FitchRatings

Structured Finance

ABS/Japan
Servicer Report

Nissin Servicer Co., Ltd

2005 SERVICER RATING JPN
ABSS2-
FitchRatings

Rating

Asset-Backed Special Servicer.................................ABSS2-$_{\text{(JPN)}}$*

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■ Summary

Fitch Ratings has assigned an asset-backed special servicer rating of 'ABSS2-$_{\text{(JPN)}}$' to Nissin Servicer, Co., Ltd. ("Nissin Servicer"), reflecting its ability to service unsecured non-performing loans as well as to meet investors' reporting requirements.

Nissin Servicer was founded in July 2001 by Nissin Co., Ltd. ("Nissin"), a major finance company in Japan, and became operational in October 2001 after obtaining a servicer licence from the Ministry of Justice ("MoJ"). The servicer handles both secured and unsecured loans. Between inception and March 2004, Nissin Servicer serviced 13,589 loans with a combined unpaid principal balance ("UPB") of JPY1,121 billion. The servicer was listed on the MOTHERS (Market of the High-growth and Emerging Stocks) of the Tokyo Stock Exchange ("TSE") in September 2004.

In the three years since its inception, Nissin Servicer has increased its volume of loan assets rapidly, and has achieved steady profit growth. As of August 2004, the servicer employed 76 members of staff, including experienced managers with a diverse background, which allows the company to handle a wide range of asset types. Fitch will continue to monitor the servicer's performance measures and strategy as it seeks to reach its growth and profit goals.

■ Committee Highlights:

Strengths

- Seasoned management and collection staff
- Various forms of support from the parent company
- Highly motivated staff
- Comprehensive Policies & Procedures
- Stable funding sources

Concerns

- Somewhat limited performance owing to its relatively short history
- Lack of systemized training programs
- Market risk is increasing in tandem with rapid growth in purchased loans
- Market trend towards longer collection periods and higher loan asset purchase prices

Mitigants

- The servicer inherited several employees with business experience and its P&P from its parent company
- Many staff are given suitable training at the parent company
- The servicer manages market risk by adopting well-defined standards for loan loss reserves
- It is making progress in evaluating appropriate purchase prices by improving its due diligence capability.

Company Overview

In July 2001, Nissin, a major finance company in Japan and listed on the first section of the TSE and the New York Stock Exchange, founded Nissin Servicer. The servicer became operational in October of that year, having obtained its licence from the MoJ. Between its inception and March 2004, Nissin Servicer serviced 13,589 loans with an aggregate UPB of JPY1,121bn, 4% of which by UPB corresponded to third-party loans and 96% to purchased own loans. At FYE04 (the financial year ending March 2004), Nissin reported a loan book of JPY175bn and operating profit was JPY1.07bn. In September 2004, the servicer was listed on the MOTHERS of the TSE.

Immediately after inception, Nissin Servicer dealt primarily with unsecured corporate loans. More recently it has increased its volume of commercial mortgage loans and has taken on additional staff with real estate expertise. However, as of end-March 2004, the servicer's total portfolio was broken down into unsecured loans of 90% and secured loans of 10%.

Nissin Servicer has stated that its main strategy is to focus on purchasing non-performing commercial mortgage loans and real estates for its own account. The servicer does not undertake servicing for third parties except where these are partners in joint investments.

Financial Overview

The servicer posted losses in its first fiscal year (five months on an actual basis), but reported its first full year of profits in FYE02, its second fiscal year; it has since cleared any accumulated losses. For FYE04, the servicer reported revenues of JPY4.6bn (a 61% increase y-o-y), operating profit of JPY0.9bn (+164%) and net income of JPY0.4bn (+95%).

In its first and second fiscal years, collections on purchased loans accounted for 100% of revenues, and in its third fiscal year, Nissin posted marginal servicing fee income for the first time.

At FYE04, the servicer had doubled its assets to JPY6.7bn, and the balance of purchased loans was JPY5.1bn (+64%).

At FYE04, serviced loans totalled JPY575.4bn by UPB. Purchased loans accounted for 99% of this figure and entrusted loans for the remaining 1%. Approximately 90% of the entrusted loans were from partners of joint investments. At FYE04, Nissin Servicer had purchased about JPY4.5bn in loans – virtually unchanged from the previous fiscal year. The servicer participated in bidding on assets offered by all the Japanese mega banks, and has an expanding client network of Japanese regional banks. At that date, more than half of its 10 largest purchases were from mega banks.

Three-Year Financials

(JPYm)	FYE Mar 02*	FYE Mar 03	FYE Mar 04	Interim Sep 04
Operating Revenue	33	2,859	4,599	3,293
Recurring Profit	-74	309	751	758
Purchased Loan Assets	382	3,078	5,057	6,638
Retained Earnings	-74	134	519	455

* First fiscal year of five months
Source: Nissin Servicer Co., Ltd.

In 2003, in addition to borrowings from financial institutions, Nissin Servicer launched a JPY300 million debenture and a JPY500m share issue allocated to third parties. Moreover, the servicer raised about JPY2.3bn by listing its shares on the MOTHERS of TSE. At FYE04, borrowings totalled JPY4.2bn, a 77% increase from the previous year. At this time, the servicer had not borrowed any money from its parent company, nor had any new borrowings from financial institutions been guaranteed by the parent company.

At FYE04, Nissin Servicer carried out a thorough review of its reserving mechanism for expected loan losses. In addition, it adopted a more conservative reserve position by, for example, making a 100% provision for loans uncollected for two years. Therefore, as of FYE04, its loss provisions stood at JPY700m, five times the figure at the previous year-end.

Nissin Servicer has expanded its business by purchasing loans on its own account. Since trends in the loan market have a strong impact on the servicer's financial position, Fitch will continue to monitor the servicer's management of its loan portfolios with these developments in mind.

Staffing and Training

As of end-August 2004, the company had a total of 76 managers and employees: five directors, three auditors, 49 full-time employees, six contractors and 13 temporary staff.

The five-member management team consists of three alumni from Nissin, the parent company, one from the real estate finance industry and one lawyer. Management has adequate experiences of corporate finance as well as real estate and property finance, supporting the servicer's capacity to engage in a wide range of servicing operations. The average experience in related industry was 28 years and the average tenure with the company, two years at FYE04; Nissin's alumni have, on average, more than 30 years' tenure at the parent.

The management department is responsible for managing and collecting on unsecured loans as well as attempting to locate missing obligors, setting up loan files, and managing documentation. As of August 2004, the department consisted of 29 employees: one general manager, one deputy-general-manager, two managers, 17 full-time staff, two contracted employees and six temporary staff. The department's middle managers have, on average, 18 years' experience in the related industry and one year's tenure at the company. There are 16 collectors in the department, who have, on average, 15 years' experience in the related industry and one year's tenure with the company.

Nissin Servicer has an annual salary system for all employees that consists of guaranteed salaries and performance bonuses. The guaranteed element, which varies according to individual skills, is based on a position/skill matrix, is divided into 12 equal amounts and provided as monthly pay. Performance bonuses are determined by personal and corporate performance in a particular year and are awarded the following April.

The servicer undertakes semi-annual personnel performance reviews. The process includes an interactive communication form on which the individual being appraised fills in details of semi-annual goals, performance, self-evaluation, requests for a transfer to a new position and other requests to the company. After the form is completed, an interview takes place with a reviewer. In addition, the performance of each individual in a collection role is closely monitored daily.

The management department also has its own incentive pay scheme, which is based on the number of cases settled and the performance in terms of collected amounts.

Nissin Servicer provides two training programs. One is company-wide and based on the training courses provided by the Servicers' Association of Japan, and the other is organized by the management department. New hires are given a very brief orientation session explaining the company's background and organization and working rules since, as a rule, it only employs individuals with relevant experience.

Training Program Based on the Courses Provided by the Servicers' Association of Japan

Training sessions are presented by employees who have participated in the regular training programs regularly held by the Servicers' Association. This training is presented to all staff in the relevant sections. In the 12 months from August 2003, the servicer held five one-hour training sessions of this type.

Training Program Within the Management Dept

This program includes all departmental staff and takes place during a regular Monday meeting, lasting for about 30 minutes. In the six months to end-September, 14 such sessions were conducted.

Although the servicer's employee training system is not comprehensive, there do not currently appear to be any specific problems with the function. This is primarily because the servicer employs staff with experience from the parent company or industry. However, the training programs need to be extended as the volume and variety of serviced loans increase. Fitch will continue to monitor developments in this area.

■ Procedures and Controls

Nissin Servicer strengthened internal controls substantially by developing its policies/manuals and an internal audit system before listing its stock in 2004.

Its company regulations are divided into rules and procedural manuals. Rules, which are prepared by the general administration department, cover company-wide issues. These are stored in a shared folder on the LAN and are accessible by all staff. Procedural manuals, which are created and managed by each relevant department, are stored in each department's folder on the LAN and accessible by all staff. Hard copies of regulations and procedural manuals are also distributed to relevant staff.

Internal Audit

The business planning department is responsible for internal audits, which are based on the internal audit rule. At the start of each fiscal year, the general manager of the business planning department prepares an annual audit program containing audit policies, dates, departments, and the names of the auditors for approval by the company president. Based on the annual audit program, the general manager of the business planning department produces monthly audit plans, which the president will also approve. In addition to regular audits, ad hoc audits are carried out if necessary. In March

2004, the company appointed an individual with six years' auditing experience at a major credit company.

The general manager of the business planning department, as a rule, prepares audit reports containing dates, purpose, items, a summary of results and irregularities, and guidance within three weeks of each audit, and submits this to the president. At the same time, the general manager also creates an "instruction for improvement" to highlight any irregularities, which must also be approved by the president. After approval is received, the general manager requests the head of the audited department to make the improvements by handing over the "instructions for improvement". Subsequently, the relevant head prepares a report containing items to be improved and a schedule, which again is submitted to the president.

In addition to internal audits, each quarter a full-time auditor reviews various reports, minutes of the pricing committee, rules and manuals, as well as other documentation. Cash balances are checked at the end and beginning of each day.

External Audit

In May 2003, the servicer received its first on-site MoJ inspection. Although a couple of irregularities were pointed out, the servicer took prompt action to remedy these.

In February 2004, the parent company audited Nissin Servicer. There were some requests for improvements in the area of clerical errors, management of important items and development of manuals. Again, the servicer took prompt action to improve all the noted items.

As the servicer is listed, audits by the parent company have been abolished. However, since the parent company is listed on the New York Stock Exchange, it will review the results of the servicer's internal audits under the requirements of the Sarbanes-Oxley Act. Sanyu, an independent auditing firm, audited the servicer for FYE04, and found no specific irregularities.

■ Technology

Nissin Servicer uses three independent systems: for asset management, collateral management and accounting.

In August 2004, the servicer replaced its previous asset management system with the Total Collection System ("TCS"), which became fully operational in October 2004. TCS is popular with various Japanese servicers. As a part of the system migration, staff responsible for data transfer received training sessions from the vendor. The introduction of TCS resulted in the flexible handling of various reporting forms, quicker cost accounting for purchased loans, strengthened security and streamlined loan data registration. The servicer also uses its proprietary File Maker-based system for managing collateralized real estate.

Access to the systems is protected by ID numbers and passwords, and access to the data base is limited to authorized users. In September 2004, an air-conditioned server room was set up. Important documents including original copies of agreements and notices of loan transfer are scanned and stored electronically, and the original documents are held in an outside warehouse.

As for all the systems, data back-ups are run on a daily basis. The tapes are stored in a fire-proof safe in the office for a week, and the weekly data is then transferred to an outside specialty warehouse. The server is also equipped with uninterrupted power supply ("UPS", a short-term battery back-up). However, although specific disaster recovery plans are in preparation, they have not been completed or implemented/tested.

Two full-time general administration department staff are responsible for IT system maintenance. They have, on average, about six years of related experience. The servicer has a maintenance agreement with a vendor for regular inspections of the TCS server, and with another vendor for the scanning servers and the File Maker system. Servers currently operate at an average of 45% of capacity, and current capacity is considered sufficient.

The asset management and collateral management system are currently on independent platforms. However, if the volume of commercial mortgage loans increases, integration of the two would enhance the operational efficiency.

■ Servicing/Loan Administration

New Loan Set-Up

Nissin Servicer's new loan set-up procedures are as follows: (note: "clients" refers to loan sellers or third parties that entrust loans for servicing).

1. The asset management department creates an Excel sheet based on a detailed information package ("DIP", containing loan/asset information); the data are then input into the asset management system.
2. The asset management department prepares basic client data before registration (bank account, pool name, pool details, purchase price, etc).

3. The general administration department staff member responsible for the system inputs the above data into the asset management system.
4. The management department receives loan transfer agreements and original loan documents, which it scans and then stores in an offsite warehouse.
5. The management department reconciles data in the loan transfer agreement with that entered into the asset management system and on the client registration card.
6. According to loan type, the management department divides the loans between the asset management and the management departments.
7. The asset management department and the management department, respectively, prepare and mail transfer notices for purchased loans as well as servicing notices for third-party loans.

Cash Management/Reporting

Multiple bank accounts are opened for each client. The servicer confirms notice of payment by facsimile, answering service or electronic banking service. The amount of expenses related to collections is controlled according to different levels of authority.

Since Nissin Servicer is entrusted with the collections of joint investment partners, the number of investors to whom it must provide reports is also limited. Monthly investors' reports contain general information, as well as data on collection activities, balance details, loan balance movement, the disposal of collateral, auction developments, collection plans and yield calculation. The reports are detailed and well organized. The servicer's reporting capabilities were substantially improved by the upgrade to the asset management system.

The procedures for cash processing are as follows:

1. After receiving payment notices from banks, the general administration department produces a payment list.
2. The general administration department circulates the payment list to the asset management and management departments.
3. The asset management and management departments. input reasons for payment (settlement, etc.) into the asset management system.
4. The general administration department enters the payment amount in the asset management and accounting systems, based on the payment list.
5. The general administration department carries out cost accounting based on either the amortized cost or the collected cost method and enters the calculated cost into the asset management system.
6. On the basis of the cost accounting, the general administration department prepares payment details and a daily report.
7. Allocated staff in the asset management and management departments confirm whether or not expected loan payments have been credited on the payment list.
8. At the end of month, the general administration department records the aggregate costs in the accounting system.

Nissin Servicer's asset management operations function effectively in view of the current volumes handled.

■ Servicing/Defaulted Loans

At FYE04, the total portfolio balance was JPY1,043.2bn by UPB, of which 90% corresponded to unsecured and 10% to secured loans. On a purchase price basis, 72% of the purchased loans were unsecured and 28% secured loans. The management department primarily deals with collections on the unsecured loans. The average purchase price per loan was about JPY0.5m for unsecured loans and about JPY2.5m for secured loans. The servicer purchases loans primarily from mega banks, regional banks and foreign investors.

When purchasing unsecured loans, the servicer ranks them on a scale of 1-11, from performing to uncollectible loans. According to each rank, it uses a certain percentage of the unpaid loan balance as the basic data for pricing. The servicer has a cap in place to prevent the purchase price from exceeding a reasonable limit.

The loan loss allowance for unsecured loans consists of two types of provisions: general and individual. General provisions are calculated as an agreed percentage of the weighted average purchased loan balance. Provisions for individual loans are calculated according to a classification code that defines their collectibility – ranging from easily collectible to least collectible. The percentage of individual provisions is set at 100% both for contactable obligors who have not made a payment for two years, and uncontactable obligors who have not made a payment for a year.

Portfolio Statistics

	(JPYm)	%	# of Loans	%
Loans Serviced (Through Mar-04, in UPB)				
Purchased Loans	1,073,986	96	13,434	99
Third-Party Clients	47,223	4	155	1
Total	**1,121,209**	**100**	**13,589**	**100**
Loan Balance (as of Mar-04, in UPB)				
Secured Loans	107,381	10		
Unsecured Loans	941,556	90		
Total	**1,048,937**	**100**		
Collection Methods* (Through Mar-04, in Collection Amount)				
Paid by Borrowers	1,681	66		
Paid by Guarantors	561	22		
Paid by Third Party	252	10		
Others	41	2		
Total	**2,536**	**100**		

* Unsecured loans only
Source: Nissin Servicer Co., Ltd.

The basic procedures for collecting unsecured loans are as follows:

1. Based on data in the asset management system and on the customer registration card, collectors negotiate with borrowers for collection.
2. Collectors propose a repayment schedule, which must be approved by the general manager of the management department
3. Settlement conditions are negotiated, to which all parties must agree.
4. The settlement agreement is prepared and executed
5. Payments are made in accordance with the settlement conditions

The servicer has traditionally negotiated settlement conditions with obligors that involve a lump sum payment. In recent years, however, obligors have increasingly sought to pay by instalment, which has led to lengthy collection periods. About 1% of the loans payable by instalments lapse into delinquency status again, although the servicer does not view this as a specific problem.

As of end-March 2004, each collector in the management department (including middle managers) handled just under 400 obligors, which both Fitch and Nissin Servicer view as an appropriate level.

Between inception and March 2004, the servicer collected a cumulative total of about JPY7.4bn. Disposals of the collateral property accounted for 16% of this amount, while payment by obligors, guarantors or third partiers accounted for 81%. Collections for FYE04 totalled JPY4.5bn, 4% of which corresponded to the disposal of the collateral property, and 93% to payments by obligors, guarantors or third parties. Even in the case of secured loans, where disposal used to be the most usual route for collection, the increase in sub-performing loans has made collections through obligors' payments the most common method. Nissin Servicer has achieved higher-than-expected collection performances every year, although the excess margin has consistently decreased. Therefore, at FYE05, the company slightly reduced the benchmark for expected collection amounts. The recovery rate (collected amount/purchase price) is deemed appropriate under current market conditions.

The asset management department includes a three-member team responsible for legal duties. The head of the team has eight -years' experience as a legal clerk, while two other team members previously worked at a bank and a leasing company, respectively. Between inception and end-March 2004, cumulative collections through legal procedures, including bankruptcy cases, totalled JPY7.4bn which was about 3% of total collections for the same period.

Every Monday, each collector in the management department submits a weekly payment schedule, which is ranked in terms of the obligor's payment reliability. Management assesses the performance of each collector daily by checking the payment schedule against the payment list prepared by the general administration department

The collection manuals clearly and specifically define certain requirements, including prohibition against contact with obligors. The servicer outsources the preparation of receipt statements for obligors who have made arrangements to pay via a bank's automatic deduction service.

In Fitch's view, the servicer manages its special servicing operations for unsecured loans well, having built on its parents expertise and know-how in the area of the management and collection of unsecured loans. It also benefits from the fact that its collectors gained solid experience at the parent company. The rules for loan loss reserves are clearly established, and the risk associated with purchased loans is adequately controlled. However, given current market trends, whereby loan purchase prices are increasing and loan collection periods becoming longer, Fitch will continue to monitor the servicer's loan asset management performance closely.