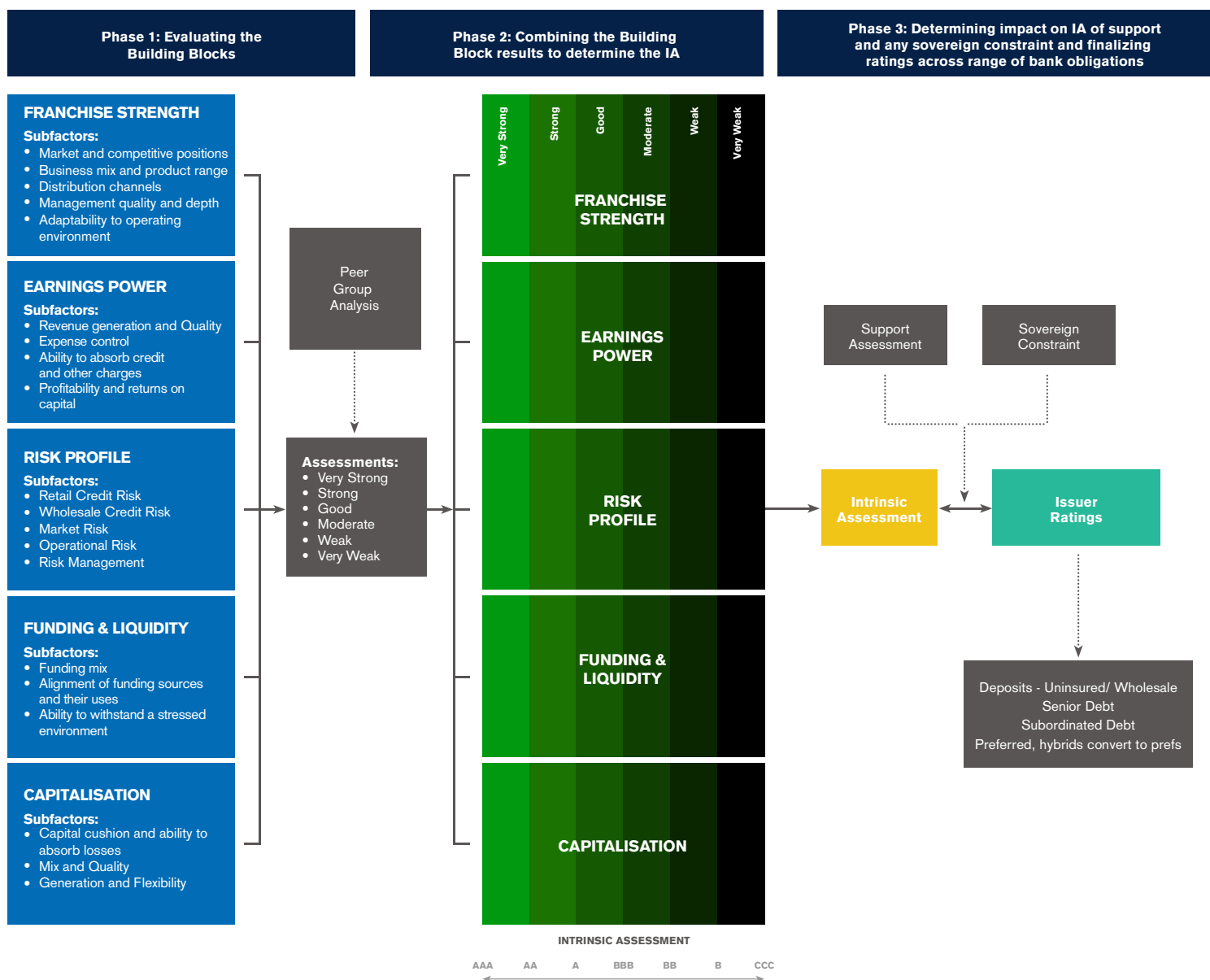
Another factor in the environment is the sovereign rating of the country. DBRS views FinCo ratings as typically constrained by the sovereign rating. This constraint reflects the government's wide-ranging powers and the extensive influence of the government on taxation, employment and business activity. Government regulations can have a direct impact on not only FinCo financials, but also the financial position of the FinCo's customers. Weakening of sovereign ratings is usually associated with a deteriorating economy with the potential for more pressure due to government actions to address fiscal imbalances and other challenges. Such deterioration also typically increases stress in financial markets and volatility in asset prices. At the same time, weakness in the financial sector generally can exacerbate stress on the sovereign.

Therefore, as a general principal, it would be unusual for DBRS to rate predominately domestic FinCos above the sovereign local currency rating, given the linkages between the financial sector and the sovereign through various government activities and entities. A potential exception to this constraint for domestically headquartered FinCos are typically for those FinCos that have a significant proportion of their franchise and earnings power located outside their home country. For example, for most aircraft lessors, their domestic market is largely irrelevant given their assets are operating globally, resulting in a majority of their revenues being generated outside of their domestic market. For a further discussion of the impact of sovereign ratings on other DBRS ratings please see *DBRS Methodology for Rating Sovereign Governments* (October 2016).

The Analytical Process – Overview

The analytical rating process starts by assessing the strength of each of the building blocks, beginning with Franchise Strength, utilizing available information including qualitative and quantitative data (see Exhibit 1). Ranging from “Very Strong” to “Very Weak”, these grades are then combined to reach an opinion on the FinCo’s Preliminary IA, expressed as a rating on the DBRS rating scale. The Preliminary IA is then checked through comparisons with peer groups. The final rating is then adjusted to take into account any explicit support from a parent or other entity in an organisation within which a FinCo operates. In limited cases, the final evaluation could consider whether the FinCo benefits from any systemic support.

Exhibit 1 – Finance Company Rating – Illustrative Workflow



The Preliminary IA reflects the combination of the various components of the building blocks. This process of combining the building blocks is an assessment of a FinCo’s integrated strength. The preliminary IA is on a continuum from AAA to CCC.

The final conclusion is not a simple additive exercise. Considerations would be given to factors such as the grade by building block, the interlocking play between the building blocks and the relative strength of each component within the blocks. Since FinCos are concentrated in particular business lines, the assessment can factor in how this business concentration affects the importance and interaction among the blocks.

Five Interlocking Building Block Detail

The following exhibit illustrates the elements of the five building blocks:

Exhibit 2:

Interconnected Building Blocks	Illustrative Elements	Building Block Weight
Franchise Strength	Business mix and product range, distribution channels, management quality and depth, adaptability to operating environment	20%
Earnings Power	Revenue diversification, net interest income, loan yield and net interest margin, non-interest income, expense control, ability to absorb credit and other charges, profitability and returns on capital	20%
Risk Profile, Asset Quality and Risk Management Processes	Retail and wholesale credit risk, portfolio granularity and concentrations, loan performance, market risk, interest rate risk, residual value risk, operational risk, legal and regulatory risks, and risk management design	20%
Funding & Liquidity	Funding mix, balance sheet encumbrance, alignment of funding and uses, liquidity and ability to withstand a stressed environment including contingent liquidity plans	20%
Capitalisation	Capital cushion over regulatory or internal requirements, mix and quality, and capital generation and flexibility	20%

Using the building blocks to determine the rating

DBRS considers these building blocks to be significantly interrelated and considers each building block an essential element in the overall assessment.

Therefore, DBRS has determined that building block weightings should be equalized reflecting their interconnectedness and equal importance. Indeed, while weakness in liquidity and the lack of diversity in funding sources typically leads to a FinCo bankruptcy, weaknesses in the other building blocks generally tend to precede the deterioration in the FinCo's liquidity position. If a specific building block is viewed as significantly weak, it would likely act as a constraint on the Preliminary IA. However, a single building block that is viewed as substantially strong relative to other building blocks may not provide sufficient uplift to the Preliminary IA to result in a higher rating.

Franchise Strength

From DBRS's perspective, franchise strength is an important driver underpinning a FinCo's rating. The stronger the franchise, the higher the rating is likely to be. It is unusual for a FinCo to be well-rated if it has a weak franchise, absent some form of parent or structural support mechanism. Better-rated FinCos tend to have stronger, more defensible franchises and hence can generate more resilient earnings power.

Earnings Power

Strong, resilient earnings provide the first line of protection for creditors. DBRS views a FinCo's earnings power as a critical factor in the rating. Resilient earnings provide the FinCo with the capability to withstand adverse events without invading capital and continue to provide resources for the FinCo to absorb weakness in the credit quality of its lending/financing portfolio. Importantly, strong earnings power means a FinCo can generate the resources to rebuild capital after adverse events. From DBRS's perspective, these positive attributes of strong earnings generation also provides confidence to investors, which will typically allow the FinCo to access liquidity during periods of general market distress. While a strong franchise does not guarantee strong earnings power, usually there tends to be a positive association between the two. In assessing earnings power, DBRS takes into account the risk profile that reflects, among other things, the business mix, concentrations and exposure to stress scenarios.

Risk Profile, Asset Quality and Risk Management Processes

The central risk which dominates most FinCo's risk profiles is credit risk. The analysis focuses not only on the characteristics of the FinCo's credit risk, but also how well the FinCo manages this risk. Underwriting processes, collateral valuation and various other specific aspects of risk management can be important elements in analyzing a FinCo's credit risk profile. FinCos also have extensive operational risk related to their management of originations and servicing in their lending operations and other activities. Market risk is typically a modest component of overall risk and primarily reflects the potential impact of interest rate movements, but can also involve risk in holding of securities, securitization residuals and other asset holdings related to a FinCo's

lending activities. For instance, for leasing companies, risk from changes in market values, i.e., market risk (or asset risk), is a larger component of the overall risk profile due to the exposure of these companies to the residual value of the leased asset.

Funding & Liquidity

Funding and liquidity are also critical components given FinCos' need to fund their credit activities. DBRS views a good funding profile as one that is diverse by sources and type, as well as a low level of balance sheet encumbrance, which allows financial flexibility. Another feature of a good funding profile is the alignment of the characteristics of the assets being funded with the characteristics of the funding, for example, by aligning maturities, interest rates and currencies. As most FinCos are reliant on confidence-sensitive sources of wholesale funding, a FinCo's funding profile is typically a constraint on its final rating. As the first line of defense during a funding crisis, liquidity is a critical component of this building block that is not assessed in isolation, but rather is considered in the context of the entire institution. A highly rated FinCo is not likely to have weak liquidity, but high liquidity by itself would not necessarily result in a high rating should the company's franchise and earnings power be viewed as weak.

Capitalisation

Similarly, in the case of the assessment a FinCo's capitalisation, high capital ratios are unlikely to drive a high rating in isolation. In evaluating the strength of a FinCo's capital, the analysis seeks to identify how well the company is capitalized relative to its risk profile, earnings power and regulatory requirements. It is important for well-rated entities to have a comfortable capital cushion above levels that DBRS considers necessary to be strongly capitalized to absorb low-frequency, deep loss events such that they can manage their capital and maintain market confidence.

III. Assessment of the Building Blocks – Detailed Considerations

Building Block (1) – Franchise Strength – (20% Weighting)

Market, scope and competitive positions

DBRS considers the franchise strength of a FinCo as an important factor in the rating. Franchise strength is typically reflected in the robustness and resiliency of a FinCo's market position. This position is generally underpinned by the FinCo's competitive advantages and management's skills. For some FinCos, a key component is often its various client bases and the strength of its relationships with these clients. For others, client relationships are more transactional, and their franchise strength reflects their reputation for service and responsiveness, often utilizing a visible brand. DBRS views a strong and defensible franchise as a central factor in a finance company's ability to generate resilient and sustainable earnings.

In evaluating a finance company's market position, DBRS considers the FinCo's brand positioning and awareness in the market along with its market share. In this evaluation, DBRS takes into account the overall size and state of the market. The strength of a company's market presence directly impacts its capacity to attract new business and compete effectively. In this respect, market penetration is a key consideration, as measured by the size and breadth of the FinCo's business and product offerings. For some types of FinCos, the depth of client relationships can be a key factor, especially for sectors such as aircraft leasing or fleet management. The analysis will then focus on the strength of the customer relationships and the depth and breadth of the customer base. For other FinCos, particularly ones where retail customers borrow for a specific one-time purchase, such as in auto or home buying, the evaluation of franchise strength may focus on the strength of the FinCo's ability to source new business. This involves consideration of characteristics such as the company's track record, service quality and brand position.

Scale can be particularly relevant in providing commoditized services profitably. Greater scale enables a FinCo to spread the typically higher overhead costs associated with these businesses over a larger revenue stream. Indeed, a leading market position often leads to scale and cost efficiencies. The analysis considers a FinCo's position and the extent to which it can take advantage of such economies or is at a disadvantage versus competitors. Technology capabilities can be an important differentiator in this respect. FinCos with strong IT platforms and the ability to leverage these capabilities can have an important advantage in competing, even against larger competitors.

Those companies with strong and sizeable market positions tend to have the resources to more readily cope with, and adjust to, changes in the regulatory and operating environment. Generally, such stronger FinCos are also better positioned to respond to shifts in strategies of existing competitors or the entry of new competitors. An important component of franchise strength can be the FinCo's licenses and regulatory vehicles for conducting its businesses. This could include banking licenses.

Business mix and product range

Revenue potential expands with the ability to provide a deep set of products, to offer access to value added services, tailor products to the local market or customer requirements and increase visibility and acceptance among customers. Importantly, the ability to withstand competition improves with greater market share.

Distribution channels

DBRS views favorably those FinCos with a diverse and deep distribution network. Distribution networks include direct, indirect and digital channels to originate and deliver products to customers. A broad range of distribution channels allows a FinCo to reach a diverse pool of potential customers while delivering the product in the customers' preferred manner, deepening the customer relationship. DBRS reviews a FinCo's utilization of direct and indirect sales channels, as well as its ability to leverage on-line and mobile technologies to broaden its distribution capabilities. Typically, DBRS views a high preponderance of broker-originated assets as a negative, given that typically the FinCo does not have an established relationship with the customer. While having a wide range of distribution channels is generally a positive, if these channels are not sufficiently deep, the benefits of diversity may not be captured. For example, while a FinCo may have a direct-sales force with nationwide coverage, if the number of sales representatives is small relative to the number of customers within their region, then the benefit of broad geographic coverage is unlikely to be fully realized.

A FinCo's international scope and success in operating internationally may be an important strength, if these international operations add to the FinCo's diversification and resiliency of earnings. DBRS evaluates international operations in light of the FinCo's franchise position in each country or region where it is operating. In considering international operations, DBRS is concerned with the FinCo's ability to operate successfully in more than one jurisdiction, including its management capabilities, technology, compliance, risk controls, financial structure and regulatory requirements. In some cases, international operations could pose more risks for a FinCo than they add in franchise scope or earnings power.

Once a company's competitive advantages have been identified, DBRS evaluates whether these advantages are sustainable and defensible. A FinCo's ability to generate earnings, its ability to manage through competitive pressures and business cycles and its ability to defend its franchise are all important attributes to be considered when assessing the strength of its business franchise. Given FinCos' reliance on wholesale funding, DBRS sees those FinCos with strong franchises as better able to navigate capital market disruptions, all other factors being equal.

Management quality and depth (includes ownership and corporate governance)

Management is also an important component when considering the strength of a FinCo's franchise. A strong management team is important for achieving the potential of the FinCo's franchise through strong earnings, well managed risk, well aligned funding and liquidity and appropriate capitalisation. Strong management teams sustain the development of a FinCo's franchise to ensure that it remains competitive. Strong management is more capable of maintaining investor confidence, which allows a FinCo to maintain access to markets during periods of weakening market confidence. A strong board of directors with the appropriate level of independence and expertise is also important to ensure appropriate corporate governance and reduce the risk of adverse management action.

In evaluating management, DBRS assesses the depth of management experience, succession planning and corporate governance. Additionally, management's ability to execute on operating strategies is assessed to gauge the effectiveness of management. Further, management's acquisition appetite and experience integrating previous acquisitions are included in the assessment of franchise strength. Stronger management teams generally have proven their ability to respond to evolving operating environments and successfully execute their strategies that build the strength of their companies.

The second component of the analysis of this factor is a review of the quality of corporate governance. In addition to reviewing the track record of any corporate governance-related issues at the FinCo, DBRS's analysis focuses on the structure of the executive management, the board of directors, how involved both are in the business, as well as risk decisions, and the independence of the board of directors and auditors. Strong corporate governance can improve the likelihood of long-term financial health and can reduce the costs of having to address issues that arise from ineffective governance. From DBRS's perspective, there is also a correlation between governance and the extent that DBRS can have confidence in a management team and board of director's ability to execute on the strategies and plans as described to DBRS.

To the extent that information is available, DBRS generally focuses on the following general areas in order to detect potential governance issues that warrant further in-depth analysis. In evaluating the Board of Directors, DBRS will review the structure and independence of the board, as well as the expertise of board members and the frequency of turnover of board members. DBRS evaluates the risk function at the board level including the composition of the risk committee and its independence. Further, DBRS reviews the process for setting the company's risk appetite and the reporting structure of the risk function into the risk committee. Whereas the independence of the audit function and presence of external auditors are positive from the point of view of a FinCo's franchise strength, DBRS considers unexplained or frequent replacement of auditors, and qualifications to audit opinions negatively.

Separately, a FinCo's ownership structure and the organisational structure may have an important impact on its corporate governance and how it operates. DBRS's analysis seeks to understand how the ownership structure impacts the FinCo's operations, objectives, strategies and governance. Investors in listed companies benefit from increased disclosures and the additional scrutiny of the markets that reflects ownership of the FinCo's securities.

Adaptability to operating environment

The final point in the analysis of Franchise Strength involves the structure of the market in which the FinCo operates. DBRS aims to understand the level of competition including number of players in the FinCo's market and type and breadth of products offered by the FinCo and its peers. A key point is to evaluate whether an element of macroeconomic, regional, or sector-specific cyclicality is observable for the FinCo's specific market.

Additionally, DBRS considers the level and type of regulation of the specific sector, which are also associated with the structure of the market in general. Changes in both the operating and regulatory environment may have significant implications for the sustainability of the FinCo's observed financial results. In its analysis, DBRS typically considers how adaptable the FinCo is to a change in its operating and regulatory environment.

Building Block Analytical Process

On the following page is the grid that is used for the assessment of the Franchise Strength building block. Each subfactor is graded on the scale from "Very Strong" to "Very Weak". The scores are then combined to reach a final score for the Franchise Strength Building Block. That score is in turn combined with the other building blocks to reach a complete assessment.

Building Block: Franchise Strength

Subfactors	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Market, scope, competitive positions	Top tier and dominant, resilient positions in most or nearly all markets in diversified major business lines with strong brand presence and/or deep customer relationships; significant geographic reach adds to diversification.	Top or second tier, but resilient, defensible positions, in the majority of markets and in a number of business lines with a material brand presence and/or strong customer relationships; geographic reach adds significant diversification.	Mid-tier presence in some markets/ business lines with a solid brand presence and/or solid customer relationships; or Top or 2nd Tier position in limited number of business lines with some geographic diversification.	Moderate presence in some markets and business lines with an acceptable brand presence and/or established customer relationships; geographic presence adds some diversification.	Limited presence in a few markets and business lines with little brand presence and/or limited customer relationships; geographic presence adds limited benefit.	Very limited presence in a highly fragmented market and business lines with little brand presence and/or very limited customer relationships; limited benefit from geographic presence.
Business mix and product range	Complete or nearly complete product set for major business lines for the specific model the FinCo pursues across its operating geography; very significant benefit from diversification, synergies and scale	Robust product set for a number of business lines for the specific model the FinCo pursues across its operating geography; significant benefits from diversification, synergies and scale	Strong product set in some business lines for the specific model the FinCo pursues across its operating geography; with benefits from diversification, synergies and scale	Solid product set in some business lines for the specific model the FinCo pursues across its operating geography; some benefit from diversification, synergies and scale	Moderate product set in a few business lines for the specific model the FinCo pursues across its operating geography; limited benefit/added cost from diversification, synergies and scale	Limited product set in a few business lines for the specific model the FinCo pursues across its operating geography; diversification is a negative/adds costs; small scale
Distribution channels	Wide or nearly complete distribution network in sectors where it operates; very skilled personnel; appropriately located; very close relationship with customers; very consistent/ experienced service capabilities	Robust distribution network in sectors where it operates; skilled personnel; appropriately located; very strong relationship with customers; consistent/ experienced service capabilities	Strong distribution network in sectors where it operates; generally skilled personnel; mostly located in key markets; strong relationship with customers; largely consistent service capabilities	Solid distribution network in sectors where it operates; skilled personnel; located in key markets; solid relationships with customers; service capabilities	Limited distribution network in sectors where it operates; less skilled personnel; poorly located; weak relationships with customers; below peer service capabilities	Limited distribution network in sectors where it operates; unskilled personnel; very poorly located; very weak relationships with customers; unreliable service capabilities
Management quality & depth	Well articulated and consistent strategy; high degree of management stability; depth and experience; clear and appropriately organized reporting lines, and effective corporate governance.	More average performance or minor weakness in one or more of the following: articulation and consistency of strategy management stability/experience; reporting lines, and corporate governance.	Some level of weakness in one or more of the following: articulation and consistency of strategy; management stability and experience and corporate governance.	Higher level of weakness in several of the following: articulation and consistency of strategy; management stability and experience; reporting lines and/or moderate corporate governance.	Poorly articulated and inconsistent strategy; high management turnover and relative inexperience; unclear and inappropriately organized reporting lines and/or weak corporate governance and consistency of strategy; management stability and experience; succession plan; reporting lines, and BoD	Very poorly articulated and inconsistent strategy; high management turnover and relative inexperience; unclear and inappropriately organized reporting lines and/or weak corporate governance.
Adaptability to Operating environment	Very strong ability to cope with and adapt to changes in the environment.	Well positioned to cope with and adapt to possible future environmental changes.	Has the capacity to handle change but major changes could be challenging.	Limited capacity to handle change and major changes could be materially challenging.	Not well positioned for any major changes in the operating environment.	Poorly positioned for any major changes in operating environment.

Building Block (2) – Earnings Power – (20% Weighting)

Earnings power is the capacity of a FinCo's to generate resilient and sustainable earnings. Considerable emphasis is placed on earnings, as they are the first layer of defense protecting creditors. DBRS's approach is to consider this capacity across a business cycle, rather than focusing only on current earnings. Stronger earnings power means a FinCo has the capacity to absorb unanticipated losses and non-recurring expenses, build capital and invest in the franchise while paying the dividends expected by its shareholders. In assessing earnings power, the analysis looks at the components of the underlying earnings and the FinCo's ability to withstand stress. Finance companies that demonstrate strong and consistent earnings generally will have continued access to funding and can build capital to protect creditors. In assessing the earnings power of a FinCo, DBRS concentrates not simply on the level of earnings, but also on the quality of earnings, which encompasses the components of earnings and the volatility of separate earning streams that underpin the sustainability of earnings.

Revenue generation & quality

To understand the strength, resiliency and reliability of revenues and the potential for growth, the revenue analysis examines the contributions of various components. The analysis looks at the diversity of the business mix in terms of customers, products, and geography, as well as the contribution from fee-based products and services. The broader this diversity, the more resistant revenues are generally to economic dislocations in a specific market or industry.

Revenue Diversification

The analysis of revenue diversification starts by examining the contribution of various components that contribute to earnings. The analysis takes into account any diversification across industry sectors that is represented in the loan portfolio, as well as the geographic dispersion of loans and receivables. The broader the industry coverage and geographic dispersion in the loan portfolio, the more resistant net interest income is to economic dislocations in a specific market or industry. Customer revenue concentration could significantly constrain a favorable evaluation of this component. The analysis also takes into consideration the competency of the FinCo in originating and underwriting the risk in those asset classes and geographic areas, as well as its ability to appropriately price the risk inherent in those transactions. The evaluation of revenue diversification also considers the contribution of fees and commissions that are generated either as a component of lending activities or through fee-based products.

Net Interest Income

The principal source of revenues for most FinCos is net interest income (NII). As such, a major focus of the analysis of earnings power is on the generation of NII. Typically, NII is the difference between the yield generated by a FinCo's assets and the interest paid on its funding. The level and stability of loan yields is an important component of interest earnings. The analysis also looks at funding costs and other components of interest expense, as data permit. While NII is one common metric, another key metric, especially for those with operating leases, is net finance revenue and net finance margin, which includes lease related income, as well as depreciation associated with the leased asset.

Loan Yield and Net Interest Margin

An important indicator of earnings power is the loan yield, which reflects the FinCo's business mix and the risks inherent in its loan portfolios. A lower-than-peer group average yield on loans can be mitigated by a lower risk profile in the loan portfolio. To evaluate a FinCo's loan yield relative to its peers, one DBRS measure compares yields and margins on a risk-adjusted basis, which is calculated as net interest income (excluding interest on investments) less credit losses (provisions) over average earning assets.

Net interest margin (NIM) is an important gauge of a FinCo's ability to generate a spread between its funding costs and the yield on its assets. A stable NIM for a sustained period indicates both a balanced loan portfolio with a stable funding base and prudent management of interest rate risk, and would therefore be viewed as a positive rating consideration.

Non-Interest Income

An important element in analyzing earnings is the contribution of non-interest income sources, typically service charges, transaction charges, insurance and other fee-related revenue streams. A well-balanced contribution from non-interest income from these items as a percentage of net revenues is generally considered favorably, because such products or businesses typically involve limited amounts of assets, capital and credit risk. Thus, non-interest income boosts profitability and, at the same time, lowers the FinCo's exposure to credit and interest rate risk.

Some FinCos, however, generate a substantial portion of their revenues from originating and selling new loans or other financings. These gains on sale, as well as origination fees tend to be more closely correlated to the volume of originations and can be volatile. FinCos also generate revenues from a variety of fees and commissions related to the provision of financing and other services, such as servicing loans. If gains on sale are an important component of revenues, the analysis may also consider the ability of the FinCo to

generate assets that can meet market requirements on a consistent basis. Nevertheless, FinCo's whose revenue generation is reliant on gains on sale will tend to have their ratings constrained at a lower level than those with either more diverse or less cyclical revenues.

Expense Control

DBRS aims to understand the FinCo's culture around cost control and how it has managed to control its costs through time.

An important consideration for earnings power is the efficiency of the FinCo's operations and how well operating expenses are managed, while delivering revenue growth. One useful measure is the efficiency ratio, which is generally the ratio of operating expenses to operating revenues, evaluated over time and compared to peers. Alternatively, DBRS will also consider the ratio of operating expenses to average earning assets in evaluating a FinCo's efficiency. In comparing efficiency ratios across FinCos, differences in business mix are taken into account. Where feasible, comparisons are made across FinCos with similar business mixes.

Operating Leverage – Another measure of expense control is operating leverage defined as either the difference between growth in revenues and the growth in expenses, or as the ratio of the increase in expenses/increase in revenues. Sustained positive operating leverage can indicate a FinCo's success in controlling expenses and aligning expense growth with its revenue trajectory.

Underlying Earnings – Income before Provisions and Taxes

In assessing earnings power, DBRS focuses on the strength of recurring earnings. A key measure in this analysis is income before provisions and taxes (IBPT), or pre-provision earnings. In assessing the strength of a company's IBPT, DBRS evaluates underlying core earnings adjusted for one-time or non-core items. Such items typically include one-time gains or losses on the sale of assets or businesses, gains on sale of securities, gains or losses on the redemption of debt, fair value adjustments, fresh start accounting accretion, restructuring costs, legal and regulatory fines and debt extinguishment charges. While the analysis of earnings may adjust for such non-recurring items, these items may still be factored into the ratings if they have a significant impact on the other building blocks. For example, they may indicate weaknesses in the franchise or in risk management. Moreover, DBRS considers the trends and history of underlying earnings in evaluating the trajectory and volatility of earnings. This evaluation favors FinCos with a history of sustained increases in earnings over FinCos with more volatile earnings. In this assessment, DBRS also considers the level and trend in a company's earnings relative to that of its industry peers.

Ability to absorb credit and other charges

A key measure of earnings power is the ability of those earnings to absorb credit losses from the portfolio of interest earning assets. DBRS uses the ratio of provisions for loan losses-to-IBPT as an important barometer of this capacity. This measure helps indicate the extent to which earnings are absorbing losses and how much further earnings can decline without invading capital.

Taxation

Taxes are an important factor in deriving earnings available for capital accumulation and dividends. The analysis seeks to understand normal tax rates and the drivers of any changes in tax rates. Tax rates for FinCos with international businesses can vary over time, as the business mix and earnings change by country. Where appropriate, deferred tax assets and the likelihood that they can be realized are evaluated.

Profitability and returns on capital

Profitability Metrics Details

In gauging the strength of earnings and the return on capital, the analysis looks at various profitability measures. Effective use of the balance sheet is reflected in returns on average assets (ROAA), which is net income as a percentage of average assets (annualized). Return on average equity (ROAE) is also used to evaluate management's ability to generate appropriate returns on capital. Reported ROAE can be distorted by non-recurring elements. Where appropriate and feasible, the analysis may adjust for non-recurring elements to obtain a better perspective on underlying trends. While a good starting point, these ratios can be distorted by differences in tax rates among industry participants, as such, DBRS will use both pre-tax and post-tax in its evaluations. Provision levels can also differ. Accordingly, DBRS considers IBPT-to-average assets as another useful profitability measure.

An important aspect of a FinCo's earnings is its capacity to pay interest on its debt. In reviewing a FinCo's leverage, one metric is interest coverage. Generally, DBRS looks at interest coverage as core EBITDA-to-annual interest expense. For DBRS, core EBITDA is a FinCo's EBITDA adjusted for any non-recurring revenue or expenses. Further, DBRS may exclude gains on sale of assets, if DBRS considers the gains on sale of assets to be volatile or unsustainable. For leasing companies and rental car companies, depreciation is a significant expense and a cost of doing business. As such, DBRS will adjust EBITDA to include depreciation on leased or fleet assets, while excluding general corporate depreciation from the calculation of EBITDA.

Earnings Quality

The quality of earnings is another important consideration to the assessment. In evaluating earnings quality, the analysis considers the stability, predictability and diversity of earnings. Interest and other fee-based revenues are generally considered stable, recurring and predictable and are viewed positively. DBRS considers those entities that are reliant on gains on sale for revenue generation as having lower quality of earnings given that these gains can be volatile and unpredictable.

DBRS may utilize all or some of the ratios above to gauge a company's dependency on its origination abilities as a chief source of profitability. Origination fees and gain on sale of loans as a percentage of total revenues indicate a firm's dependency on new loan originations. Two ratios, net interest income as a percentage of revenues and loan servicing fees as a percentage of revenues, are useful in identifying firms with strong recurring and predictable earnings.

Building Block Analytical Process

On the following page is the grid that is used for the assessment of the Earnings Power building block. Each sub-factor is graded on the scale from "Very Strong" to "Very Weak". The scores are then combined to reach a final score for the Earnings Power Building Block. That score is in turn combined with the other building blocks to reach a complete assessment.

Building Block: Earnings Power

Subfactors	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Revenue generation & Quality	Powerful and resilient revenue generation supported by solid, extensively diversified mix across business lines, customer segments and/or geographic regions; high, very stable risk-adjusted NIM reflects resilient assets yields and consistently low funding costs	Strong revenue generation; above peer level of revenue mix across well-diversified business lines, customer segments and/or geographic regions; high, relatively stable risk-adjusted NIM reflects resilient yields and generally low funding costs	Largely resilient revenue generation; above peer level of revenue mix across well-diversified business lines, customer segments and/or geographic regions; high, but variable risk-adjusted NIM reflects yields and variable funding costs	Mostly solid revenue generation, with reasonable balance of net interest income and non-interest income for sector(s) in which it operates, diversification across business lines, customer segments, or geographic regions; risk-adjusted NIM is acceptable.	Weakness in: sources of revenue, balance and stability of net interest income and non-interest income, more concentrated revenue by business lines or geographic regions; less stable, moderate risk-adjusted NIM with above average exposure to elevated funding costs	Very weak and unstable revenue generation; below peer mix of revenues; weakening demand in key markets, customer segments or business lines; unstable, inadequate risk-adjusted NIM with significant exposure to elevated funding costs
Expense control	Well-established cost control culture with demonstrated ability to manage costs over time.	Robust cost control culture with strong ability to manage costs over time.	Sound cost control culture with satisfactory ability to manage costs over time.	Acceptable cost control culture with a demonstrated ability to manage costs over time.	Weak, inflexible cost control culture with consistently weak operating efficiency and operating leverage.	Very weak, very inflexible cost control culture with very weak operating efficiency and operating leverage.
Ability to absorb credit and other charges	A robust capacity to generate earnings/IBPT to consistently absorb credit or other losses with no recent history of capital invasion.	Strong ability to generate earnings/IBPT to absorb credit and other losses with little history of capital invasion.	Solid ability to generate earnings/IBPT to absorb credit and other losses with infrequent historical episodes of capital invasion.	Adequate ability to generate earnings/IBPT to absorb credit and other losses with some history of capital invasion.	Lack of ability to generate sufficient earnings/IBPT to absorb credit costs and other losses with frequent or sizeable episodes of capital invasion.	Inability to generate sufficient earnings/IBPT credit costs with very frequent or sizeable episodes of capital invasion.
Profitability and returns on capital	Top tier of peer group for most key earnings power metrics; demonstrated robust capacity to sustain performance.	Upper tier of peer group for most key earnings power metrics; demonstrated capacity to sustain performance.	Upper to mid tier of peer group for most key earnings power metrics; resilient capacity to sustain performance.	Mid tier of peer group for most key earnings power metrics; adequate capacity to sustain performance.	Lower end of peer group for key earnings power metrics; limited capacity to sustain performance.	Near bottom of peer group for key earnings power metrics; very limited capacity to sustain performance.

Earnings Power Key Metric(s) –

The following table identifies key metrics and indicative ranges for use in the objective assessment of a FinCo's earnings power:

Building Block: Earnings Power

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Pre-Tax ROA	> 5%	4% – 5%	3% – 4%	2% – 3%	1% – 2%	< 1%
IBPT % of Avg. Assets	>4.5%	3.5% – 4.5%	2.5% – 3.5%	1.5% – 2.5%	0.5% – 1.5%	< 0.50%

- DBRS ratings are primarily based on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction and, in some cases, industry. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles.

- It is not uncommon for a FinCo's metrics to move in and out of the ranges noted in the table above, particularly for cyclical industries. In the application of this assessment, DBRS looks beyond the point-in-time ratio.

While the key financial metric above will be the most important metric(s) that will guide DBRS in benchmarking the FinCo in its relevant universe, other additional metrics may be used, depending upon a FinCo's activities, capital structure, off-balance sheet obligations, etc. Such other metrics may include the following:

Profitability Ratios (%)

Net interest margin (NIM)

Risk adjusted margin

Efficiency ratio

EBITDA-to-annual interest expense

IBPT/ avg. assets

Net income growth

ROAE

Quality of Earnings Ratios (%)

Gain on sale of loans/revenue

Non-interest income/revenue

Servicing and other fee income/revenue

Origination fees/revenue

Building Block (3) – Risk Profile – (20% Weighting)

Overview

An important element of the rating process is evaluating the nature and extent of the risks that a FinCo has taken and how well it manages these risks. This involves a review of a number of current and historical financial ratios, comparing these to the FinCo's peers to the extent possible, but also a review of the FinCo's overall risk management culture.

Retail and Wholesale Credit Risk

Regardless of whether the FinCo is specialized in retail or wholesale lending, the analysis evaluates the characteristics of a FinCo's loan portfolio(s) and past performance to determine their quality and potential performance depending on available information. This evaluation can involve analysis of the loan mix and loan characteristics by customer type, industry, and geographic location, including granularity and concentrations. After this step, DBRS analyzes a number of key ratios on asset quality, provisioning and write-offs. Finally, the analysis considers the level of non-performing assets compared to the FinCo's capitalisation and revenue generation.

The most recently reported ratios, as well as historical trends in these ratios are reviewed for each FinCo and compared to industry peers.

Identifying loan portfolio characteristics: Portfolio granularity and concentrations

FinCo's generally have higher levels of concentration both on the asset side and the liability side compared to banking organisations. Their more focused areas of operation expose them to sectoral risks and afford them limited means to diversify away from cyclicity. Some FinCo's such as aircraft leasing companies or container leasing companies are inherently even more concentrated given the limited number of customers regionally or globally. Concentration by geography, sector, and/or customer base may lead to certain vulnerabilities as discussed earlier in Earnings Power section, but it also exposes the quality of the FinCo's lending book to the weakening operating performance of these clients. Concentration of exposure to large customers in the lending book can expose a FinCo to the weakening operating performance of one or more of these customers.

Given these risks, as relevant, DBRS typically reviews a FinCo's top twenty customers by outstanding balance and annual revenues to evaluate the risks posed by concentration, where this risk is significant.

Assessing Loan Performance, Handling Problem Loans, Loan Loss Provisioning

Credit risk and asset quality vary widely from institution to institution and are largely dependent on the FinCo's mix of borrowers (credit profiles), the sector within which it operates and the degree to which the company retains or sells its risk exposures. Asset quality impacts future earnings through provisioning, and credit losses can eventually impair capital. Therefore, asset quality measures are an integral part of DBRS's analysis. However, the analysis of delinquencies, net charge-offs (NCOs), roll-rates, provisioning and other traditional measures are not the entire asset quality story.

DBRS analyses a FinCo's asset quality performance and the prevailing trends looking at key asset quality ratios, loan migration data based on the FinCo's internal rating scale and trends in customer creditworthiness and collateral coverage. DBRS looks at delinquency rates, roll rates and both gross and net loss rates as a preliminary gauge of asset quality. DBRS notes that high origination volume can artificially lower credit ratios and, considers this especially in its analysis of FinCo's with very rapid credit expansion. Alternatively, in situations of significant growth or noteworthy changes in underwriting practices, DBRS may request loan performance data on a vintage basis to better judge asset performance relative to expectations.

When available, DBRS reviews the FinCo's credit policy in regards to the delinquency horizon and length of time until asset repossession and/or charge-off, and takes into consideration the impact a FinCo's charge-off policy on the timing of loss realization.

As part of its analysis, DBRS reviews the FinCo's policy towards reporting loan delinquencies and the use of loan modifications and forbearance practices, as a company's policies in these methods can mask asset quality issues. The most conservative method is reporting loans based on original contractual payment, where loans remain delinquent unless payments, which are contractually due are received. However, lenders can report delinquencies using less conservative methods. These reporting methods often distort delinquencies, as loans that are current through the use of extensions and renewals may never be made current by the borrower. Even though such payment arrangements are an integral part of prudent loan servicing the danger is that these collection techniques may push out the recognition of loss.

Nevertheless, DBRS does recognize that, in certain cases, the receipt of one, or just a few, delinquent payments positively impacts the ultimate evaluation of the loan. As appropriate and where data is available, the company's actual cure rate for troubled loans is determined and compared to that of the company's peer group. DBRS evaluates the volume, frequency and effectiveness of extensions and modifications, as compared to the FinCo's peers and to its own historical rates.

After getting an understanding of the FinCo's approach towards asset quality and loss recognition, DBRS then reviews the FinCo's approach for provisioning for loan losses and the adequacy of its loan loss reserves.

Management's ability and confidence in its projections and provisioning levels can also provide insight into the effectiveness of risk management, in particular during periods of stress. Reserve adequacy is assessed given the FinCo's underwriting standards, loan mix and operating environment. Further, DBRS compares the levels and trends in reserves to those of the company's peers as an evaluation of trends in credit quality and provisioning for a FinCo's peers can provide a useful context for the overall operating environment, the specific sector, and the customer base when evaluating the FinCo's performance. The analysis would typically view FinCo's that are producing asset quality metrics that are superior to their peers as having stronger credit performance, although this assessment would take into consideration any differences in the mix of a FinCo's loan portfolio.

Common equity, revenue generation and asset quality

The final step in DBRS's analysis of credit risk provides a more comprehensive view of how the credit risks interact with the other components of the FinCo analysis, the Earnings Power and the Capitalization. The analysis of the level of non-performing assets (NPAs) relative to a FinCo's IBPT gives an indication of the extent of risks in the FinCo can run without invading the capital. Ideally, a FinCo that measures and prices its risks prudently can cover its cost of credit from its earnings. Finally, the analysis considers the level of NPAs versus the FinCo's common equity to understand how much the latter covers the former.

Other Elements of Credit Risk

In its analysis, DBRS also considers other balance sheet risks for the FinCo including, through retained interests in securitizations, seller's interests, and servicing rights.

Amongst other elements of credit risk is the FinCo's exposures to single counterparties or concentration risk. This exposure could be in the form of a single or limited number of counterparties within a FinCo's derivative portfolio. For this DBRS obtains and reviews the company's largest single exposures.

Market Risk

For most FinCo's market risk is generally comprised of interest rate risk. For those FinCo's with substantial leasing portfolios, the exposure to residual value risk, or asset risk, is also a significant source of market risk that DBRS considers in its analysis.

Interest Rate Risk

Given the importance of interest rate risk for FinCos, considerable attention is paid in the analysis to evaluating the FinCo's exposure to interest rate risk and how well it manages this risk. The analysis considers the maturity profile of the FinCo's assets and liabilities. The primary purpose of DBRS's assessment is to understand how well a FinCo's uses and sources of funding are aligned from the perspective of interest rate risk. Interest rate risk is generally reduced when a FinCo's funding maturities are generally aligned with the maturities of the loans it extends to its customers, or when the base index and the timing of the rate reset of its floating rate instruments match that of its floating rate loans. Alternatively, such alignment can be achieved through interest rate swaps or other arrangements. As part of this process, DBRS reviews the company's interest rate hedging strategies and use of derivatives, as well as the mix of fixed and variable rate funding and any potential mismatches including basis mismatch with the funded assets. Even though interest rate risk is assessed under the broader category of Risk Profile, it is closely associated with both Funding & Liquidity and Earnings Power. One form of assessing the overall risk to a FinCo is to measure the impact on net interest income from a parallel shift in the interest rate yield curve.

Residual Value Risk

For FinCos with substantial leasing portfolios, the exposure to loss from residual assets is a critical risk. Losses from residual assets occur when the value of a returned asset realized at disposition is below that of the book value. To gauge a FinCo's residual value management, DBRS reviews the FinCo's residual value setting and depreciation methodology, and compares it to industry practice.

In evaluating a FinCo's residual value setting, the analysis first looks at a FinCo's residual book value on leased assets as a percentage of the gross book value. DBRS calculates residual book value as the book value of leased assets, net of depreciation less the minimum future rental payments under operating leases on those assets. This ratio is then compared to industry peers to evaluate whether the FinCo is setting residual values too high for the benefit of near-term earnings, and would be at risk of higher losses should secondary market values decline.

Further, the analysis includes a review of the FinCo's protection against potential losses or impairments on leased assets. For this evaluation, DBRS utilizes the ratio of residual book value-to-common shareholder equity, and reviews this ratio in comparison to industry peers. DBRS views those FinCos with a higher ratio compared to the peer group as riskier.

DBRS also evaluates the FinCo's asset remarketing abilities and channels for disposing of returned assets. To complement this analysis, DBRS compares the actual performance of the disposition of returned assets with the book values. The ratio of realized residual value-to-stated residual values is analyzed to determine the efficiency in managing residual value risk and the ability to liquidate off-lease assets.

Operational Risk

Operational risk is an important consideration in evaluating a FinCo's soundness and the potential for unexpected losses that could impair earnings and capital as a result of inadequate or failed internal processes, people and systems, or from external events. These risks include diverse elements such as human error, to failures in operating systems and technology including cybersecurity issues, and the inability to meet regulatory and compliance requirements.

Although there are commonalities in the analysis of operational risk in areas, such as disaster recovery where DBRS pays considerable attention to the FinCo's plans, the risks can vary across FinCos due to differences in the products, footprint, senior management involvement and strategy. As a result, DBRS looks to understand the answer to wider operational risk questions such as "What could go wrong for this entity?" and "What support and planning is in already in place to provide comfort should such an event occur?" The response that the FinCo formulates in response to these questions, as well as its track record in managing operational risks are relevant for the analysis. The FinCo's track record of managing headline risk is an important factor as DBRS considers this risk to be elevated for all institutions that lend to consumers and small businesses.

Risk Management

DBRS's evaluation of a FinCo's risk profile begins with an understanding of the FinCo's risk management and control functions. Weakness in risk management that results in unexpected losses can potentially lead to negative investor reaction and an inability to access the capital markets. A FinCo's track record in managing risk, particularly its asset-quality performance, through economic cycles is a key rating consideration for DBRS. However, DBRS also considers the make-up of the FinCo's risk committee at the Board level and the process for setting the risk appetite, as well as the risk reporting function. From DBRS's perspective, the chief risk officer reporting into the risk committee of the Board is the optimal structure for maintaining the independency of the risk function from the business side of the house.

Assessing Credit Risk Management

For most FinCo's credit risk is typically the predominant risk. In order to view credit risk management, DBRS analyzes the credit risk policies, procedures and practices at the FinCo. DBRS views strong credit risk management as entailing sound underwriting and origination processes along with strong servicing and collections operations. In evaluating a company's management of its credit risk, DBRS reviews the company's underwriting standards; management of concentrations by geography, sector and product; and use of proprietary scoring models. Where relevant, the analysis will also consider policies regarding exceptions and the processes for managing and limiting exceptions. This also applies to constraints on portfolio risk, such as limits on certain types of loans or other types of lending products. DBRS seeks information on revisions to underwriting criteria and the approval process for these revisions. Further, DBRS evaluates the process for updating the proprietary scoring model, including validation testing and approval process for model updates. From DBRS's perspective, sound servicing and collections are a requisite for effective management of any loan or lease portfolio. As such, DBRS assesses the robustness of the servicing and collection IT platforms, training and practices. Further, to the extent that it is relevant under national regulatory regimes, DBRS reviews regulatory compliance, training, and monitoring.

Building Block Analytical Process

On the following pages is the grid that is used for the assessment of the Risk Profile building block. Each sub-factor is graded on the scale from "Very Strong" to "Very Weak". The scores are then combined to reach a final score for the Risk Profile Building Block. That score is in turn combined with the other building blocks to reach a complete assessment. DBRS uses a separate and distinct Risk Profile grid for companies operating in the Rental Car industry due to their unique business model amongst FinCos, which includes the absence of any meaningful credit risk exposure. Please see Appendix C for further detail on the sub-factors assessed when evaluating the Risk Profile of a Rental Car Company.

Building Block: Risk Profile

Subfactors	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Retail Credit Risk	Low loss history, well-diversified portfolio mix by geography, sectors &/or products. Portfolios have characteristics such as: generally low LTV loans; owner-occupied; high level of primary lien position; strong borrower characteristics; self/co.-originated; full recourse to borrower/guarantor; very strong servicing and collection capabilities.	Strong retail credit risk profile is typically characterized by many of the attributes of very strong risk profile with few attributes of weak risk profile.	Good retail credit risk profile FinCo is typically characterized by attributes of very strong risk profile, but has some attributes of weak risk profile.	Moderate retail credit risk profile is typically characterized by some attributes of very strong risk profile, but attributes of weak profile are more evident.	Material loss history, concentrated portfolio by geography, sector &/or product, high LTV loans, investor owned properties, high level of second lien positions, weak borrower characteristics, broker-originated, limited recourse/ guarantees; weak inconsistent servicing and collection capabilities.	Significant retail loss history, very concentrated portfolio by geography, sector & product, high LTV loans, investor owned properties, high level of second lien positions, weak borrower characteristics, broker-originated, limited recourse/ guarantees; very weak, inconsistent servicing and collection capabilities.
Wholesale Credit Risk	Low wholesale loss history, well-diversified portfolio mix by geography, sectors &/or products. Portfolios have characteristics such as: granularity, high quality of collateral/secured loans, limited high LTV loans, low level of subordinated positions, strong borrower characteristics, self/co.-originated, full recourse to borrower/guarantor; very strong servicing and collection capabilities.	Strong wholesale credit risk profile is typically characterized by many of the attributes of very strong risk profile with few attributes of weak risk profile	Good wholesale credit risk profile FinCo is typically characterized by attributes of very strong risk profile balanced by attributes of weak risk profile.	Moderate wholesale credit risk profile is typically characterized by some attributes of weak profile with limited attributes of the very strong profile.	Material wholesale loss history, concentrated portfolio by geography, sector & product. Portfolios have characteristics such as: non-granular/ large single-name concentrations, low quality of collateral/ security, high LTV loans, a high level of broker-originated loans, high level of subordinated positions, weak borrower characteristics, limited recourse to borrower/guarantor; weak inconsistent servicing and collection capabilities.	Significant wholesale loss history, concentrated portfolio by geography, sector & product. Portfolios have characteristics such as: non-granular/ large single-name concentrations, low quality of collateral/ security, high LTV loans, a high level of broker-originated loans, high level of subordinated positions, weak borrower characteristics, limited recourse to borrower/ guarantor; very weak, inconsistent servicing and collection capabilities.

Building Block: Risk Profile (Continued)

Subfactors	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Market Risk	Very low risk reflects either very well hedged interest rate risk, low FX risk, and very limited exposure to residual assets; OR very well managed market risk, which typically consists of: appropriate MTM requirements relative to balance sheet, very well hedged interest rate risk, proven ability to dispose of leased assets in excess of NBV, and low FX risk.	Strong market risk profile is typically characterized by many of the attributes of very strong risk profile with few attributes of weak risk profile.	Satisfactory market risk profile FinCo is typically characterized by attributes of very strong risk profile, but has some attributes of weak risk profile.	Passable market risk profile is typically characterized by some attributes of very strong risk profile, but attributes of weak profile are more evident.	Elevated market risk reflects either ineffectively hedged interest rate risk, high FX risk and history of losses on disposal of assets; OR poorly managed market risk, which typically consists of: sizeable MTM requirements relative to balance sheet, ineffectively hedged interest rate risk, periodic losses on disposal of off-lease assets and high FX risk.	High market risk reflects either ineffectively hedged interest rate risk, high FX risk and history of consistent losses on off-lease asset disposal or sizeable impairment charges; OR poorly managed market risk, which typically consists of: sizeable MTM requirements relative to balance sheet, ineffectively hedged interest rate risk, frequent losses from disposal of off-lease assets, and high FX risk.
Operational Risk	Very strong operational capabilities and track record across organisation, immaterial regulatory issues and significant adaptability, successful history of managing reputational risk and legal risks effective/harmonized technology and infrastructure.	Strong operational risk FinCo has many of the attributes of the very strong risk profile with limited attributes of the weak risk profile.	Satisfactory operational risk FinCo has many of the attributes of the very strong risk profile balanced by some attributes of the weak risk profile.	Passable operational risk FinCo typically has some attributes of the weak profile with a few attributes of the very strong profile.	Weak operational capabilities and track record, especially if operating in numerous jurisdictions, material regulatory issues and weak adaptability, poor history of managing reputational risk and legal risks, poor technology and infrastructure.	Very weak operational capabilities and track record, especially if operating in numerous jurisdictions, noteworthy regulatory issues and weak adaptability, poor history of managing reputational risk & legal risks, under-developed technology, infrastructure, weak disaster recovery plan.
Risk Management	Highly effective and established policies and processes, appropriate reporting lines, strong underwriting, proven loan loss reserve management, effective counterparty risk management, and sound remedial credit management.	Strong risk management FinCo typically has many of the attributes of the very strong risk profile with limited attributes of the weak risk profile.	Good risk management FinCo typically has attributes of a very strong risk profile balanced by some attributes of a weak risk profile.	Moderate risk management FinCo typically has some attributes of the weak profile with a few attributes of the very strong profile.	Weak and poorly defined policies and processes, inappropriate reporting lines, weak underwriting, unproven loan loss reserve management, ineffective counterparty risk management and weak remedial credit management.	Very weak and poorly defined policies and processes, inappropriate reporting lines, weak underwriting, unproven loan loss reserve management, ineffective counterparty risk management and weak remedial credit management.

Risk Profile Key Metrics

The following tables identify key metrics and indicative ranges for use in the objective assessment of a FinCo's risk profile. The first metric, provision as percentage of IBPT, is applied to most FinCos that have credit risk on their balance sheet and maintain a loan loss reserve for future losses. Meanwhile, the second metric, impairments as a percentage of IBPT, is applied to operating lessors, to evaluate the riskiness and performance of their lease portfolio.

Building Block: Risk Profile

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Provisions % of IBPT	<10%	10 – 20%	20% – 30%	30% – 50%	50% – 75%	>75%

Building Block: Risk Profile (for FinCo's with material leasing exposures)

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Impairments % of IBPT	0.00%	0% – 5%	5% – 30%	30% – 55%	55% – 80%	> 80%

- DBRS ratings are primarily based on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction and, in some cases, industry. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles.
- It is not uncommon for a FinCo's metrics to move in and out of the ranges noted in the table above, particularly for cyclical industries. In the application of this assessment, DBRS looks beyond the point-in-time ratio.

While the key financial metrics above will be the most important metric(s) that will guide DBRS in benchmarking the FinCo in its relevant universe, other additional metrics may be used, depending upon a FinCo's activities, capital structure, off-balance sheet obligations, etc. Such other metrics may include the following:

Asset Quality Ratios (%)

60-day delinquencies/net receivables

NCOs/avg loans

Reserves/NCOs

Reserves/gross receivables

NPAs/owned receivables

Reserves/NPAs

NPAs/tangible common equity

NPAs/pre-provision income

Loss recovery ratio

Residual Value Risk

Residual value % of gross book value of leases

Residual value % of common shareholder equity

Quality of Balance Sheet

Goodwill and intangibles/avg. assets

Mark-to-market assets/ avg. assets

Building Block (4) – Funding & Liquidity – (20% Weighting)

DBRS considers a FinCo's funding profile and the management of its funding and liquidity to evaluate whether it can withstand times of stress. FinCos are generally dependent on wholesale funding, which is typically more susceptible to the loss of confidence than retail deposits. The need for FinCos to have well-developed and diverse funding sources to the extent possible is, therefore, essential. However, some FinCos benefit from retail funding through their ownership of or by a bank or other deposit taking institution. Other FinCos are part of a larger organisation and can benefit from the strength of the parent organisation and its ability to provide funding. The analysis considers these structures and their contribution to the funding profile of the FinCo. The financial crisis of 2008-2009 tested the liquidity position of many firms, as well as their contingency funding plans. One of the leading causes of failure among FinCos is a combination of a loss of access to funding and limited liquid resources. Those FinCos with strong funding and liquidity profiles are better able to cope with funding stress and maintain or restore capital market funding within a reasonable period.

Funding Mix

The profile of a FinCo's funding has several dimensions, including the sources, maturity, collateralization/securitisation and seniority of its funding. Stronger profiles generally demonstrate diverse stable sources with a balanced maturity profile and appropriate use of collateral/securitisation with some unencumbered assets. DBRS views a well-developed funding profile as a FinCo's first layer of protection against a liquidity crisis. Indeed, to minimize the risk of a liquidity crisis, in the case of a market disruption, a FinCo should remain active in multiple funding channels and not be overly dependent on any single funding source or type.

Balance Sheet Encumbrance and Potential Notching of Unsecured Corporate Debt

A consideration in DBRS's analysis is the level of encumbrance in a FinCo's balance sheet. In general, FinCos have a mixture of both secured and unsecured funding, but typically are more reliant on secured funding than banks. This often leads to subordination for senior unsecured obligations. To achieve liquidity, lower-rated firms typically pledge their assets in securitizations and various forms of secured lending, such as warehouse lines, asset-backed commercial paper (ABCP), secured lines of credit and repurchase agreements. Consequently, pledged (secured or encumbered) assets are not available to unsecured creditors in the case of a default, placing the unsecured lender in a subordinate position. DBRS reviews the amount and quality of unencumbered (or unsecured) assets as a ratio to unsecured debt, as well as a secured debt as a percentage of total assets. In cases where unencumbered assets are limited, meaning that the company's balance sheet is largely encumbered, DBRS may notch the unsecured debt below the issuer debt rating by one or more notches, to reflect the subordination.

Alignment of funding sources and uses

While a diverse and stable funding profile is critical, a funding profile that is not properly aligned with the asset base can increase the exposure of a FinCo to firm specific or market wide liquidity events. The usage of short-term debt to fund longer-dated assets, for example, could expose the FinCo to a liquidity stress if it is unable to roll over its short-term funding. DBRS notes that such funding profiles were a key contributor to the difficulties faced by those FinCos that failed during the most recent financial crisis. As a result, DBRS reviews a FinCo's asset-liability management reporting and funding philosophy, including funding mix targets in relation to the expected behavior of the assets. DBRS recognizes the positive attributes of securitisation, particularly those structures in which the assets are funded for their life, thereby largely eliminating refinancing risk. Nonetheless, securitisation can result in asset encumbrance, which can reduce financial flexibility.

Liquidity and the ability to withstand a stressed environment

DBRS's analysis of liquidity brings together the first two factors of the analysis in a broader context and aims to understand the potential gap that may need to be funded given the sources and characteristics of the FinCo's funding, and the characteristics of its loans and other assets. The analysis focuses on the sources and forms of liquidity, the quantum of available liquidity compared to the requirements, and the stability of funding under changing economic and interest rate environments.

The form and sources of liquidity are an important factor in the assessment of the FinCo's resilience given potential market distress. DBRS views unrestricted cash and committed unsecured facilities to be the most reliable form. DBRS reviews the bank counterparties to the facilities and the length of these banking relationships, as well as other banking products utilized by the company. Moreover, DBRS reviews any material adverse change clauses (MACs) and financial covenants that may preclude the company from accessing the facility in certain scenarios. If a finance company holds a securities portfolio, DBRS will review the quality and liquidity of those securities and will apply a haircut to valuations where appropriate.

DBRS reviews the contingency liquidity plans to withstand potential funding dislocations, and expects them to include sufficient committed long-term funding and reliable additional borrowing capacity from various sources to continue operations without major disruptions. DBRS considers the FinCo's risk profile and the stability of earnings generation in determining the minimum

timeframe of liquidity coverage, but in most cases DBRS views 12 months of liquidity in the absence of funding in order to achieve investment grade ratings. Moreover, DBRS will compare a company's liquidity plan/coverage to those of its peers in assessing the appropriateness of the timeframe to required funding. For corporate commercial paper programs, DBRS applies the principles of the *DBRS Criteria: Commercial Paper Liquidity Support for Non-Bank Issuers* (March 2017) in considering the appropriateness of back-stop facilities.

Finance companies whose operations include entities with bank charters may be rated higher than their peers with similar profiles that do not have such charters, due to superior liquidity, funding flexibility and increased regulation. A bank charter or similar charter provides access to deposits, as well as access to central banks and other sources of official funding (e.g., the Federal Home Loan Bank (FHLB) advances). This funding flexibility can reduce the firm's reliance on wholesale funding and may provide back-stop liquidity. In assessing the position of FinCos with deposit gathering abilities, DBRS will review the deposit base applying DBRS's *Global Methodology for Rating Banks and Banking Organisations* as relevant.

Building Block Analytical Process

On the following page is the grid that is used for the assessment of the Funding and Liquidity Building Block. Each subfactor is graded on the scale from "Very Strong" to "Very Weak". The scores are then combined to reach a final score for the Funding and Liquidity Building Block. That score is in turn combined with the other building blocks to reach a total score.

Building Block: Funding & Liquidity

Subfactors	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Funding mix	Exceptionally strong and resilient funding profile underpinned by a diversity of funding channels; sizeable sources of very stable funding, such as deposits; wholesale funding sources are very well diversified, deep and dependable; good, flexible balance of secured and unsecured funding appropriate for business mix.	Strong and resilient funding profile underpinned by diversity in funding channels; some sources of very stable funding, such as deposits; wholesale funding sources are diversified, deep and dependable; good flexible balance of secured and unsecured funding appropriate for business mix	Sound and largely resilient funding profile underpinned by diversity in funding channels; some sources of stable funding, such as deposits; wholesale funding sources are diversified, deep and dependable; good balance of secured and unsecured funding appropriate for business mix	Solid funding profile with diversity in funding sources such that there would be alternatives if funding challenges arose in one source; some sources of stable funding, such as deposits; wholesale funding sources are generally diversified, deep and dependable; acceptable balance of secured and unsecured funding appropriate for business mix	Less robust funding profile with reliance on securitization or other secured funding sources; reliance on less diversified and relatively less reliable wholesale funding sources	Very weak or challenged funding profile typically reliant on a single wholesale funding channel with little to no diversity in funding sources
Alignment of funding sources and their uses	Funding profile is very well aligned with the nature, scale and maturity of the assets being funded.	Funding profile is broadly aligned with the nature, scale and maturity of the assets being funded.	Generally well aligned funding profile with some mismatches in the nature, scale and maturity of the assets being funded.	Generally aligned funding profile with some mismatches in the nature, scale and maturity of the assets being funded.	Overly reliant on limited funding sources; significant mismatches in the nature, scale and maturity of the assets being funded.	Generally reliant on one channel of funding with limited providers; substantial mismatches in the nature, scale and maturity of the assets being funded.
Ability to withstand a stressed environment	Well-established contingency funding plan is in place supported by accessible emergency liquidity sources and on balance sheet liquidity through cash, securities and a high level of unencumbered assets relative to potential liquidity needs; typically backstopped by highly rated parent.	Well-developed contingency funding plan is in place supported by a high level of unencumbered assets relative to potential liquidity needs supported by an accessible liquidity buffer and relatively reliable emergency liquidity sources; or well rated parent can be important source of support.	Solid, well-developed contingency funding plan is in place supported by a strong level of unencumbered assets relative to potential liquidity needs supported by an accessible liquidity buffer and relatively reliable emergency liquidity sources.	Contingency funding plans are in place and viewed as acceptable. An appropriate level of unencumbered assets relative to potential liquidity needs supported by an accessible liquidity buffer and relatively reliable emergency liquidity sources.	Limited unencumbered assets and/or a high level of encumbered assets relative to potential liquidity needs supported by a modest liquidity buffer.	Contingency plans are either non-existent or insufficient given requirements and narrow funding profile. High level of asset encumbrance restricts flexibility.

Funding and Liquidity Key Metrics

The following table identifies two key metrics and their indicative ranges for use in the objective assessment of company funding and liquidity:

Building Block: Funding & Liquidity

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Secured Debt / Total Funding (%)	<=15%	15% – 20%	20% – 45%	45% – 70%	70% – 100%	100%
Secured Debt / Total Assets (%)	<=5%	5% – 15%	15% – 25%	25% – 45%	45% – 65%	>= 65%

- DBRS ratings are primarily based on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction and, in some cases, industry. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles.
- It is not uncommon for a company's metrics to move in and out of the ranges noted in the table above, particularly for cyclical industries. In the application of this assessment, DBRS looks beyond the point-in-time ratio.

While the key financial metrics above will be the most important metric(s) that will guide DBRS in benchmarking the FinCo in its relevant universe, other additional metrics may be used, depending upon a FinCo's activities, capital structure, off-balance sheet obligations, etc. Such other metrics may include the following:

Liquidity Ratios

Deposits/total funding base (%)

Short-term debt/total debt (%)

EBITDA/debt maturing in one year

Liquidity Coverage (Available Liquidity-to-Next 12 months maturities)

Building Block (5) – Capitalisation: Structure and Adequacy – (20% Weighting)

A FinCo's capitalisation level indicates the buffer available to protect the liability holders from loss and is important for the FinCo to retain the confidence of its investors and counterparties. Strong capitalisation implies that a FinCo has ample capital to cope with the risks inherent in its business and risk profile under diverse economic environments and financial market conditions.

A simple measure of capital is the difference between a FinCo's assets and liabilities. A larger difference makes it more likely that liability holders would be paid in full, if the FinCo were to be wound up. However, in practice, a FinCo's capitalisation is more complicated. Adjustments to capital are necessary, because this difference may not reflect the resources that would actually be available. As FinCo's may be highly levered, the level of capital can vary substantially with only a modest change in the value of its assets or liabilities. Capital may also have to be adjusted for potential calls on capital that are not reflected in the FinCo's assets or assets that may have limited value in a wind-up of the FinCo, such as goodwill.

For those FinCos that are bank holding companies and that have banking subsidiaries, DBRS assesses the FinCo's capital using the same approach as for banks, see *Global Banking Methodology for Rating Banks and Banking Organisations* (May 2017) pages 26-29.

Links to Other Building Blocks

Strong earnings power reflected in resilient underlying earnings provides the best protection for bondholders, as these resources can absorb the impact of adverse events without invading capital. An important consideration in assessing the need for capital is the scale of losses that a FinCo could absorb out of income before provisions and taxes on a current basis, as well as in a stressed environment. The FinCo's ability to generate capital internally from its operations to sustain balance sheet growth, make strategic acquisitions and accommodate required capital expenditures, as well as the management's practice in prioritizing capital adequacy relative to meeting shareholder expectations regarding dividends, share repurchases, and return on equity are all relevant considerations. In addition to these connections to the other building blocks, DBRS considers the ability of a FinCo to raise new capital to also be a reflection of the strength of its franchise. Strong capital also bolsters the confidence of debt holders, counterparties and investors, which supports funding stability and reduces the risk of potential liquidity pressure. In other words, strong capital enables a FinCo to remain solvent despite losses, continue to operate through times of distress and return to profitability.

This assessment involves considering both the FinCo's available capital and the risks that this capital needs to address. In line with the above links, DBRS's analysis of a FinCo's capitalisation generally considers:

- The scale and structure of a FinCo's capital and its ability to protect the FinCo and its liability holders.
- The adequacy of this capital given DBRS's consideration of the FinCo's risk profile and earnings power.
- The FinCo's management of its capitalisation, the assessment of its risk profile, need for capital, evaluation of its businesses risk and allocation of capital to ensure appropriate management of business risk.
- Capital flexibility including the FinCo's capacity to generate internal capital, policies on dividends and share buybacks.
- Where appropriate, the analysis also considers the importance of the regulators in determining the adequacy of a FinCo's regulatory capital and how well the FinCo meets these requirements.
- The size of the FinCo's capital cushion above required levels, whether internal or regulatory, or DBRS's expectation of a FinCo's needs.

Measuring a FinCo's Capital and its Structure – Mix and Quality

DBRS evaluates the scale and structure of a FinCo's capital, which may be composed of various components. In principle, DBRS views those FinCos whose capital is predominantly common equity with limited preferred and hybrid securities as having higher quality capital, making them better positioned for a given level of capital to ride out stressed conditions.

- *Equity Capital* The primary component of a FinCo's capital is its book equity, which is the difference between its reported assets and liabilities. This capital generally equates to common equity and preferred shares.
- *Common Equity* DBRS views common equity as the best protection for a FinCo's bondholders and other obligors, as a FinCo can readily absorb losses through common equity and continue to function.
- *Preferred Shares* Preferred shares as equity also provide protection for liability holders, but they cannot readily absorb losses. A FinCo's quality of capital is viewed as weaker the more it relies on preferred shares.

Capital Ratios and the Adequacy of a FinCo's Capitalisation

A variety of measures are employed to evaluate the strength of a FinCo's capitalisation, as no single measure captures all the elements that determines a FinCo's capitalisation. The complexity of measuring capital and assessing a FinCo's risk profile limits each measure. To illuminate different perspectives on a FinCo's capital position, the analysis employs a matrix approach using various measures to help establish how well a FinCo is capitalised.

Total Equity / Total Assets The simplest capital ratio is the ratio of total equity to assets, which indicates how well a FinCo is protected from insolvency due to a decline in the value of its assets on a book value basis, where total equity includes both common and preferred equity.

Common Equity / Total Assets This ratio focuses on the amount of common equity a FinCo could use to absorb losses when experiencing a significant decline in the value of its assets on a book value basis.

Tangible Common Equity / Tangible Assets (TCE/TA) This ratio deducts intangibles from common equity, as well as from total assets to provide a better measure of the adequacy of capital adjusted for the potential that goodwill and other intangibles are written down in a stressed environment.

Regulatory Capital Ratios

These ratios are generally applicable to FinCo's that are banks or have banking subsidiaries and so are treated as banking organisations by the regulators.

Regulatory capital ratios reflect two types of adjustment, when applicable:

- Adjusting book capital to provide a better measure of capital that is available to protect a FinCo's liability holders.
- Using the risk weighting of assets to provide better measures of the risks that capital must protect against. The resulting risk weighted assets (RWA) is a better measure of a FinCo's risk profile than simple assets that include allocations for risks that are not "on-balance sheet", such as commitments, market risk and operational risk.

Amongst the regulatory capital ratios considered when evaluating a FinCo's capitalisation are Tier 1 Ratio, Core or Common Tier 1 ratio, Tier 1 Leverage and Tangible Common Equity to RWAs. For more detailed discussion on the definition and calculation of these ratios please see DBRS's Global Methodology for Rating Banks and Banking Organisations (May 2017) pages 26 – 29.

Cushion over Regulatory or Internal Requirements

Leverage varies greatly between participants in the FinCo sector. DBRS assesses the level of required capital in the context of the FinCo's risk profile as determined above. All other things being equal, the higher the risk profile of the balance sheet and/or more volatile the earnings profile of a FinCo the lower the tolerance DBRS has for leverage.

For those FinCo's, which own a banking subsidiary, a useful yardstick for capital adequacy is the scale of a FinCo's cushion above regulatory requirements. With increased concerns about the adequacy of capitalisation at a time of uncertainty about asset values and future credit costs, regulators have elevated their requirements for banks to maintain higher capital ratios than they have in the past and have built in capital cushions to help banks cope with stressed environments. Systemically important banks also face capital add-ons to ensure that their regulatory capitalisation reduces the systemic risk that they pose. Increased use of stress testing by regulators has added the potential for regulators to require increased capital for banks to cope with the stressed scenarios. Thus, banks generally are being required to be better capitalised. The analysis evaluates the capital requirements for a bank that take into account its particular characteristics and the regulatory requirements, as warranted, as well as considering the potential impact or results of any stress tests.

Stress Testing

For traditional FinCo's that do not own a bank and thus are not subject to regulatory capital requirements, DBRS will evaluate the capital cushion to internal requirements, typically covenants related to tangible net worth or leverage. In stress testing these covenants, DBRS will evaluate the level of losses the FinCo can absorb through IBPT generation, available reserves, and capital before breaching a covenant. This stress level of losses is then compared to the FinCo's observed level of losses during periods of economic stress to determine the reasonableness of such a level of losses being realized, as well as the appropriateness of the capital cushion above the covenant.

Generation and Flexibility

Along with the quantity and quality of capital, a FinCo's capital management plans are an important consideration in the rating process. DBRS considers management's targets for leverage, capital ratios and capital distribution. Indeed, DBRS reviews the payout ratio as established by management, including the practice of paying dividends and its stock repurchase activity. A high dividend payout rate could be constraining, as shareholders may come to expect the same amount of dividends in the future irrespective of the company's earnings. Moreover, DBRS considers a FinCo's asset growth rate compared to its internal capital generation retention rate. As these growth rates can be volatile on a short-term basis, DBRS looks to long-term trends and views FinCos with asset growth rates in excess of internal capital retention rates as likely to be riskier with more leveraged balance sheets, potentially weaker provisioning levels and substandard investment in the firm's infrastructure and businesses, particularly its origination, servicing and risk management systems.

Building Block Analytical Process

On the following page is the grid that is used for the assessment of the Capitalisation Building Block. Each subfactor is graded on the scale from "Very Strong" to "Very Weak". The scores are then combined to reach a final score for the Capitalisation: Structure and Adequacy Building Block. That score is in turn combined with the other building blocks to reach a complete assessment.

Building Block: Capitalisation: Structure and Adequacy

Subfactors	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Capital cushion and the ability to absorb losses	Capital and leverage ratios comfortably exceed required minimums and relevant buffers and provide an exceptionally robust cushion to absorb losses under stressed conditions. Leading capital levels and ratios amongst the peer group, and well-below average leverage relative to peer group.	Capital and leverage ratios easily exceed required minimums and relevant buffers and provide a robust cushion to absorb losses under stressed conditions. Capital ratios are in the upper tier amongst peers, and leverage is below to low relative to peers.	Capital and leverage ratios exceed required minimums and relevant buffers and provide an ample cushion to absorb losses under stressed conditions. Capital ratios are in the upper tier amongst peer group, and leverage is low to middle tier relative to peers.	Capital and leverage ratios are closer to require minimums and relevant buffers and provide a limited cushion to absorb losses under stressed conditions. Capital ratios are mid-tier amongst peers, while leverage is middle tier compared to peers. Capital is viewed as relatively aligned with risk profile.	Capital and leverage ratios are at or approaching required minimums and relevant buffers and offer minimal cushion to absorb losses under stressed conditions. Mid-to-lower tier capital levels and ratios amongst peers, and mid to high leverage relative to peers. Capital considered not aligned with risk profile.	Capital and leverage ratios are at or below required minimums and offer minimal to very little protection against losses with weak to poor capital and leverage ratios relative to peers.
Mix & Quality	Capital is completely comprised of tangible common equity	Capital is comprised almost entirely of tangible common equity, with small levels of non-core equity elements, such as intangibles and preferreds	Capital contains a low level of non-core equity elements, such as intangibles and preferreds	Capital contains a moderate level of non-core equity elements, such as intangibles and preferreds	Capital contains a material level of non-core equity elements, such as intangibles and preferreds	Capital contains a sizeable level of non-core equity elements, such as intangibles and preferreds
Generation and Flexibility	Powerful and consistent internal capital generation ability and/or appropriate dividend/share repurchase policy provides flexibility aligned with business and capital needs	Robust and reliable capital generation ability and/or an appropriate dividend/share repurchase policy aligned with business and capital needs	Strong and consistent capital generation ability and/or an appropriate dividend/share repurchase policy aligned with business and capital needs	Solid and generally consistent internal capital generation ability and an appropriate dividend/share repurchase policy	Adequate but less consistent internal capital generation ability, and/or a more aggressive dividend/share repurchase policy	Limited and inconsistent internal capital generation ability and/or an inappropriate dividend/share repurchase policy

Capitalisation Key Metrics – The following tables identify key metrics and indicative ranges for use in the objective assessment of a FinCo's capitalisation:

Building Block: Capital (for non-lessor FinCos)

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
TCE Ratio	>24%	20-24%	16% – 20%	12% – 16%	7% – 12%	< 7%

Building Block: Capital (for lessors)

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
TCE Ratio	> 30%	27% – 30%	24% – 27%	17% – 24%	10% – 17%	< 10%

Building Block: Capital (for Rental Car Companies and Asset Servicers)

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Debt/EBITDA	<0.5x	0.5x – 1.0x	1.0x – 2.0x	2.0x – 3.0x	3.0x – 4.0x	>4.0x

- DBRS ratings are primarily based on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction and, in some cases, industry. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles.
- It is not uncommon for a company's metrics to move in and out of the ranges noted in the table above, particularly for cyclical industries. In the application of this assessment, DBRS looks beyond the point-in-time ratio.

While the key financial metrics above will be the most important metric(s) that will guide DBRS in benchmarking the FinCo in its relevant universe, other additional metrics may be used, depending upon a FinCo's activities, capital structure, off-balance sheet obligations, etc. Such other metrics may include the following:

Quality of Capital Ratios (%)

Preferred securities/total equity

Goodwill and other intangibles/total equity

IV. Support Considerations for FinCos

In addition to the five interconnected building blocks, DBRS also notes that the following considerations can be critical considerations in the final rating for a FinCo.

Internal Support

The corporate structure of each rated entity is appraised. DBRS attempts to identify and discuss salient risks and rating implications within the corporate structure and ownership. DBRS begins with the ownership structure and the degree of separation between a parent company and its finance arm.

For wholly or partially-owned FinCos, parental considerations, such as the credit strength of the parent and the parent's intentions with regard to the finance subsidiary are considered. If the rated entity is a subsidiary of a larger corporation, a stand-alone intrinsic assessment is determined prior to adjusting for parental support or drag if the parent is a weaker entity.

Any formal agreement between the subsidiary and the parent are considered. In most cases, the benefit of internal support will hinge largely on an assessment of how important the finance subsidiary is to the parent organisation. Generally, the parent/subsidiary agreement ranges from the strongest form of support, an unconditional guarantee of the subsidiary's debt to the weakest, an operating agreement. Where an unconditional guarantee is in place, DBRS will likely rate the FinCo the same as the parent (assuming a higher-rated parent). Where support is minimal, then little or no parental support is factored into the rating.

Refer to DBRS's "Rating Corporate Holding Companies and Their Subsidiaries" for additional detail.

Systemic Support

A FinCo that owns a bank charter may have the ability to utilize generally more stable deposit funding to the extent that it can originate and sell its loans to the bank or originate its loans within the bank. These activities are constrained by regulatory requirements that vary across countries by type of lending.

The analysis also considers the stability of the deposits raised by the FinCo's banking subsidiary, as deposits raised by a full service bank are typically more stable than those attracted simply by paying relatively high rates with limited banking services. If meaningful in relative size, the bank can add significantly to a FinCo's funding diversity; but the ability of the bank to provide funding to its FinCo parent is typically constrained by regulation. Banking subsidiaries may also provide avenues to add business lines to the franchise that provide additional diversification and/or regulation that are viewed positively in terms of the DBRS credit assessment.

A FinCo that is owned by a banking organisation that is systemically important may benefit from external support from the sovereign or other authorities that strengthens the overall credit assessment of the banking-organisation parent. In exceptional cases, if any external support is factored into the rating of the FinCo, it would reflect the systemic importance of the FinCo.

Support Assessments – Systemic Support and Internal Support

Introduction

This section addresses how DBRS evaluates and incorporates support into its ratings of FinCos. Support comes in two forms: systemic support from external sources, principally government entities, and internal support from within the corporate structure and ownership.

Support is generally prospective (sometimes referred to as ‘implicit support’) in that DBRS assumes that support would be provided in case of need. Actual support, for example through capital injections, would be assessed to be included in a FinCo’s IA once it was received.

In general, the likelihood and strength of each of these forms of support is determined by analysing the motivations and resources of the potential supporting parties. This determination takes into consideration any legal or regulatory constraints or requirements.

Assessment of Systemic Support

Our approach to systemic support bifurcates into two types of regimes. Under one regime, systemic support is judged to be sufficiently predictable in timeliness and scale to improve the rating of some senior obligations of a FinCo through notching above the FinCo’s IA. Under the other regime, systemic support may still be possible, but it is not considered sufficiently predictable in terms of its timeliness and scale to improve a FinCo’s senior rating from its IA. While there are considerable variations in actual regimes, this approach enables DBRS to address support across the range of regimes currently in place.

DBRS’s systemic support assessments reflect DBRS’s opinion of the likelihood and predictability of timely support for a FinCo or other financial institution in case of need. Such support may include actions that extend beyond a specifically programmed subsidy, or customary support within the national regulatory and central banking system. Reflecting a reduction in default probability, the notching of the final rating above the IA due to such prospective systemic support will depend on our assessment of the likelihood of such support and the strength of the supporting entity relative to the supported entity. To the extent that national policies change towards reduced systemic support, the assessment may result in the conclusion that systemic support is no longer sufficiently likely to be timely, which may impact the ratings of FinCos where systemic support is incorporated into their ratings. DBRS continues to evaluate these potential changes and their implications for its assessments of systemic support. If and when this evaluation indicates that the level of support has changed, DBRS would update its assessments accordingly.

The approach to internal support provided by banking organisations to a wholly-owned FinCo subsidiary is to evaluate the willingness and capacity of these entities to provide such support. During the most recent financial crisis, banking organisations demonstrated their support for their subsidiaries through the provision of funding, capital injections and other actions. These actions indicate the importance to banking organisations of supporting their FinCo subsidiaries, even across borders. The evolving environment may also have an increasing impact on the relationship between parents and subsidiaries within a banking organisation. As yet, regulatory changes have not had significant impact on the ability of parents to support their FinCo subsidiaries. In the future, local regulators may have a larger impact on particular subsidiaries through various actions ranging from increased capital demands to constraints on the upstreaming of resources. The single point of entry approach to resolution and recovery for banking organisations may impact the position of parent bank holding companies relative to their major operating businesses. The future adoption of the ring fencing of certain banking activities also may affect how support can be provided to such ring-fenced subsidiaries or how these subsidiaries are integrated into the banking organisation.

Assessment of Support – Internal Support and Systemic Support

While DBRS does not currently rate any FinCos that are likely to be labeled as systemically important financial institutions (SIFIs), DBRS notes that in the U.S. GE Capital was designated a SIFI following the financial crisis of 2008/2009. Moreover, Fannie Mae and Freddie Mac would most likely have been labeled SIFIs if not already in government conservatorship. The analysis first addresses the willingness and capacity of government entities to provide systemic support to FinCos that are considered systemically important. A government’s incentive to support SIFIs reflects its concern about the adverse systemic impact of financial institution failures and financial market disruptions. The net impact of these motivations and the potential for systemic support may lead to uplifts of one or more notches from a FinCo’s IA for the ratings of those obligations that are expected to be supported.

Next, if the FinCo is not independent, the analysis addresses the willingness and capacity for internal support from within the banking organisation or corporate structure, and how this internal support is reflected in the notching from the parent’s rating, which is the anchor rating in much of the subsequent analysis.

As discussed in more detail below, the strength and nature of the supporting relationships are indicated with a designation of SA1, SA2, SA3 and SA4. SA1 is used to designate internal support, where the rating of the FinCo is driven primarily by the internal support provided by the parent or other entities within the financial organisation. SA2 indicates systemic support, while SA3 indicates no benefit from systemic support. SA4 indicates that support has a negative effect, due to the potential risk for financial drain or other negative pressure on the subsidiary as a result of its relationship to the parent and the financial organisation.

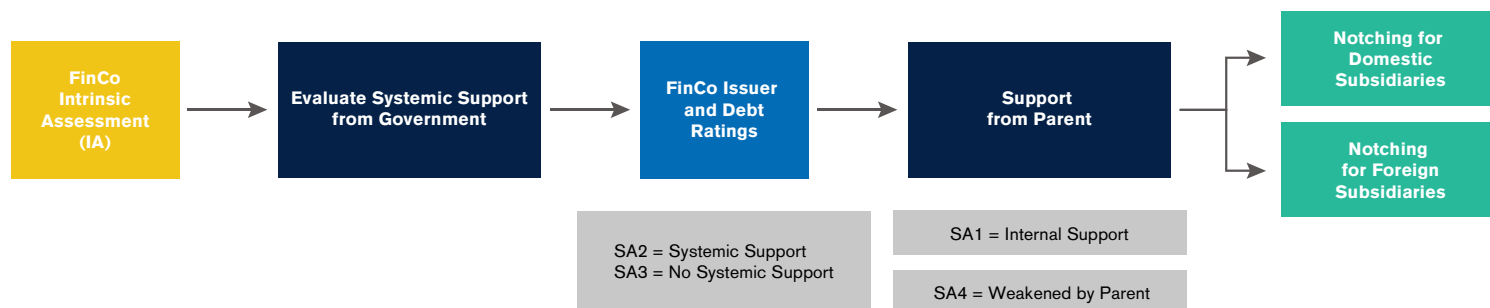
It is important to note that this methodology applies to countries that pose low cross-border risk for FinCos and subsidiaries and where such risk is not material enough to impact the notching for internal support. Cross-border risk is broadly categorized as the risk that governments take adverse actions involving nationalisation, expropriation, transferability and convertibility. In countries where this risk is material, there is a greater risk that parent support could be inhibited by such actions, leading to a widening of the notching between the FinCo organisation and its subsidiaries in these countries. In those situations where cross – border risk is material, DBRS would address this risk on a case by case basis that would reflect the circumstances of the FinCo organisation and the country.

The Chain of Analysis

The analysis starts with the IA of the FinCo. Support from outside the financial organisation is then considered. In countries where systemic support is determined to provide some uplift, this support is combined with the IA to derive the Issuer Rating and consequently the ratings for those debt instruments that would benefit from such systemic support (See Exhibit 3). The Issuer Rating then serves as the anchor for determining the extent to which the collective strength of the parent flows through to a subsidiary or other affiliates, taking into account the financial and reputational importance of the subsidiary, as well as its location as a domestic or foreign operation.

The result of the systemic support analysis can lead to the conclusion that systemic support will be sufficiently timely to raise the final rating above the IA in some jurisdictions. In other jurisdictions, the conclusion can be that systemic support is not sufficiently predictable in timeliness and scale to impact the final rating relative to the IA.

Exhibit 3: Chain of Analysis



DBRS Support Assessment Designations – SA1, SA2, SA3, SA4

SA1. Internal Support – Notched from Parent

This category is used for internal support for entities that are owned or controlled by the supporting party and are typically an integral component of its operations. It is also used for entities that benefit from guarantees or other contractual support. As the supported entity will often be integrated into the operational capabilities of the parent through shared systems, controls, strategy, management reporting, treasury management, risk management etc., the supported entity may not function as a truly standalone entity, making an intrinsic assessment difficult. Included in this category would be captive FinCos that benefit from a guarantee, a strong support agreement or keep-well agreement. In most cases, entities with SA1 assessments have final ratings that are equal or notched down from the final rating of the parent or other dominant support provider, rather than being derived from their intrinsic strength.

SA2. Timely Systemic Support Expected – Some Uplift from IA

While DBRS has not observed a FinCo that this category applies to FinCos for which some form of timely systemic support is expected from government entities that have interests in maintaining the supported FinCo. The uplift over a FinCo's IA due to systemic support is driven by the willingness and ability of the government or other external support provider to provide systemic support as discussed previously. In all cases, the notching for support is limited by the rating of the external support provider.

SA3. Timely Systemic Support Not Expected – No Uplift from IA

This category is for FinCos in countries where DBRS has no expectation of systemic support or is not confident enough that timely systemic support would be forthcoming in times of need to add any notches for systemic support. To date, FinCos rated by DBRS have typically received the SA3 designation.

SA4. Potential Provider of Internal Support – Pulled down from IA by Parent

This category applies to a subsidiary FinCo and other affiliate whose ratings were lowered by its position within a larger corporate structure or banking group that is weaker overall than the FinCo. The analysis typically reveals that this entity could face the potential for the parent or other entities in the corporate structure to drain resources from what otherwise would be considered a stronger standalone business. To date, no FinCo rated by DBRS has received a SA4 designation.

Support Assessment Dynamics

In general, the primary source of support for subsidiaries is its parent, which would be represented by an SA1 designation. In certain circumstances, however, DBRS may determine that a subsidiary may also benefit from systemic support from the government where the subsidiary is domiciled, reflecting the subsidiary's systemic importance to that country. While such systemic support is still not viewed as the primary source of support, this perspective on the primary source of support can change, if the circumstances change. For example, in a situation where both the parent and subsidiary are in difficulty and DBRS determines that systemic support is sufficiently likely, but parent support is becoming less likely, the designation may be changed to SA2 to reflect the benefit of such systemic support becoming more important for the subsidiary's rating rather than internal support.

Incorporating Systemic Support from Governments

DBRS first looks at the reasons why a FinCo may be likely to attract governmental support. The analysis evaluates the potential impact of a FinCo's failure on the financial markets, the economy or key sectors, including its implications for other FinCos of similar type and scope. DBRS then looks at indicators of the willingness of governments to prevent failures of financial institutions through capital injections or other forms of explicit assistance, as a matter of policy. The next step is to consider whether the government is likely to face fiscal constraints on the type and scale of support that it may be able to provide. Also to be considered are any legal or other constraints that may limit the ability of regulators or other government agents to provide support, such as the Bank Resolution and Recovery Directive (BRRD) in the European Union.

DBRS considers government support for a FinCo as highly unlikely given the current political environment and the lack of a FinCo that would currently be considered as systemically important enough to warrant support. For a more detailed discussion on DBRS's analysis of systemic support including the evaluation of a sovereign's willingness and ability to provide systemic support to banks and other financial institutions, as well as the determination of the uplift to the final ratings, please see DBRS's Global Methodology for Rating Banks and Banking Organisations (May 2017) pp 34 –48.

Incorporating Internal Support

In evaluating the likelihood that a FinCo may receive some form of internal support, DBRS first analyzes the corporate structure to determine if the FinCo is independent or part of a larger banking organisation or non-bank corporate organisation. For independent FinCo's the analysis of internal support ends here as there is no avenue for internal support.

For those FinCo's that are part of a larger non-bank corporate organisation, these FinCos are considered captive FinCos. For further detail on DBRS's approach to rating captive FinCos please see Appendix A.

For the remainder of this section, the focus is on the approach to evaluating and incorporating internal support for a FinCo due to its position within a banking organisation. This form of support typically originates from the parent or other owner, whether the FinCo is a subsidiary or some other form of affiliate. First, this section discusses FinCo subsidiaries that are owned by banking organisations. In evaluating the provision of internal support, the analysis seeks to assess the benefits to the banking organisation or group of providing support to the FinCo versus the cost of providing such support. Going forward, some changes in the evolving regulatory environment may become a more important factor in this analysis. One element is the larger role that local regulators may take on.

The operational structure and legal basis for banking organisations vary both within and across countries. There are individual banks, groups, holding companies, co-operatives, including credit unions, mutuals, and various other institutional forms. Globally, the most common form of banking organisation is a group, where the lead entity is a bank that owns other subsidiaries, including other banking subsidiaries, both domestic and international. In most instances, the main operating bank is the dominant component of the group and houses most of the group's assets and earnings. As a legal entity, it may be incorporated or otherwise organised with shares that trade on stock exchanges. In certain countries, particularly the U.S., however, bank holding companies (BHCs) are more

commonly the ultimate parent entity that owns the lead bank and other subsidiaries. Constraints on activities permitted for banks have been an important factor contributing to this organisational structure, as have tax laws and other regulations. The adoption of the single point of entry approach may expand the role of bank holding companies to more banking organisations in more countries.

Internal Support from within Banking Organisations

The analysis starts with the contribution of the FinCo subsidiary to a banking organisation's business objectives and their franchises. This evaluation utilizes the analysis that is already undertaken under the Global Banking Methodology to establish the bank's IA. In determining support for particular FinCo subsidiaries, the analysis goes into more depth as necessary on that subsidiary's contribution and its position within the banking organisation, including any specialized role that it performs for particular business lines. Given the structure of many banking organisations, the rating of a particular FinCo subsidiary may involve analysing more than one level of subsidiaries and intermediate parents to link the rating to the ultimate parent.

Underpinning banking organisations' support for their FinCo subsidiaries are the incentives that these organisations have to preserve their franchises and maintain their earnings. Importantly, as financial institutions, banking organisations have an added incentive to support their subsidiaries to protect their reputations with counterparties and other customers, as well as meeting the regulations and supervisory requirements in the countries where they operate. Performing a wider range of business purposes than branches, FinCO subsidiaries also extend the geographic reach or product diversity of the banking organisation, but they can also contribute through differences in their regulatory characteristics, legal restrictions and tax treatment.

In evaluating the likelihood of internal support, the analysis also considers the ability of a banking organisation to provide support. In general, this ability is reflected in the rating for the banking organisation, as determined by its fundamentals and including any systemic support that is warranted. In rating FinCo subsidiaries where deterioration is already evident, the analysis considers any explicit support already provided and considers the likelihood of further support in light of the increased burden. Deterioration of an important subsidiary and/or the growing burden of support for its subsidiaries are likely to put negative pressure on the parent's intrinsic assessment. Support for subsidiaries can come in the form of capital injections, funding, technical assistance and other services provided by the banking organisation.

Further Support Information for FinCos that are part of a Banking Organization

For a more detailed discussion on the determinations of the internal support for a FinCo this is part of a banking organisation, please see the *Global Methodology for Rating Banks and Banking Organisations* (pp. 39-42).

Typical Notching for SA1 and SA4 Designated Subsidiaries and Other Affiliated Entities

While there is considerable complexity across these diverse situations, the extent of the notching can be summarized for the most common situations. At one extreme, the final ratings for critical nonbank financial subsidiaries would be equalised with the parent's ratings. At the other extreme, a foreign nonbank subsidiary in a business line that is noncore or being exited would typically be rated at least three notches below the parent to reflect the greater risk that internal support would be less likely to be timely. In the latter cases, more attention would be paid to the intrinsic assessment of such a subsidiary and its potential need for support.

In between these extremes, are the fairly common foreign banking subsidiaries, which are generally rated one notch below the parent. Two notches or more might be appropriate, if a banking organisation had weak international operations or is retreating from its international operations, or the subsidiary was located in a country that is under significant stress. A domestic nonbank subsidiary in a core business would typically be rated one notch below the parent. The notching could be wider, if the nonbank subsidiary has become noncore and/or if the extent of the support of the subsidiary could pose a risk to the parent's financial position.

V. Impact of Related Methodologies and Criteria – Final Rating and Ratings for Specific Securities

Once DBRS has determined the intrinsic assessment for the FinCo, there are several other methodologies and criteria that may be applicable in determining the final Issuer Rating and all ratings for specific securities. Some of the more frequent criteria used for FinCos are as follows:

Rating Corporate Holding Companies and Their Subsidiaries (December 2016)

- The criteria discusses the DBRS approach to rating parent/holding companies, which will in some cases also have implications for the ratings of the subsidiaries that are held by the parent organisation.
- The application of this criteria means that most cases where the operating company and the holding company have issued debt, in the absence of any intercompany guarantees, the holding company debt effectively ranks behind the debt at the operating company resulting in structural subordination. Typically, this results in Holding Companies being rated one notch below the rating of the Operating FinCo.

Global Methodology for Rating Banks and Banking Organisations (May 2017)

- As noted in the introduction of this methodology and section III above, where appropriate, DBRS will use the Global Banking Methodology, along with this methodology when assessing FinCos with banking operations. In the absence of meaningful support related to a banking relationship, ratings on FinCos are based primarily on the intrinsic strength of the rated entity.

Guarantees and Other Forms of Support (February 2017)

- The criteria discusses the DBRS approach for guarantees and other forms of explicit support, which will in some cases have implications for the ratings of the subsidiaries of FinCos or for FinCos that are subsidiaries of non-financial corporations, including captive FinCos.

Preferred Share and Hybrid Criteria for Corporate Issuers (December 2016)

- The criteria discusses the DBRS approach to rating preferred shares and hybrid securities for corporate issuers, which will also have implications for the ratings of preferred shares and hybrid securities by FinCos that do not have banking subsidiaries.
- The application of this criteria means that preferred shares and hybrid securities are generally rated two and three notches below the Senior Debt rating of the FinCo.

Commercial Paper Liquidity Support for Non-Bank Issuers (May 2017)

- The criteria discusses the DBRS approach for commercial paper (CP) liquidity backup, which will in some cases have implications for those FinCos with active CP issuance programs.
- The application of this criteria means that for those FinCos with active CP programs DBRS expects those FinCos to have 100% CP liquidity backup availability for their programs, with exceptions for those FinCos with short-term instruments ratings of R-1 (middle) or R-1 (high).

Evaluating Corporate Governance (May 2017)

- The criteria discusses the DBRS approach for assessing corporate governance. Amongst the key areas of consideration in the evaluation are the Board of Directors, Senior Management, Audit function, and Other, which includes ownership structure, legal and regulatory issues, country issues, and other potential unique situations.

Sovereign Ratings Provide a Benchmark for other DBRS Credit Ratings (March 2011)

- DBRS credit ratings are subject to consideration of the sovereign risk of the country in which the issuer of the security is domiciled. This is not only because of the central government's wide-ranging powers, but also because of the extensive influence of the central government on taxation, business profitability and employment decisions.
- As a general rule, these powers and controls suggest that FinCos should be rated no higher than the relevant central government. It would be unusual for a predominantly domestic FinCo to be rated above the sovereign local currency rating, given the linkages between the financial sector and the government. Government regulations and other actions have a direct impact on financial institutions and could constrain a financial institution's debt servicing capacity. In the case of FinCos that are not predominantly

domestic, it is possible that the linkages noted above may represent less of a concern, and this can allow for ratings to exceed the domestic sovereign rating. (For additional information, see DBRS commentary “Sovereign Ratings Provide a Benchmark for other DBRS Credit Ratings – March 2011”).

Global Methodology for Rating Secured Obligations of Finance Companies (October 2017)

- This methodology is a supplement to the DBRS Global Methodology for Rating Finance Companies and is applicable when rating (1) secured debt issued by FinCos or their subsidiaries or affiliates and (2) when the pledged assets or security consists of large ticket operating equipment such as aircraft, railcars, construction or other similar high cost, long-lived operating assets.

VI. Appendix

Appendix A – Captive Finance Companies

Ratings for captive FinCos are typically very close to the parent

The strength of the parent is typically a key consideration and often a limiting factor for establishing the credit strength of a captive FinCo (CFC). DBRS defines a CFC as an entity whose main purpose relates to providing financing for customers to buy the products of the operating parent or in the case of retail companies, facilitate sales from the parent company's stores. Typically, the finance entity is a wholly owned subsidiary of the parent.

By their nature, CFCs have at least three risks that are normally not present at their parent operating entities: high leverage, interest rate sensitivity and credit risk. However, if these are well managed, the “stand-alone” credit strength of the CFC may be stronger than its parent due to several potential advantages:

- CFC earnings may be less sensitive to economic and industry conditions, as the interest spread business has at least some annuity-like characteristics provided the CFC appropriately aligns its funding and lending characteristics, such as maturities and interest rate flexibility. In contrast, the parent may face less flexible costs for production and staff benefits (pensions, healthcare etc.) that may impact its profitability and its rating, but not its ability to manufacture and sell its products.
- The FinCo's lending portfolio is typically well diversified, relatively liquid, easily identifiable and mobile. More mobile assets, such as loans or leases, are ones that can have the servicing transferred or even the asset itself transferred to another owner. The parent typically has a high proportion of assets that are non-liquid and have specific uses related to the parent's operations.
- Given that the average age of the financial assets held by the CFC is typically much shorter than the physical assets of the parent, the CFC's balance sheet is typically more liquid than that of the parent.

However, in rating the CFC, DBRS gives considerable weight to the strength of the parent because of the following considerations:

1. The CFC is heavily dependent on the parent as its receivables are generated by the sale of the parent's manufactured products or customer purchases at the parent's store location. Given that the primary business of the CFC relates to the products of the parent, it would typically be affected by problems at the parent. Any major challenges at the parent could threaten the operations and asset values of the CFC and under the worst-case scenarios (i.e. a default or a bankruptcy filing of the parent), it is difficult to envision a situation where the CFC would be able to continue as an ongoing operating entity, if the parent could no longer manufacture or were to close store locations. As a result, the parent's default could potentially result in a default by the CFC.
2. For CFCs that are not regulated or are only lightly regulated and wholly-owned, the operating company has some power in terms of areas such as dividends and intercompany transactions. As such, difficulties at the operating entity could easily translate into balance sheet and other pressures for the CFC.
3. The parent and its CFC typically have a high degree of sharing in areas such as strategy, management, marketing, and in some instances, financing incentives/subsidies. In general, the parent provides a high level of support to the CFC and the level of interdependence and business ties between the two entities means that their long-term prospects are closely linked.

These factors meaningfully limit the degree to which even strong CFCs can be rated above their respective parent companies.

Circumstances when CFCs could be rated lower than the parent

A CFC would typically be rated lower than its parent under the following circumstances:

1. There is no guarantee from the parent for the CFC's debt and other support agreements, such as keep wells, are considered inadequate in some respect.
2. In those instances when DBRS determines the stand-alone credit strength of the CFC, it is considered weaker than that of the parent such that the parent would not have any incentives to support the subsidiary. The CFC's key metrics are not considered strong, so that the stand-alone strength of the CFC would be considered as below the rating of the parent.
3. The financing provided by the CFC for the parent's products would not be considered as a “core” activity to the parent. A “core” activity or product line would be one which a parent would have major difficulty continuing without, and would make every effort to support so that the finance operation could be maintained.

4. Any product lines outside of those with the parent are not important sources of strength.

Circumstances when CFCs could be rated higher than its parent

Despite the aforementioned factors, there are cases in which a CFC's rating could be higher than that of its parent. In most cases, the difference would be limited to one notch. To exceed this limit, the CFC would have to be less than 50% controlled by the parent and there would have to be some comfort that the CFC has a franchise that would not be meaningfully damaged by major challenges at the parent. To achieve this, the CFC would likely need meaningful product lines beyond those related to the parent. These situations are expected to be infrequent and would be considered on a case-by-case basis.

In most cases, the CFC would not be eligible for a rating of more than one notch above its parent. To determine when the one notch benefit is applicable, DBRS considers the following factors. These factors are not exhaustive and DBRS may consider additional factors on a case-by-case basis.

1. The value of CFC's assets and the ability of the CFC to independently pledge its assets to secure funding without interference from the parent

DBRS considers the value of a CFC's assets under various negative scenarios and the likelihood that creditors of the CFC would have first claim on its assets. Strength in both areas increases the possibility that the CFC's IA could be higher than that of its parent. Relevant factors to consider would typically include:

- Creditors of the CFC have first claim on its assets (Are there criteria used by a bankruptcy court to determine if the CFC is an extension of the parent and not a separate company for the court proceedings, i.e., legal ring fencing?)
- Are there any present or potential abilities for the parent to infringe on this first claim ability through intercompany transactions, dividend policies or other means?
- Is there an expectation that under a worst-case scenario, the parent would be restructured rather than liquidated? (This has an impact on the value of the CFC's assets. Both wholesale and retail asset values would be much higher in a restructuring versus liquidation.)
- Value retention of the financed assets (with recognition for both retail and wholesale) under bankruptcy/restructuring or liquidation type scenarios.
- CFC's finance receivables are liquid, mobile and diversified.

2. The relationship between the CFC and the parent

The greater the extent to which the CFC and its parent operate in unison, the less possibility there is for considering the CFC as "separate" and assigning it a higher rating than the parent. Relevant factors to consider would typically include:

- Support agreements or cross-default covenants in existence between the CFC and the parent (In this context the support agreements include keep well type agreements).
- Preponderance of financing incentives, intercompany obligations or transfer pricing arrangements between CFC and the parent.
- Whether the transfer pricing arrangements, are established: i) on market terms ii) on a subordinate basis relative to other debt iii) with any demand or acceleration provisions
- Ownership structure and the ability for this ownership to change.
- CFC's dividend policy, the level of payout, and CFC's flexibility to adjust the dividend payout independently.
- CFC's independence from its parent with respect to functions such as strategy, systems and marketing
- Whether the CFC has a separate board which includes independent directors.
- Whether the CFC has a mix of third party and wholesale receivables.
- The size of the CFC relative to the parent.

3. The stand-alone strength of the CFC

If the CFC has no stand-alone ability to maintain its operations should the parent encounter default, bankruptcy or liquidation-type scenarios, there is less rationale for rating the debt of the CFC higher than that of its parent. Relevant factors to consider would typically include:

- Allowing for the relationship with the parent, is the CFC profitable? Specifically, does the parent make up the differential needed to ensure the commercial terms for the CFC's portfolio reflect market terms and values (i.e., any implicit subsidy is financed by the parent not the subsidiary)?
- To what extent does the CFC have profitable operations not related to the parent's products?
- If the parent were to cease manufacturing products, what is the likelihood that the CFC would be able to remain a going concern? What is the ability of the FinCo to manage any resulting decline in residual values that could be significant? Is there availability of spare parts to keep existing products functioning? Are there third parties that could fill the gap with new products?
- Does the CFC have appropriate bank lines and securitization ability separate from the parent?
- How strong are the capital and asset quality metrics, and future expectations of such at the CFC (with appropriate adjustments for off-balance sheet aspects)?

4. The level of ratings in the credit spectrum

Lastly, DBRS considers the rating level of the operating entity, as it is typically more difficult for a CFC to be rated above the parent when the parent itself is highly rated because the strength of the parent's brand, market position, earnings and other characteristics that underpin the parent's rating are too important to the underlying rating of the CFC.

Appendix B – Rating Approach for Business Development Companies Operating in the United States

The main body of the Global Methodology for Rating Finance Companies provides the core framework for DBRS's approach to rating business development companies (BDCs) operating in the United States. This appendix to the methodology provides additional details on the rating factors for BDCs, as well as rating metrics. BDCs are publicly registered companies, established under special laws in the United States governing their structure and operation, which invest in small and mid-sized businesses. BDCs have high capital and diversification requirements under law, relatively detailed reporting requirements and are required to pay at least 90% of their taxable income to shareholders.

DBRS considers the business models of BDCs as similar to FinCos. However, they are subject to very specific regulations and tax requirements that result in a number of significant characteristics that are different from the typical FinCo. Like most FinCos, BDCs operations are monoline with the assets owned by BDCs being the primary source of credit risk, and consistent access to capital markets is critical to maintaining liquidity and supporting growth. Accordingly, this Appendix is added to address the specific features of BDCs that DBRS considers in its rating analysis. This Appendix focuses on the emphasis of various key factors of BDCs within the methodology. DBRS highlights the following:

1. *Specific BDC Regulatory Oversight* – BDCs are regulated by the Small Business Investment Incentive Act of 1980 (the 1980 Act), a modification of the 1940 Investment Company Act (the 1940 Act). In addition, most BDCs register with the SEC as a registered investment company (RIC) for corporate tax purposes. DBRS views regulatory oversight and the reporting required under these regulations as providing superior visibility into a BDC's portfolio holdings, performance and strategy relative to typical FinCos, many of which continue to be closely held, with less transparency in their disclosures. BDCs are not subject to consumer protection regulation, as the typical BDC is not engaged in retail consumer lending.
2. *Constraints on capital retention* – BDCs that are registered as RICs must distribute at least 90% of ordinary taxable income to shareholders, including short-term capital gains. Further, a RIC that fails to distribute 98% of its taxable income must pay an excise tax of 4% on the portion between 90% and 98%. Most FinCos, are not subject to these requirements, as they are not typically RICs. By restricting the ability of such BDCs to retain earnings to build capital and support growth or fortify their balance sheets, these requirements limit the financial flexibility of such BDCs and constrain their ratings.
3. *Requirements for asset diversification and sources of income* – Under the 1980 Act, a BDC must invest 70% of the total value of its assets in eligible portfolio companies and designated assets (defined as private U.S. companies and publicly listed companies with a public float under \$250 million). Meanwhile, a BDC must generate at least 90% of its gross income for each taxable year from dividends, interest, payments with respect to certain securities, gains from the sale of stock or other securities, net income from certain qualified publicly traded partnerships, or other income, which is typically fee related such as for providing loans and facilities, prepayment penalties, transaction break-up, administration, and other activities. Finance companies typically have no such constraints on income generation.
4. *Asset coverage regulatory requirement for issuance of debt and preferreds and payment of dividends* – The 1940 Act requires BDCs to maintain an asset coverage ratio of 200% or more. The asset coverage ratio is defined as the market value of assets, less all liabilities and indebtedness not represented by senior securities divided by the aggregate amount of senior securities. A BDC may not incur additional debt or issue preferred stock unless its asset coverage is at least equal to 200% immediately following the issuance. In addition, a BDC may not declare dividends on its common stock unless its senior securities have at least 200% asset coverage. DBRS views these regulations as a form of prudential capital regulation. In general, FinCos are not subject to such constraints on leverage and dividends from regulation, although they may be faced with similar, if lesser, constraints from covenants with debt holders.
5. *Ability to invest in the equity of non-related entities* – A BDC's investment portfolio may include equity investments in small and middle market companies, which can be difficult to value thereby increasing the overall risk profile of the BDC. This differs from FinCos, which typically only make equity investments in related subsidiaries or joint ventures.

These various factors are integrated into the analysis of the individual building blocks and are considered when combining the blocks to derive the final rating.

The considerations for business development companies below are organized into the building blocks that underpin DBRS's approach to rating FinCos:

Franchise Strength

Strong BDCs tend to have scale, expertise and reputations that provide these companies with greater access to attractive investment

opportunities. Moreover, strong BDCs have better ability to assess these opportunities and then manage these investments. Nevertheless, given the limited diversity in the business model of BDC's, it is unlikely that DBRS would assess the franchise of any BDC as "Very Strong" in the rating methodology grids.

Among the factors considered when assessing the franchise of a BDC are:

- In assessing the market competitive position of a BDC, DBRS looks at the BDC's reputation, tenure in the industry, scale, and key relationships.
 - Reputation within the industry is important to BDCs who tend to rely on financial sponsors and other financial intermediaries to present potential investments. BDCs that are recognized as being able to close investments on time will tend to be presented more investment opportunities, affording those BDCs the ability to select better prospects across potentially a more diverse pool of investments.
 - Scale is useful as an indicator of success not only for market position of a BDC, but also for its potential to achieve economies of scale. However, this indicator cannot be taken in isolation from other factors. Indeed, DBRS would view scale less favorably, if achieved in a relatively short period of time, and asset quality metrics provided evidence that proper risk management was sacrificed for the sake of growth.
 - BDCs affiliated with larger alternative investment organisations tend to have an advantage, given the wider access to investment opportunities in the market that these organisations can potentially offer a BDC, as well as the substantial organisational benefits that these entities can bring to bear to support the BDC. Further, these organisations can provide the BDC expertise in assessing investments.
- DBRS considers management's strategy and ability to execute on the strategy. DBRS views favorably those management teams that focus on lending and services within their core areas of expertise. A review of the BDC's track record, including length and quality of investment performance, is an important consideration in evaluating management. DBRS looks at three to five years of investment history and performance, or longer depending on the availability of information and need for a longer perspective on performance.
 - When available, DBRS reviews management's performance during periods of market distress. DBRS views positively those teams that successfully manage through periods of market disruption by selling assets and reducing dividends.
 - A BDC's history of gross investment results can be a useful indicator of a BDC's management's skills. A pattern of frequent losses at a BDC may indicate weak risk management capabilities, a higher risk appetite, or inadequate corporate governance.
- DBRS evaluates a BDC's supporting business processes, including valuation policies, systems and disaster recovery.
- DBRS reviews the Board of Directors composition and experience. A higher proportion of independent directors with relevant experience is viewed positively.
- DBRS considers the current regulatory environment to be supportive of the BDC model; however, a lowering of the capital and disclosure requirements under the 1980 Act could weaken what are two key characteristics that contribute to the strength of the sector.

Earnings Power

DBRS's analysis of a BDC's earnings power focuses on the ability of the BDC to generate resilient and consistent earnings from its investment portfolio. As such, the DBRS analysis of earnings focuses on a BDC's net investment income generation (total investment income from the investment portfolio less total expenses). DBRS also considers a BDC's realized earnings (net investment income along with unrealized gains and losses on the investment portfolio).

BDC's do not book a reserve for credit losses on their investments, but mark-to-market their portfolio of investments. Thus, DBRS's consideration of income before provisions and taxes (IBPT) typical for a non-bank finance company is not as relevant for a BDC.

DBRS assesses the earnings power of BDCs in a number of ways, including:

- One measure is the proportion of a BDC's investment portfolio that is in instruments yielding interest. DBRS considers a higher proportion of income from recurring and predictable sources, such as interest from debt investments, more favorably than less reliable sources such as dividends, which may be interrupted, or less predictable still such as realized gains on the sale of investments.
- DBRS also evaluates transaction fees, monitoring fees and other fee income and whether these are indeed predictable, and recurring revenues.

- Given that the balance sheet is marked-to-market, there tends to be higher volatility in the income statement of BDC's than a typical FinCo. DBRS considers those BDC's with lower volatility more favorably, as this is often due to better asset selection and/or less aggressive lending and investment policies. To judge the volatility of earnings, DBRS looks to the return on the investment portfolio (net investment income as a percentage of average portfolio investments, at cost). DBRS would view those BDCs that maintain a return on the investment portfolio in the 7% to 9% range as demonstrating a good earnings generation ability, while those that have a sustained return below 3% as having a very weak earnings power.

Building Block: Earnings Power

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Net Investment Income % of Avg. Portfolio at Cost	> 11%	9% – 11%	7% – 9%	5% – 7%	3% – 5%	< 3%

- DBRS ratings are primarily based on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction and, in some cases, industry. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles.
- It is not uncommon for a company's metrics to move in and out of the ranges noted in the table above, particularly for cyclical industries. In the application of this assessment, DBRS looks beyond the point-in-time ratio.
- DBRS evaluates interest coverage as it compares to the other BDCs. DBRS defines interest coverage for BDCs as follows: The ratio of earnings before interest and taxes (EBIT)-to interest expense, where EBIT excludes gains, losses and payments in kind (PIKs). Also, DBRS looks to more stable revenues (interest income and dividends from investment portfolio) as a percentage of dividends to be paid by the BDC, including dividends on preferred stock.
- DBRS also assesses a BDC's cost base and compensation structure relative to peers to judge efficiency and whether compensation is in line with peers. Patterns over time can also indicate trends in a BDC's efficiency and expense control. DBRS considers a BDC's ratio of operating expenses (total expenses less interest and compensation related expenses) as a percentage of the average investment portfolio at cost.
- DBRS also evaluates a BDC's compensation to the investment advisor relative to peers through the ratio of compensation expense (base management fee plus incentive fees) as percentage of average investments at cost.

Risk Profile

Generally, the risk profile of BDCs is elevated due to their exposure to small and middle market companies. This customer segment is generally riskier than large corporates and less granular than lending to households. However, BDCs generally seek to manage this risk by taking a senior position in the capital structure secured by collateral. Further, regulatory limits around diversification of the investment portfolio and the asset coverage ratio restricting leverage offset some of the credit risk exposure.

- In reviewing a BDC's risk profile, DBRS begins with the investment underwriting and selection process, which is key to a BDC managing its investment losses. DBRS also reviews a BDC's credit monitoring process and procedures. Asset value protection arrangements, such as structural position, collateral security, covenants, and use of sweep accounts, are evaluated and recovery history are reviewed.
- DBRS considers the proportion of proprietary investments originated by the BDC within its investment portfolio compared to the proportion of syndicated investments originated by others.
- DBRS evaluates the composition of the investment portfolio with a focus on the nature of the BDC's investment positions. DBRS considers an investment portfolio with a higher percentage of equity investments and subordinated positions in the capital structure of the target companies as inherently more risky than those comprised of first lien, secured positions.
- Concentrations within the investment portfolio are typically evaluated. DBRS reviews concentrations by seniority, industry and vintage. Further, DBRS typically reviews the top single name concentrations. In measuring concentrations, DBRS looks at concentrations as a percentage of total assets and as percentage of tangible equity.
- DBRS evaluates growth trends and looks for concentration in any one vintage.
- DBRS also looks to trends in the portfolio to evaluate investment performance. These include trends in the net unrealized appre-

ciation (depreciation) of the portfolio, which may be early indicators of credit issues in the investment portfolio. Further, DBRS reviews trends in the current fair value as a percentage of portfolio cost, and the ratio of non-accruals at cost to portfolio loans. Indeed, DBRS considers those BDCs with sustained levels of non-accruals above 4.00% as having a very weak risk profile.

Building Block: Risk Profile

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Non-accruals as % of portfolio at cost	< 0.15%	0.15% – 0.40%	0.40% – 1.00%	1.00% – 2.00%	2.00% – 4.00%	> 4.00%

- DBRS ratings are primarily based on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction and, in some cases, industry. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles.
- It is not uncommon for a company's metrics to move in and out of the ranges noted in the table above, particularly for cyclical industries. In the application of this assessment, DBRS looks beyond the point-in-time ratio.
- The volatility in the quarterly mark-to-market of the investment portfolio is used to evaluate the riskiness of the lending undertaken by the BDC. More volatile mark-to-market activity compared to BDC peers is illustrative of such a risk appetite, in DBRS's opinion.
- DBRS considers robust and transparent valuation procedures of the qualified investments (and, as relevant, the track record of any third-party evaluator) as evidence of good risk management discipline.
- Market risk is evaluated, especially exposure to changing interest rates. DBRS reviews the mix between fixed and floating-rate investments. Further, DBRS reviews this mix in the context of the BDC's funding structure.
- DBRS evaluates the usage of structured vehicles or off-balance sheet arrangements in assessing the risk profile of a BDC. This evaluation includes the strategic fit of the structured vehicle within the BDC's investment focus.

Funding & Liquidity

BDCs are dependent on their ability to access the debt markets. In addition, BDCs are very dependent on equity markets to support growth, because of the high capital requirement and the constraints on a BDC's ability to retain organically generated capital.

In general, strong BDCs are those with a diversified wholesale funding platform.

- More robust funding platforms include a diversity of debt issuances by investor type and duration along with bank credit facilities that include a diverse number of participating financial institutions and staggered maturities.
- While most BDCs utilize their asset portfolios as collateral to secure funding, DBRS considers those BDC's with a higher level of unencumbered assets as a percentage of unsecured debt as demonstrating a more prudent management of liquidity.
- Stronger BDCs typically have more established track records of raising equity capital.
- Given DBRS's baseline assumption that in a stress environment a BDC's investment portfolio will become more illiquid, DBRS evaluates a BDC's ability to meet near-term obligations and sustain the franchise without selling investments.
- DBRS utilizes a liquidity coverage ratio to assess liquidity. DBRS's liquidity coverage ratio for a BDC measures its unrestricted cash plus available capacity under committed bank facilities, as well as proceeds from sales and pay-downs (including prepayments) from investments as a percentage of debt maturing over the next 24 months plus the BDC's committed investments to fund. DBRS may discount high cash balances resulting from financing sales, as these may be intended by management to be drawn down in additional investments.

Capitalization

Regulatory constraints on the leverage a BDC may employ results in BDCs being well-capitalized in comparison to other FinCos. The breach of the 200% Asset Coverage Ratio (ACR) by a BDC may result in regulatory constraints including being prohibited from issuing debt, raising equity capital, and paying dividends. In addition, the ACR is typically a covenant in most BDC bank credit

facilities. Insufficient capital to meet this covenant is the most substantial liquidity risk to a BDC as it could lead to an acceleration of the BDC's credit lines, which may aggravate cash flow problems.

While not as burdensome as a bank breaching regulatory capital requirements, the consequences of a BDC breaching the asset coverage regulation is more constraining than for a typical FinCo breaching covenant requirements, which typically can be negotiated.

Among the factors considered in assessing a BDC's capital adequacy are:

- In considering leverage, DBRS is mindful of the regulatory constraints limiting the upper bound of leverage. At the same time, DBRS views those BDCs with a sustained history of moderate leverage more favorably. DBRS does not give rating credit for low leverage ratios, as DBRS considers that in most cases leverage is likely to rise as BDCs find attractive investments. Conversely, DBRS views those BDCs with asset coverage ratios closer to the regulatory asset coverage cap as more aggressive given their smaller cushion over regulatory requirements and limited ability to generate organic capital. DBRS could consider capital adequacy of such aggressive BDCs on the weaker end of the rating methodology grids.
 - For those BDCs that do not publicly report an asset coverage ratio, DBRS uses debt-to-equity as a proxy. In calculating the leverage ratio, DBRS does not use net debt, as DBRS views the levels of unrestricted cash held by BDCs as inclusive of cash required to fund near-term investments and not necessarily in place solely for debt redemptions.
 - Those BDCs that maintain leverage over a period of time in the range of 0.55x to 0.80x would be considered by DBRS as sustaining moderate leverage. Meanwhile, a BDC that has sustained leverage at or close to the ACR (0.80x to 1.0x) would be viewed as maintaining weak capitalisation, in DBRS's view. In applying the ranges below, DBRS will also factor in the BDC's portfolio mix and current market conditions. During periods of market weakness, DBRS would view lower leverage as prudent management of capital and more favorably from a ratings perspective.

Building Block: Capitalisation: Structure and Adequacy

Metric	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Debt/equity	< 0.20x	0.20x – 0.40x	0.40x – 0.55x	0.55x – 0.80x	0.80x – 1.00x	> 1.00x

- DBRS ratings are primarily based on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction and, in some cases, industry. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles.
- It is not uncommon for a company's metrics to move in and out of the ranges noted in the table above, particularly for cyclical industries. In the application of this assessment, DBRS looks beyond the point-in-time ratio.
- DBRS evaluates the BDC's cushion above the ACR by reviewing the level of realized losses the BDC can absorb through equity before breaching the regulatory minimum.
- DBRS considers common equity as providing a more stable capital base. DBRS assesses the composition of a BDC's capital base with higher levels of preferred stock viewed less favorably.
- DBRS considers a track record of dividend payouts that exceed realized earnings (net income less unrealized gains and losses) as aggressive. Sustaining such a level of dividends in the future is likely to force management into a consistent sale of investment assets, which could ultimately pressure the asset coverage ratio cap.

Summary:

In general, from DBRS's perspective, investment grade BDCs will tend to have a number of the following characteristics:

- Strong franchise underpinned by scale, reputation, and solid management with an appropriate track record of solid performance in their areas of expertise, and may include strong links to larger sponsor organisations.
- Strong earnings benefiting from a sizeable component of recurring cash income and efficient cost base.
- Strong risk management capabilities and an investment portfolio that is well-balanced.
- Diversified funding platform with a well-laddered maturity profile.
- Conservative BDC leverage.

Appendix C: Specialized Risk Profile Methodology Grid for Rental Car Companies

On this and the following page is the grid that is used for the assessment of the Risk Profile building block for Rental Car Companies. DBRS uses a separate and distinct Risk Profile grid for companies operating in the Rental Car industry due to their unique business model amongst FinCos, which includes the absence of any meaningful credit risk exposure. Each sub-factor is graded on the scale from “Very Strong” to “Very Weak”. The scores are then combined to reach a final score for the Risk Profile Building Block. That score is in turn combined with the other building blocks to reach a complete assessment.

Building Block: Risk Profile – Car Rental Companies

Subfactors	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Fleet Residual Value Risk	Very low exposure to residual values and losses from movements in used vehicle prices. At this level, most likely due to absence of risk vehicles from fleet.	Low exposure to residual values and losses from movements in used vehicle prices. Historically, a significant majority of the fleet has been comprised of program vehicles or proven consistent ability to dispose of risk-vehicles in excess of NBV.	Exposure to residual values and losses from movements in used vehicle prices is well-managed with a balance of program vehicles and "risk" vehicles and/or a proven consistent ability to dispose of risk-vehicles in excess of NBV, with minimal losses on disposition and in line with the industry.	Exposure to residual values and losses from movements in used vehicle prices is appropriately managed with a balance of program vehicles and "risk" vehicles. Proven ability to dispose of risk-vehicles in excess of NBV, with infrequent episodes of losses on disposition.	Exposure to residual values and losses from movements in used vehicle prices is inappropriately managed with a fleet comprised largely of "risk" vehicles and an inconsistent record of disposing of risk-vehicles in excess of NBV.	Exposure to residual values and losses from movements in used vehicle prices is poorly managed with a fleet entirely comprised of "risk" vehicles and a history of consistently disposing of "risk" vehicles below NBV generating losses on disposition.
Fleet Management Risk	Robust fleet management with proven ability to consistently maintain fleet well-aligned with demand and travel volumes. Very high utilization rates and leading revenue per vehicle per month are illustrative of this management. Well-diversified operations both on-airport and off-airport, by channel as well as geographically.	Strong fleet management with proven ability to maintain fleet well-aligned with demand. High utilization rates and top-tier revenue per vehicle per month are illustrative of this management. Strong diversification in operations both in the on-airport and off-airport, by channel, as well as geographically.	Good fleet management with demonstrated ability to maintain fleet aligned with demand and infrequent and brief periods of mis-alignment. High utilization rates and top-tier revenue per vehicle per month are illustrative of this management. Appropriate diversification both on – and off-airport as well as geographically.	Acceptable fleet management with ability to maintain fleet aligned with demand and infrequent and short periods of mis-alignment. Good utilization rates for business model and top-tier to mid-tier revenue per vehicle per month are illustrative of this management. Acceptable diversification with some concentration in volumes from the on-airport market, a particular channel, or region.	Poor fleet management with demonstrated inability to consistently maintain fleet aligned with demand. More frequent periods of mis-alignment. Mid-to-lower tier utilization rates and mid-to-bottom tier revenue per vehicle per month are illustrative of this management. Concentrated exposure to travel volumes from the on-airport market, channel, or region.	Very poor fleet management with consistent mis-alignment of fleet with demand. Lower than peer utilization rates and below peer revenue per vehicle per month are illustrative of this management. High concentration to on-airport volumes, from a particular channel, or region.
Market Risk (excluding residual value risk)	Very low risk reflects either very well hedged interest rate risk and low FX risk; OR very well managed market risk, which typically consists of: appropriate MTM requirements relative to balance sheet, very well hedged interest rate risk, and low FX risk	Strong market risk profile is typically characterized by many of the attributes of very strong risk profile with few attributes of weak risk profile	Satisfactory market risk profile FinCo is typically characterized by attributes of very strong risk profile, but has some attributes of weak risk profile	Passable market risk profile is typically characterized by some attributes of very strong risk profile, but attributes of weak profile are more evident	Elevated market risk reflects either ineffectively hedged interest rate risk and high FX risk; OR poorly managed market risk, which typically consists of: sizeable MTM requirements relative to balance sheet, ineffectively hedged interest rate risk, and high FX risk.	High market risk reflects either ineffectively hedged interest rate risk, and high FX risk; OR poorly managed market risk, which typically consists of: outsized MTM requirements relative to balance sheet, ineffectively hedged interest rate risk, and high FX risk.

Building Block: Risk Profile – Car Rental Companies (Continued)

Subfactors	Analytical Assessment					
	Very Strong	Strong	Good	Moderate	Weak	Very Weak
Operational Risk	Very strong operational capabilities and track record across organisation, immaterial regulatory issues and significant adaptability, successful history of managing reputational risk and legal risks effective/harmonized technology and infrastructure	Strong operational risk FinCo has many of the attributes of the very strong risk profile with limited attributes of the weak risk profile	Satisfactory operational risk FinCo has many of the attributes of the very strong risk profile balanced by some attributes of the weak risk profile	Passable operational risk FinCo typically has some attributes of the weak profile with a few attributes of the very strong profile	Weak operational capabilities and track record, especially if operating in numerous jurisdictions, material regulatory issues and weak adaptability, poor history of managing reputational risk and legal risks, poor technology and infrastructure	Very weak operational capabilities and track record, especially if operating in numerous jurisdictions, noteworthy regulatory issues and weak adaptability, poor history of managing reputational risk & legal risks, under-developed technology, infrastructure, weak disaster recovery plan
Risk Management	Highly effective and established policies and processes, appropriate reporting lines, strong underwriting, proven loan loss reserve management, effective counterparty risk management, and sound remedial credit management; track record of very effective response to deterioration in credit conditions or environment	Strong risk management FinCo typically has many of the attributes of the very strong risk profile with limited attributes of the weak risk profile	Satisfactory risk management FinCo typically has attributes of a very strong risk profile balanced by some attributes of a weak risk profile	Passable risk management FinCo typically has some attributes of the weak profile with limited attributes of the very strong profile	Ineffective and poorly defined policies and processes, inappropriate reporting lines, weak underwriting, unproven loan loss reserve management, ineffective counterparty risk management and weak remedial credit management; track record of weak, ineffective response to deterioration in credit conditions or environment	Risk management processes are considered very weak overall. Policies and processes are not properly defined, inappropriate reporting lines, weak underwriting, unproven loan loss reserve management, ineffective counterparty risk management and weak remedial credit management; track record of weak ineffective response to deterioration in credit conditions or environment



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