Presale:

Silver Arrow China 2023-2 Retail Auto Loan Asset Backed Notes Trust

August 31, 2023

Preliminary Ratings As Of Aug. 31, 2023

<table>
<thead>
<tr>
<th>Class</th>
<th>Preliminary rating</th>
<th>Preliminary amount (mil. RMB)</th>
<th>Credit support provided by subordination and overcollateralization* (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>AAA (sf)</td>
<td>8,000.0</td>
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<tr>
<td>Subordinated</td>
<td>NR</td>
<td>421.1</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Note: This presale report is based on information as of Aug. 31, 2023. The rating shown is preliminary. Subsequent information may result in the assignment of final ratings that differ from the preliminary ratings. This report does not constitute a recommendation to buy, hold, or sell securities. N/A—Not available. NR—Not rated. *Potential credit support could also come from additional overcollateralization in the form of yield supplement overcollateralization (YSOC) at 1.73%. YSOC is not dedicated to cover credit losses and might be released.

Profile

Expected closing date  September 2023

Legal final maturity date  May 26, 2030

Collateral  Renminbi-denominated, fully amortizing loans to prime-quality borrowers, secured by mortgages over vehicles

Structure type  Prime auto loan-backed securities with sequential repayment mechanism following a 12-month revolving period

Issuer  China Foreign Economy And Trade Trust Co. Ltd. as trustee of Silver Arrow China 2023-2 Retail Auto Loan Asset Backed Notes Trust

Servicer  Mercedes-Benz Auto Finance Ltd.

Primary credit enhancement  Note subordination, overcollateralization, and potential support from yield supplement overcollateralization.

Supporting Ratings

Bank account provider  Industrial And Commercial Bank of China Ltd.

Initial Loan Pool Statistics As Of April 30, 2023

| Total number of loans | 55,215 |

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Initial Loan Pool Statistics As Of April 30, 2023 (cont.)

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
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<tbody>
<tr>
<td>Total receivable balance of contracts (RMB)</td>
<td>9,191,343,922.76</td>
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<tr>
<td>Maximum receivables balance of contracts (RMB)</td>
<td>2,046,008.29</td>
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<tr>
<td>Average receivables balance of contracts (RMB)</td>
<td>166,464.62</td>
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<tr>
<td>Weighted average down-payment (%)</td>
<td>37.63%</td>
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<tr>
<td>Weighted average interest rate (%)</td>
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<td>Total balloon payments as a percentage of total pool balance (%)</td>
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<tr>
<td>Weighted-average contract seasoning (months)</td>
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<tr>
<td>Weighted-average remaining term to maturity (months)</td>
<td>33.70</td>
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</table>

Rationale

We assigned our 'AAA (sf)' preliminary rating to the class A notes to be issued by China Foreign Economy And Trade Trust Co., Ltd. as trustee of Silver Arrow China 2023-2 Retail Auto Loan Asset Backed Notes Trust (the issuer). This is an auto loan securitization transaction originated by Mercedes-Benz Auto Finance Ltd. (MBAFC).

The preliminary rating reflects the following factors:

- The credit risk associated with the underlying collateral portfolio and the credit support provided for the class A notes in the form of subordination and overcollateralization are commensurate with our view of credit risk under 'AAA' rating stresses. Our assessment of credit risk takes into account originator MBAFC’s underwriting standards and centralized approval process, which are largely consistent with Mercedes-Benz Group AG’s financing business practice and risk-management approach, with some local adaptation. Mercedes-Benz Group AG is MBAFC’s parent company.

- The transaction’s cash flows can meet the timely payment of interest and ultimate payment of principal to holders of the rated notes under stresses commensurate with the ratings assigned.

- The timely payment of senior expenses and rated note coupon is supported by the use of interest and principal collections from the underlying pool of loans and a liquidity reserve of about Chinese renminbi (RMB) 90.3 million. The liquidity reserve will not amortize and will be topped up through the priority of payments on each payment date.

- A proportion of the collateral portfolio comprises contracts that have an interest rate lower than that required to cover the trust’s senior expenses and class A note interest. However, the transaction's cash flows are further supported via the provision of additional overcollateralization in the form of yield supplement overcollateralization (YSOC).

- 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) and The People's Bank of China's (PBOC) 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 Industrial And Commercial Bank Of China
LTD., coupled with the replacement trigger of the bank account provider if this rating falls below a certain level, is consistent with our counterparty criteria to support a 'AAA' transaction.

- The preliminary rating on the 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 on 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 sound quality of the loan portfolio at close. All underlying loans have a full-recourse feature, and are backed by new passenger vehicles for personal use. The initial portfolio is well diversified, with a single borrower concentration of around 0.02%, and it is seasoned by more than seven months in weighted-average terms. Our observations in other markets suggest these features tend to support consistent and stronger performance.

- The shorter exposure period compared with peers in the U.S. and Europe. Loans with remaining terms no longer than 36 months account for 70% of the initial pool balance. The underlying pool at the initial cut-off date has a weighted-average remaining term of around 34 months. Although the pool has a revolving period of 12 months before it goes static, we believe the overall risk exposure period of the pool--or weighted-average life of the notes--is likely to remain short.

- The repayment structure of the transaction. Once the transaction starts amortization, the principal payments will be made to the class A noteholders, and then to the subordinated noteholders only when the class A notes are paid in full.

- High global consistency between MBAFC and Mercedes-Benz Group AG's financing business on underwriting process, risk management, and technology platform. Mercedes-Benz Group AG is heavily involved in the development of MBAFC's operation, underwriting, and risk management processes. MBAFC also has more than a decade of operating experience in China for local adaptation. A comprehensive technology system is deployed to store data, facilitate loan origination, and support auto loan securitization in line with global standards. MBAFC has committed to continuous system improvements to meet the needs of business growth.

Weaknesses

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

- The shorter operating history of China's auto finance sector, which has grown rapidly only in the past decade. As a result, the sector has limited historical performance data available for analysis, and it has not experienced true periods 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 stringent requirements on auto loan origination, and have adopted continued supervision and administrative guidelines on loan quality control. In our view, such
regulatory oversight, along with MBAFC's underwriting capability and risk management, will prevent a lowering of the origination standards in auto finance.

- Relative lack of experience in servicing transition in China's securitization market. Despite the recent rapid development of Chinese securitization, 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 effects on the transaction's cash flow. In this transaction, the risk of servicer transition and cash-flow continuity are partly mitigated by the payment arrangements such as direct debit associated with borrowers and a liquidity reserve.

- This is not a closed-pool transaction. New receivables can be added during the transaction’s revolving period, and this could cause a shift in the collateral pool’s characteristics and credit quality. We have factored in the potential change in pool composition in our credit and cash flow analysis. We also note that some of the early amortization triggers may help contain the risk of a sharp reduction in the credit enhancement level during the revolving period. Such triggers include a failure to purchase sufficient new receivables to maintain the asset pool balance at a certain level or a breach of the cumulative default rate threshold.

Environmental, Social, And Governance (ESG) Factors

Our rating analysis considers a transaction’s potential exposure to ESG credit factors. For the auto asset-backed securities (ABS) sector, we view its exposure to environmental credit factors as above average, social credit factors as average, and governance credit factors as below average (see “ESG Industry Report Card: Auto Asset-Backed Securities,” published March 31, 2021).

The transaction’s above-average exposure to environmental credit factors is in line with our sector benchmark, given that the collateral pool primarily comprises vehicles with internal combustion engines (ICE). While the adoption of electric vehicles (EV) and future regulation could in time lower the value of ICE vehicles, we believe our current approach to evaluating recovery value is adequate. As a result, we have not separately identified this as a material ESG credit factor in our analysis.

The transaction’s exposure to social credit factors is average, in line with the sector benchmark. Social risks for the auto sector could become more relevant over the longer term if consumer preferences change regarding vehicle ownership and usage.

In our view, the transaction has relatively higher exposure to governance credit factors than our sector benchmark given the revolving collateral pool and the originator’s more active role over the transaction’s life, exposing investors to the risk of loosening underwriting standards or potential adverse selection. To account for this risk, we assumed that the pool’s composition will migrate to the lowest credit quality allowable under the transaction’s pool composition tests, resulting in a higher expected loss than that of a typical amortizing pool.

Notable Features

The transaction has a revolving period of 12 months after close, during which additional receivables can be purchased in accordance with certain eligibility criteria, via asset collections, provided an early amortization event has not occurred. The addition of new receivables ideally should maintain the asset pool balance during the revolving period at a level that generates equivalent asset yield as of the initial cut-off date.

The credit enhancement comprises the subordination from the subordinated notes and
overcollateralization, including additional overcollateralization in the form of YSOC.

The interest and principal collections from the YSOC portion, which is an indistinguishable part of the securitized loans, constitute additional support to the transaction. But the additional support is primarily for covering the expected shortfall of loan yields against transaction payments for tax, senior fees/expenses and note coupons. The YSOC will initially be approximately 1.73% of the total pool balance at transaction close. The YSOC is sized so that the effective asset yield on the collateral portfolio would be sufficient to generate excess spread. As the collateral portfolio and the class A notes then amortize and the expected difference between asset yields and note interest decreases, the notional amount of YSOC will amortize through payment to junior waterfall items accordingly.

After the revolving period, and after addressing negative carry, any collections from the YSOC portion will also be available to cover credit losses or commingling losses, by paying down the class A notes if the asset pool is under-collateralized. In other words, it could provide another source of credit enhancement under some scenarios. In a severe negative carry environment, the collections from the YSOC should be used to cover negative carry first, so the likelihood of the YSOC collections being available to cover credit losses and commingling losses would decrease. After covering negative carry, credit losses and commingling losses, the collections from the YSOC can be used to cover indemnity expenses or be released to the originator.

**Transaction Structure**

The transaction is based on China’s CAS scheme set up by NAFR and PBOC.

MBAFC will sell a pool of auto loans receivables to an SPT, which is set up by China Foreign Economy And Trade Trust Co. Ltd., the trustee, for the purpose of securitization. To fund the purchase of such receivables, the trustee will issue (on behalf of the SPT) two classes of trust certificates. The class A notes will be placed with the investors, while the subordinated notes will be held by the originator.

The collateralized assets are receivables on loans extended to retail borrowers, used to finance the purchase of new cars manufactured by Mercedes-Benz Group AG, including those made by local joint ventures under the Mercedes-Benz brands. As of the initial cut-off date, these loans have original terms spanning up to 60 months. The weighted-average remaining term is around 34 months. The initial LTV ratios of most loans in the pool ranged from 40%-80%, and the weighted average initial LTV was 62.37%.

The asset pool will be revolving for the initial 12 months. During this time, asset collections (inclusive of interest, principal, penalties, and any other payments) will be used to purchase additional receivables, after paying SPT taxes, senior fees and expenses, and interest on rated notes. Asset collections will also be used to replenish the liquidity reserve based on the priority of pre-enforcement waterfall, provided an early amortization event has not occurred. No principal payments will be made to the noteholders during the 12-month revolving period.

At the end of revolving period or upon the occurrence of an early amortization event, the asset pool will become static, and no asset substitution or reinvestment will be allowed. Thereafter, collections (inclusive of interest, principal, penalties, and any other payments) from the assets will be used to pay SPT taxes, senior fees and expenses, interests on the rated notes, and replenish liquidity reserve if required. The remaining proceeds will be used to pay down the principal of the rated notes in accordance with the principal distributable amount.

A liquidity reserve equal to around 0.98% of the initial asset pool balance, and equivalent to 1% of the initial adjusted pool balance (aggregate outstanding pool balance minus YSOC), will be funded
upon transaction closing. The liquidity reserve provides liquidity support to the transaction’s expenses and interest on the rated notes, if needed.

The structure of the transaction is shown in chart 1.

Chart 1

**Silver Arrow China 2023-2 Retail Auto Loan Asset Backed Notes Trust**

**Transaction structure**

Borrowers

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Interest and principal repayment

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MBAFC Servicer

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Transfer of interest and principal collections

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Industrial And Commercial Bank Of China Ltd.

Account bank

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Transfer of interest and principal payment of notes

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CCDC

Notes custodian and paying agent

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Transfer of interest and principal payment of notes

---

China Foreign Economy and Trade Trust Co. Ltd.

Trustee / issuer

---

Notes

---

Purchase price

---

Investors

---

Purchase price

---

MBAFC Originator

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Entrustment of the loans

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Disbursement of loans at loan origination

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**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 reflect 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 car 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 (Contracts) of China’s Civil Code. The asset eligibility criteria stipulated in this transaction confirms that the purchased loan receivables are assignable.

Legally, the issuer will have the title of the loans and the associated rights, including the mortgage, after the receivables are sold through securitization. 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 borrower, each guarantor, if any, and the vehicle’s insurance company. 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 or the replacement servicer'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 replacement servicer’s account or the issuer's account.

Note Terms And Conditions

Interest payments structure

The rated notes are fixed-rate notes. Interest payments on the class A notes rank in priority to interest payments on the subordinated notes.

Principal payment structure: revolving period

During the revolving period and before the occurrence of an early amortization event, monthly collections from the assets (after meeting payment obligations in tax, transaction expenses and notes interest, and topping up the liquidity reserve) will be used to purchase additional receivables from the originator. No principal payments will be made to the noteholders during this period. The acquisition of additional receivables is subject to documented eligibility criteria and will maintain the asset pool balance at a level that generates equivalent asset yield as of the initial cut-off date. The residual proceeds will then be released to the originator.

The transaction will start amortizing upon the occurrence of an early amortization event, at which point reinvestment will stop and collections will be used to pay down the notes. An early amortization event includes a servicer termination event, the cumulative default rate exceeding a
certain level, insufficient receivables, failure to maintain the asset pool balance at certain level, and the originator ceasing to be an affiliate of Mercedes-Benz Group AG.

**Principal payment structure: amortization**

Principal repayment to the class A and subordinated notes will be sequential. The subordinated notes will receive payments only after the class A notes' principal is fully repaid. On each payment date, the class A notes will be paid down based on the formula of "principal distributable amount." This formula is the amount of the assets' principal collections after deducting the collections from the YSOC that are not used to cover negative carry or credit losses.

**Clean-up call**

The originator has a "clean-up call" option to purchase the auto loan receivables from the trust if the pool balance at the end of any month is reduced to less than 10% of the initial note balance. The originator may exercise its clean-up call option only if the clean-up call price for the receivables, together with amounts in the collection account, general reserve account, and commingling reserve account if any, will be sufficient to repay in full the rated notes 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 a combined interest and principal cash-flow priority of payments. The pre-enforcement priority of payments after the revolving period is summarized in table 1.

| 1 | To pay any taxes of the trust due under applicable laws that have not been paid |
| 2 | Trust fees and expenses |
| 3 | Senior fees—to pay the servicer, account bank, paying agent, rating agencies and auditor |
| 4 | Interest on class A notes |
| 5 | Top up the liquidity reserve up to its required level |
| 6 | After the end of the revolving period, to pay class A notes principal to target level in accordance with principal distributable amount. (During the revolving period, new receivables will be purchased to maintain the asset pool balance at a level that generates equivalent asset yield as of the initial cut-off date. The residual collections will be released to the originator.) |
| 7 | Interest on subordinated notes (stated coupon is zero) |
| 8 | Subordinated notes principal if class A notes are paid in full |
| 9 | Indemnity payments |
| 10 | To originator (subordinated noteholder) |
Originator/Servicer Overview

Company background

MBAFC is a NAFR-regulated auto finance company incorporated in Beijing, China, in September 2005. The company initially was wholly owned by Mercedes-Benz Group AG, a leading global automotive manufacturer of premium cars and commercial vehicles based in Germany. Since May 2015, Mercedes-Benz Group AG and Mercedes-Benz Group China Ltd. own 52.2% and 47.8% of MBAFC, respectively.

MBAFC offers both passenger and commercial vehicle financing products across China for the purchase of Mercedes-Benz passenger cars, Mercedes-Benz commercial vehicles and Mercedes-Benz branded trucks. Its target customers are retail customers, small businesses, corporates, and dealerships.

The company manages sales through its four regional offices and a nationwide network of around 700 dealers in China. Loan origination has been stable in the past five years.

Loan origination and underwriting

Dealerships recommend MBAFC products to the end-customer and refer the customer to an onsite financial consultant as the first-contact point at MBAFC for the borrowers. The consultants perform initial checks on each borrower’s identity, collect supplementary documents, and enter the loan application data in MBAFC's system for credit review. Besides the in-person application process, customers may also submit credit applications through MBAFC's express application channel.

The regional credit department carries out the credit review. There are four regional credit teams and the number of credit analysts in each team is based on the volume processed. A centralized credit governance team is responsible for the policies, procedures, and credit underwriting quality in retail and wholesale credit operations, which include headquarters coordination, credit policies and procedures maintenance, and quality assurance in credit processes.

MBAFC uses both a credit-scoring system and manual assessment to conduct credit reviews. Upon receiving the loan documents, MBAFC first verifies customer information via external sources such as National Citizen Identity Information Center and State Administration for Industry and Commerce data and checks credit history from the PBOC credit system before passing the application to the scoring system for credit assessment.

The credit-scoring system reviews the application and suggests that it is eligible for automatic approval or refers it for a manual assessment. According to MBAFC, around 84% of retail individual loan applications are approved through the automatic decision system as of March 2023. All auto-approved cases will then be checked manually again for the completeness and quality of the documents. Applications that are not automatically approved will all go to manual review conducted by the credit analysts for further investigation and a more comprehensive analysis. Credit analysts can only approve a loan that falls within their credit approval limit.

The credit scoring system developed in 2014 has been enhanced periodically since then. It borrows the framework from Mercedes-Benz Group AG’s global practices, but has different parameters to reflect China-specific features. The scoring system calculates a composite score for each applicant based on the application information and data from PBOC credit system.
scores range from 1 to 1000 and are categorized into four classes from A to D, to represent borrowers of different risk levels and default probabilities. Separate scorecards are applied for retail borrowers and small business borrowers at MBAFC to address the different risk factors of the various customer segments. Scorecards are monitored on a quarterly basis in model performance, variables distribution, and stability performance.

In addition to the scorecard, business policy rules are a supplementary tool used to form credit opinions and to reflect MBAFC’s policy appetite. Some of the rules are to reject borrowers to reflect restrictions by law and NAFR regulation, or to flag a high-risk factor such as a delinquency record or unemployment status. Each business policy rule is monitored and reviewed jointly by the headquarters and the local risk teams on a quarterly basis.

MBAFC adopts a strict process for contract activation and disbursement after loan approval. For an approved application referred by a dealer, MBAFC will notify the dealer to sign the contract with the borrower and submit it back to MBAFC along with additional documents such as insurance and direct-debit mandate. For an approved application submitted through MBAFC’s mobile app, the customer will sign a digital contract and MBAFC will send a delivery agent to collect any additional relevant documents. MBAFC’s retail operation team then verifies the documents to activate the loan and checks vehicle registration for disbursement.

**Loan servicing**

MBAFC will be responsible for servicing the receivables in the collateral pool. Its customer service and collection departments track and manage loan repayments. Part of the late collection process is outsourced, but supervised by MBAFC.

Borrowers repay their loans mainly through direct-debit repayments into MBAFC’s account. To make direct-debit repayment, borrowers need to maintain a bank account at one of the nine cooperating banks, and deposit sufficient money for periodic loan repayments. Each of these banks has a nationwide network in China for such service.

MBAFC has defined processes and timelines to manage contracts in arrears based on the delinquency lifecycle. For loans that are at early collection stage (1 to 60 days past due), MBAFC sends a text message and makes a phone call to the borrowers using a call center vendor, and conducts an outsourced home visit. If the delinquency cannot be remedied within 60 days after missing the first payment, it will be passed to the late stage collection officers and outsourced agents to follow up. Contracts that are over 90 days past due may trigger contract termination and vehicle repossession. At this stage, MBAFC may arrange obligors’ repayment, and voluntary or involuntary vehicle sales for borrowers to repay the loans. For any remaining amount owed to MBAFC after vehicle sale, including costs and expenses incurred during the collection process, MBAFC has the right to continue pursuing the borrowers, due to the full-recourse nature of the loans. If a loan is more than 180 days overdue, MBAFC generally charges off the loan amounts. All outsourced activities and vendors are supervised by MBAFC’s agent management team to ensure collection quality and consistency.

**Stringent regulatory oversight and characteristics of prime loans**

MBAFC’s loan underwriting policies reflect the regulatory control on auto loan risks in China. The amended “Auto Loans Management Guideline” promulgated by the PBOC and NAFR in 2018 constitutes certain basic loan underwriting requirements that all auto finance companies and commercial banks must follow in their auto loan business. These requirements are:
- The borrowers need to have good credit history, with evidence of stable income or other property to support the down payment and continued debt servicing.
- The term of the loan financing a new vehicle should not be longer than five years, and the loan tenor for preowned vehicles should not be longer than three years.
- The highest LTV ratio on retail loans is 80% for new vehicles, except defined new energy cars, and 70% for preowned vehicles.
- The value of the vehicles for the calculation of LTV ratio should be the lower of the manufacturers' suggested vehicle price and the amount actually paid by the buyer (for new vehicles).

Borrowers with good credit quality and debt serviceability are no longer required to mortgage the vehicles financed by such loans or other collateral to the lenders after the amendment. However, all loans in the securitized pool as of the initial cut-off date have a vehicle mortgage as confirmed by the originator. Besides, the originator also confirmed that mortgage registration waiver products will not be acquired as additional receivables during the revolving period.

Collateral

The initial pool contains 55,215 consumer loan contracts, secured by vehicles manufactured by Mercedes-Benz Group AG and its China affiliates. In terms of the repayment method, all of the receivables require equal instalments. The aggregate outstanding principal balance is about RMB9.2 billion.

The following summarizes some distinct features of the initial collateral pool:
- The entire portfolio comprises receivables that are backed by new passenger vehicles. Historical data in other markets show that losses when the motor vehicle financed was new are typically lower than those when the motor vehicle was pre-owned.
- There are no balloon or bullet loans in the asset pool; all loans are fully amortized with equal instalments.
- The pool has a diversified borrowers base, with the largest single loan accounting for around 0.02% of the initial loan balance. Borrower concentrations therefore do not present an additional risk for this transaction.
- The collateral pool is somewhat seasoned, with a weighted-average contract seasoning as of the cut-off date of 7.46 months.
- The loans in the collateral pool have a weighted-average interest rate of 5.31%. The loans with interest rates higher than 6% account for 32.71% of the pool, while those with interest rates less than or equal to 3% represent 18.30%.
- All contract payments, including interest, principal, expenses, and prepayment penalty, are full-recourse obligations of the borrowers.
- The trust is not exposed to any market-value risk associated with the sale of the motor vehicles (on performing receivables), which is a risk that could be associated with products such as operating leases.

The initial receivables pool for Silver Arrow China 2023-2 Retail Auto Loan Asset Backed Notes Trust as of April 30, 2023, is summarized in table 2.
### Loan Pool Characteristics (% pool by outstanding principal balance)

<table>
<thead>
<tr>
<th>Category</th>
<th>Value of loans (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customer type</strong></td>
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</tr>
<tr>
<td>Retail business owner</td>
<td>51.61</td>
</tr>
<tr>
<td>Retail private individual</td>
<td>48.39</td>
</tr>
<tr>
<td><strong>New and used (financed vehicle)</strong></td>
<td></td>
</tr>
<tr>
<td>New</td>
<td>100.00</td>
</tr>
<tr>
<td>Used</td>
<td>0.00</td>
</tr>
<tr>
<td><strong>Loan payment method</strong></td>
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<tr>
<td>Direct debit</td>
<td>100.00</td>
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<tr>
<td><strong>Seasoning (months)</strong></td>
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<tr>
<td>Less than or equal to 6</td>
<td>53.66</td>
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<tr>
<td>Greater than 6 and less than or equal to 12</td>
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<td>Greater than 12 and less than or equal to 24</td>
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<td>Greater than 24 and less than or equal to 36</td>
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<td>Greater than 36 and less than or equal to 48</td>
<td>0.00</td>
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<tr>
<td><strong>Remaining term to maturity (months)</strong></td>
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<tr>
<td>Less than or equal to 6</td>
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<td>Greater than 6 and less than or equal to 12</td>
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<td>Greater than 48 and less than or equal to 60</td>
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<td><strong>Effective interest rate (%)</strong></td>
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</tr>
<tr>
<td>Greater than 0 and less than or equal to 3</td>
<td>18.02</td>
</tr>
<tr>
<td>Greater than 3 and less than or equal to 6</td>
<td>48.99</td>
</tr>
<tr>
<td>Greater than 6 and less than or equal to 9</td>
<td>31.01</td>
</tr>
<tr>
<td>Greater than 9 and less than or equal to 12</td>
<td>1.21</td>
</tr>
<tr>
<td>Greater than 12</td>
<td>0.50</td>
</tr>
<tr>
<td><strong>Receivables balance (RMB)</strong></td>
<td></td>
</tr>
<tr>
<td>Less than or equal to 50,000</td>
<td>0.40</td>
</tr>
<tr>
<td>Greater than 50,000 and less than or equal to 100,000</td>
<td>9.71</td>
</tr>
<tr>
<td>Greater than 100,000 and less than or equal to 150,000</td>
<td>23.17</td>
</tr>
<tr>
<td>Greater than 150,000 and less than or equal to 200,000</td>
<td>23.86</td>
</tr>
<tr>
<td>Greater than 200,000 and less than or equal to 250,000</td>
<td>15.13</td>
</tr>
<tr>
<td>Greater than 250,000 and less than or equal to 300,000</td>
<td>10.85</td>
</tr>
<tr>
<td>Greater than 300,000 and less than or equal to 350,000</td>
<td>6.18</td>
</tr>
</tbody>
</table>
Table 2

Loan Pool Characteristics (% pool by outstanding principal balance) (cont.)

<table>
<thead>
<tr>
<th>Value of loans (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater than 350,000 and less than or equal to 400,000</td>
</tr>
<tr>
<td>Greater than 400,000</td>
</tr>
</tbody>
</table>

Car brand

<table>
<thead>
<tr>
<th>Car brand</th>
<th>Value of loans (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mercedes-Benz</td>
<td>100.00</td>
</tr>
</tbody>
</table>

The obligor concentrations for the initial collateral pool are set out in table 3.

Table 3

Obligor Concentrations (% Of Pool By Outstanding Receivables Balance)

| The largest obligor               | 0.02  |
| The largest 10 obligors          | 0.18  |
| The largest 20 obligors          | 0.30  |

Chart 2

Securitized loans
Borrower geographic distribution
Selective Eligibility Criteria

- Each loan receivable has been originated in China for the sale of a financed vehicle in the ordinary course of the originator’s business in compliance with the credit and collection policy;
- Each loan receivable is secured by a mortgage over the relevant financed vehicle;
- Each loan receivable is free of third-party rights, including any set-off rights, any defense, retention or revocation rights of the relevant obligor;
- Each loan receivable constitutes the legal, valid and binding obligations of the obligor(s), enforceable against the obligor(s) in accordance with its terms;
- The financed vehicles are classified as Mercedes-Benz or smart passenger cars or vans by MBAFC;
- Each financed vehicle to which such loan receivable relates is not a pre-owned vehicle;
- The interest rate applicable to each loan receivable is fixed, and the interest rate of the value-add loan portion (if any) of such loan receivable is not lower than the interest rate of the vehicle loan portion;
- Each loan receivable has a seasoning above one month and shall mature in less than 60 months;
- Each loan receivable is classified as "performing" according to the 5-grade NAFR classification;
- At origination, the relevant obligor is not an employee of MBAFC;
- At origination, each loan receivable has an LTV ratio equal to or lower than the then current maximum level permitted by regulations in China;
- No loan receivable is overdue and no loan receivable has been delinquent for more than 30 days in a row; and
- Each loan receivable is not a balloon loan receivable.

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 MBAFC, acting as the servicer in this transaction, can hold the collections for a period of one month before remittance to the SPT account.

A commingling reserve account will be established for this transaction with the account bank upon closing. The reserve will be topped up to an amount that equals to the amount of scheduled receivables instalments to be received by the servicer during the next monthly collection period (defined as "required commingling reserve amount") if the rating on the servicer is lowered to certain levels, based on local ratings agencies' scales.

In our view, the current transaction arrangement (such as uncertainty about the commingling reserve amount and rating triggers that do not include S&P Global Ratings’ ratings) 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 before collections could be
redirected to the SPT accounts or the accounts of the replacement servicer, when the original
servicer becomes insolvent. We have considered this one-month collection loss in our cash-flow
analysis of the transaction.

Set-Off Risk

We believe the obligor set-off risk in this transaction is remote because MBAFC is not an
authorized deposit-taking institution in China and the eligibility criteria require that the obligor is
not an employee of MBAFC at the time the loan was originated. In any event, the representations
and warranties provided by MBAFC in respect of the collateral pool include that the borrowers in
particular have no set-off claim thereto or thereunder the loans, or the status and enforceability of
the purchased loan receivables is not impaired by set-off rights.

Counterparty Risk With Respect To The Bank Account Provider

Issuer accounts for this transaction will be held with Industrial And Commercial Bank of China Ltd.
The bank will be replaced if the ratings on the bank are lower than 'A/A-1', within 30 calendar days
of the downgrade. This arrangement meets our counterparty criteria to support a 'AAA' rated
transaction, considering the transaction’s cash-flow arrangement.

Counterparty Risk With Respect To The Servicer

MBAFC cannot resign from its role as the initial servicer, but can be removed if a servicer
termination event occurs. Such an event might happen if MBAFC: (1) becomes insolvent; (2) fails to
remit collections to the issuer when due; (3) can't remedy its failure to perform material
obligations under the servicing agreement; (4) can't remedy a case of false or incorrect
representation or warranty in the servicing agreement or false or incorrect servicer report; (5) is
placed under business sanctions; or (6) is dissolved. The transaction does not have a back-up
servicer upon transaction closing, MBAFC as the servicer will be replaced following the occurrence
of a servicer termination event, and a noteholders' meeting will appoint a back-up servicer.

Prime auto transactions in other markets do not typically include back-up servicers upon
transaction closing, because of the high credit quality and homogeneous nature of the
receivables, combined with the availability of institutions experienced in servicing them. We
believe that in China the most likely servicer replacement would be other auto finance companies
or commercial banks that have a nationwide network for loan collections.

All loan payments in this transaction will be collected through the direct debit of borrowers’ cash
accounts in major national banks rather than by other, more demanding collection process. This
will reduce the workload of the servicer and make it easier to find a replacement. We have also
factored into our analysis a potential increase in servicer fees should a replacement servicer
require a higher return. The transaction includes a liquidity reserve that is funded up front and
could cover two to three months of transaction senior expenses and note interest should asset
collections be temporarily unavailable to meet the transaction obligations. In our view, this will
allow the transaction sufficient time to find a new servicer and resume asset collections.
Liquidity Support

Timely payment of senior expenses and rated note interest is supported by the use of principal collections through the combined waterfall, and a liquidity reserve funded at closing by MBAFC, at around RMB90.3 million or around 0.98% of the initial receivables balance.

The liquidity reserve is held in the general reserve account. It does not amortize and will be topped up to around RMB90.3 million through remaining proceeds available on each payment date. On each payment date, the trustee may draw funds in the general reserve account if asset collections are insufficient to cover the tax, if any, senior fees/expenses, and interest due to the rated notes.

Upon the full repayment of the class A notes, any balance remaining in the liquidity reserve will be distributed to the subordinated notes.

Interest Rate Risk

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

Credit And Cash-Flow 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 criteria titled, "Global Auto ABS Methodology And Assumptions," published March 31, 2022, to the credit risk analyses in this transaction.

Historical performance data

We received the following historical performance data for auto loan pools originated by MBAFC:

- Static pool data grouped by origination month, including detailed origination amounts, repayments every month, and delinquency track every month. The data included vintage performance data from January 2018 to March 2023.

- Dynamic pool data: aggregate loans amounts, repayments, and delinquency statistics for each month from January 2018 to March 2023.

The pay-out ratio for each vintage is depicted in chart 3.
MBAFC generally sets 90-plus and 180-plus days delinquencies for the recognition of loan defaults and loan losses, respectively.

In our credit-risk analysis, we assumed all loans delinquent for more than 90 days and loans that have been restructured would default, and used this classification to determine the base-case default frequency for the securitized pool. This assumption reflects the low stable cure rates—returning from delinquency to current—of loans overdue for more than 90 days, and the practical collection operations MBAFC adopts. MBAFC typically starts court processes and conducts vehicle repossession after loans become delinquent for 180 days. Our assessment also takes into account the comparison with the loans' performance in major peers in the China auto finance industry and MBAFC's customer and product features.

We assume that loans overdue for more than 180 days or charged off would be deemed as a loss. We use this as a benchmark to estimate the recovery after defaults for the collateral pool.

MBAFC may agree to restructure loans in early delinquency, most likely within 60 days, if it believes the likelihood of continued repayment on the loans could increase after the restructuring. In our view, restructured loans typically have a much higher likelihood of default eventually than non-restructured loans do. As a result, we include the then-outstanding amounts of loans upon restructuring into the calculation of defaults. We however exclude the then-outstanding amounts of these restructured loans from the default calculation if we believe such loans have been captured in the more-than-90-day-delinquent amounts.
Charts 4 and 5 illustrate the cumulative default and cumulative loss experience of MBAFC’s total auto loan portfolio, based on our assumptions of deemed default and deemed loss. The cumulative default and cumulative loss figures in Charts 4 and 5 might be higher than MBAFC’s actual loan performance due to such assumptions.

Chart 4

**Historical performance**

**Cumulative default rate**

![Cumulative default rate chart]

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Data limitations

There was a limit to the data we received in respect of the credit risk analysis for this transaction.

Relatively short operating history of China auto captive finance companies limits the availability of historical performance data under economic stress. More than five years of performance data are available for our credit risk analysis in this transaction. However, China has not experienced true macroeconomic stress during this period. This makes default and loss projections purely based on the historical performance data more difficult. We took into account the worse-performing vintages and focused on the recent performance trend when determining base-case default rates, and applied a higher stress multiple to reflect higher expected losses under stress conditions.

Base-case assumptions and stressed default and loss

Our base-case default assumption for the collateral pool is 0.8% based on the consistently strong and stable historical performance observed in the static pool and dynamic pool data, securitized pool characteristics, China’s macroeconomic conditions, peer comparison, and our observation of the originator’s underwriting and servicing capabilities.
We applied a stress multiple to the base-case default percentage in the 'AAA' rating category. The magnitude of the stress multiple that we applied reflects the respective rating levels on the notes, the underlying pool's revolving nature that could render a portfolio profile different from the initial pool, and our consideration of the relatively short development history of auto loan securitization in China. We have not observed any significant macroeconomic stress because the economic environment has been relatively benign in the past decade. We therefore applied a higher stress multiple.

We have taken into account the revolving period of 12 months and the relatively short remaining terms of the initially securitized loans in our analysis. We believe these factors help in making the risk exposure period of the transaction, or weighted-average life of the notes, relatively short.

We gave limited credit to recoveries. Our base-case recovery assumption for the collateral pool is 10.0%, which we derived from the migration analyses of the "deemed default" and "deemed loss" loans. For a 'AAA' rating stress scenario, we gave 50% credit to the 10% base-case expected recoveries to arrive at a loss severity assumption of 95%.

Table 4 shows a summary of the credit assessment.

<table>
<thead>
<tr>
<th>AAA</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Base-case default frequency (%)</td>
<td>0.8</td>
</tr>
<tr>
<td>Stress multiple used (x)</td>
<td>6.6</td>
</tr>
<tr>
<td>Default frequency (%)</td>
<td>5.3</td>
</tr>
<tr>
<td>Loss severity (%)</td>
<td>95.0</td>
</tr>
<tr>
<td>Minimum credit support after credit to recovery (%)</td>
<td>5.1</td>
</tr>
</tbody>
</table>

**Cash-flow analysis**

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 the rated notes. Our cash-flow analysis included various scenarios that reflect different combinations of the following factors:

- Level of defaults and recoveries commensurate with the rating level.
- Three different default curves: a front-loaded, back-loaded, and normal default curve. The curves we employed primarily reflected the default timing that we observed in MBAFC's static default curves.
- Recovery period (assumed to be nine months).
- Stressed fees and expenses upon servicer transition and unexpected expenses increase.
- The loss of one month of collections due to the potential commingling risk.
- Different prepayment rates.

For the prepayment rates, we modeled three different prepayment curves. The prepayment stresses assumed include voluntary prepayments. In addition to the normal constant prepayment rate (CPR) test that mimics MBAFC's historical prepayment behavior, we used a high CPR.
test--increasing to 15% annualized CPR under high CPR stress and a low CPR scenario (constant at 1%).

Table 5

**Assumed Constant Prepayment Rates (CPR)**

<table>
<thead>
<tr>
<th>Transaction seasoning</th>
<th>Normal CPR (% per year)</th>
<th>High CPR (% per year)</th>
<th>Low CPR (% per year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>5.0</td>
<td>4.0</td>
<td>1.0</td>
</tr>
<tr>
<td>2</td>
<td>5.0</td>
<td>6.0</td>
<td>1.0</td>
</tr>
<tr>
<td>3</td>
<td>5.0</td>
<td>8.0</td>
<td>1.0</td>
</tr>
<tr>
<td>4</td>
<td>5.0</td>
<td>10.0</td>
<td>1.0</td>
</tr>
<tr>
<td>5</td>
<td>5.0</td>
<td>12.0</td>
<td>1.0</td>
</tr>
<tr>
<td>6</td>
<td>5.0</td>
<td>14.0</td>
<td>1.0</td>
</tr>
<tr>
<td>7+</td>
<td>5.0</td>
<td>15.0</td>
<td>1.0</td>
</tr>
</tbody>
</table>

The transaction can pass all of the scenarios that we analyzed in our cash-flow adequacy tests. Some of the noteworthy features of the transaction cash flows are as follows:

- Credit support for the class A notes is provided by the subordination of the subordinated notes, overcollateralization, and a portion of the YSOC. The subordinated notes will never be paid before the class A notes are paid in full. As a result, the credit support from the subordinated notes for the class A notes will remain at a fixed amount and increase in percentage as the class A notes are gradually paid down.

- However, the notional amount of YSOC will amortize according to the schedule, and collections from YSOC will be treated as excess spread and used to cover negative carry and then pay down the class A notes only if the asset pool becomes under-collateralized due to commingling losses or credit losses. Otherwise, collections from YSOC assets will be used to cover indemnity expenses or released to the originator.

- Should credit losses or commingling losses occur at a later stage of the transaction's life when the majority of the YSOC has been released or used to cover negative carry, the adequacy of the YSOC to cover commingling losses and credit losses would decrease. However, the risk of such potential leakage of principal collections from the YSOC is mitigated by sufficient credit support from the subordinated notes and the overcollateralization.

**Sensitivity Analysis**

We cash-flow modeled two additional scenarios to determine how vulnerable the notes would be to a downgrade under each scenario:

- Scenario 1: Base-case default frequency is 25% higher than our expected level of 0.8%.
- Scenario 2: Base recoveries are only 75% of our expected base recovery rate of 10%.

The minimum credit support under each scenario is set out in table 6.
Table 6

Minimum Credit Support After Credit To Recovery (%)

<table>
<thead>
<tr>
<th>Scenario</th>
<th>AAA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected</td>
<td>5.1</td>
</tr>
<tr>
<td>Scenario 1</td>
<td>6.3</td>
</tr>
<tr>
<td>Scenario 2</td>
<td>5.1</td>
</tr>
</tbody>
</table>

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

Table 7

Rating Transition

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Class A notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected</td>
<td>AAA (sf)</td>
</tr>
<tr>
<td>Scenario 1</td>
<td>AAA (sf)</td>
</tr>
<tr>
<td>Scenario 2</td>
<td>AAA (sf)</td>
</tr>
</tbody>
</table>

Related Criteria

- Criteria | Structured Finance | ABS: Global Auto ABS Methodology And Assumptions , March 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions , March 8, 2019
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology , March 29, 2017
- 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: ABS And RMBS Tracker July 2023, Aug. 30, 2023
- China Securitization Performance Watch 2Q 2023: Issuance Continues At A Slow Pace, Aug. 11, 2023
- S&P Global Ratings Definitions, June 9, 2023
- China Structured Finance Outlook 2023: Issuance Likely To Slowly Stir, Jan. 12, 2023
- A Primer On China's Auto Loan Asset-Backed Securities Market, April 28, 2022
- ESG Industry Report Card: Auto Asset-Backed Securities, March 31, 2021

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.