S&P Global Ratings

Research

New Issue: Anyihua 2023 Phase III Personal Consumption Loan Asset Backed Securities

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Table Of Contents

3026848

Table Of Contents (cont.)

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Ratings Detail

Ratings As Of July 28, 2023			
Class	**Rating***	**Amount (mil. RMB)**	**Credit support provided by subordination (%)**
A	AAA (sf)	1,490.00	25.5
B	NR	210.00	15.0
Subordinated	NR	300.00	0.0

*NR--Not rated. RMB--Chinese renminbi.

Profile	
Closing date	July 28, 2023
Legal final maturity date	April 26, 2028
Collateral	Renminbi-denominated, fully amortizing unsecured consumer loans to retail borrowers
Structure type	Consumer loan-backed securities with sequential turbo repayment mechanism
Issuer	Chongqing International Trust Co. Ltd. as trustee of Anyihua 2023 Phase III Personal Consumption Loan Asset Backed Securities
Originator, seller, and servicer	Mashang Consumer Finance Co., Ltd.
Primary credit enhancement	Note subordination

Supporting Ratings	
Bank account provider	Bank of China Ltd.

Loan Pool Statistics As Of March 18, 2023	
Total number of contracts	443,006
Total receivable balance of contracts (RMB)	2,000,000,006.27
Maximum receivables balance of contracts (RMB)	50,000.00
Average receivables balance of contracts (RMB)	4,500.00
Weighted-average interest rate (%)	23.83
Total balloon payments as a percentage of total pool balance (%)	0.00
Weighted-average contract seasoning (days)	35.80
Weighted-average remaining term to maturity (days)	274.17

Rationale

S&P Global Ratings assigned its 'AAA (sf)' rating to the class A notes issued by Chongqing International Trust Co. Ltd. as trustee of Anyihua 2023 Phase III Personal Consumption Loan Asset Backed Securities (the issuer). This is a consumer loan securitization transaction originated by Mashang Consumer Finance Co. Ltd. (Mashang CFC).

The rating reflects the following factors.

- The credit risk associated with the underlying collateral portfolio and the credit support available are commensurate with our view of credit risk under a 'AAA' rating stress. Our assessment of credit risk takes into account the originator Mashang CFC's underwriting standards and centralized approval process, which are comparable to major peers in the China consumer finance industry.

- Credit support for the class A notes comprises the subordination of the class B notes and the subordinated notes, while credit support for the class B notes comprises the subordination of the subordinated notes. Any loss on the collateral pool will be absorbed by the subordinated notes, followed by the class B notes and then the class A notes. In addition, any release from the liquidity reserve (if in excess of the required amount or when asset balance declines to zero) will be diverted to interest waterfall, which, together with residual interests, can enable turbo note principal payment and provides additional credit support.

- The transaction's cash flows can meet the timely payment of interest and ultimate payment of principal to the rated noteholders under stresses commensurate with the rating assigned. An amortizing cash reserve sized at RMB20 million funded upon transaction closing by the originator, and an ability to use principal collections for senior expenses and rated notes interest, provide liquidity support for transaction. The liquidity reserve will be maintained at a required amount of two times of monthly taxes, senior fees and expenses, and interest on class A and B notes from the first trust payment date onward.

- The legal structure of the trust, established as a special-purpose trust (SPT) under China's Trust Law, and the transaction structure and terms, are consistent with the governance of the National Administration of Financial Regulation (NAFR), the former China Banking and Insurance Regulatory Commission, and The People's Bank of China (PBOC)'s credit assets securitization (CAS) scheme. The legal structure of the SPT reflects our criteria for insolvency remoteness.

- The rating on the bank account provider, currently Bank of China Ltd., coupled with the replacement trigger of the bank account provider if the rating on the bank falls below a certain level, is consistent with our counterparty criteria to support a 'AAA' rated transaction.

- The rating on the class A notes is higher than our sovereign rating on China. We applied our "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," criteria published Jan. 30, 2019, and determined that the highest rating that can be considered for this transaction is 'AAA'.

Strengths And Weaknesses

Strengths

In our opinion, the strengths of the transaction observed in the rating analysis are:

- The initial portfolio is well-diversified, with a single borrower concentration of around 0.003% of the aggregate outstanding pool balance and no outstanding arrears for each loan as of the initial pool cut-off date. The originator also undertakes to repurchase loans that have been overdue for more than 30 days as of the trust effective date. In our view, such feature tends to support consistent and stronger performance.
- The limited exposure period. Underlying loans in initial pool have remaining terms of no longer than 12 months, and a weighted-average remaining term of about nine months. The asset eligibility criteria also require the weighted-average remaining term of newly purchased loans to not exceed 365 days. Therefore, we believe the risk exposure period of the pool--or weighted-average life of the notes--is likely to be short.
- The securitized pool has a high weighted-average interest rate of 23.83% as of cut-off date and needs to maintain a minimum portfolio yield at 22% at each subsequent asset purchase during the revolving period. Excess spread, if any, can be used to turbo pay the notes principal, although the excess spread might decrease in a high-default or high-prepayment scenario.
- The repayment structure of the transaction. The transaction adopts a sequential repayment mechanism with a turbo payment feature once it reaches the amortization period. Income collections from the consumption loans, after paying various senior amounts, will be applied under a turbo principal repayment mechanism. This feature can build additional credit support for the rated notes through the more rapid reduction of the rated notes relative to the assets. It can also ensure no principal will be passed through to the class B and subordinated notes until the class A notes have been fully amortized.
- The comprehensive risk management and data-driven technology platform used in the servicer's operation. Mashang CFC adopts a sophisticated internal credit scoring system with heavy use of big data and advanced information technology systems to automate the credit approval process and prevent fraud, as well as to support loan operations. Its information technology infrastructure can monitor borrowers' payment behavior, track payments, and suggest different arrear management measures for various delinquency scenarios.

Weaknesses

In our opinion, the weaknesses of the transaction and the corresponding mitigants observed in the rating analysis are:

- The unsecured consumer loan sector usually is more susceptible to economic downturn than secured asset classes such as auto loans and residential mortgage loans, largely due to the sector's unsecured nature, typical borrower profile, and interest rate charged. We have considered such risk in our base-case default rate assumption for the securitized portfolio.
- The prepayment rate among these borrowers is higher due to the higher interest rate charged. Accordingly, despite the high interest rate, the support provided to the transaction by excess spread may reduce due to loan defaults or prepayments. We have factored in loan defaults consistent with 'AAA' rating stresses and along with high prepayment rate assumptions in our cash flow analyses to further stress excess spread.
- This is not a closed-pool transaction. New receivables can be added during the revolving period, and this could shift the collateral pool's credit profile. In our credit risk analysis of the transaction, we have considered the asset

eligibility criteria, originator's representations and warranties, and a higher rating multiple to address potential changes in pool composition. We have also factored in the minimum portfolio yield, as well as the transaction's acceleration events, early amortization events, and the mechanism for excess spread to cover asset defaults in our cash flow analysis.

- The shorter operating history of China's consumer finance sector, which has seen rapid growth only in the past couple of years after the full liberalization of the consumer finance industry. As a result, the sector has limited historical performance data available for analysis, and it has not experienced a full period of economic stress. We have factored this potential weakness into our credit risk analysis of the transaction. We also note that China's regulators have set forth certain requirements on consumer loans originated by NAFR-licensed consumer finance companies, and have adopted continued supervision and administrative guidelines on the operation of consumer finance business in China. In our view, such regulatory oversight to some extent will prevent a cash loan bubble resulting from fraudulent lending practices, excessive borrowing or lending, and abnormal interest rates in China's consumer finance sector.
- Relative lack of experience in servicing transition in China's securitization market. Despite the recent rapid development of securitization in China, only a few transactions to date have experienced the critical stress of a failure of important counterparties such as the servicer, and the potential for negative effect on the transaction's cash flow. In this transaction, the risk of servicer transition and cash-flow continuity is largely mitigated by the payment arrangements such as direct debit associated with borrowers and a liquidity reserve.

Environmental, Social, And Governance (ESG) Factors

In our opinion, the transaction has relatively high exposure to social credit factors due to the pool consisting of predominantly obligors with relatively high interest rates. Affordability considerations for these borrowers could increase legal and regulatory risks if the validity of the loan contracts or the servicer's collection practices were challenged. We believe this risk is mitigated by the representations made by the originator that underlying loans' interest charge is not more than 24%, which complies with applicable laws, and the existence of legal and compliance departments at the originator that manage adherence to applicable laws.

In our view, the transaction has relatively higher exposure to governance credit factors than a static pool transaction. The revolving collateral pool and the originator's active role over the transaction's life may expose investors to the risk of loosening underwriting standards or potential adverse selection. To account for this risk, we consider the transaction's asset eligibility criteria and originator's representations and warranties and assumed the pool's composition for possible migration in pool credit quality and yield. Ultimately, we have not identified any material ESG credit factors in our analysis, and therefore, ESG credit factors do not influence our assessment of the transaction's credit quality.

In our view, the transaction has relatively low exposure to environmental risk factors. The unsecured underlying loans and granular collateral pool diversification by obligor reduce exposure to physical climate risks.

Transaction Structure

This is a securitization transaction based on China's CAS scheme set up by the NAFR and PBOC.

Mashang CFC sold a pool of consumer loan receivables to an SPT, which is set up by Chongqing International Trust Co. Ltd., the trustee, for the purpose of securitization. To fund such receivables purchase, the trustee issued, on behalf of the SPT, three classes of trust certificates: class A, B, and subordinated notes. The class A and B notes are placed with investors, while the subordinated notes are held by the originator.

The collateralized assets are consumer loans extended to retail borrowers. The borrowers draw personal lines of credit to purchase goods and services, and pay later through monthly instalments. Assets securitized in this transaction are present and clearly defined receivables, rather than future receivables arising from specific credit users.

The asset pool will be revolving for seven months. During revolving period, principal collections and residual interests (interest collections in excess of expected amount of tax, trust senior fees, expenses, interest of class A and class B notes, as well as any top-up of cash reserve and reimbursement of defaults and principal draws) will be used to purchase additional receivables from Mashang CFC. At the end of the reinvestment period or upon the occurrence of an event under the trigger mechanisms, the asset pool will become static. Thereafter, principal collections, after application of principal draws, will be used to pay down class A, B and subordinated notes sequentially. Excess income, if any, will be diverted to principal waterfall for note principal payment.

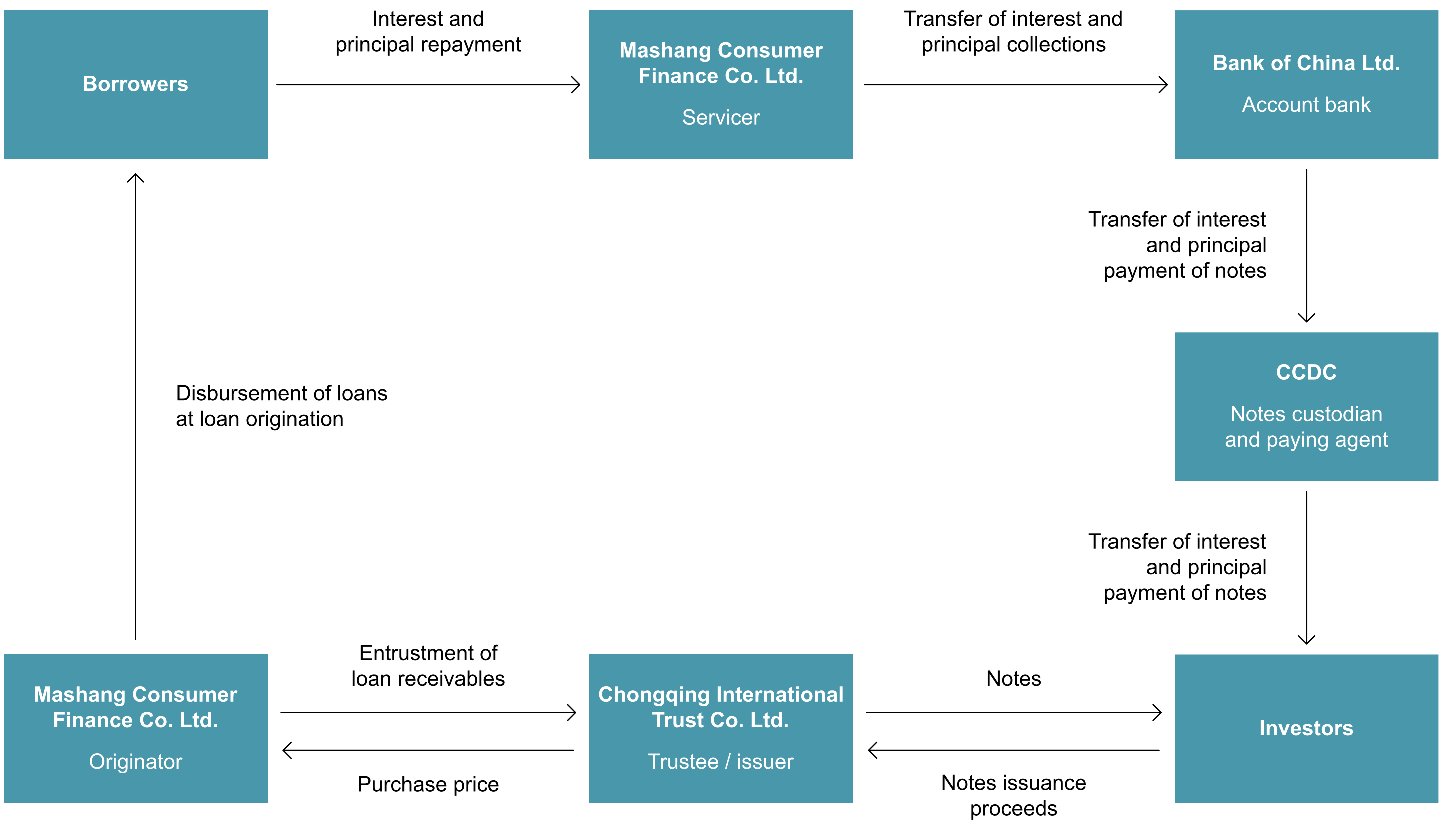
A cash liquidity reserve equivalent to RMB20 million will be funded by the issuance proceeds upon transaction closing to provide liquidity support to the transaction. During the transaction life, the liquidity reserve will be maintained at a required amount (two times of monthly taxes, expected senior fees/ and expenses, and interests of on class A and B notes) from the first trust distribution date onward. Any deficient or excess amount will be topped up or released through the transaction's interest waterfall.

The originator is the transaction's servicer to collect borrowers' payments and to manage arrears.

The structure of the transaction is shown in chart 1.

Chart 1

Anyihua 2023 phase III personal consumption loan asset backed securities
Transaction structure



Source: S&P Global Ratings.

Note Terms And Conditions

Interest payment structure

The class A and B notes are fixed-rate notes. Interest paid on the class A and B notes will be calculated based on the outstanding principal, which is the initial principal as reduced by cumulative principal repayments on previous payment dates. Interest payments on the class A notes rank in priority to interest payments on the class B notes.

Principal payment structure: revolving period

During the revolving period and before the occurrence of an event under the trigger mechanisms, principal collections and residual interests (interest collections in excess of expected amount of tax, trust senior fees, expenses, interest of class A and class B notes, as well as any top-up of cash reserve and reimbursement of defaults and principal draws) will be allocated to purchase new receivables from the seller. The transaction will continue reinvestment for seven

 3026848

months. However, if any event under the trigger mechanisms occurs, the transaction will stop reinvestment and start amortization. The acquisition of additional receivables in the revolving period is subject to documented eligibility criteria and originator's representations and warranties.

Principal payment structure: amortization

Principal collections--after application of principal draws, if necessary, to cover income shortfalls--will be passed through to pay down class A and B notes sequentially until they are fully repaid. The remaining principal collections will be used to pay transaction expenses and indemnities exceeding the cap amount, and then the subordinated noteholders.

Clean-up call

The originator has a "clean-up call" option to purchase the consumer loans from the trust if: (1) the pool balance at the end of any month is 15% or less of the initial pool balance, or outstanding notes balance reduced to 15% or less of the initial note balance; and (2) the market value of the pool balance is not less than the aggregate amount of the class A and B notes' outstanding principal balance and accrued interest, and all fees and expenses of the trust.

Our analysis is on the basis that the notes are fully redeemed by their legal final maturity date. We don't assume the clean-up call will be exercised.

Priority Of Payments

The transaction has separate interest and principal waterfalls. The pre-enforcement priority of payments are summarized in tables 1 and 2.

Table 1

Interest Priority Of Payments	
1	To pay any taxes of the trust due under China's laws that have not been paid
2	Issuance fees – to pay registration fees, information disclosure fee, and bank related fee
3	Senior fees and expenses--to pay trustee, custodian, paying agent, rating agencies, auditor, servicers, and any other senior fees, expenses, and indemnities--capped at RMB150,000 per month
4	Class A note interest
5	Class B note interest
6	Pari passu and pro rata, top up the liquidity reserve and servicer transition and notification reserve
7	Upon the occurrence of accelerant event, all remaining amounts will be diverted to the principal collection account. Otherwise, remaining amounts will be diverted according to the following order:
8	Current period defaults, unreimbursed defaults from prior periods, and unreimbursed principal draws
9	All remaining amounts will be diverted to principal collection account

Table 2

Principal Priority Of Payments	
1	The amount equal to shortfall from (1) tax to (6) replenishment of required reserves in the interest waterfall
2	Class A note principal until zero
3	Class B note principal until zero
4	Any unpaid expenses and indemnities under item 3 in Interest Priority of Payments
5	Subordinated note principal until zero

Table 2

Principal Priority Of Payments (cont.)	
6	Income to subordinated noteholders

Originator/Servicer Overview

Company background

Mashang CFC is a licensed consumer finance company incorporated in Chongqing, established in June 2015. Mashang CFC is one of the largest consumer finance institutions licensed in China in terms of asset size. As of Dec. 31, 2022, Mashang CFC reported total assets of around Chinese renminbi (RMB) 66.51 billion and cumulative loan origination volume of over RMB1.12 trillion, while the number of registered users reached 166 million.

Mashang CFC utilizes technology and big data for customer sourcing. It targets young clients with stable work and income who seek relatively small loan amounts and diversified geographic distribution, but who have limited or no credit history. The differentiation in clientele enables the company to cover a segment of borrowers that is underserved or not effectively tapped by commercial banks.

The consumer loans that Mashang CFC offers are consumption-related loans that are disbursed directly to the borrowers for the purchase of goods or services. Loans for the purposes of investment, business-related, house purchase, or gambling are strictly prohibited. The loan contract requires borrowers to provide supporting documentation for loan usage after loan disbursement, subject to Mashang CFC's verification.

Mashang CFC's management team has extensive experience in the consumer finance and data science industries. The management team, together with the company's organization structure, and fintech-driven operations, helped Mashang CFC establish operating procedures, models, and guidelines for managing dynamic risks in the consumer finance space.

Loan origination and underwriting

All of Mashang CFC's loan origination is online. The company has developed technology capabilities, including AI technology, cloud computing and big data analytics that support digital delivery of financial services and risk management. Meanwhile, Mashang CFC also promotes its products via other portals. As of end-2022, loans originated via Mashang's own channels accounted for around 66% of the company's annual loan origination.

Mashang CFC offers revolving credit facilities, in which the borrower can withdraw and repay with pre-determined instalments within the approved credit limit. All customers must go through an underwriting process to obtain consumption loans. Once an amount is drawn down, that amount is an installment loan, which can be securitized.

Mashang CFC's credit process includes checks on each borrower's identity, the borrower's credit history, and affordability. The company's scoring model assesses applications. It also takes into account the overall leverage ratio of obligors, given those obligors might have more than one outstanding loan with other financial institutions. Based on the applicant's financial soundness and completeness of application materials, the system will automatically approve or reject the application. The credit line and interest rate will be determined by the system simultaneously. No manual decision making is involved in the underwriting process.

 3026848

Mashang CFC employs several scorecards and risk management models for assessing consumption loans. Models and algorithms are periodically assessed and updated, subject to changes in macroeconomic conditions and asset performance. Following the onset of the pandemic in 2020, the company has further tightened customer sourcing, fine-tuned scoring models, and adopted more comprehensive risk control measures to contain adverse impacts. This has led to substantial improvement in asset performance since the second quarter of 2020.

Mashang CFC has developed a system to detect and prevent fraudulent behavior. Customer profiles and traits are fed into the risk assessment system to facilitate the detection of fraudulent transactions. The number of fraudulent cases has gradually declined in recent years, thanks to model updates and the build-up of complete customer profiles.

Stringent regulatory oversight

In our view, Mashang CFC's loan underwriting policies reflect the stringent regulatory control on consumer loan risks in China. The "Pilot Measures for the Administration of Consumer Finance Companies (2013)" and related guiding documents promulgated by the PBOC and NAFR constitutes the basic business operation requirements that all licensed consumer finance companies must follow. This is reflected in the screening of loan purpose and exclusion of student borrowers in Mashang CFC's loan origination process, as well as the maximum interest rates charged by the company, maximum loan amount and credit limit per obligor of RMB200,000, and the requirement of obligors to provide consumption proof following loan disbursement for the consumption loans.

Loan servicing and arrear management

Mashang CFC is responsible for servicing the receivables in the collateral pool. It manages the collection, maintains loan data, and compiles and delivers periodic servicer reports to the issuer.

Underlying borrowers repay their loans through voluntary repayment and direct-debit repayments into Mashang CFC's account.

Mashang CFC has a dedicated collections team responsible for strategic planning of collection operations and managing third-party collection agents outsourced by the company for manual collection work.

Preventive measures are put in place to facilitate on-time repayment. For example, text reminders will be sent to all customers before the payment due date. When a contract falls into arrears, Mashang CFC follows a collections process--done in stages--beginning with text messaging, phone notification, official letters, and legal actions, depending on how long the loans are delinquent. Mashang CFC may initiate court process when the payment has been overdue for more than 365 days, or if it considers the borrower has no willingness to repay. Mashang CFC would generally charge off loans that have been delinquent for more than 180 days and if borrowers still failed to repay after six attempts at recourse.

Securitized Pool

Collateral characteristics

The pool contains unsecured consumer loan contracts. The aggregate outstanding principal balance is about RMB2 billion.

The following summarizes some distinct features of the collateral pool:

- The collateral pool may change with reinvestment of receivables in the first seven months after transaction close.
- There are no balloon or bullet loans in the asset pool; all underlying loans are fixed rate, equal-instalment loans.
- The transaction has a diversified pool, with the largest single loan accounting for around 0.003% of the initial pool by outstanding principal balance. Borrower concentrations therefore do not present an additional risk for this transaction.
- The collateral pool has a relatively short tenor, with a weighted-average contract term of 309.97 days and remining term of 274.17 days as of the initial cut-off date. The asset eligibility criteria further require the weighted-average remaining term of additional purchase loans not to exceed 365 days.
- The collateral pool has a weighted-average contract seasoning as of the initial cut-off date of 35.8 days. The originator's representations and warranties further ensure the weighted-average seasoning of additional purchase loans of at least one month.
- The loans in the collateral pool have relatively high interest rates, with a weighted-average interest rate of 23.83% in the initial portfolio. The asset eligibility criteria also require the weighted-average interest rate of additional purchase loans not to be lower than 22%.
- Almost all loans have a credit score above 650 in the initial pool. The asset eligibility criteria and originator's representations and warranties further ensure the credit score of each newly purchased loan is not lower than 630.

The loan pool for Anyihua 2023 Phase III Personal Consumption Loan Asset Backed Securities as of March 18, 2023, is summarized in table 3.

Table 3

Loan Pool Characteristics (% Pool By Outstanding Principal Balance)	
Customer type	
Retail	100.00
Corporate	0.00
Seasoning (months)*	
0 and less than or equal to 1	59.77
Greater than 1 and less than or equal to 2	30.95
Greater than 2 and less than or equal to 3	3.94
Greater than 3 and less than or equal to 4	3.27
Greater than 4 and less than or equal to 5	1.55
Greater than 5 and less than or equal to 6	0.51
Remaining term to maturity (months)	
Greater than 0 and less than or equal to 3	11.35
Greater than 3 and less than or equal to 6	9.59
Greater than 6 and less than or equal to 9	8.77
Greater than 9 and less than or equal to 12	70.29
Effective interest rate (%)	
Greater than 17 and less than or equal to 18	1.73
Greater than 19 and less than or equal to 20	0.91

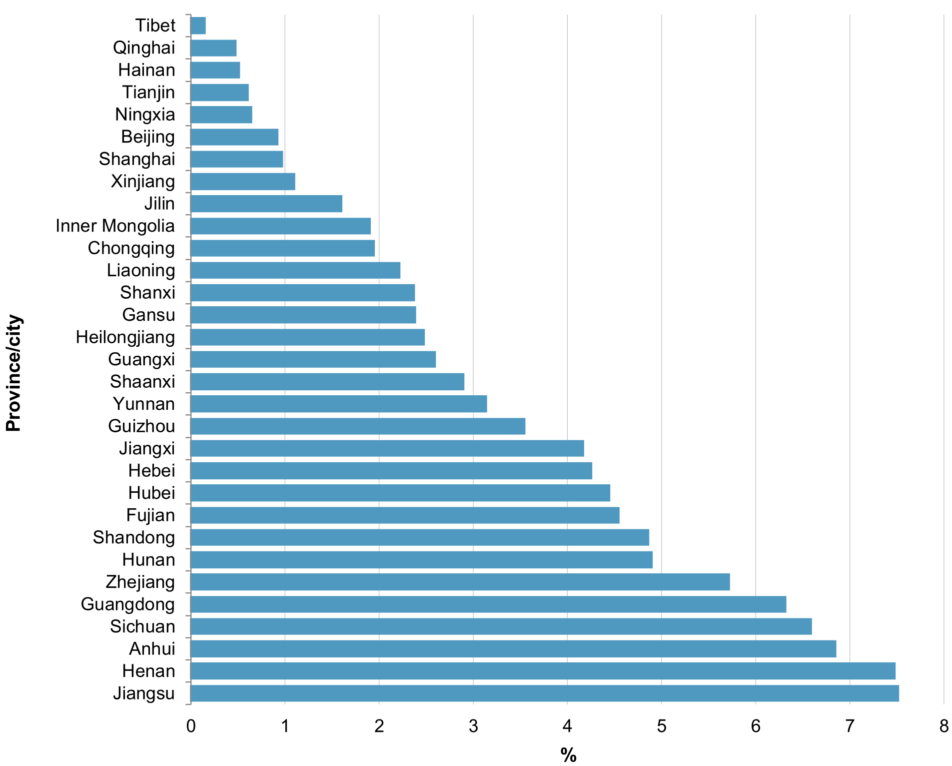
Table 3

Loan Pool Characteristics (% Pool By Outstanding Principal Balance) (cont.)	
Greater than 21 and less than or equal to 22	1.02
Greater than 22 and less than or equal to 23	0.04
Greater than 23 and less than or equal to 24	96.30
Outstanding principal balance (RMB)*	
Greater than 0 and less than or equal to 10,000	55.73
Greater than 10,000 and less than or equal to 20,000	20.59
Greater than 20,000 and less than or equal to 30,000	10.62
Greater than 30,000 and less than or equal to 40,000	6.48
Greater than 40,000 and less than or equal to 50,000	6.59
Credit score	
650 or below	1.25
Greater than 650 and less than or equal to 700	65.39
Greater than 700 and less than or equal to 750	32.96
Above 750	0.40

*Results subject to rounding.

Chart 2

Securitized loans
Borrower geographic distribution



Selective Eligibility Criteria

- All loans are unsecured consumer loans extended to individuals, and the loan purpose is not for financing the purchase of house or vehicle, or for investments;
- On the initial cutoff date or the additional purchase date, each loan is a normal loan on the basis of the five-category loan classification system;
- On the initial cutoff date or the additional purchase date, for each loan, there is no ongoing overdue payment and the longest overdue payment days in the history have not exceeded 30 days;
- As of transaction close, the loan shall not be overdue for more than 30 days;
- On the additional purchase date, the weighted average credit score of additional purchase loans shall be no less than 630 under the internal rating standards of the originator;
- On the initial cutoff date or the additional purchase date, the maturity date of the loan shall be no later than three years before the final maturity date;
- The weighted average term to maturity of the loan on the additional purchase date should not exceed 730 days. The weighted average remaining term to maturity of additional purchase loans shall not exceed 365 days;
- As of any additional purchase date, the minimum weighted average interest rate of additional purchase loans should be at least 22% per year;
- There is no restrictive term in the loan agreement that will limit the assignment of the originator's right. The transfer or sale of the whole or part of the loan thereof by the originator will not be prohibited or restricted for any reason and can be conducted without the consent of the borrower or any other entity;
- Except for the statutory off-set right, the borrower has no right to claim reduction of or exemption from the payables.

Trigger Mechanisms

The transaction has employed three credit trigger mechanisms. Upon the occurrence of any event under the trigger mechanisms, the transaction will stop reinvestment and start amortization. The trigger mechanisms comprise of early amortization event (no asset purchase for three consecutive months or idle cash in principal collection account exceeding 20% of outstanding pool balance for three consecutive additional purchase dates), the event of default, and acceleration event (including the occurrence of originator insolvency, servicer termination, and accumulative default ratio exceeding 6%, etc.). Our credit and cash flow analysis and evaluations on this transaction are based on the possible portfolio features allowable by the stated asset eligibility criteria, trigger mechanisms, as well as the originator's historical performance and representations and warranties.

Credit Analysis

We consider a significant performance deterioration of the underlying receivables to be the principal factor affecting rating transition in this transaction. We have applied our "Global Consumer ABS Methodology And Assumptions" criteria, published March 31, 2022, to the credit risk analyses in this transaction.

Historical performance data

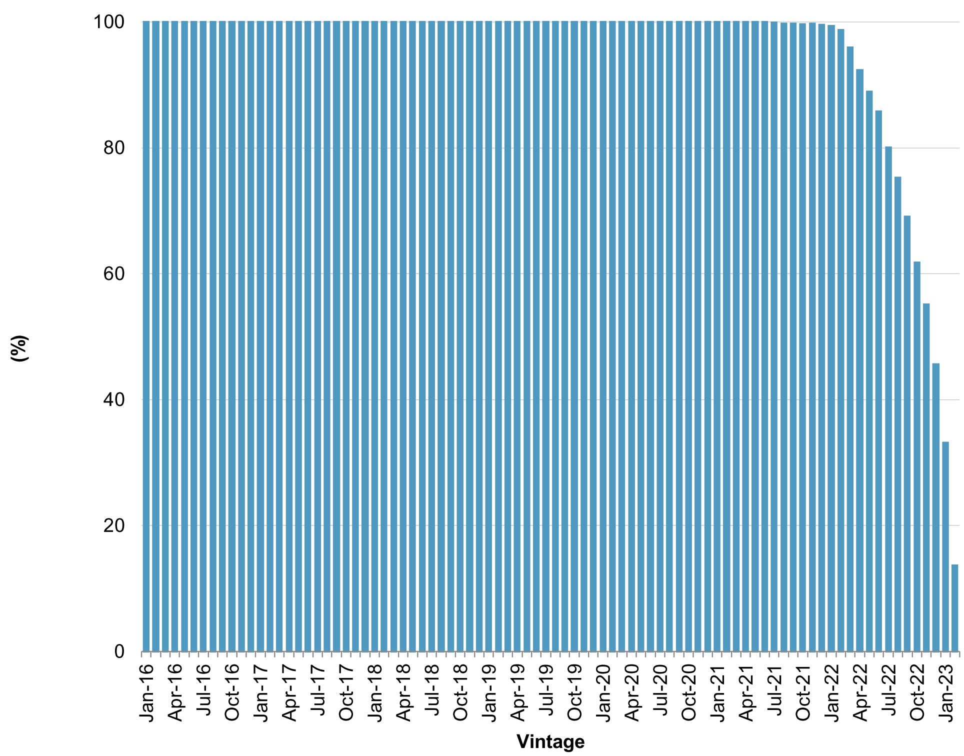
We received the following historical performance data for consumer loan pools originated by Mashang CFC:

- Static pool data: The data includes vintage performance data from January 2016 to February 2023.
- Dynamic pool data from January 2016 to February 2023.

The pay-out ratio for each vintage is depicted in chart 3.

Chart 3

Manshang CFC's loan vintages
Payout ratio

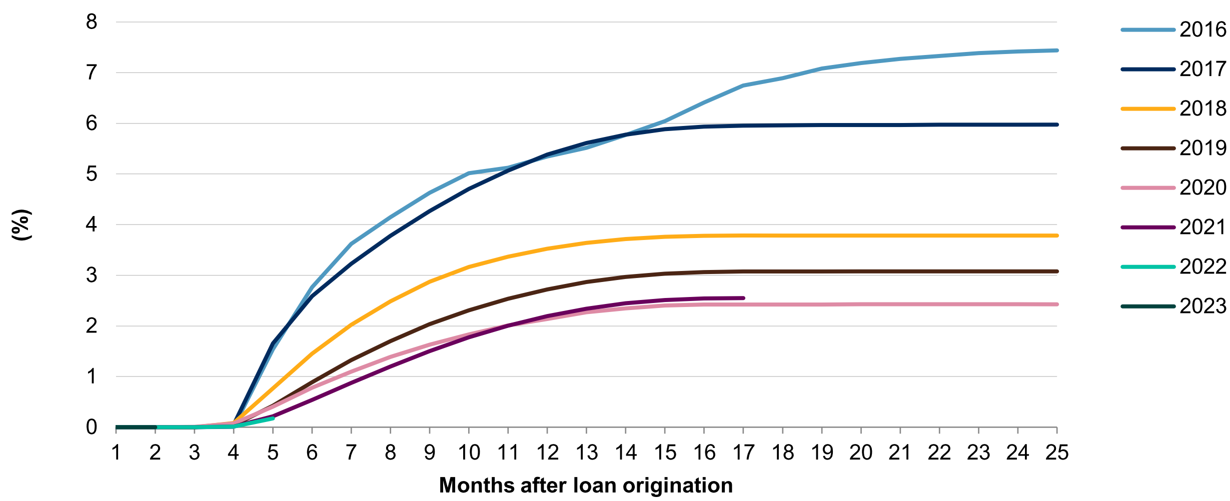


In our credit risk analysis, we assumed all loans that have been delinquent for more than 90 days would default, and used this classification to determine the base-case default frequency for the securitized pool. This assumption is supported by the low historical cure rates--returning from delinquency to current--of loans overdue for more than 90 days.

Chart 4 illustrates the cumulative default experience of Mashang CFC's total consumer loan portfolio, based on our assumptions of deemed default, from 2016 to 2023.

Chart 4

Historical performance
Cumulative default rate by year of origination



Base-case assumptions and stressed default and loss

Our base-case default assumption for the collateral pool is 3.0%, based on the historical performance observed in the static pool and dynamic pool data. It also reflects China's macroeconomic conditions and our forward-looking view on asset performance trends. Though the delinquency ratio before 2019 across the overall loan portfolio was relatively high, the originator's management attributed it to the small origination volume and less comprehensive risk management when Mashang CFC launched operations. Asset performance has improved notably and stabilized after 2019, following the company's tightening in customer sourcing and loan underwriting, as well as enhancing risk-management measures.

Based on the above, we formed our base-case default assumption by putting more weight on the asset performances of the originator's portfolio since 2019. We have also considered the temporary volatilities in the originator's asset performance under pandemic impacts, and the subsequent remedial actions taken by the originator to enhance its asset quality.

We applied a stress multiple to the base-case default percentage in the 'AAA' rating category for the class A notes. The magnitude of the stress multiple that we applied reflects the rating level for the notes, the underlying pool's revolving nature that could render a portfolio profile different from the initial pool, as well as our consideration of the relatively short development history of consumer loan securitization in China and limited experience of macroeconomic stress in the past decade. We therefore applied a relatively high stress multiple within the criteria range.

Due to the unsecured nature of the loans in the portfolio, we assumed the whole amount of defaulted loans will become a loss, i.e. zero recovery.

Table 4 shows a summary of the credit assessment.

Table 4

Credit Assessment Summary

	AAA
Base-case default frequency (%)	3.0
Stress multiple used (x)	6.6
Default frequency (%)	19.8
Loss severity (%)	100.0
Minimum credit support after credit to recovery (%)	19.8

Cash Flow Analysis

Cash-flow modeling assumption

We analyzed the capacity of the transaction's cash flows to support the rated notes--i.e., timely interest payments and repayment of principal by the legal maturity date--by running several different scenarios correlated with a 'AAA' rating level for class A notes. Our cash-flow analysis included various scenarios that reflect different combinations of the following factors:

- Level of defaults commensurate with the rating level and zero recoveries.
- Three different default curves: a front-loaded, back-loaded, and normal default curve. The curves we employed primarily reflect the default timing that we observed in Mashang CFC's static default curves.
- Different prepayment rates--high, normal, and low (see table 5). We observed a prepayment trend based upon the aggregate loan book, in which prepayments in the first two months after loan disbursement are relatively high compared with the remaining tenor. Given the minimum loan seasoning of one month in weighted-average term for additional loan purchase, we construct the normal prepayment curve based on historical prepayment rates from the second month onwards. Assuming a high constant prepayment rate (CPR) further stresses the prepayment rate to historically high levels, while the low CPR assumption stresses the effect of prolonged deal amortization.
- Stressed fees and expenses upon servicer transition and unexpected expenses increase.
- The loss of one month of collections due to potential commingling risk.
- Minimum pool yield required by the asset eligibility criteria.

Table 5

Assumed Constant Prepayment Rates (CPR)

Transaction seasoning	Low CPR (% per year)	Normal CPR (% per year)	High CPR (% per year)
1	5.0	35.0	35.0
2	5.0	35.0	40.0
3	5.0	35.0	45.0
4	5.0	35.0	50.0
5	5.0	35.0	55.0

Table 5

Assumed Constant Prepayment Rates (CPR) (cont.)

Transaction seasoning	Low CPR (% per year)	Normal CPR (% per year)	High CPR (% per year)
6+	5.0	35.0	60.0

The transaction can pass all of the scenarios that we analyzed in our cash-flow adequacy tests.

Liquidity Support

Timely payment of senior expenses and rated note interest is supported by the use of principal draw, and a liquidity reserve funded at closing by Mashang CFC, initially equals RMB20 million.

The liquidity reserve will amortize over time, but will be maintained at two times of monthly taxes, senior fees and expenses, and interest on class A and B notes. Any deficiency in the required amount will be topped up through the interest waterfall and principal draw.

Interest-Rate Risk

All collateralized loans carry fixed interest rates, and the interest rate is fixed on the class A and B notes. As a result, there is no interest rate mismatch risk in this transaction.

Counterparty Risks

The bank account provider

Issuer accounts for this transaction are held with Bank of China Ltd. pursuant to the account bank agreement. Among other transaction arrangements, the bank will be replaced within 90 calendar days if the rating on it is lower than 'A'. This arrangement meets our counterparty criteria to support a 'AAA' rated transaction, considering the transaction's cash flow arrangement.

Servicer commingling risk

Our counterparty criteria consider a transaction's commingling risk through the rating on the servicer, the amount of funds likely to be held in a servicer account at any given time, and the potential impact of a delay in receipt of those funds on the supported securities. In our opinion, there is potential commingling risk in this transaction if the servicer defaults, because Mashang CFC, acting as the servicer in this transaction, can hold the collections for a period of one month before remittance to the SPT account.

Collections could be redirected to the SPT accounts if the rating on the servicer is lowered to certain levels, based on local rating agencies' scale. In our view, the current transaction arrangement does not sufficiently mitigate commingling risk in accordance with our counterparty criteria. For this reason, we have assumed that one full month of collections may be lost due to commingling risk, before the payment redirections kick in. We have considered a one-month collection loss that roughly reflects the average monthly exposure for the early period in the transaction life in our cash flow analysis of the transaction.

Set-off risk

We believe the obligors' set-off risk in this transaction is remote because Mashang CFC is not a deposit-taking institution in China. In addition, according to the asset eligibility criteria, none of the obligors is an employee of Mashang CFC. Hence, no set-off risk arising specifically for employees.

Legal Risks

Asset segregation and issuer's bankruptcy remoteness under the CAS scheme

The CAS pilot program shares the typical features of international securitization transactions, such as asset sale and issuer bankruptcy remoteness. The program is primarily for bank and nonbank financial institution originators under the management of NAFR.

We believe the asset true sale and issuer's bankruptcy remoteness in this transaction meet our special-purpose entity criteria. The primary reason for this is that the securitization transaction adopts an SPT structure by referring to China's Trust Law, in line with the regulations in the CAS pilot program.

Collateral assignment

Typical consumer loan contracts in China have clauses addressing the transferrable and assignable nature of the receivables, meaning that the originators can sell/transfer the contracts to third parties without the borrowers' consent, pursuant to Part III (Contract) of China's Civil Code. The asset eligibility criteria stipulated in this transaction confirm that the purchased loan receivables are assignable.

Legally, the issuer will have the title of the receivables and the associated rights after the asset sale. Practically, however, the transfer will not be effective against the borrowers if the originator does not notify the borrowers of the transfer. Without such notification, although the receivables have been legally acquired by the issuer, the borrowers' payments will continue to be made to the originator or the initial servicer. This issue could be more complicated if the originator becomes insolvent, making it unable to issue a notice to borrowers that a trust has been created over the related loan and that borrowers should redirect their payments to the new lender.

The transaction addresses this concern by introducing a rights perfection event upon the termination of the initial servicer. The occurrence of a rights perfection event will cause the title and rights transfer to be perfected through the originator's notification to each obligor. Such notification will state a trust has been created over the related loan and all payments on the loans should be made from then on to the issuer's account.

Through an executed power of attorney upon transaction closing, the originator has empowered the trustee to issue the transfer notices to individual obligors directly if the servicer does not do so, and to redirect the loan payments to the issuer's account.

Sensitivity Analysis

We cash-flow modeled an additional cash flow scenario to determine how vulnerable the notes would be to a downgrade. This additional scenario assumes the base-case default frequency is 25% higher than our expected level.

The stressed loss rate under the additional scenario is set out in table 6.

Table 6

Summary Stressed Loss Assumptions

Scenario	AAA
Base-case default frequency (%)	3.75
Stress multiple used (x)	6.60
Default frequency	24.75
Loss severity (%)	100

Table 7 sets out what the rating level of class A notes would be at transaction close under such scenario.

Table 7

Rating Transition

Scenario	Class A notes
Expected	AAA (sf)
Additional stress scenario	AA- (sf)

Related Criteria

- Criteria | Structured Finance | ABS: Global Consumer ABS Methodology And Assumptions , March 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities , Dec. 22, 2020
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions , March 8, 2019
- Criteria | Structured Finance | General: Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions , Jan. 30, 2019
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology , March 29, 2017
- Criteria | Structured Finance | General: Global Framework For Assessing Operational Risk In Structured Finance Transactions , Oct. 9, 2014
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- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011
- Criteria | Structured Finance | General: Methodology For Servicer Risk Assessment , May 28, 2009

Related Research

- China Securitization: Auto ABS And RMBS Tracker May 2023, June 27, 2023
- A Primer On China's Consumer Loan ABS Market, June 9, 2023

- S&P Global Ratings Definitions, June 9, 2023
- China Securitization Performance Watch 1Q 2023: A Slow Quarter For Issuance, May 17, 2023
- China Structured Finance Outlook 2023: Issuance Likely To Slowly Stir, Jan. 12, 2023
- Global Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 17, 2016

The issuer has not informed S&P Global Ratings whether the issuer is publicly disclosing all relevant information about the structured finance instruments that are subject to this rating report or whether relevant information remains non-public.