Reviewing Unique or Complex Transactions

Cross-Sector Criteria

Unique Transactions Scrutinized

Unique or Complex Transactions: Transaction screening committees (TSC) are cross-disciplinary committees that screen new securities or issuers early in the rating process. The primary purpose of the TSC is to determine the feasibility of assigning a rating to a new security. Committees are selected from a designated pool of senior members of India Ratings & Research (India Ratings) analytical groups and Credit Policy group.

Transactions Serve Economic Purpose: India Ratings does not rate transactions that exist solely for tax and/or accounting considerations. India Ratings reviews and declines to rate transactions whose only motivation appears to be tax avoidance. India Ratings has no reason to believe that these transactions are illegal; generally, these types of structures are not suitable for a rating from India Ratings.

Arm's Length Transactions: India Ratings role is to provide opinions on the credit quality of capital markets transactions that are executed on an arm's length basis and have discernable economic substance. Analysts are asked to be watchful for transactions that exist solely to promote tax avoidance and/or to achieve a desired financial statement result.

Review of Unique Securities or Complex Transactions

India Ratings TSC process will review any proposal for rating a new security type or a transaction with a complex or unique feature. India Ratings defines a new security as an innovative or highly complex security or one that lacks robust data on the underlying assets of the security.

A new security includes:

- Structures that consist of a new asset class or an asset class without an empirically based model.
- A transaction that lacks a pre-existing methodology or deviates materially from existing methodologies or models.
- Complex transactions with unusual structural features; those proposed in sectors undergoing structural changes and/or high credit stresses; and those proposed by unrated or financially weak seller/servicers.

A TSC is a cross-disciplinary committee to determine the feasibility of assigning a rating to a new security, as defined above. The TSC is not a substitute for the normal rating process but rather a first step to determine whether a full rating process shall be commenced. Each committee will be selected from a designated pool of senior members of India Ratings analytical and Credit Policy groups. TSCs are coordinated by group credit officers (GCO) for the group seeking to convene a TSC. The GCO will select the quorum members having the skill sets most relevant for the issues under discussion.

The TSC will undertake a review of the relevant parties to the transaction (e.g. the sponsors, issuers, arrangers, and bankers, among others), including their financial capacity and experience, as well as supporting legal and accounting documents. If any of the parties will provide ongoing services to the transaction or performance of the transaction is subject to the performance of any of the key parties, such factors will be noted and incorporated into the review process.

Related Criteria
Managing Criteria and Models September 12, 2012

Related Research
The Rating Process, September 12, 2012

Unique or Complex Transactions Defined

India Ratings prohibits any assignment of ratings to transactions that exist solely for tax and/or accounting considerations without serving a fundamental economic purpose. The TSC determines whether the new security or transaction is in full conformity with these policies.

Typical features of transactions that may require additional scrutiny include:

- Lack economic substance or business purpose.
- Designed or used primarily for questionable accounting, regulatory, or tax objectives, particularly when the transactions are executed at year end or at the end of a reporting period for the customer.
- Raise concerns that the client will report or disclose the transaction in its public filings or financial statements in a manner that is materially misleading or inconsistent with the substance of the transaction or applicable regulatory or accounting requirements.
- Involve circular transfers of risk (either between the financial institution and the customer or between the customer and other related parties) that lack economic substance or business purpose;
- Involve oral or undocumented agreements that, when taken into account, would have a material impact on the regulatory, tax, or accounting treatment of the related transaction or the client’s disclosure obligations.
- Have material economic terms that are inconsistent with market norms (e.g., deep “in the money” options or historical rate rollovers).
- Provide the financial institution with compensation that appears substantially disproportionate to the services provided or investment made by the financial institution or to the credit, market, or operational risk assumed by the institution.

If a transaction structure raises questions, analysts are encouraged to consult with their group credit officer and/or the Legal department to consider a TSC.

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