

RMBS Special Servicer
Thailand
Servicer Report

Capital Advisory Services (Thailand) Limited

Ratings



^a Denotes its relevance in Thailand's legal, economic and social context

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Related Research

- *Thai Servicers Rating Criteria (June 2008)*
- *Global Rating Criteria for Structured Finance Servicers (August 2010)*

Summary

Fitch Ratings (Thailand) Limited has affirmed Capital Advisory Services (Thailand) Limited's (CAS) Residential Mortgage Special Servicer rating at 'RSS2(tha)'.

The affirmation is based on CAS's strong servicing capabilities supported by relatively stable and experienced senior and middle management, a highly efficient IT platform for servicing, and satisfactory performance in managing and collecting residential non-performing loan (NPL) portfolios in Thailand. While CAS's business prospects remain weak – no new portfolios have been entrusted since H208 and it experienced a high staff turnover rate in its asset management division in 2009 – the agency notes that these factors are offset by an improvement in the risk control area following CAS's increasing local participation in risk management and internal audit processes. In addition, CAS's existing financial position and continued cost control measures should allow the company to weather the business downturn over the next 12 months.

CAS's major challenges remain the uncertainty over the continuation of its servicing contracts for NPL portfolios owned by entities related to Lehman Brothers (Lehman) (from which the majority of CAS's revenue is generated) as well as its ability to secure new servicing business. At present, the aforementioned portfolios are in the process of being sold, while still being serviced by CAS. Despite the upcoming change in the portfolios' owner, Fitch believes that CAS has a high possibility of continuing to service the portfolios, due to its servicing expertise and long experience with the portfolios (as well as the scarcity of servicers for third-party investors in Thailand). Nonetheless, should the new owner discontinue the servicing by CAS and the latter is unable to secure new business, CAS's Residential Special Servicing (RSS) rating is likely to face negative rating action.

Strengths

- Relatively stable and experienced senior and middle management.
- Highly efficient IT platform for servicing and satisfactory historical performance in managing and collecting residential NPL portfolios in Thailand.
- Increasing local participation in risk management and internal audit processes.

Challenges

- To maintain existing servicing portfolios as well as securing new businesses.
- To keep the size of the company (in terms of number of staff) consistent with expected future business volume, without impacting servicing ability.

Approach to Challenges/Mitigants

- CAS's established servicing expertise, its familiarity, and its strong performance track record with the NPL portfolios currently serviced by the company are its key advantages in maintaining existing servicing portfolios. In early 2010, CAS set up a business development division to increase the focus on new business generation. The company has provided due diligence services and other services to several new clients
- While CAS has been downsizing its operation over the past two years, the company has been able to maintain key managers and employees. The measures

CAS has implemented to improve employee satisfaction include: a recent change in organisational structure to increase layers within the company (which allows more employee promotion); discretionary bonus; and continued training.

Company Overview and Strategy

Established in 2000, CAS is the second-largest subsidiary of the Capital Services Holding Corporation (CSHC). CSHC operates Capital Services Group (CSG), consisting of subsidiaries engaged in loan servicing and real estate asset management businesses in Asia. CAS's sister company in Japan – Capital Servicing Co., Ltd (CSC, rated 'CSS1-(JPN)') – is CSHC's largest subsidiary, providing primary and special servicing in the field of commercial mortgage portfolios. Since its inception, CAS had been the main special servicer of residential NPL portfolios for Lehman's investments in Thailand. The company also provided an asset management service to part of Lehman's real estate investments (REI) in Thailand.

Despite the bankruptcy of Lehman in September 2008, CAS has continued to service the residential NPL portfolios owned by Lehman's subsidiaries, Global Thai Property Fund (GTPF) and Palarp Asset Management Company (PAMCO). CAS has been servicing four Thai residential NPL portfolios (transferred from different entities) with the latest two portfolios entrusted in late 2007; all four portfolios are owned by GTPF and PAMCO. As of March 2010, the unpaid principal balance (UPB) of the residential NPL portfolios was THB12.8bn (which was approximately 52% of the peak balance at end-2000), involving over 8,700 loans.

The aforementioned residential NPL portfolios are in the process of being sold by the court-appointed administrator of Lehman. Despite the upcoming change in the portfolios' owner, Fitch believes that CAS has a high possibility of continuing to service the portfolios, due to its servicing expertise and long experience with the portfolios (combined with the scarcity of servicers for third-party investors in Thailand). Should CAS be unable to secure new business while its existing NPL services are discontinued, its RSS rating is likely to be negatively affected.

Year-End UPB of NPL Portfolios Serviced by CAS

(THBm)	Portfolio								Total portfolios	
	FRA		TDB		SCB		BAY			
	No. of loans	UPB	No. of loans	UPB	No. of loans	UPB	No. of loans	UPB	No. of loans	UPB
2000	11,930	16,599	6,295	8,275					18,225	24,874
2001	9,810	13,595	5,873	7,764					15,683	21,359
2002	8,127	11,055	5,301	6,982					13,428	18,037
2003	6,620	9,012	4,501	6,176					11,121	15,188
2004	5,943	6,955	4,263	5,619					10,206	12,574
2005	4,864	5,726	3,504	4,464					8,368	10,190
2006	4,303	5,311	3,324	4,377					7,627	9,688
2007	3,758	4,691	3,044	4,072	1,509	4,330	2,482	3,473	10,793	16,566
2008	3,425	4,349	2,867	3,870	1,316	3,468	2,037	2,886	9,645	14,573
2009	3,239	3,963	2,764	3,756	1,156	2,908	1,729	2,407	8,888	13,033
Q110	3,203	3,922	2,723	3,717	1,124	2,856	1,683	2,315	8,733	12,811

Source: CAS

CAS has indicated its strategy to grow as an independent servicer, although no new NPL servicing agreements have been secured since Lehman's bankruptcy. This is partly due to lower activities in the Thai NPL markets, as well as the stronger presence of government-owned asset management companies (which have their own servicing capabilities) in bidding for NPL portfolios. In February 2010, CAS set up a business development division to increase the focus on new business generation. The company holds business development meetings on a bi-weekly basis where it updates the status of business developments and discusses revenue and profit generation. Participants include senior management and business line managers.

CAS has provided due diligence services for several potential NPL portfolio investors, as well as diversifying its businesses into property brokerage and Management Information System (MIS) services. Revenue contribution from the non-servicing activities remains low at approximately 10% of the company's total revenue. Besides diversifying into new businesses, CAS will continue its cost-saving measures to weather the anticipated business slowdown.

Financial Condition

CAS's servicing income declined by 17% yoy to THB173.1m in 2009, mainly because no new NPL portfolios were added. Despite falling asset management and due diligence fees and higher bad debt expenses (partly related to its sister company in Malaysia), CAS reported a net profit of THB5.3m in 2009, improving from a THB9.3m loss in 2008. CAS's improvement in profitability was mainly due to: a large increase in disposition fees resulting from the REO sales; higher other income from additional advisory services; a large headcount reduction (personnel expenses declined 31% yoy); lower inter-company charges; and the absence of FX losses (versus a THB7.2m FX loss in 2008).

CAS forecasts its profitability to further improve in 2010, despite an expected further decline in servicing income. The main supporting factors for this are its cost-cutting measures – through lower personnel expenses and inter-company charges (as CAS continues to downsize its operation) – as well as expected lower bad debt expenses and lower withholding tax charges (related to inter-company transactions). The company's financial projection is based on CAS continuing to service the existing NPL portfolios, from which almost 60% of its total revenue is generated. Any deviation from this assumption will significantly impact CAS's profitability and financial position.

CAS's cash position remained strong at end-2009, with THB150m cash and cash equivalent. Its shareholders' equity increased slightly to THB163m at end-2009, due to the profit made during the year. As a pure servicing provider, CAS has no borrowings. At end-2009, its major liabilities included THB66.4m due to customers (covered by CAS's restricted bank deposits) and THB36.4m of account payables owed to related companies. Its equity-to-asset ratio (net of investor cash) increased to 74% at end-2009, from 59% at end-2008. Despite the expected decline in its revenue, CAS believes it should be able to maintain a strong financial position over the next 12 months, partly supported by its continued cost cutting measures. Owing to its strong liquidity position, CAS was able to lend THB97.4m to its parent (CSHC) during H110; the loan tenors are six months and one year with renewable options. CSHC used the loan proceeds to fund its new investments.

Four-Year Financials

(THBm)	2006	2007	2008	2009
Total revenue	236.6	205.8	215.0	187.1
Net income	34.1	4.6	-9.3	5.3
Shareholders' equity	162.9	167.5	158.1	163.4
Equity-to-asset ratio, net of investors' cash (%)	62.3	64.3	58.9	73.5

Source: CAS

Employees and Training

In early 2010, CAS re-organised its business structure to increase the layers within the company; it did so by dividing its operations into three key divisions, namely loan management, real estate investment, and finance and support. The newly set-up loan management division oversees asset management, asset administration and operations functions. The marketing and sales as well as valuation and property inspection functions have been moved into the real estate investment division, which also oversees investors' investments in hospitality, commercial building management and structured loan servicing.

Given the absence of new NPL portfolio entrustment since H208, CAS's permanent staff declined to 48 at end-July 2010, from 57 at end-2009 and 77 at end-2008. The number of permanent staff in the loan management division was 16 at end-July 2010, down from 19 at end-2009 and 25 at end-2008. In 2009, there were 20 leavers (11 resignations, eight lay-offs and one transfer). Six resignations were related to NPL staff. During the first seven months of 2010, there were 11 leavers (five resignations and six lay-offs) and two new joiners. No resignations were related to NPL staff.

Staffing

Division	Dec 2008	Dec 2009	Jul 2010
Management	1	1	1
Business development	0	0	2
Legal	2	1	2
Management reporting	4	2	1
Loan management division	0	0	1
Asset administration	8	6	4
Asset management	12	9	7
Operations	5	4	4
Finance and support division	0	0	1
Finance and accounting	9	8	9
HR and administration	4	3	3
IT	3	1	0
Real estate investment division	0	0	1
Marketing and sales	11	7	6
Commercial building management	0	0	2
Valuation and property inspection	6	5	4
Portfolio management	1	1	0
REI	10	8	0
Structured loan servicing	1	1	0
Total	77	57	48

Source: CAS

Due to the relocation of the former managing director, the former head of the portfolio management division was promoted to the role of managing director in early 2010. Fitch does not expect any operational disruptions, as the new managing director has been with CAS since the company's inception and has been actively supervising the portfolio management function. The former head of the asset management department (who has been with CAS for five years and has 17 years of relevant industry experience) was promoted to head the loan management division.

The four middle managers in the loan management division and real estate investment division have, on average, almost 14 years of industry experience and seven years with CAS. Almost 90% of its permanent staff has more than three years of service with the company. CAS now outsources all IT functions, with one outsourced IT staff stationed at its office. Despite an increase in staff turnover after the Lehman's bankruptcy in late 2008, CAS has been able to retain key managers and staff. CAS does not expect any major lay-offs for the remainder of this year, provided that it continues to service the existing NPL portfolios.

As regards maintaining the quality of its staff, Fitch continues to view CAS's measures as adequate, despite difficulties following Lehman's bankruptcy. The company continues to emphasise the importance of staff training. Average training hours per employee were 41.4 for 2009, with internal training hours increased significantly (partly due to cost saving measures). Nonetheless, external training still accounted for the majority of training hours (65%). In 2010, the company has maintained its target of 40 hours training per employee; since 2007, CAS's average actual training hours per employee have exceeded 40 hours.

CAS promoted two staff during 2009 and seven during H110, the latter mainly reflecting CAS's revised organisational structure. The company's basic policy of maintaining adequate staff by effective training and internal promotions remains unchanged.

Policies and Procedures/Internal Control

Through the establishment of its own risk management committee (Thailand Risk Management Committee, TRMC) and the appointment of its staff as the internal audit officer for Southeast Asia (covering Thailand and the Philippines) since 2009, CAS has increased local participation and self-reliance in terms of risk management and internal audit. TRMC members include senior/middle management from CAS and participants from CSHC.

CAS's risk management framework is based on the structure developed by the risk management committee at CSHC (CSHC-RMC). TRMC conducts risk assessments annually to identify, prioritise, analyse and initiate mitigation strategies for risks that could potentially have a significant impact on CAS's operations. The status update of existing risks and the identification of new risks are discussed among TRMC members on a monthly basis. Minutes of the meetings are forwarded to CSHC's board of directors (which provide feedback).

CAS has a comprehensive set of policies and procedures, which can be accessed online. In 2010, CAS added three new procedures and updated 84 procedures.

CAS's internal audit was previously conducted by the internal audit officer of CSHC. Since 2009, a CAS staff member has been the internal audit officer for South East Asia and has assumed the internal audit work for CAS and its sister company in the Philippines. The internal audit officer has been working with the company since 2001 in the finance and accounting division, with prior experience in auditing.

CAS's internal audit approach is based on the internal audit programme used by its Japanese sister company and incorporates CAS's unique business processes. The scope of the internal audit is proposed by TRMC and approved by CSHC's board of directors. It includes company-level controls, client and corporate operations, and fraud risk mitigation.

The internal audit is conducted semi-annually, with an internal audit report approved by CAS's managing director, CSHC's board of directors, the chairman of CSHC-RMC, and the internal audit officer of CSHC. The internal audit results for H109 and H209 showed some minor deficiencies in company-level controls (ie approval matrix had not been updated to reflect personnel changes) and in client and corporate operations (ie the internal custodian service); these deficiencies were subsequently remedied. There were no exceptions as regards fraud risk mitigation. The internal audit is now conducted by CAS's local staff and Fitch believes this should improve overall local compliance and on-time audits, as per its schedule.

CAS's first internal IT audit was conducted by the group's regional IT security officer in 2008. The internal IT audit now involves a coordinated approach between the regional IT security officer and CAS's outsourced IT security officer on a semi-annual basis. The IT audit for M909 revealed some minor deficiencies which were noted and remedied. CAS continues to review its principal third-party outsourced servicers, including deficiency claim servicers, external brokerage and external custodian servicers. CAS is subject to both a stand-alone statutory audit and a US GAAP consolidated group audit at the parent company level. Both audits are performed by Ernst & Young. CAS received an unqualified opinion on its stand-alone FY09 financial statement.

Technology

There has been no significant change to CAS's technology strategy since the last review. CAS has been using the group's internally-developed loan servicing system – the Servicing Company Operating and Reporting Engine (SCORE) – as its main technology platform. SCORE is a web-based loan management solution that provides fully integrated servicing and reporting functions. The system is designed for global servicing capabilities with multi-language, multi-currency and multi-product functionality. CSHC also set up a subsidiary in Singapore to own, develop and commercialise SCORE for third-party clients. SCORE has been licensed to third parties in several countries.

In line with the group's policy, CAS has continually upgraded the SCORE platform to increase operational efficiency and remain competitive. In 2009, CAS added new features including online business plan generation and tracking, online resolution approval, online action approval memo generation and tracking, as well as an online scenario engine.

Besides SCORE, CAS also maintains its local marketing and sales platform – Capital Real Estate Website (CREW) – which contains information on properties for sale and auction events for retail investors. CAS also uses CREW to track property sales, title deeds, and property inspections. The level of automation is high as regards functions such as asset management, asset administration, operations, as well as marketing and sales (via the use of SCORE and CREW).

All SCORE data is stored at CSC's servers in Tokyo via a virtual private network (VPN) and backed up at CSC's Osaka business continuity plan (BCP) site. Besides data backup via CSC, CAS also has a BCP site in Bangkok, where its local server data is backed up via an automated tape back-up system. In September 2010, CAS changed its local BCP site to one on the outskirts of Bangkok, in order to avoid potential political protests which tend to take place in the central business district (CBD). CAS's previous local BCP site was close to its office, which is in the CBD area and was closed during the political protests in May 2010. Fitch views the change of local BCP site positively, as the provider of the new BCP site is the subsidiary of a major telecoms firm in Thailand and appears to be fully equipped.

The current SCORE and file server average capacity usage is 40% and 68%, respectively. System capacity is monitored and maintained at 80% thresholds for the main servers. CAS conducted a disaster recovery test and an emergency calling tree in Q210 with a 100% success rate. CAS now outsources all IT functions, with one outsourced IT staff stationed at its office and working closely with the regional IT officer.

Special Servicing

The servicing functionalities are largely handled by four departments, namely asset management, asset administration (including operations), valuation and property inspection, and marketing and sales. Supporting functions are mainly provided by the finance and support division, the legal department and the management reporting department. The loan administration and default management process remains largely unchanged from the previous year and is listed in the Loan Administration and Default Management table.

Loan Administration and Default Management

Key Departments	Responsibility
Asset management	Formulate strategies and conduct negotiation to maximise collections
Asset administration	Monitor and direct litigation and deficiencies collections conducted by external law firms
Operations	Conduct agreement signing, mortgage transfer/release
Valuation and property inspection	Inspect properties, review third-party appraisal, manage property maintenance, conduct in-house valuation and analysis
Marketing and sales	Manage marketing, conduct in-house sales and oversee third-party broker performance

Source: CAS

CAS’s senior and middle management are well-experienced. Although CAS has recently changed its organisational structure, increasing the layers within the company, the senior management still efficiently oversees the day-to-day operations.

The company outsources several servicing functions to local sub-servicers and service providers; these include cash collections, deficiency claim servicing, legal document custody, sales brokers and property management for REO properties. The performances of those sub-servicers and servicer providers are monitored by the relevant groups within CAS.

Loan Administration

CAS’s loan administration process is highly automated and based on the SCORE system. The company has clear guidelines on loan administration processes, while tasks performed by outsourced sub-servicers and service providers are reviewed by the relevant groups within CAS. The new portfolio set-up processes involve the following key steps:

- electronically upload portfolio and collection data to SCORE;
- litigation monitoring by assigning cases to law firms;
- handle original documents, transfer of credit and legal files, mortgage transfer; and
- send out notices of assignment to borrowers.

Loans that do not meet the requirements of the sales and purchase agreements are submitted to the investor for consideration, to be put back to the seller. The timing of the new portfolio set-up process depends on the completeness of data. CAS indicates that the company is able to finish the system set-up within one week from receipt of the complete set of final data. CAS’s most recent residential NPL portfolio entrustment was in late 2007; the portfolio set-up process took longer than expected, due to further seller and buyer negotiation.

Defaulted Loan Management

After the completion of the portfolio set-up process, CAS’s workout strategy for defaulted loans involves conducting litigation in parallel with negotiation. This is partly due to Thailand’s time-consuming litigation process and the expected influence ongoing litigation will have on a borrower’s propensity to negotiate. Fitch views that internal competition between departments that handle litigation and negotiation enhances CAS’s overall collection efficiency and helps maximise investor returns. Written approval is required to hold back litigation.

Borrower negotiation is handled by the asset management department. Loans are allocated equally across team members, based on criteria such as whether offers are made by the borrowers, whether the borrowers are contactable, the status of litigation and the geographical distribution of borrowers. The team manager conducts portfolio reshuffles semi-annually to increase collection efficiency.

CAS has clear guidelines on the resolution amount and approach (depending on collateral value, litigation timing and borrowers' financial status) and borrower contact (including call frequency and method of negotiation). The company's resolution approach includes payoffs, discounted payoffs, loan restructuring, loan sales, deed-in-lieu/voluntary surrender of collateral and guaranty release. Asset managers are required to update the borrower contact log on a daily basis while the team manager reviews the SCORE communication log at least twice a month. The team holds weekly meetings to share ideas, problems and solutions.

As of July 2010, the asset management department consisted of the team manager, four asset managers, a skip tracer and an administrator. The team manager sets up individual and team collection targets, which are monitored through monthly reports and used to determine the bonus/commission rate of individuals and the team. Given the shrinking loan portfolio, each asset manager handled approximately 270 residential loans (including about 70 post-auction loans, which are normally inactive) as of May 2010. CAS indicates that each manager generally is able to handle up to 330 loans.

Litigation is handled by the asset administration department, which monitors and directs litigation proceedings and deficiency claim collections (which are outsourced to external law firms). CAS currently uses 15 outsourced law firms. The asset administration department also works closely with the execution office to promote auction sales. Litigation is monitored through a monthly litigation monitoring report, which contains information on litigation aging and movement, as well as exceptional legal cases. As of March 2010, almost 1,700 loans (representing about 20% of total loans) were in various stages of the litigation process, of which 97% were in the post-judgment stage. The asset administration department consisted of the team manager and three staff, as of July 2010.

The auction of properties is marketed by the marketing and sales department, which is also responsible for the sale and marketing of properties in REO, conducting in-house sales promotions, as well as overseeing third-party broker performance. Its main marketing and sales platform is CREW, which contains information on properties for sale and auction events for retail investors. CAS also uses outside property brokerage firms to market the REO properties. Meanwhile, the valuation and property inspection department is in charge of property maintenance, with most of the inspection/renovation field work outsourced to managing brokers.

Overall, CAS has achieved high collection efficiency, with an annual collection-to-UPB ratio of over 100% in 2009 and Q110. The average ratio of collection amount-to-corresponding-UPB for each resolution method since inception was 127% for restructuring, 114% for full payoffs, 92% for discounted payoffs, 91% for auction and 98% for REO sales.

CAS's senior management closely monitors the day-to-day administration and servicing of the portfolios through the SCORE system, conducting surveillance, operational reporting and regular portfolio review meetings. The head of the asset management department is actively involved in this process and makes decisions related to collection/resolution activities. Fitch views that the level of internal communications, as well as the clear policies and procedures as regards operations, supports CAS's collection efficiency.

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