

Guidance | Criteria | Financial Institutions | General:

Assumptions For Liquidity Stress Test Analysis Under "Nonbank Financial Institutions Rating Methodology"

March 22, 2018

Overview And Scope

1. This article is a Guidance Document. It is related to our methodology for deriving nonbank financial institutions (NBFIs) ratings, "Nonbank Financial Institutions Rating Methodology," published Dec. 9, 2014, and provides additional information and guidance related to the analytical application of our NBFIs methodology. It is intended to be read in conjunction with those criteria. Specifically, this guidance focuses on assumptions we typically make when we generate a finance company's liquidity stress test, including but not limited to refinancing assumptions, principal and interest income reductions, advance rates with regard to secured facilities, asset value liquidation haircuts, undrawn commitment drawdown contingent obligations, and business origination decline. We make these assumptions when we calculate a stress case cash flow forecast as described in the funding and liquidity section of the methodology applicable to finance companies. For a further explanation of Guidance Documents please see the description below.

Key Publication Information

- Originally published March 22, 2018.
- Related to "Nonbank Financial Institutions Rating Methodology" published on Dec. 9, 2014.
- We may revise this guidance from time to time when market dynamics warrant reevaluating the assumptions we generally use in our stress case cash flow analysis.

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Guidance

2. We conduct company-specific stress tests to consider a firm's sensitivity to short-term liquidity needs and liquidity resources. Given the wide breadth of business models, assets, and funding platforms applied by nonbank financial institutions, we consider the assumptions listed below in creating company specific stress scenarios as a baseline, but they may not all apply to a specific issuer and may not be exhaustive. Divergence from the baseline can be expected and not all of the following assumptions may be applicable. Rather, we analyze only those most relevant or sensitive under a stress scenario. Specific assumptions, such as access to funding sources and declines in principal and interest received may vary by country, business segment, credit quality of obligors, or the presence of government ownership. We also consider the expected timing of cash flows in our analysis. The stress scenario adopted is typically a low-probability (but still possible) scenario customized for the company. Ultimately, debt stability, asset encumbrance, and asset amortization are key factors in the stress case.
3. We typically assume a company has reduced capacity to rollover unsecured debt maturities for 12 months. If the company primarily funds itself through the securitization markets, we typically assume restricted access to the securitized markets. Consistent with NBF1 criteria (§176), we may expect the company to lose access to short-term funding sources, particularly unstable wholesale funding markets. Nevertheless, we would generally expect firms to rollover unsecured bank facilities at a reduced level, depending on the country, market conditions and credit quality of the company. In general, we would expect the following rank ordering in terms of loss of access to funding sources:
 - a. Unsecured short-term (wholesale)
 - b. Unsecured long-term (wholesale)
 - c. Securitized funding (wholesale)
 - d. Unsecured bank facility
 - e. Secured debt and repo facilities
 - f. Related party funding
 - g. Special funding for certain government-related entities
4. We typically assume a deposit-taking finance company will experience faster deposit withdrawals under stress, at rates that could differ depending on the counterparty, country, market conditions and credit quality of the company. In general, we would expect counterparties to withdraw their deposits in the following order, with the most sensitive counterparty at the top:
 - a. Institutional deposits
 - b. Corporate deposits
 - c. Heavily rate driven deposits
 - d. Uninsured deposits
 - e. Insured deposits
 - f. Transactional deposits
5. We typically assume a decline in principal and interest received (interest income) due to borrower distress. The decline may vary, and is typically relative to recent levels of nonperforming assets, scaled up to reflect the expected stress conditions over the forecast period. This can be based on

a combination of the historical experience of the company, past stresses experienced by similar peers, and our expectations of future market conditions. For higher risk assets, this decline could be up to 25%.

6. Company- and facility-specific information drives our assumption for the advance rate that companies can expect on their secured facilities. If the company has margin call exposure, we typically assume up to a 25% decrease in collateral value.
 - a. If it triggers a margin call, we would typically expect the borrower to
 - i. Post available cash; or
 - ii. Post eligible unencumbered assets (assuming up to a 25% decrease in value); or
 - iii. Sell unencumbered assets at a haircut (which typically varies based on asset type and quality, but could be up to 25%) to raise cash to post as collateral.
7. We typically assume a decline in origination volume of 10% to 50%. Even in a stressful scenario, it is unlikely a company will completely stop originating new loans, though we would expect the company to be highly selective in new loans originated. We would expect a company to first attempt to satisfy draws against undrawn commitments. We would not assume a company would go insolvent because of new originations. Under such a scenario, we would expect the company to completely stop originating new loans if necessary and preserve cash from existing amortizing loans to fulfil its obligations.
8. We may assume the company would sell assets to raise cash, if necessary, but typically at a discount of up to 25%, depending on asset type and quality.

Related Criteria

- Key Credit Factors For U.S. Business Development Companies, Dec. 9, 2014
- Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014

Related Research

- Criteria And Guidance: Understanding The Difference, Dec. 15, 2017

*This article is a guidance document for Criteria (Guidance Document). Guidance Documents are not Criteria, as they do not establish a methodological framework for determining Credit Ratings. Guidance Documents provide guidance on various matters, including: articulating how we may apply specific aspects of Criteria; describing variables or considerations related to Criteria that may change over time; providing additional information on non-fundamental factors that our analysts may consider in the application of Criteria; and/or providing additional guidance on the exercise of analytical judgment under our Criteria.

Our analysts consider Guidance Documents as they apply Criteria and exercise analytical judgment in the analysis and determination of Credit Ratings. However, in applying Criteria and the exercise of analytic judgment to a specific issuer or issue, analysts may determine that it is suitable to follow an approach that differs from one described in the Guidance Document. Where appropriate, the rating rationale will highlight that a different approach was taken.

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