

Asset-Backed
Criteria Report

**Rating U.S. Auto Loan ABS
Seller/Service**

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Related Research

- “Rating Auto Loan-Backed Securitizations: A Tune-Up,” dated Nov. 17, 2005
- “Rating U.S. ABS Seller/Service,” dated April 20, 2006

■ **Summary**

This auto loan asset-backed securities (ABS) criteria report summarizes the principal factors considered in Fitch Ratings’ review of auto loan seller/service. This report is an addendum to Fitch Research titled “Rating ABS Seller/Service,” dated April 20, 2006 (*available on Fitch’s web site at www.fitchratings.com*).

Fitch’s seller/service review process determines the quality and effectiveness of an organization’s origination, underwriting, and servicing platform, as well as its operational and financial stability, its compliance with stated guidelines, and the soundness of its internal control procedures. While Fitch’s auto loan ABS ratings have always included a seller/service evaluation, the seller/service rating program formalizes and standardizes this information, providing a clear indication of origination, underwriting, and servicing capabilities based on standard benchmark assessments. This report outlines how Fitch ABS seller/service rating assessments will be conducted.

The seller/service ratings will be used to augment Fitch’s analysis of auto loan collateral and transaction structure components when determining credit enhancement. The ratings serve as an added measure of any additional risk or benefit associated with the seller/service.

Fitch’s ABS seller/service rating scale ranges from level one (full acceptance with overall superior performance) to level five (not acceptable) (*see Appendix, page 10*). Fitch expects that experienced servicers going through their first reviews are likely to be rated in the level two to three range.

Fitch’s auto loan seller/service rating criteria focus on three principal areas — corporate background, origination and underwriting, and servicing — each with various subcategories. Corporate background analysis centers on the quality of the company’s management, its financial strength, and its ability to manage operational risk at a corporate level. Evaluation of origination and underwriting activities covers origination channels, marketing, and dealer relationship management, the credit approval process, underwriting criteria, and internal scoring systems. The servicing review focuses on account maintenance, customer service, billing and payment processing, collections, investor reporting, staffing and training, and technology. Operational risk management of all functions, as well as quality control (QC), is evaluated for all three principal factors. This report discusses the key rating factors that make up Fitch’s seller/service rating methodology and offers insights on the qualitative factors and quantitative metrics that will influence the evaluation.

Fitch will refine its seller/servicer rating criteria regularly to keep it reflective of the auto loan origination and servicing landscape by including observations noted during annual servicer reviews, as well as issues arising in the ABS market.

■ Rating Process

Fitch's auto loan ABS seller/servicer rating reviews will be one factor among others included in the ABS rating process. These reviews will be completed in conjunction with the Financial Institutions and/or Corporate and ABS groups. A description of the steps generally taken in the seller/servicer review and rating process is explained below.

To make the process efficient and focused, Fitch requests advance information from the seller/servicer, such as descriptions of corporate and operating structures, organization charts, audited financial statements, and select portfolio statistics. Additional documentation, such as policies and procedures manuals, QC reviews, compliance reports, and internal audits are also reviewed and discussed. Prior to the on-site review, Fitch reviews the seller/servicer's agenda to determine that the relevant topics are covered, the appropriate personnel are present, and adequate time is allocated for each topic.

During the on-site review, Fitch meets with senior management and functional managers to discuss origination, underwriting, and servicing operations, tour the facilities, and participate in system demonstrations. Fitch expects the duration of on-site reviews to range from one to two days, depending on the seller/servicer review type(s), product(s), and number of platform sites.

Results of this analysis are entered into an auto loan seller/servicer scorecard consisting of both quantitative and qualitative measures, generating a recommended seller/servicer rating. The rating recommendation is then presented to a credit committee consisting of Operational Risk Group, ABS, Corporate, and Financial Institutions analysts. Once a rating is agreed upon, the approved seller/servicer rating is published in the marketplace via a press release, which may be followed by publication of a report describing Fitch's evaluation of the seller/servicer and the rationale for the rating. Current seller/servicer ratings and reports are available on Fitch's web site at www.fitchratings.com.

Fitch seller/servicer ratings are valid for one year from issuance; however, Fitch continues to monitor the

organization's operating characteristics, performance, and status of key personnel for the one-year tenure of the rating. For a servicer with an existing rating, the annual review focuses on changes that have occurred over the past 12 months or since the prior review.

Auto loan seller/servicers vary in terms of the extent of their vertical integration. While some servicers are specialized in servicing loans originated by other institutions (third-party servicers), others service only loans they have originated. Fitch is able to evaluate either case using the servicer-only or seller/servicer combined evaluation.

■ Rating Criteria

Fitch's auto loan seller/servicer criteria are divided into three principal areas — corporate background, originations and underwriting, and servicing. The following sections describe more specific criteria and rating factors in these principal areas that apply to auto loan seller/servicers.

Corporate Background

Company Management

Fitch pays close attention to the stability of the seller/servicer and its capacity to and capability of meeting its business objectives, together with its ability to proactively manage market changes. Fitch views management adaptability and resiliency and demonstrated strategic planning as necessary company characteristics to remaining viable in the highly competitive and dynamically changing auto loan industry.

Fitch evaluates management's commitment to providing strategic direction and developing operational tactics used to fulfill loan origination, underwriting, and servicing objectives. Factors considered as part of this assessment include the following:

- Management stability and depth.
- Operating experience.
- Operating history and portfolio characteristics.
- Growth strategy.
- Legal structure and ownership.
- Competitive position.
- Compliance and corporate governance.

Management is measured individually and as a team. At the individual level, industry experience, tenure with the company, and time in the current position are evaluated. Fitch also assesses management collectively for overall breadth and depth and to

gauge the tenure and diversity of experience of the core management team. In addition, Fitch considers management's participation in industry roundtable conferences, forums, or other associations that can shape industry standards or best practices as positive.

Fitch also reviews historical portfolio growth to understand volume fluctuations and assess the company's ability to meet growth objectives. As part of this evaluation, Fitch reviews merger and acquisition activity, expansion plans, or intentions to exit or scale back specific businesses that could influence operating performance. Aggressive growth objectives involving portfolio acquisitions require greater scrutiny of the seller/servicer's volume capacity and resources, as well as integration planning and execution.

It is critical that the company demonstrate overall integrity in corporate governance (*for more information, see Fitch Research on "Evaluating Corporate Governance: The Bondholders' Perspective," dated April 12, 2004, available on Fitch's web site at www.fitchratings.com*). In the auto loan seller/servicer evaluation, Fitch focuses on elements of corporate governance that are particularly relevant to loan origination, underwriting, and servicing, such as the integrity of the audit process and regulatory compliance.

Financial Condition

Fitch believes that the financial condition of a company has a direct impact on the stability of its operating platform and ultimately on auto loan ABS performance. An auto loan seller/servicer with limited financial flexibility may not be able to appropriately support its various originations and servicing functions, resulting in weaker collections, higher delinquencies, less efficient remarketing and disposition, and ultimately higher losses. Below are several factors and quantitative metrics considered by Fitch in its seller/servicer financial condition review:

- Unsecured debt rating/credit assessment.
- Capitalization.
- Funding diversity and liquidity.
- Operating performance.

The purpose of the financial condition review is to assess the seller/servicer's business viability. As such, the review is limited in scope and not meant to substitute for a credit rating, which offers an opinion on an institution's ability to meet its debt obligations. Public credit ratings provided by Fitch, where available, serve as a main indicator of the seller/servicer's financial condition. In the absence of

an explicit debt rating, Fitch's Financial Institutions group would conduct a credit assessment, which entails a review of the seller/servicer's financial statements, with a focus on liquidity, profitability, capitalization, and leverage trends. Fitch also considers funding diversification and stability, as well as the key financial covenants embedded in facilities/programs.

Controls and Policies and Procedures

Fitch views policies and procedures manuals to ascertain comprehensiveness and coverage of each function. Fitch reviews whether manuals are made available to all staff and views favorably those that are electronically accessible. Close attention is also paid to the update process. The frequency and responsibility of maintaining and revising the manuals to keep up with evolving procedures are explored. Fitch expects seller/servicers to have tight controls in place to ensure that auto loans are administered within the parameters of the governing pooling and servicing agreement (PSA).

Fitch assesses seller/servicers' QC measures in place for each process. QC reviews serve several vital purposes. Foremost, reviews that are benchmarked by the seller/servicer to company policies and procedures and PSAs ensure that processes are being carried out accurately and timely. QC reviews also spot procedural errors not easily detectable and can identify trends in exceptions. Additionally, through frequent checks and reporting of exceptions, management can quickly institute changes to areas needing improvement.

Fitch also views favorably servicers that conduct comprehensive internal audits on a regular basis, preferably annually. Whether performed by a third-party vendor or handled by an independent group within the company, the internal audit review ensures adherence to the company's stated policies and procedures, PSA guidelines, and governmental regulations. Fitch expects to review all audit reports, including findings, recommendations, and management responses, to determine the scope of the audit and seriousness of identified concerns.

In addition, Fitch obtains recent external audits that may have been conducted by an independent firm to ensure that the servicer is carrying out its responsibilities in accordance with its stated policies and procedures.

Originations and Underwriting

Originations

When reviewing the originations processes, Fitch focuses on the ability of the seller/servicer to devise and execute an approach to originations that is complementary to its core competencies and strategic objectives, which should include maintaining adequate long-term profitability. The review of originations includes an analysis of the organization of the staff dedicated to this function, as well as the channels of origination. The majority of auto loans are generated indirectly through a network of independent or affiliated dealers located across the country. Auto loans can also be originated by targeting obligor prospects directly, such as through direct mail or through use of the internet.

Fitch's analysis begins with a review of the originations staff organization, including reporting structure and segmentation, whether by geographic region, target market, or product type. The prospect universe should be segmented to allow for some differentiation of loan structure and enable efficient management of the risk/reward tradeoff. The auto finance industry is competitive, requiring seller/servicers to develop compelling financing packages and target the appropriate prospect segment to mitigate the risk of adverse selection.

Building and maintaining dealer relationships is a vital link in the originations chain. In most cases, dealers must execute a dealer agreement with the purchasing seller/servicer, which defines the terms, guidelines, and procedures of the originations process. According to the terms of the dealer agreement, the dealer submits the retail loan application, along with proposed terms of the loan, to the seller/servicer for confirmation of compliance with underwriting criteria.

Dealers have many alternatives in today's competitive landscape, and improved efficiencies allow dealers to select from a wide variety of financing sources. Software program developments, such as DealerTrak, enable a dealer to send an application electronically to multiple lenders, which emphasizes the importance of speed and efficiency of the application process. Thus, the originator's level of automation and procedures for prospect evaluation are critical factors in Fitch's evaluation of a seller/servicer's originations.

An assessment of the seller/servicer's ability to ensure dealers have a good working knowledge of the issuer's credit criteria, rates, and buying profile and to manage dealer compensation and support are other factors of the originations review. Ensuring that dealers understand target criteria serves to prioritize prospects and expedite the loan process, reducing negotiations with the obligor and contributing to higher approval rates. Properly balanced compensation and incentives direct the focus on origination quality rather than quantity.

Direct originations generally rely on targeting prospects through direct mailings or through the seller/servicer's web site. Potential prospects may be identified through preapprovals obtained from credit bureaus and through customer lists obtained from partners or affiliates. Prospects can submit applications by mail, by telephone, or electronically over the internet. Upon receipt of the application, the seller/servicer substantiates the accuracy of the information provided by the prospect and confirms compliance with underwriting criteria. Fitch reviews the efficiency of a seller/servicer's direct originations efforts and the effectiveness of application verification procedures.

Underwriting

In instances where the seller/servicer also performs an underwriting function, analysis of this process represents an integral part of the seller/servicer review. Fitch places special emphasis on the degree of separation between origination and underwriting objectives. In the evaluation of the underwriting function, Fitch pays close attention to the strength and integrity of the risk management, credit approval, exception management, and funding processes.

Risk managers identify and evaluate risks, implement control measures, and monitor results, as well as modify control techniques where necessary. One of the key responsibilities of the risk management department is development, implementation, and realignment of credit scorecards. Fitch reviews metrics used in scorecard analysis and looks at how often the predictive value of the scorecard is tested and the frequency with which the scorecard is refined and updated. During the review of the scorecard metrics, Fitch also assesses the degree of separation between origination and underwriting objectives. The degree of automation as measured by auto approval and auto decline rates is also reviewed.

The credit approval function reviews submitted applications and either approves or declines an application based on its scorecard parameters. During

this stage, the applications are also sorted into appropriate credit tiers that determine interest rates available to the potential obligor. For a large percentage of issuers, this process is highly automated. Nevertheless, some contracts are reviewed manually, and even contracts for which a decision was automatically generated can be renegotiated as necessary or appropriate. This creates an opportunity for dealers that are very familiar with the credit approval procedures to influence the application process such that an application could have a higher probability of approval. Fitch reviews seller/servicer's capabilities in monitoring dealer compliance with underwriting standards.

The exception processing function addresses situations in which automatic credit decisions are re-reviewed manually for possible modification. Fitch reviews organization structure in terms of level of experience and training of the associates that make override decisions in exception processing. Fitch considers the frequency of overrides by measuring the total number of overrides per decline and assesses the quality of overrides by looking into how overrides are typically resolved, such as if the loan is restructured to require higher investment from the customer.

During the review of the credit function, Fitch pays close attention to such measures as applications submitted to applications approved ratios, the number of credit tier upgrades per number of contracts, and the volume of obligor information verified per contract. Fitch reviews the credit approval process to assess efficiency of operations by analyzing auto-decision rates, turnaround time, and days-to-funding measurements.

The funding function can be more manual than the credit process and ensures that the funds are delivered to the designated dealers. During this stage, supporting loan documents are received, and the lien on the vehicle title is perfected. In reviewing this function, Fitch focuses on the experience of funding analysts and the compliance processes in place and verifies that procedures are properly followed. Among other factors, Fitch reviews such metrics as the number of daily process reviews and the number of calls audited per funding analyst.

Servicing

The servicing function is one of the most critical aspects of loan and transaction performance. Fitch has witnessed several cases in which pools with nearly identical underwriting criteria produced different loss

numbers due to servicing capabilities or deficiencies. As such, servicing functions are important factors in the auto loan seller/servicer review.

The remainder of this section describes in more detail the rating factors that drive the evaluation of servicing and operations, which are grouped in the following subcategories: account maintenance; customer service; billing and payment processing; investor reporting and remittance; collections and asset management; resources; and technology.

Account Maintenance

Fitch views account management as an important function in an auto loan seller/servicer's operation. Account maintenance functions of auto loans include account establishment and management in a servicing system. Many of these functions are mostly administrative, consisting of inputting the account into the system and processing changes of the accountholders and loan contracts, such as address changes, contract modifications, and due date or amount changes. Fitch evaluates policies and procedures for account establishment and modifications, including system accuracy, automation, and internal controls.

With expense control and efficiency as growing concerns, many auto loan seller/servicers are expanding the use of technology in account maintenance functions. Title tracking and automated mailing of forms and letters are becoming common practices. Additionally, when the loan is paid in full, the titles and contracts are mailed, and any refunds must be paid in accordance with the contract. Fitch believes that the effective use of automation is a critical element in achieving efficiency and consistency in account maintenance and that well-executed program tracking and portfolio management information systems (MIS) can create a competitive advantage.

Customer Service

Fitch views customer service as a valuable direct link with customers that can either enhance a seller/servicer's relationship with an accountholder or damage it. This function is largely engaged in handling inbound inquiries from existing and previous customers for information on their accounts regarding, for example, payoff quotes, payments received/due, requests for extensions, or due date changes.

In evaluating customer service operations, Fitch focuses on the quality, efficiency, and consistency of

processes, whether customer service functions are undertaken internally or outsourced. Below are several factors and quantitative metrics considered by Fitch in its customer service evaluation:

- Customer service strategy.
- Customer service technology.
- Correspondence and dispute handling.
- Internet/web site availability.
- External audit reports and studies.
- Metrics captured.
- Attrition rates.

Fitch believes that the effective use of automation is a critical element in achieving customer satisfaction in today's competitive auto loan marketplace. Most customer service operations are supported by an automated call routing/distribution system that effectively routes incoming calls to available customer service representatives (CSRs). Once the call reaches the CSR, customer inquiries and transactions are processed with the help of graphical user interfaces. These applications present CSRs with information in a logical flow and user-friendly manner, thereby eliminating the need to hunt for account data across information technology (IT) platforms. In addition to reducing call-handling times, this automation provides greater consistency in interacting with the account holder and assists in controlling and managing compliance with stated policies and procedures.

Fitch also evaluates the customer service management structure and staffing levels, as well as processes used to monitor CSR compliance with internal policies and procedures, as well as legal and regulatory requirements. A consideration in this review is the IT security environment: how CSR data access is governed; system security clearance requirements; and other safeguards against internal fraud. Larger auto loan servicers are beginning to monitor CSR calls through call-recording applications. Focused audits are also an integral part of the compliance/management process for most issuers.

Billing and Payment Processing

Processing operations encompass many vital behind-the-scenes functions for auto loan seller/servicers. These functions include preparing/printing customer billing statements, processing payments, and posting payments to customer accounts, among others. Seller/servicers can handle these functions in-house, outsource them to third parties, or employ some combination of the two strategies. As part of the review process, Fitch focuses on the efficiency and

effectiveness of processes and policies in place governing these various functions, as well as supportive IT and MIS reporting. Several rating factors and quantitative metrics considered in Fitch's review are the number of payments processed, number of exceptions per payment processed, and frequency of bank statement reconciliation. Fitch also considers the accuracy of the statement process.

Payments may be received by mail, internet, or wire transfer. Fitch evaluates the operations flow for payment submission, mail collection, and processing. Additionally, Fitch explores whether the billing and payment receipt platform is viable under certain failure scenarios. Potential for concern may arise from a lack of geographic dispersion (for example, sending all payments to a single post office) or a high dependence on in-person payment submission.

Investor Reporting and Remittance

Fitch focuses on the policies, systems, and controls that govern the investor reporting and remittance functions. Performance is measured by accuracy and timeliness. Fitch inquires of its own internal performance analytics team its perspective on the quality and timeliness of servicer reports. When reviewing this area, Fitch examines reporting lines, management oversight, and functional responsibilities. Fitch also reviews the risk management or control environment established, including the segregation of responsibilities, internal audits, securitization-related compliance audits, and IT security requirements.

While acknowledging the valuable role trustees play in auto loan ABS transactions, Fitch recognizes that the ability to administer and manage trust accounts is more significantly influenced by the process and control environment of the seller/servicers than that of the trustees. As such, Fitch reviews the policies and procedures for account reconciliation and investor report generation and distribution. Fitch also examines reporting and remittance handling/tracking and occurrences of late investor reporting. Fitch assesses the level of automation employed in the cash management and investor reporting functions with respect to gathering internal data, distributing reports, data modeling, and utilization of verification and management tools. Fitch believes that the proper use of automation may benefit reporting accuracy by substantially reducing human error. Similarly, seller/servicers can enhance reporting timeliness by filing reports electronically or making them available to investors on dedicated web sites.

Collections and Asset Management

Fitch recognizes that a well-organized strategy that employs effective collection and asset management, including repossession policies, remarketing procedures, and portfolio review processes, can directly affect portfolio performance. In contrast to unsecured loans, such as credit card and student loans, repossession and remarketing the vehicle collateral are critically important for auto loan servicing. Below are several factors and quantitative metrics considered in Fitch's review:

- Effectiveness of contact and collection strategy.
- Use of specialized collection programs and third parties.
- Collections IT.
- Delinquency policy.
- Chargeoff policy.
- Remarketing management process.
- Repossession effectiveness.
- Disposition channels.
- Recovery timeline and rates.
- Portfolio monitoring and procedures.

Most collection groups are divided into separate teams employing different strategies required for borrowers in early-, middle-, and late-stage delinquencies. In dealing with early delinquencies, segmenting between "high-risk borrowers" and "low-risk procrastinators" is important from a cost and resource perspective, since a significant portion of auto loan customers can inadvertently miss one monthly payment. As such, in creating calling campaigns, lenders use account management segmentation, prior behavior, and customized collections scores. Through these and other tools, they can distinguish the low-risk slow payers from accounts with either an inability or unwillingness to pay and prioritize them in the collection queue.

Some seller/servicer collection teams are organized by a "cradle-to-grave" philosophy rather than based on stage of delinquency. The cradle-to-grave approach assigns one collector to work an account from its earliest stage of delinquency until assignment for repossession. The rationale for this structure is that collectors will develop a relationship with the borrower, become familiar with his or her individual circumstances, and, thus, be more likely to develop a cure for the delinquency.

Collection efforts generally escalate in intensity as an account cycles into a more advanced delinquency category. Generally, more seriously delinquent accounts

often require the skills of experienced, seasoned collectors to bring the accounts current. These senior collectors are the last opportunity the borrower has to work out the problem before repossession. Fitch evaluates how effectively various resources are utilized to maximize returns during the late-stage delinquency collection and the effectiveness of modification policies as a loss mitigation tool.

Fitch reviews the repossession timeline for each seller/servicer, paying careful attention to each point in the timeline, as disruptions can influence recoveries on repossessed collateral. Fitch examines when the vehicle is assigned for repossession and considers how much collection effort the account has received prior to assignment for repossession and whether the borrower has been given sufficient opportunity to bring the account current. Fitch views positively a process in which repossession occurs after all other collection measures have been taken and after a thorough financial cost benefit analysis has been considered.

Fitch also reviews the timing and procedures for locating and physically repossessing a vehicle. The seller/servicer should have sufficient knowledge of specific state or local laws regarding collateral repossession, and such state or local requirements should be incorporated into the collections guidelines. A fully licensed and bonded repossession agent should be able to locate and repossess the vehicle within days. Additionally, Fitch evaluates the time it takes from repossession to ultimate sale. It is important that vehicles be sold as quickly as possible to maximize the recovery on the vehicle and minimize carrying costs. Fitch examines the seller/servicer's historical recovery rates as an indication of efficient repossession procedures.

A review of the disposition channels utilized by the seller/servicer is also conducted. Fitch prefers that repossessed vehicles be disposed of through wholesale auctions or cyber lots, with a seller/servicer representative on site. Disposition through wholesale markets tends to be more efficient, cost effective, and predictable, compared to disposition through retail channels, where vehicles are sold on used car lots, which can result in lengthy delays and further depreciation of the vehicle.

Fitch examines the seller/servicer's chargeoff policy to review conformance of internal policies with those outlined in securitization documentation. The ability of the seller/servicer to maintain consistent chargeoff

policies and complete the repossession process within a timeframe required by the securitization documentation minimizes the risk of full-balance chargeoffs and prevents delays in payments to securityholders.

Reporting and MIS are essential to collections. Fitch expects the seller/servicer to provide timely and thorough analysis for all collections staff and specifically reviews roll rate reports, repossession timelines, and recovery rates. Fitch views favorably processes in which delinquency data are reviewed by collection staff on a daily basis, with aggregate portfolio reporting provided to senior managers via performance-tracking reports, audit reports, production reports, and online policy manuals.

Fitch reviews QC processes in place to track collector compliance with internal policies and procedures, as well as external laws and regulations. At most seller/servicers, collectors are regularly monitored through a combination of methods, including silent monitoring, side-by-side sitting, random call recording, and focused group audits. Fitch also evaluates QC procedures and metrics used to monitor the performance of third parties when they are engaged to assist with collections functions.

Topics Common to Origination, Underwriting, and Servicing

Staffing and Training

Maintaining a stable and efficient work force is a critically important challenge for the auto loan industry. Recruitment and hiring of staff depend on the type of position being filled. The servicing and operations functions of auto loan seller/servicers typically require tens to hundreds of hourly staff. Fitch reviews whether the seller/servicer selects candidates with the proper skill set and ability to fit in to the work environment.

To assess the relative success of the recruitment and hiring process, Fitch reviews the number of open positions, length of staff vacancies, average tenure, and turnover rates for different areas. Below are several qualitative factors and other quantitative metrics considered by Fitch as part of its staffing and training evaluation:

- Hiring and retention strategies.
- Employee performance-monitoring procedures.
- Level of experience.
- Turnover rates.

- Supervisor-to-staff ratios.
- Staffing composition (full time, part time, and seasonal).

Fitch also examines the adequacy of a seller/servicer's training strategy and how effectively it integrates various types of training to maintain a viable work force. Skills-based and compliance training can be utilized. Much of it may be done on the job, but for new employees in the servicing and operations areas, there is usually an orientation program that must be completed before they begin to work with customers. Fitch also inquires about the prevalence and success of internal management development programs. Fitch reviews the performance management system to determine the frequency of reviews, the way employees are rated, and the effectiveness in identifying both good and bad performers.

Fitch expects seller/servicer compensation structuring to be competitive and protect against adverse selection of employees. Compensation will vary for different geographical areas and different job functions, and consequently, Fitch may inquire about compensation studies and employee satisfaction studies to determine management's attention to this area. Fitch also reviews collector incentive compensation structures to ensure they are prudent and properly aligned with collection strategies.

Some auto loan seller/servicers outsource certain functions to third parties, and in some cases offshore, that traditionally have been performed in-house, such as customer service and collections. While outsourcing may provide a cost benefit to the company, operational risks unique to such an arrangement may arise. In Fitch's opinion, excessive reliance on third-party vendors may introduce incremental elements of risk to an organization and therefore requires additional scrutiny. Fitch's review of seller/servicer outsourcing practices focuses on the following:

- Functions outsourced.
- Vendor selection and concentrations.
- QC systems in place.
- Training of offshore staff.
- MIS reporting.
- Contingency planning.

Technology

Effective use of technology is essential to the success of auto loan servicing. Fitch's evaluation includes determining the primary functionality of all systems that are critical to the core servicing functions, such

as account maintenance, collections, and asset management. To evaluate the effective use of technology, Fitch considers management's strategic policy on IT, as well as the experience of technology staff and timeliness of updates and enhancements. Given that auto loan seller/servicers vary in terms of the size and complexity of their operations, Fitch believes that the use of technology must be appropriate for the characteristics of the operations. Other issues to be reviewed include the following:

- Degree of automation.
- Integration of multiple systems.
- Report-writing capability.
- Disaster recovery plans.
- Internet and web site availability for related parties.
- QC of any outsourced or offshore systems management.

The use of the internet is becoming increasingly important in the auto loan business. A seller/servicer's web site can be used not only as a marketing tool, but also as a means to disseminate pertinent information to borrowers and investors. Fitch assesses the robustness, versatility, and interactive capabilities of the seller/servicer's web site.

Because of the high reliance on technology involved in auto loan servicing, a seller/servicer must have a sound plan in place to curtail the amount of time critical systems are offline. Fitch reviews disaster recovery plans, test results, and business resumption plans to evaluate their adequacy and completeness.

■ Scorecard and Weightings

Fitch's auto loan seller/servicer rating evaluation is divided into three principal areas — corporate background, origination and underwriting, and servicing. For seller/servicers that manage multiple auto loan programs, the origination and underwriting and servicing performance will be evaluated for each program. The overall seller/servicer score will represent a weighted average of the analyses of each auto loan program. In each principal area, there are groupings of categories that pertain specifically to the area, referred to as criteria groups. In turn, these criteria groups are scaled from 1 to 5, with 1 being the highest. Each criteria group is assigned a relative weight to generate a principal area score. These principal area scores are assigned relative weights to determine the overall seller/servicer ratings.

■ **Appendix: Fitch Seller/Servicer Rating Scale**

The ABS seller/servicer rating scale is designed to provide investors and other market participants with a tool to differentiate between various seller/servicers, as well as many best practices in the industry. The ratings are based on Fitch’s review, evaluation, and analysis of the company’s ability to manage operational risks in accordance with regulatory guidelines, industry standards, and origination/servicing agreements.

Level One — Fully Acceptable (With Overall Superior Performance)

- ‘ABPS/S1 (Seller/Servicer)’
- ‘ABPS/S1 (Seller)’
- ‘ABPS/S1 (Servicer)’

ABS seller/servicers receiving rating level one have achieved high scores in all areas of assessment. Specific origination/servicing requirements and market environments differ by product type, but level one-rated companies have an established and successful business record. These ABS seller/servicers commonly have experienced management and company history of successful operations over a period of time, demonstrating their ability to deal with market and regulatory changes. They demonstrate proactive and comprehensive management of operational risks, including compliance with all major industry-related regulations. These companies have a strong and stable financial standing, supported by an investment-grade debt rating for the company (or its parent) and/or sound financials for at least three years. In addition, level one-rated companies have attained high assessments in all other areas of evaluation.

Level Two — Fully Acceptable (With Noted Strengths)

- ‘ABPS/S2 (Seller/Servicer)’
- ‘ABPS/S2 (Seller)’
- ‘ABPS/S2 (Servicer)’

ABS seller/servicers that receive Fitch’s level two rating have demonstrated satisfactory performance for all rating criteria. In addition, this designation indicates that the seller/servicer has noted strengths in several of these criteria. Such companies are generally successful, stable, and efficient, with a solid management and employee base, supported by successful training programs and strong financial resources. The company’s inability to attain a level one rating may be due to a short history or other factors that may need further refining or enhancement to fully develop. However, these seller/servicers have demonstrated that they have accomplished a

high level of performance, risk mitigation, and operational excellence.

Level Three — Fully Acceptable

- ‘ABPS/S3 (Seller/Servicer)’
- ‘ABPS/S3 (Seller)’
- ‘ABPS/S3 (Servicer)’

Level three ratings represent Fitch’s full acceptance as an ABS seller/servicer, with overall acceptable levels of performance in Fitch’s evaluation scheme. The seller/servicer receiving this rating has demonstrated an adequate capacity to originate and service portfolios in accordance with industry standards and investor and securitization agreements.

Level Four — Qualified Acceptance

- ‘ABPS/S4 (Seller/Servicer)’
- ‘ABPS/S4 (Seller)’
- ‘ABPS/S4 (Servicer)’

ABS seller/servicers at level four have shown originating/servicing proficiency comparable to level three standards. However, some area of operation requires continued surveillance. Servicers at this rating level may not be acceptable for ABS transactions, unless additional support or structural features are incorporated. Situations that could cause a level four rating for an otherwise fully acceptable servicer include: limited time originating/servicing a particular product type; or a recent event, such as a merger, acquisition, management change, and/or system conversion. Other issues are high management or staff turnover or major litigation relating to operational risks. A level four seller/servicer may be upgraded to level three, if the circumstances in question are positively resolved, as long as all other features of the operation remain consistent.

Level Five — Not Acceptable

- ‘ABPS/S5 (Seller/Servicer)’
- ‘ABPS/S5 (Seller)’
- ‘ABPS/S5 (Servicer)’

Seller/servicers that receive a level five rating have failed to meet commonly accepted industry standards and benchmarks. Fitch has concerns with some aspects of their operation, operational risk management, personnel, or financial condition. They have not demonstrated sufficient performance capabilities in origination or servicing to meet investor and/or securitization requirements. Seller/servicers at this level are considered not acceptable for ABS by Fitch.

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