

Screening: the six requests and the four numbers

Chapter 22, Stage one, and Chapter 4. Two weeks. The objective is to decide whether to spend real money on diligence.

Transaction		Originator	
Reviewer		Date	

Request	Received	What it shows
Monthly origination by product and channel, three years		
Static pool cumulative loss curves by quarterly vintage, full history		
Current portfolio stratification		
Audited financials, three years, and current management accounts		
Existing warehouse and facility term sheets		
Credit policy, current and all versions over the loss history		

Number (Chapter 4)	Estimate	Evidence behind it	Horizon and timing
Gross loss rate			
Recovery (severity)			
Prepayment or turnover			
Yield net of servicing and losses			

Observation	What it could mean	Question for diligence

Net loss below the credit enhancement, with acceptable timing, is the whole investment case. Compare vintages at the same age: a book growing fast looks pristine on an aggregate ratio.

Decision: proceed to diligence / decline. Budget and weeks:

--

Originator diligence checklist

Appendix B. The pool is half of it: every transaction contains an operating company risk, even when the structure is designed to eliminate it.

Transaction		Originator	
Reviewer		Date	

Item	Status	Evidence / note
Business and financials		
Three years audited financials plus current management accounts		
Unit economics: acquisition cost, cost of funds, servicing cost, loss rate, contribution per loan		
Cash runway at current burn; equity backers, their capacity and any support obligation (usually none)		
Funding stack: every facility, size, maturity, advance rate, covenants, cross-defaults; dependence on any one provider		
Origination		
Monthly volume by product, channel and geography, three years; approval rate, score distribution and channel mix by month		
Credit policy, current and every version over the loss history		
Underwriting model: inputs, validation, last recalibration, override rate and override performance		
Channel economics, channel-level loss data, broker and vendor agreements (risk sharing, recourse)		
Performance data		
Static pool loss and prepayment curves by quarterly vintage, full history		
Recovery timing and severity by product; loss data by channel, product, geography, score band, tenor		
Reconciliation of loss data to the audited accounts		
Servicing		
Independent servicing review; staffing, accounts per collector, surge plan		
Contact strategy, forbearance policy and use, complaints; SOC report or equivalent		
Systems: platform, boarding, payment application, volume handled outside the system		
Legal and regulatory		
Licences by jurisdiction and product, and whether the purchaser needs one		
Regulatory findings, enforcement, litigation, data protection and breaches		
Standard contract form reviewed for enforceability in each jurisdiction		
File review		
Sample size agreed; tape-to-file reconciliation; documentation, perfection, policy and disclosure compliance		
Findings quantified and extrapolated to the pool		

File review log

Chapter 4 and Chapter 22, Stage two. A statistically valid sample, reviewed against the stated criteria. Findings fall into three categories; the third is the most dangerous.

Transaction		Originator	
Reviewer		Date	

Sample	Value
Contracts in the pool / balance	
Contracts sampled / balance	
Selection: by product, channel, vintage, introducer	
Reviewer and dates	

Contract	Product / channel	Data integrity (tape vs file)	Documentation	Security perfected?	Compliance	Finding

Category	Findings	Share of sample	Extrapolated to the pool	Remedy (repurchase, exclusion, criterion)
Data integrity				
Documentation				
Security registration				
Compliance (enforceability)				

A cluster matters more than a rate: eleven defective registrations from one broker in one quarter is a process failure at that broker, and a criterion ("security registered and evidenced"), not a statistic.

Borrowing base certificate

Appendix C. Every line produced from the loan tape by the servicer and independently verifiable by the lender from the same tape. Test at least monthly; weekly in higher-risk facilities.

Facility		Servicer	
Reporting date		Tape reference	

Line	EUR	% of gross	Prior period	Lender recomputed
Gross pool balance				
less contracts failing eligibility criteria				
less contracts more than X days delinquent				
less contracts in dispute or subject to set-off				
less excess over obligor concentration limit				
less excess over industry concentration limit				
less excess over geography concentration limit				
less excess over channel concentration limit				
less excess over tenor concentration limit				
= Eligible pool balance				
times advance rate				
= Gross availability				
less dilution reserve				
less yield reserve				
less servicing transition reserve				
less commingling reserve				
less interest reserve				
less any other agreed reserve				
= Net availability				
less current outstanding advances				
= Headroom (deficiency: cure within N business days)				

Certified by the servicer (name, date). Recomputed by the lender from the same tape (name, date, differences):

--

Eligibility criteria: drafting and testing

Appendix D. A prompt, not a template. The test of a criterion is what proportion of the current pool it excludes; if the answer is zero, it excludes nothing.

Transaction		Originator	
Reviewer		Date	

Criterion	Drafted as	% of pool failing
Obligor		
Jurisdiction and type; not an affiliate or employee; never previously in default; identity and sanctions screening passed		
Contract		
Approved governing law and currency; standard form or approved variant; validly executed and enforceable; not amended beyond what is permitted; originals held		
Terms		
Minimum and maximum principal and original term; remaining term; minimum rate; amortisation profile; maximum balloon or residual; minimum deposit		
Status		
Not more than N days delinquent, never more than M since origination; no forbearance, restructuring or payment holiday; no dispute or set-off		
Origination		
Credit policy in force at the time; approved channel and introducer, not on the excluded list; disclosures given; affordability assessed and documented		
Security		
Created, registered and perfected in every relevant jurisdiction; asset insured; title noted; valuation within its validity		
Data		
Every tape field accurate; contract value matches the executed document; obligor identifiers correct		
Portfolio composition tests (on the aggregate)		
Weighted average score at or above X; weighted average remaining term at or below Y		
Proportions by channel, product, geography, score band and tenor within ranges		
Deviation from the closing-date composition within a stated tolerance		

Criteria that are represented but never tested are worth less than they read: the repurchase obligation is only as good as the originator's ability to pay, and it is tested precisely when the originator is failing.

Advance rate and stress cases

Chapter 5 and Appendix G. Work from the stress analysis, not the market. Where the market is more generous than the analysis supports, the analysis is the one to follow.

Transaction		Originator	
Reviewer		Date	

Step	Value	Source / note
Base case cumulative net loss (vintage curves, adjusted for mix and underwriting)		
Years of loss history; does it span a full cycle?		
Downside multiple: 2.0 with fifteen years and two recessions; 3.0 to 4.0 if shorter		
Downside cumulative net loss		
Margin for servicing transition and data risk		
Floor for the enhancement (downside plus margin)		
Advance rate offered by the market		
Advance rate set; enhancement = 1 - advance rate		
Break-even loss multiple = enhancement / base		

Case	Cumulative net loss	Multiple of base	Absorbed by enhancement?	Loss to the senior
Base				
Downside (triggers firing, revolving period ending)				
Severe (originator insolvency, realistic transition, collections -20% to -30%)				
Break-even solve				

Single-factor sensitivity	Effect	Still absorbed?
Residual value to zero on any position dependent on it		
Largest obligor to zero		
Take-out market closed for eighteen months		
Discount spread +200 basis points		

Appendix A: below 2.0 times is aggressive in any segment, above 4.0 times conservative; data shorter than a cycle belongs at the conservative end. Run every case with the structure operating: a stress that assumes the facility keeps revolving measures the wrong thing.

Trigger design grid and headroom

Appendix E and Appendix A question three. Set levels from the vintage data, not from precedent. For level three ask: at what performance would I want to stop buying assets?

Transaction		Originator	
Reviewer		Date	

Expected performance (from the vintages)	Value
Expected 60+ day delinquency	
Excess spread floor	
Base cumulative net loss on a vintage at the measurement age	
Amortisation-level cumulative net loss	

Level	Measures and levels	Consequence
1 - Watch: delinquency expected +30%; excess spread floor +100bp; covenant within 10%		
2 - Tighten: delinquency expected +60%; vintage loss base +50%; dilution above reserve		
3 - Stop: delinquency or cumulative loss at the amortisation level; deficiency not cured; covenant breach; servicer default		
4 - Default: payment default, insolvency, misrepresentation, loss of licence, reporting failure		

Trigger	Leads or lags	Level	Current (3-month average)	Headroom	Headroom %

Delinquency leads default; default leads charge-off; charge-off leads cumulative loss; excess spread compression leads all of them. A structure whose only trigger is cumulative net loss reacts about a year late: three months to default, six to sale, three to recognition.

Servicing review, cash control and the backup servicer

Appendix F and Chapter 16. Servicing is where transactions actually fail: the pool can perform as modelled and the investment still be impaired.

Transaction		Servicer	
Backup servicer		Date	

Item	Status	Evidence / note
Ask for		
Organisation chart with headcount by role; accounts per collector, current and at peak		
Surge plan for a doubling of arrears; contact strategy by days past due		
Cure rates by bucket, monthly, three years; recoveries after charge-off		
Forbearance policy and volume; complaints by theme and ombudsman outcomes		
Core system and version; share of accounts managed outside it; payment application and exceptions		
Bank accounts and cash flow diagram from obligor to lender; reconciliation process		
Call monitoring; business continuity testing; a sample monthly loan-level tape		

Cash control	Answer
Where obligors pay: vehicle account / servicer account with daily sweep / monthly sweep	
Share of collections outside the controlled account; maximum float in euros	
Commingling reserve, sized on realistic redirection (months, never complete), not a two-day float	

Backup servicer	Answer
Named party and grade: cold (3-6 months), warm (4-8 weeks), hot (days)	
Date of the last successful data load test, and the result read	
Licensed for this asset class in this jurisdiction? Capacity given its other mandates?	
Transition time expected; who pays; transition reserve funded?	

The summary test: if the servicer stopped tomorrow, who would collect, how long before they start, how much collection is lost meanwhile, who pays, and have they ever seen the data?

The ten clauses to read first

Chapter 17. For a facility reviewed under time pressure. Anything that looks negotiated rather than standard in these ten places was negotiated for a reason.

Transaction		Originator	
Reviewer		Date	

Clause	What to establish	Standard or negotiated?	Note
1. Eligibility criteria, in full			
2. Borrowing base calculation, every reserve			
3. Advance rate, and any provision letting it change			
4. Trigger schedule, current performance against each			
5. Definitions of "defaulted" and "delinquent"			
6. Repurchase obligation and its practical enforceability			
7. Servicer termination events and transition mechanics			
8. Cash control and commingling exposure			
9. Permitted amendments and who consents			
10. Waterfall, revolving and amortisation modes			

Also in the document set	Read?
Legal opinions: true sale, non-consolidation, enforceability, perfection (read the assumptions and qualifications)	
Credit policy covenant: is "material" defined; is consent more than "not unreasonably withheld"?	
Control: who directs enforcement, waives a trigger, replaces the servicer, amends	

Monthly composition report

Chapters 15 and 21, and the Conclusion. Read the composition report before the performance report: performance tells you what happened, composition tells you what is about to.

Facility		Reporting month	
Prepared by		Date	

Dimension	At closing	Last month	This month	Limit / tolerance	Drift?
Weighted average score					
Share in the lowest score bands					
Weighted average remaining term					
Share above the long-tenor threshold					
Share by channel: broker					
Share by channel: vendor / direct					
Share by product: the highest-loss product					
Largest introducer					
Top twenty obligors					
Largest jurisdiction					
Share of new purchases at the edge of the criteria					

Vintages at the same age	Month 6	Month 12	Month 18
Latest vintage: 60+ delinquency / cumulative loss			
Vintage a year earlier, same age			
Change			

Almost every deterioration in this book happens inside the rules: the mix moves toward the worst assets that qualify, and nothing is breached. A book that is growing fast flatters every aggregate ratio; only the same-age comparison is immune.

The five-question structure review

Appendix A and Chapter 5. Applied to any unfamiliar transaction, in this order. A practitioner who can answer these five has understood the transaction.

Transaction		Originator	
Reviewer		Date	

Question	Answer	Verdict
1. Advance rate, and the cumulative net loss the enhancement absorbs: absolute, and as a multiple of base (below 2.0 aggressive, above 4.0 conservative)		
2. Share of the current pool failing a strict reading of the criteria, run against the actual tape (zero means the criteria exclude nothing)		
3. Triggers: level, current performance, headroom %, leading or lagging		
4. Speed of repayment after the revolving period: weighted average remaining life of the eligible pool, months to 50% and to 90% repayment of the senior, against the final maturity		
5. Servicing if the originator disappears tomorrow: named party, grade, last load test date, licence, capacity, transition time, who pays		

Question four is where a pool's remaining term and its weighted average life get confused: for level-payment contracts the life is roughly half the term, and the difference is a year of exposure after a trigger.

Allocator questions and good answers

Appendix I and Chapter 20. Separate a real asset-based platform from a repackaged credit team. Score each answer weak, adequate or strong.

Manager		Strategy / fund	
Interviewer		Date	

Question	Strong answer looks like	Answer given	Score
How is this different from direct lending?			
Where does your origination come from?			
What have you declined, and why?			
Show me your realised losses			
What is your look-through leverage?			
Who services if the originator fails?			
How do you mark the book?			
Fees on invested or committed capital? Fixed or floating hurdle?			

Strong answers, in the book's words: a distribution rather than a company, and a structure that deleverages; named relationships with volumes; three segments rejected with reasons; the fund's losses position by position; fund leverage multiplied through the advance rates, in a minute; a named backup with the last load test date; dispersion of marks, write-downs before default, back-tests and minuted challenge.