ICRA Indonesia Rating Feature

December 2014

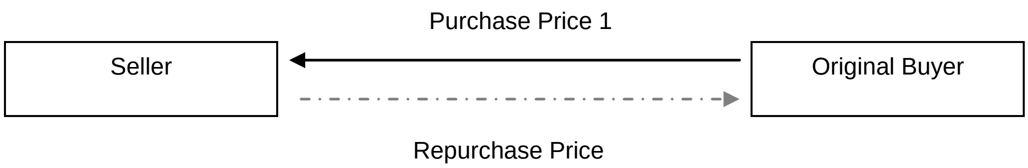
RATING TRANSFER CERTIFICATE PAYOUTS
A Note on Methodology

Introduction

The rating of Transfer Certificate Payouts (Transferee Payouts) addresses the likelihood of the Transferee getting the promised payouts under the Transfer Certificate Agreement in a timely manner. All factors that have a bearing on the payouts promised to the Transferee are evaluated while assigning the ratings.

A typical transaction involving the execution of Transfer Certificate Agreement - with a Repo transaction as the underlying - would involve a two stage process.

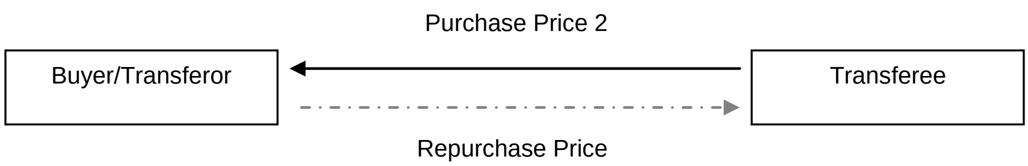
Stage 1 (Repo transaction)



Stage 1 would involve sale of underlying security (such as government's bonds) by the Seller to the Buyer at some purchase consideration (Purchase Price 1). The Buyer would be obligated to sell the underlying security back to the Seller and the Seller would be obligated to buy the underlying security from the Buyer at a pre-decided price (Repurchase Price) after the expiry of a certain period (tenure of the transaction). The two parties may decide to eventually settle on a net cash basis i.e. the Seller may pay the Buyer an amount equivalent to the Repurchase Price less the Market Value of the Security (without actually any need for transfer of the security) on the Settlement Date.

Sometimes, the transaction may unwind on its own on the maturity date of the underlying security (Repurchase Price is the same as the redemption amount due on the security, and the settlement date of the transaction is the same as the maturity date of the underlying security). In such a transaction, the Buyer would get the redemption proceeds on the maturity date of the security and there would be no need to transfer the security to the Seller.

Stage 2 (Transfer of rights and obligations under the Repo transaction by the Buyer to the Transferee)



Stage 2 would involve transfer of all rights and obligations under the Repo transaction by the Buyer in Stage 1 to another party (Transferee) through execution of the Transfer Certificate Agreement. In other words, the Transferee now owns the underlying security and effectively replaces the Buyer in Stage 1 of the transaction.

Key Rating Considerations

ICRA Indonesia's rating for the Transferee Payouts would address the likelihood of the Transferee getting its dues on time – either through payment from the Seller or through redemption of the underlying security. Thus, a key element of the rating process is to determine whether the Transferee Payouts carry the credit risk of the government alone (as the issuer of the securities) or even the Seller. In other words, ICRA would determine whether the payments to the Transferee are due only from the government or whether some portion of the payments (on occurrence of a few identified events, as highlighted in the transaction documents) are due from the Seller as well.

The key factors that would influence the rating of Transferee Payouts are summarised below.

- **Credit profile of the Seller** – Payment is due from Seller to the Transferee on the Settlement Date of the Repo transaction. Even for transactions where no payment is due from the Seller in the normal course (transactions unwinding on their own, as explained earlier), the transaction documents may specify certain event of defaults related to winding up/bankruptcy of the Seller, under which the Seller needs to make some payment to the Transferee. Therefore, Seller's own credit profile as reflected by its credit rating (or ICRA Indonesia's internal rating view on the Seller), would be an important rating factor for the Transferee Payouts.

- **Legal risk** – ICRA Indonesia would vet the executed copy of the transaction documents to determine whether the rights and obligations of the Buyer under the repo transaction have been adequately captured and subsequently assigned to the Transferee. Additionally, ICRA Indonesia may seek an independent legal opinion on the validity and enforceability of the transaction documents.

- **Credit risk of the underlying security** – Understandably, the rating of the Transferee Payouts should also have linkages with the credit risk of the underlying security (i.e. likelihood of default on the underlying security/probability of delivery failure of the underlying security). However, in this case as the underlying security is sovereign in nature, this risk is minimal.

ANNEXURE:

ICRA INDONESIA RATING SCALE AND DEFINITION – STRUCTURED FINANCE/OBLIGATION

Long-term: Structured finance instruments with original maturity exceeding one year

[Idr]AAA(SO)
Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.

[Idr]AA(SO)
Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.

[Idr]A(SO)
Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.

[Idr]BBB(SO)
Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.

[Idr]BB(SO)
Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.

[Idr]B(SO)
Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.

[Idr]C(SO)
Instruments with this rating are considered to have very high likelihood of default regarding timely payment of financial obligations.

[Idr]D(SO)
Instruments with this rating are in default or are expected to be in default soon.

The letters SO in parenthesis suffixed to the rating symbol stand for Structured Obligation. An SO rating is specific to the rated issue, its terms and its structure. SO ratings do not represent ICRA Indonesia's opinion on the general credit quality of the Issuers of the securities concerned.

Note:
Modifiers "+" (plus) or "-" (minus) can be used with the rating symbols for the categories [Idr]AA(SO) to [Idr]C(SO). The modifiers reflect the comparative standing within the category.

Short-term: structured finance instruments with original maturity of up to one year

[Idr]A1(SO)
Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligation. Such instruments carry lowest credit risk.

[Idr]A2(SO)
Instruments with this rating are considered to have strong degree of safety regarding timely payment of financial obligation. Such instruments carry low credit risk.

[Idr]A3(SO)
Instruments with this rating are considered to have moderate degree of safety regarding timely payment of financial obligation. Such instruments carry higher credit risk as compared to instruments rated in the two higher categories.

[Idr]A4(SO)
Instruments with this rating are considered to have minimal degree of safety regarding timely payment of financial obligation. Such instruments carry very high credit risk and are susceptible to default.

[Idr]D(SO)
Instruments with this rating are in default or expected to be in default on maturity.

The letters SO in parenthesis suffixed to the rating symbol stand for Structured Obligation. An SO rating is specific to the rated issue, its terms and its structure. SO ratings do not represent ICRA Indonesia's opinion on the general credit quality of the Issuers of the securities concerned.

Note:
Modifier "+" (plus) can be used with the rating symbols for the categories [Idr]A1(SO) to [Idr]A4(SO). The modifier reflects the comparative standing within the category.

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