

# Credit Guarantee and Investment Facility

## Full Rating Report

### Rating

National Insurer Financial Strength Rating	AAA(idn)
National Long-Term Rating	AAA(idn)

### Sovereign Risk (Indonesia)

Long-Term Foreign-Currency IDR	BBB-
Long-Term Local-Currency IDR	BBB-

### Outlook

National Insurer Financial Strength Rating	Stable
National Long-Term Rating	Stable
Sovereign Long-Term Foreign-Currency IDR	Positive
Sovereign Long-Term Local-Currency IDR	Positive

### Credit Guarantee and Investment Facility

	31 Dec 16
Total equity (USDm)	728
Total assets (USDm)	772
Total equity/total assets (%)	94.2
Guarantee exposure <sup>a</sup> /total equity (x)	1.16

<sup>a</sup> After-reinsurance

### Key Rating Drivers

**Leverage to Remain Manageable:** Fitch Ratings Indonesia expects Credit Guarantee and Investment Facility (CGIF) to judiciously manage its net-par-to-capital leverage as its guarantee portfolio grows. CGIF's net-par-to-capital leverage, defined as the ratio of the total amount of outstanding guarantee exposure after reinsurance relative to CGIF's members' equity, stood at 1.16x at end-2016. Fitch expects CGIF to keep its net-par-to-capital leverage at or below 2.0x.

**Extremely Prudent Investment Strategy:** CGIF invests only in fixed-income securities with maturities of more than a year that are rated at least 'AA-' on an international scale. Its investments in short-term fixed-income instruments cannot be lower than 'F1' on Fitch's rating scale. It cannot invest in the assets it guarantees.

**Relatively Short Track Record:** The profile of CGIF presents far less certainty than that of a company with an established track record of financial and operational success. This limits CGIF's ratings under Fitch's criteria, although this is not fully applicable in CGIF's case.

**High-Risk-Insured Portfolio:** CGIF's insured portfolio is exposed to issuers with non-investment-grade ratings as well as uncapped currency risks because it provides largely local-currency-denominated guarantees on emerging-market Asian debt. This means that under extremely adverse scenarios, the portfolio is likely to experience periods where default rates are very high, while recoveries on defaulted securities are low. Losses on defaulted securities would also be magnified if exchange rates were to move unfavourably.

**Sponsorship Mitigates Certain Risks:** CGIF's Insurer Financial Strength (IFS) rating has implicitly factored in its sponsorship by the 'AAA' rated Asian Development Bank (ADB), which is a trustee and part-owner. ADB appoints all relevant staff, and manages the funds and assets. CGIF has also adopted ADB's applicable operational policies, and shares the bank's multilateral supranational status. These linkages reduce many, but not all, the risks, given that CGIF is still in its expansion mode.

**Diverse Ownership Structure:** CGIF's initial capital of USD700 million was contributed by various Asian sovereign nations and ADB, which formed CGIF to support the development of Asian capital markets. Several of the capital contributors are very highly rated. The contributors are considering increasing CGIF's paid-in capital by USD500 million to USD1.2 billion by end-2023, but there are no formal commitments in place by the owners to provide additional capital, making any future contributions voluntary.

### Rating Sensitivities

**Weakening in Capitalisation:** Downgrade rating triggers include an increase in the net-par-to-capital leverage ratio to above 3.0x, losses developing in the guarantee portfolio outside of expectations, and a move towards a higher use of, or reliance, on reinsurance protection with the ratio of net to gross notional par insured falling below 75%. The ratings could also be downgraded if CGIF's capital providers fail to pre-fund business growth with capital injections, and instead allow the leverage ratio to (even temporarily) exceed targets.

**Highest National Scale Rating:** CGIF's National IFS Rating and National Long-Term Rating are already at the highest possible rating and cannot be upgraded. In Fitch's view, CGIF's credit profile is stronger than Indonesia's Long-Term Local-Currency IDR of 'BBB-', which supports assignment of an 'AAA(idn)' IFS rating on the National scale.

### Analysts

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## Business Profile

- Steadily building up its track record in bond guarantee segment
- Benefits from operational linkages to ADB
- Eventual growth in size depends on business viability

## Steadily Building Up its Track Record in Bond Guarantee Segment

CGIF was established in late-2010 to support the development of debt capital markets in Asia by providing financial guarantees on debt issues, primarily corporate issuers. It commenced operations in 2012 and wrote its first bond guarantee in 2013.

Premiums from the guarantee business amounted to USD7.7 million in 2016 and USD4.7 million in 2015. There were 14 guarantees issued to 11 issuers by CGIF at end-2016. Among these, 12 are fully guaranteed while it shares the risk with the ADB on the remaining two guarantees.

Fitch expects CGIF to steadily build up its operating track record in the bond guarantee segment as its coverage further expands. It focuses on providing support to corporates in China, Korea, Japan and ASEAN countries. It targets first-time issuers without, or with limited, access to the local bond market.

Additionally, the company seeks to give guarantees to existing issuers to extend their bond maturities without elevated premiums associated with long tenures. CGIF supports cross border transactions within its target markets by looking for opportunities to give guarantees to local corporates to raise bonds in matching currencies.

## Benefits from Operational Linkages to ADB

In Fitch's view, CGIF is unique as it is sponsored and operated by ADB, which is a well-established multilateral supranational that carries an 'AAA'/Stable rating on an international scale from Fitch. This sets CGIF apart from commercial start-ups. CGIF's operational linkages with ADB mitigate some, but not all, of the aforementioned risks of a start-up, thus allowing CGIF to be rated by Fitch well above 'BBB' (based on an international scale).

CGIF is set up as a trust fund of ADB – as opposed to a separate, independent legal entity. Hence, CGIF is accorded the same supranational status as ADB. This is incorporated under Article 13.2 of CGIF's Articles of Association, which states that "The privileges, immunities, and exemptions accorded to ADB pursuant to the Agreement Establishing the Asian Development Bank shall apply to (i) the Trustee, and (ii) the property, assets, archives, income, operations and transactions of CGIF". As with ADB, CGIF is not subject to the law of the Philippines; and as such, it is immune from taxation, local business law, and bank/insurance regulation.

ADB has close ties with CGIF, and provides strong operational support. As set out in the Articles of Association, ADB appoints relevant staff, and holds in trust and manages the funds and assets. CGIF's risk management culture and procedures are largely adopted from ADB's.

In addition, Fitch views the growth strategy of CGIF more favourably than that of a commercial operator. There is no time pressure from ADB or the capital contributors to quickly utilise the USD700 million capital for guaranteeing bond obligations, giving CGIF more leeway to carefully select the corporate bond issuances to guarantee – as opposed to adopting an aggressive or fast-growth path. This approach is in line with ADB's philosophy.

Nonetheless, CGIF focuses on a business segment that is not yet developed, as the use of debt guarantees has been quite limited in Asia. This means CGIF's business carries higher-than-average uncertainties with respect to the risk of adverse selection. It is difficult to judge at this time whether there is a negative bias among issuers that seek to issue insured debt. This risk is core to CGIF's business model, and not mitigated by the operational linkages to the ADB.

## Related Criteria

[Insurance Rating Methodology \(April 2017\)](#)

**Corporate Governance and Management**

- CGIF’s corporate governance is considered to be effective and neutral to the ratings.
- The governance structure of CGIF consists of the Meeting of Contributors, an eight-member board and three board committees, and two management committees.
- The Meeting of Contributors determines strategic objectives, provides the board and the CEO with strategic guidance on overall operations and management, and elects the chairperson and other members of the board.
- The eight-member board comprises the CEO, two representatives each from China and Japan, and one each from the Association of Southeast Asian Nations (ASEAN), Korea and ADB. These country representatives are from the ministries of finance or development banks. The board meets at least three times a year.
- Reporting to the board are three committees: namely, the Audit Committee, Internal Control and Risk Management Committee, and Nomination and Remuneration Committee, which meet regularly.
- There are also two management committees at the operational level – the Executive Committee chaired by the CEO, and the Guarantee and Investment Committee, chaired by the Chief Risk Officer. The management team has experience across the fields of investment banking, risk management and credit evaluation.

**Eventual Growth in Size Depends on Business Viability**

The figure below shows how the ratings of companies with stronger business profiles in terms of diversification within and between key business lines and markets would more frequently fall into a higher range than insurers with weaker business profiles.

CGIF is categorised as having a “moderate business profile,” based on Fitch’s guidelines for capital and revenue, as its capitalisation of USD700 million is just below that of a guarantor with “strong business profile”, and its current revenue size clearly aligns it with those of a small company. However, when viewed in the context of the much larger ADB, CGIF could also be considered a much larger organisation from the perspective of operational infrastructure.

Furthermore, if the business model proves successful, CGIF could grow over the next few years to meet the attributes of a medium – or even large – financial guarantor. CGIF plans to increase its paid-in capital to USD1.2 billion by 2023, subject to the volume of its business.

**Ratings Range Based on Business Profile**



Source: Fitch

### Ownership is Neutral to the Rating

Fitch believes CGIF has a strong group of owners/capital providers, but there is no explicit uplift to CGIF's ratings due to ownership – other than the previously discussed benefits of operational linkages to the ADB that help mitigate a portion of risks associated with its short operating track record.

Japan, China and Korea contributed 90% of the capital, with the average rating of these key contributors in the 'AA' category on an international scale. The number of votes for each contributor is equivalent to the proportion of its capital contribution, and hence the largest capital contributors retain the strongest decision-making power.

However, there are no formal commitments in place by the owners to provide additional capital, making any future capital contributions strictly voluntary. Callable capital facilities are used with certain other supranational organisations, but CGIF's capital providers chose not to use such an approach.

#### Capital Contributors of CGIF at End-2016

	(%)	Rating/Outlook
Asian Development Bank	18.57	AAA/Stable
Japan	28.57	A/Stable
China	28.57	A+/Stable
Korea	14.29	AA-/Stable
Brunei Darussalam	0.80	n.a.
Cambodia	0.01	n.a.
Indonesia	1.80	BBB-/Positive
Lao People's Democratic Republic	0.01	n.a.
Malaysia	1.80	A-/Stable
Myanmar	0.01	n.a.
Philippines	1.80	BBB-/Positive
Singapore	1.80	AAA/Stable
Thailand	1.80	BBB+/Stable
Vietnam	0.16	BB-/Positive
<b>Total</b>	<b>100</b>	

Source: Company information

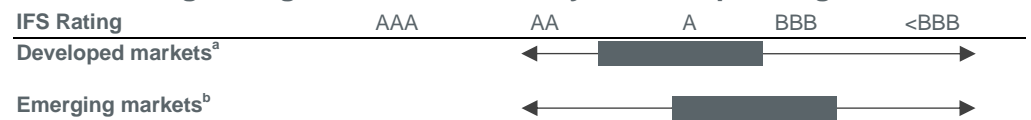
**Sovereign- and Country-Related Constraints**

CGIF enjoys the same supranational status as ADB, so its rating is not constrained by any particular sovereign or macroeconomic risks. Thus, while CGIF is based in the Philippines, Fitch's 'BBB-' sovereign rating does not constrain the rating of CGIF.

**Industry Profile and Operating Environment**

Asia Pacific (APAC) consists of developed and emerging markets. While the majority of Fitch-rated APAC insurers in developed markets have IFS ratings in the 'A' category, most insurers in emerging markets have IFS ratings in the 'A' to 'BBB' range.

**APAC Ratings Range, Based on Industry Profile/Operating Environment**



<sup>a</sup> Consist of Australia, New Zealand, Hong Kong, Korea, Taiwan and Singapore

<sup>b</sup> Consist of the rest of the APAC ex-Japan region

Source: Fitch

Fitch considers the current financial guarantee industry to be a grouping of niche markets. In Asia, financial guarantees are typically granted either through direct guarantees by government institutions or commercial guarantees provided by private institutions, and the proportion of these two types differs from market to market. In countries such as Indonesia, Japan, Korea, Malaysia, and Taiwan, the credit guarantees to corporates are mostly provided by the government or government-related institutions. In comparison, these credit guarantees in China are largely granted by commercial enterprises.

Not all Asian financial guarantee companies have been successful. For instance, Asian Securitisation and Infrastructure Assurance Ltd, which was set up in 1995 in Singapore as Asia's first regional credit guarantee company, was severely affected by the Asian Financial Crisis in the late 1990s, and was subsequently wound up.

The key challenges facing management in the financial guarantee industry in Asia include the need to maintain a sufficient capital buffer to combat any large regional shock. This is due to the high correlation risk within the Asian markets, as well as exposure to foreign-currency risks – particularly if the guarantees are provided to overseas corporates. They also need to guard against adverse selection risks, as the market for financial guarantee in Asia is not yet mature.

## Capitalisation and Leverage

	2012	2013	2014	2015	2016	Fitch's expectation
Shareholders' equity (USDm)	714	715	716	723	728	Fitch expects capitalisation to remain solid with net par-to-capital ratio below 2.0x for the foreseeable future.
Maximum guaranteed amount <sup>a</sup> (USDm)	0	125	616	749	1,120	
Net par to capital leverage (x)	0	0.17	0.86	1.04	1.16	
Total financing commitment ratio (x)	0	0	0	0	0	
Financial leverage (%)	0	0	0	0	0	
Shareholders' equity to total assets (%)	99.9	99.6	96.8	96.1	94.2	

<sup>a</sup> Maximum guaranteed amount includes principal and coupon  
Source: The company and Fitch's calculation

### Capital and Leverage - Solid Buffer Maintained

- Carefully managed par-to-capital leverage
- Additional capital infusion to support growth

### Manageable Net Par-to-Capital Leverage

Fitch expects CGIF to manage its net par-to-capital leverage at 2.0x. This target falls within Fitch's ratings guideline for an 'A' rating on an international scale and is more closely aligned to that of Very High Frequency/High Severity standard that applies to financial guarantee organisations that face the possibility of very high frequency and high severity defaults on the bonds they guarantee.

CGIF guaranteed 14 bonds at end-2016, comprising bonds denominated in Singapore dollar, Vietnamese dong, Philippine peso, Thai baht, and Indonesian rupiah. The total amount of guarantees amounted to USD1.1 billion at end-2016. These guaranteed bonds, which had tenures of three to 10 years, were issued by corporates in different sectors, such as telecommunications and automobiles. While several transactions are still in the pipeline, CGIF's net-par-to-capital leverage amounted to 1.16x at end-2016. Fitch estimated that the leverage would increase to 1.17x at end-1Q17.

### Additional Capital Infusion to Support Growth

In view of the current growth pace, CGIF contributors are considering increasing the paid-in capital by another USD500 million to USD1.2 billion by end-2023. The capital increase plan will be implemented in stages.



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**Debt Service Capabilities and Financial Flexibility**

	2012	2013	2014	2015	2016	Fitch's expectation
Fixed-charge coverage (x)	n.a.	n.a.	n.a.	n.a.	n.a.	CGIF is prohibited from issuing debt to finance its operations according to its operating policies.
Interest expense (USDm)	0	0	0	0	0	

Source: Company

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**Debt Issuance Prohibited**

The company's operating policies strictly prohibit any debt issuance to finance its operations. So there is no constraint on financial and operational flexibility in terms of interest servicing and debt repayment.

## Financial Performance and Earnings

	2012	2013	2014	2015	2016	Fitch's expectation
Net income (USD 000)	4,109	2,718	3,548	7,781	10,082	The company's operating result is likely to remain volatile in the near term given its early phase of expansion.
Pre-tax operating return on assets (%)	0.6	0.4	0.5	1.0	1.3	
Return on equity (%)	0.6	0.4	0.5	1.1	1.4	
Combined ratio (%)	n.a	1,110	438	125	99	
Investment yield (%)	1.2	1.1	1.2	1.3	1.4	

Source: The company and Fitch's calculation

### Financial Performance – Risk Management Focus

- Steady improvement in operating profitability
- Managing a high-risk-insured portfolio with uncapped currency risks

#### Steady Improvement in Operating Profitability

CGIF's operating result has gradually improved over the last three years. Its pretax return on assets amounted to 1.3% in 2016 (2015: 1.0%). Its combined ratio, which is the sum of loss ratio and expense ratio, improved to 99% in 2016, as its premium volume grew further.

CGIF does not need to achieve any specific profit targets or mandates aside from its objective of supporting the development of the Asian bond market. This differs from most privately owned and commercially run organisations that have earnings growth and dividend expectations.

It makes CGIF's performance goals similar to those of many mutual insurance companies or government agencies, in which profit margins are set to assure reasonable compensation for the risks being assumed, and to support long-term growth in capital commensurate with expected business growth.

#### Managing a High-Risk-Insured Portfolio with Uncapped Currency Risks

Within the context of its ratings criteria for financial guarantors, Fitch views CGIF's insured portfolio as "high risk" – characterised by a portfolio expected to demonstrate high frequency/high severity losses, and with uncapped currency risks. CGIF's underwriting and controls appear to be well-thought-through and prudent (albeit as yet untested) to manage the high risks from its insured portfolio.

CGIF is exposed to volatile guarantee risk because it provides guarantees to corporate issuances that are rated at non-investment grade. It is also exposed to foreign-currency risks as it provides largely local-currency-denominated guarantees to emerging markets such as the ASEAN+3 countries (ASEAN and Japan, Korea and China).

CGIF has capped the size of each bond guarantee at 20% of its maximum guarantee capacity (MGC), with sub-limits of up to 20% of its MGC per country and up to 40% per currency, to ensure business diversification and curb CGIF's exposure to any single country or currency. CGIF factors in the level of its paid-in capital and retained surplus, credit loss reserves, foreign exchange loss reserves, amount of illiquid investments, and the maximum leverage ratio when it determines the level of MGC. The bonds guaranteed by CGIF are generally limited to tenors of 10 years or below.



## Investments and Asset Risk

	2012	2013	2014	2015	2016	Fitch's expectation
Total investment assets (USDm)	711	712	715	722	728	Fitch does not anticipate the risk profile of CGIF's investments to change significantly given its current investment approach.
Cash and cash equivalents to total invested assets (%)	12.6	1.6	5.2	1.4	1.4	
Fixed-income securities/total invested assets (%)	87.4	98.4	94.8	98.6	98.6	
Stocks/total invested assets (%)	0	0	0	0	0	
Risky assets to shareholders' equity (%)	0	0	0	0	0	
Liquid assets to net claims reserves (%)	n.a.	n.a.	n.a.	n.a.	n.a.	

Source: The company and Fitch's calculation

### Investments – Conservative Strategy

- Prudent investment guidelines
- Exposure to foreign-currency risk
- Liquidity risk reasonably managed

### Prudent Investment Guidelines

CGIF's key investment objective is to protect the principal amount of the investments by investing in liquid, low-risk and high-credit quality instruments.

Investments are managed by ADB Treasury in accordance with CGIF's investment guidelines, which have been adopted in agreement with ADB. CGIF invests in only cash and deposits, and fixed-income securities. No equity investments are to be considered. Eligible fixed-income securities with maturity terms of more than one year must be rated at least 'AA-' on an international scale. CGIF may invest in fixed-income securities with shorter terms, but such investments have so far been minimal. The approved investment return target given to CGIF is 1.25% in 2016.

It is CGIF's policy to limit its aggregate exposure to any non-bank corporate to a level below 10% of the organization's equity.

### Exposure to Foreign-Currency Risk

CGIF does not plan to fully hedge its foreign-currency exposure. The company has entered into foreign exchange forward contracts to manage its foreign exchange risk. The nominal amount of the forward contracts was about USD20 million at end-2016.

CGIF has significant exposure to foreign-currency risk because it guarantees bonds denominated in the various currencies of the markets of issuance, while its functional currency is the US dollar. Once CGIF receives its guarantee fees in the local currency, it will immediately convert them to US dollars.

If CGIF is unable to obtain a sufficient amount of the bond issue's currency at the time of payment, the company retains the right to pay in US dollars, and the method of calculating the exchange rate will be determined upfront as part of the policy language. Thus, CGIF is not at risk of defaulting on a guarantee due to a lack of the bond issue's currency.

**Liquidity Risk Reasonably Managed**

Fitch does not expect CGIF to face any severe liquidity problems given its appropriate management of liquidity risks. As far as possible and practicable, CGIF will match the duration of investments closely with the tenor of the guarantee obligations. CGIF allocated about 85% of its investments in bonds and time deposits with maturity duration of less than five years at end-2016.

Fitch views favourably CGIF's right to accelerate or retain the original interest/principal payment schedule in the event of a default on an insured bond. Thus, the possibility of an unexpected liquidity crisis is quite limited, as there is no real liability-acceleration risk.

In the event that bond defaults are high during a period in which interest rates are also high (implying unrealised losses exist on the investment bond portfolio), management indicates it would pledge securities as collateral to obtain liquidity in the repo market, when necessary, as opposed to simply liquidating a security before maturity (especially if at a loss). As a contingency, CGIF said that a standby loan facility might be used in times of need.

## Reserve Adequacy

(%)	2012	2013	2014	2015	2016	Fitch's expectation
Net claims reserves/net claims incurred (x)	n.a.	n.a.	n.a.	n.a.	n.a.	CGIF's claim reserve ratio could be volatile in the short term given the limited track record on the development of the company's claims liabilities. Nonetheless, no bond that CGIF has guaranteed is in default so far.
Net claims reserves/shareholders' equity (x)	0	0	0	0	0	
Cash and bank deposits/net claims reserves (%)	n.a.	n.a.	n.a.	n.a.	n.a.	
Net technical reserve/shareholders' equity (%)	0.0	0.2	3.1	3.9	5.7	
Net claims paid/net claims incurred (%)	n.a.	n.a.	n.a.	n.a.	n.a.	
Change in net claims reserves/net premiums earned (%)	n.a.	0	0	0	0	
Reinsurance recoverables to equity (%)	0	0	0	0	0	

Source: The company and Fitch's calculation. Net technical reserve = net claim reserves plus unearned premium reserves

### No Bond CGIF Has Guaranteed Is In Default

- Conservative credit loss-reserve process

### Conservative Credit Loss-Reserve Process

No bond that CGIF has guaranteed is in default status so far. No provision for credit losses has been established under its balance sheet.

While as yet untested, CGIF appears to have in place a conservative approach for establishing credit-loss reserves. A robust approach is necessary due to the high-risk nature of GCIF's business that will result in periodic losses.

Provisions for credit losses ranging from 20%-100% of the guarantee amount will be set according to the internally generated bond ratings assigned to individual bonds. These provisions are generated based on statistical estimation/assumptions of probability of defaults and loss given default.

As a control, during CGIF's initial operations, ratings from board-approved parties will be obtained to assess the consistency between CGIF's internal ratings and those assigned by such parties to ensure the correct application of the international technical standards by CGIF and the effectiveness of its internal risk rating system.

Each outstanding guarantee will be reviewed and re-rated at least on an annual basis; and in the case of deterioration in the credit profile of the bond issuer, additional provisions will be set aside based on the perceived lower credit rating. In addition, management will make specific provisions for any guarantee that is at risk on a case-by-case basis – based on the ongoing monitoring of all guarantees outstanding.

### Reinsurance

CGIF has arranged a quota-share reinsurance treaty to support its underwriting capacity from 4Q16. All reinsurers under this treaty have an IFS rating of at least 'A'.

## Appendix B: Other Ratings Considerations

Below is summary of additional ratings considerations of a “technical” nature that are part of Fitch’s ratings criteria.

### Group IFS Rating Approach

Group IFS rating approach is not applicable for the company.

### Notching

CGIF is based in the Philippines, but has the same multilateral organisation status as that of ADB. As such, it is not subject to any local business, insurance regulations and capital regulatory frameworks.

For notching purpose, CGIF follows ‘Other’ regulatory environment classification although the regulatory environment of the Philippines is assessed by Fitch as being Effective and classified as following a ‘Ring-Fencing’ approach.

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### Notching Summary

**Holding company**

Not applicable.

**IFS Ratings**

Given its status as a multilateral organisation and the limited scope of regulation assumed by Fitch, a recovery assumption of Average applies to the IFS rating, and non-standard notching associated with the noted recovery assumption was used from the IFS “anchor” rating to the operating company IDR.

**Debt**

Not applicable.

**Hybrids**

Not applicable.

Source: Fitch

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### Criteria Variations

None

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.

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