

Second Party Opinion

Tricolor Auto Acceptance Social ABS Framework

April 19, 2022

Tricolor Auto Acceptance (Tricolor) is an integrated retail automotive and consumer lending platform that offers financing in the form of auto loans to low-income borrowers or those with no or limited credit history. Established in 2007 and headquartered in Dallas, Texas, Tricolor and its affiliate Ganas Auto Group operate 50 retail dealerships across 20 markets in Texas, California, Nevada, and Arizona, with a shared services center in Guadalajara, Mexico. In 2019, Tricolor became the only auto asset-backed securities (ABS) issuer to be designated by the U.S. Treasury as a community development financial institution (CDFI).

In our view, "Tricolor Social ABS Framework," published April 19, 2022, is aligned with:

 Social Bond Principles, ICMA, 2021

The Framework Alignment Opinion ("our alignment opinion") does not assess the alignment of any individual transaction with International Capital Market Association's (ICMA) Social Bond Principles (SBP).

Issuer's Sustainability Objectives

Tricolor's core purpose is to sell and finance relatively affordable used vehicles to low-income and credit-invisible individuals, the latter referring to borrowers with no or limited credit history. Tricolor focuses its efforts on a U.S.-residing Hispanic market due to the group's disproportionately limited access to affordable credit, which often prevents entrance into the financial mainstream. The company also aims to support its borrowers' reliance on vehicle-centric mobility, which is tied to limited remote employment opportunities. As part of its purpose-driven strategy, Tricolor has successfully helped build a credit score with a major bureau for its credit invisible borrowers. As of March 2022, Tricolor reported a track record of supporting 28% of all borrowers to establish a credit history.

To further align its activities with its social objectives, Tricolor developed a Social ABS Framework, through which it will enable its target population's access to auto lending services. With the program, Tricolor strives to advance socioeconomic progress through financing opportunities that aim to reduce income inequality for its borrowers.

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Second Party Opinion Summary

Use of proceeds

Alignment  Tricolor's Social ABS Framework is aligned with this component of the SBP.

Score Not aligned Aligned **Strong** Advanced

The framework specifies that the net proceeds of social bonds issued under its remit will be allocated solely to purchase loans for its target population, which comprise individuals with low-income or have little to no established credit.


Process for project evaluation and selection

Alignment  Tricolor's Social ABS Framework is aligned with this component of the SBP.

Score Not aligned Aligned **Strong** Advanced

The framework outlines a clear process for the selection of qualifying loans by the company's Credit Risk Committee, which consists of senior executives at the company. The eligibility criteria specified in the framework includes borrowers' lack of a FICO score or having net income that falls at or below 80% of the median county income or 200% of the federal poverty threshold, a standard maintained by the Federal Housing Finance Agency (FHFA).

Management of proceeds

Alignment  Tricolor's Social ABS Framework is aligned with this component of the SBP.

Tricolor is committed to tracking and managing the net proceeds from social bonds issued under its framework, which will be allocated to eligible loans originated within a three-year look-back period and for new loans added after closing within a three-month prefunding period. For both loan types, Tricolor commits to managing and monitoring the eligible portfolio via its Credit Risk Committee to ensure the portfolio remains in line with the eligibility criteria.

Reporting

Alignment  Tricolor's Social ABS Framework is aligned with this component of the SBP.


Score Not aligned Aligned **Strong** Advanced

Tricolor commits to complete annual and quarterly reports on the allocation of proceeds and the expected and actual impact, respectively, until full allocation. The reports will be made available on its website. The company also commits to an external third-party verification regarding its allocation of net proceeds.

Framework Assessment

Use of proceeds

The Principles make optional recommendations for stronger structuring practices, which inform our alignment opinion as aligned, strong, or advanced. For use of proceeds, we consider the commitments and clarity on how the proceeds are used.

 Tricolor's Social ABS Framework is aligned with this component of the SBP.

Commitments score

Not aligned

Aligned

Strong

Advanced

We consider Tricolor's overall use of the proceeds from the commitments to be strong.


Tricolor clearly commits to using 100% of the net proceeds issued under its framework to acquire subprime auto loans originated to its target population. The social bonds will be issued by a special-purpose vehicle (SPV) as part of Tricolor's securitization program. The social bond net proceeds will be allocated solely to the purchase of auto loans for low-income or credit-invisible borrowers in the target population to promote financial inclusion and advance social mobility. Tricolor uses a direct-to-consumer AI-driven platform and data analytics to identify and engage borrowers who are less likely to default on their loans, allowing the company to offer lower interest rates compared to its subprime auto lending peers.

Tricolor commits to disclose the proportion of net proceeds that will be used for eligible loans in the three-year look-back period and the three-month prefunding period--the latter of which is not expected to exceed a quarter of each transaction's total proceeds. Each eligible loan must follow the same eligibility criteria laid out in the framework.

We believe the eligible loan criteria included in the framework spans social themes of access to essential services and socioeconomic advancement and empowerment, which are two categories identified by the SBP.

Process for project evaluation and selection

The Principles make optional recommendations for stronger structuring practices, which inform our alignment opinion as aligned, strong, or advanced. For our project selection and evaluation processes, we consider the commitments and clarity on the process Tricolor uses to evaluate and select eligible projects to fund with the proceeds of the sustainable finance instrument.

 Tricolor's Social ABS Framework is aligned with this component of the SBP.

Commitments score

Not aligned

Aligned

Strong

Advanced

We consider Tricolor's overall process for project evaluation and selection commitments to be strong.

Tricolor's ABS Social Bond Framework clearly outlines the process by which it selects eligible loans. To this end, the company has designated a Credit Risk Committee, which consists of the company's chief executive officer, chief financial officer, chief credit officer, and other senior executives who are responsible for the framework's management, including ensuring that assets comply with the eligibility criteria. The eligible loans must be to borrowers who lack a FICO score or are considered low-income, which is defined as earning less than or equal to 80% of the median county income or less than or equal to 200% of the federal poverty threshold.

Tricolor also identifies its social and environmental risk-management processes for providing subprime auto loans to lower-income borrowers. The issuer acknowledges that its target population is more likely to be unprepared for financial emergencies and default on their loans as a result, which may increase susceptibility to a predatory lending cycle. It also acknowledges that used vehicles sold and financed in the subprime auto lending sector do not always meet regulatory emission guidelines. Tricolor manages these risks by providing its borrowers with


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inspected and reconditioned vehicles that have less accrued mileage on average than its peers, and through careful observation of federal and state-level regulation and emission standards.

Finally, although the borrowers meet the eligibility criteria at the point of loan origination, Tricolor does not ensure the eligibility criteria are met at the time of debt issuance due to the inherent complexity of securitized loans. We view this as a weakness but acknowledge that it is partly mitigated by the issuer's ongoing review of the borrowers' credit scores over the life of the loans.

Management of proceeds


The Principles require disclosure of the issuer's management of proceeds from sustainable finance over the life of the funding. Our alignment opinion focuses on how clearly the issuer's commitment is stated in the documentation to ensure that the funds raised will remain dedicated to eligible sustainability projects throughout the life of the sustainable finance funding.

 Tricolor's Social ABS Framework is aligned with this component of the SBP.

Tricolor is committed to tracking the allocation of net proceeds from future social bond issuances and disclosing those allocations in its annual sustainability report. Most of the net proceeds from the social bond issuances will be immediately allocated to acquire loans defined as eligible during the 36-month look-back period. Any remaining bond proceeds will be deposited into a segregated account that is held and managed by a third-party trustee. Those proceeds will then be used to purchase newly originated eligible loans during the three-month prefunding period, which the framework guarantees will not exceed more than 25% of the total allocation. The framework notes that Tricolor's Credit Risk Committee will track and monitor the bond proceeds to ensure that the loans acquired during the prefunding period meet the stated eligibility criteria.

Reporting

The Principles make optional recommendations for stronger disclosure practices, which inform our disclosure opinion as aligned, strong, or advanced. We consider plans for updates on the sustainability performance of the issuer for general-purpose funding, or the sustainability performance of the financed projects over the lifetime of any dedicated funding, including any commitments to post-issuance reporting.

 Tricolor's Social ABS Framework is aligned with this component of the SBP.

Disclosure score

Not aligned

Aligned

Strong

Advanced

We consider Tricolor's overall reporting commitments to be strong.

Tricolor commits to annual and quarterly reporting on the respective allocation and impact of the social bond proceeds until full allocation, with reporting made available on Tricolor's website. An external reviewer will verify the allocation of the social bond proceeds, which we view as a strong practice. The annual report will include the amount of unallocated net proceeds from the sale of any social bonds at the end of the reporting period. It will also include details on the expected and actual borrower profile characteristics, as well as metrics such as the percentage of borrowers who meet the stated eligibility criteria and receive complementary vehicle warranties.

The company also commits to report the proportion of eligible borrowers who develop a credit score with a major credit bureau after obtaining a Tricolor loan, a performance indicator that is intended to demonstrate Tricolor's support of improved financial inclusion and socioeconomic empowerment of its target population. The company tracks these metrics through individual loan-level data files and with updated credit scores that it receives from a partnership with a major credit bureau. We note that this type of measurement is difficult for many securitized bond issuers, making it a strong feature of the framework.

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Mapping To The U.N.'s Sustainable Development Goals

The Sustainable Development Goals (SDGs), which the United Nations (U.N.) established in 2015, form an agenda for achieving sustainable development by 2030.

We use the ICMA's SDG mapping for this part of the report. We acknowledge that ICMA's mapping does not provide an exhaustive list of SDGs and that ICMA recommends each project category be reviewed individually to map it to the relevant SDGs.

Tricolor's ABS Social Bond Framework intends to contribute to the following SDGs:

Use of proceeds

SDGs

Access to Essential Services



1. No poverty



10. Reduced inequalities

Socioeconomic Advancement and Empowerment



8. Decent work and economic growth



10. Reduced inequalities



1. No poverty

*The eligible project categories link to these SDGs in the ICMA mapping.

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