

OVERVIEW

After brisk business in securitisation last year, 2006 continues apace with two large auto loan securitisations already being brought to market during the first quarter. Further issuance of ABS and RMBS transactions is expected during the course of the year. CMBS as an asset class has not quite matched expectations but further issuance should also take place this year. Cash flow and synthetic CDOs seem to be the only traditional asset class that is lagging in popularity.

The new Basel II Accord is due to come in from the start of 2008 in South Africa. One motivation for the Accord is to match the regulatory capital required by banks with the actual economic risks that they are exposed to. The Accord will thus limit the regulatory arbitrage opportunities provided by securitisation. Banks are therefore expected to make use of the remaining two years until the Accord's implementation to securitise balance sheet assets for the purposes of regulatory arbitrage.

It is expected that the greatest impact of Basel II will be on RMBS transactions. Banks using the Advanced Internal Ratings-Based ('IRB') approach under Basel II would be able to hold significantly less regulatory capital against their residential home loan exposures than that required under Basel I. Despite this, opportunities for regulatory arbitrage will remain for corporate and small business loan CDOs, credit card ABS and CMBS, especially high-volatility commercial real estate ('HVCRE').

In future, banks can be expected to make greater use of securitisation as an additional funding source as well as a way to better match the tenor of their assets and liabilities. Arguably, much of recent securitisation activity by South African banks has been driven by the desire to diversify their funding sources in the light of the rapid asset growth they have been experiencing. Securitisation as a macro-risk management technique might also gain greater acceptance.

The use of securitisation as a diversified funding source might lead to South African issuers also placing asset-backed securities in offshore capital markets. The first article in this newsletter therefore explores the concept of how securitisation transactions can pierce the sovereign ceiling and the international ratings that can be assigned to local securitisation transactions.

A second article describes the ratings methodologies used by Fitch Ratings to rate money market and bond funds. These funds are generally rated in the US and European markets and such ratings can be expected in South Africa as well in future.

An interesting aspect of this area is that the flexibility of Fitch's bond rating methodology could potentially be applied to asset classes other than money market instruments and bonds. For instance, it might be possible to assign ratings to actively managed loan-backed funds.

Finally, Appendix 1 summarises all of Fitch's publicly rated South African securitisations. ■

INSIDE THIS ISSUE

Overview	1
Rating above the country ceiling	2
Money Market and Bond Fund Ratings.....	4
Appendix: Fitch Publicly Rated Securitisations in South Africa – Ratings Update	6

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BREAKFAST WITH FITCH

Fitch holds regular breakfast seminars in Cape Town and Johannesburg to discuss current securitisation topics. To be included in Fitch's mailing list, please contact Hilary Steyn on +27 11 516 4900.

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RATING ABOVE THE COUNTRY CEILING

COUNTRY CEILING AND ABS RATINGS LINKAGE

For countries with national scale ratings such as South Africa, the highest rated tranche of notes issued in a securitisation transaction – typically ‘AAA’ – will be followed by a country specific suffix which, in South Africa’s case, is ‘(zaf)’. The suffix denotes that the rating is comparable nationally only and is relative to other ratings with the same suffix. Such ratings have no meaningful comparison outside the sovereign jurisdiction within which they are assigned. Ratings are only comparable across sovereign jurisdictions when assigned on an international basis: i.e. where no national suffix is present. This article discusses assigning international ratings to local securitisation transactions, the constraints ascribed to those ratings and the reasons for the constraints.

In its recently released criteria report, “Existing Asset Securitisation in Emerging Markets – Sovereign Constraints” published on 20 March 2006, Fitch discusses the factors that condition the rating of existing asset transactions at ratings above the country ceiling. The methodology recognises that ratings can exceed the country ceiling provided certain risks are adequately addressed. Ultimately though, a limit exists as to the extent that a securitisation can be insulated from the wider macroeconomic, political and legal environment.

Although the foreign currency rating and the country ceiling no longer act as a cap on the securitisation rating they nonetheless influence the level of both the foreign currency and local currency ratings of ABS. Fitch considers that the final rating of the ABS transaction should be linked to these ratings as not only will a foreign currency default create macroeconomic pressures for transactions within the jurisdiction but stresses to the political environment and the legal and financial system will also have an impact. The foreign currency rating and country ceiling will therefore influence the performance of all transactions within the jurisdiction.

To achieve a rating above the foreign currency rating of the sovereign, the

securitisation transaction must effectively be able to demonstrate that its credit profile is stronger than that of the sovereign. In other words, the particular transaction must be able to continue to honour its obligations, even in circumstances where the sovereign and many corporates and financial institutions could not.

Fitch has developed a set of expectations that predict the possible macroeconomic reactions to a foreign currency sovereign default, based on empirical evidence gleaned from various sovereign crises over the past few years.

The stresses fall into two broad categories: *economic risks* and *event risks*, as summarised in the table below.

Foreign Currency Rating Influence

Event Risks	When a country defaults on its debt, this can cause certain event risks that cannot be covered by simple overcollateralisation, including: <ul style="list-style-type: none"> - Dysfunctional legal environment - Systemic banking crisis - Political interference
Economic Risks	As the country approaches default, macroeconomic conditions deteriorate and risks include: <ul style="list-style-type: none"> - Increase in inflation - Increase in interest rates - Collapse in asset prices/ deflation - Devaluation /de-pegging of currency - Decreasing GDP/increasing unemployment

Source: Fitch

Although the adverse effect of economic conditions may be offset by credit enhancement, event risks can jeopardise or impair a transaction in a manner that may make debt service impossible for a time (regardless of asset performance).

EVENT RISK

Fitch considers three major categories of event risk to be prevalent upon a sovereign default: legal, financial and political. These effects have been observed in a number of jurisdictions that

have suffered a sovereign crisis – most recently in Argentina in 2001/02.

Dysfunctional legal environment - A legal crisis may lead to difficulties in the practical ability to enforce and place reliance on laws, causing a deterioration from a creditor’s perspective during sovereign stress scenarios.

Systemic banking crisis - A default by the sovereign and the ensuing macroeconomic turmoil can lead to asset and liquidity problems for the banking sector. While it is impossible to predict the exact form that such a liquidity crisis could take, Fitch assesses the character of the banking system within a particular jurisdiction to reach a conservative estimate of the likely duration of such liquidity problems.

Political interference - Political interference in the event of a sovereign default could occur in a number of ways. Debt moratoriums on certain consumer payments may be introduced, borrower relief programmes may be imposed or expropriation in a variety of forms, from royalty increases to outright nationalisation, may result.

As the differential between the country ceiling and the transaction target rating increases, Fitch assumes that some form of political interference is increasingly likely to occur as stress builds up within the local economy.

This event risk therefore often serves as the ultimate determinant of how highly a transaction could be rated in any particular jurisdiction. To make this assessment, Fitch’s structured finance analysts work with the agency’s sovereign analysts and focus on a number of factors, including:

- any previous history of political interference that was detrimental to established contractual or proprietary rights in general, and to financial creditors in particular;
- the extent to which rule of law is generally perceived to be respected and the degree to which corruption is controlled within the country; ►

RATING ABOVE THE COUNTRY CEILING

Continued from page 2

- ▶ any factors in the political and economic framework that increase the likelihood of political interference (e.g. highly centralised or highly dollarised economies); and
- the characteristics of the asset class to be securitised.

Political Interference Event Risk

Low	Maximum ratings 2-3 notches above the country ceiling
Intermediate	Maximum ratings 1-2 notches above the country ceiling
High	Maximum ratings 0-1 notches above the country ceiling

Source: Fitch

Based on the above assessment, Fitch will assess a transaction's susceptibility to damaging political interference as being broadly low, intermediate or high, and this assessment will translate into limits on the maximum achievable rating for a transaction as shown in the table below.

It is important to note that this maximum achievable level would apply regardless of a transaction's ability to survive the economic stresses at even higher rating levels.

As South Africa's country ceiling is 'A-(A minus)', this would imply that the highest rating that could be achieved for a securitisation with assets and obligors located within South Africa would be 'AA-(AA minus)'. Given South Africa's stable political environment since independence in 1994, the positive rule of law and control of corruption indicators, there is a good likelihood that South Africa would fall within the "low" category for vulnerability to political interference.

ECONOMIC RISK – STRESS SCENARIOS

Fitch will typically apply the same stresses at the country ceiling of the

relevant jurisdiction as it would apply at the 'AAA' level in a developed country that has a country ceiling of 'AAA'. As an example, for a typical consumer loan or RMBS transaction, Fitch will use higher default multiples than those used in 'AAA' countries at the same rating levels.

This increased stress is intended to account for the fact that the environment in which the transaction is domiciled is much more volatile than a developed market. In addition, when ratings approach or exceed the sovereign rating, the analysis must consider the fact that the country may be in default and that the transaction must therefore be able to withstand a crisis commensurate with that event.

USING DEFAULT MULTIPLES FOR HISTORICAL DATA

When Fitch analyses historical default data, it considers the specific timeframe and the overall economic environment in which the data were sourced. If the historical data already refers to a stressful period (a sovereign crisis), Fitch may reduce the overall stress as the historical data may be abnormally high.

South African Example

Target Rating Level	Default Multipliers
AA-	6.5-7.5x
A+	5.5-6.5x
A	5.0-6.0x
A-	4.5-5.5x
BBB+	4.0-5.0x
BBB	3.5-4.5x
BBB-	3.0-4.0x
BB+	2.5-3.5x
BB	2.0-3.0x
BB-	1.5-2.5x
B+	1.0-2.0x
B	1.0-1.5x

Source: Fitch

For example, were Fitch to rate a South African RMBS transaction at the country ceiling rating category of 'A-(A minus)' a default multiple of 5.0x could be used, which additionally considers that the sovereign is on the brink of default. Fitch

adjusts its multiples upwards/downwards for ratings above and below the foreign currency rating of the sovereign.

Each category has a range, and the specific multiple chosen depends on several factors, including the quality and time horizon of available data, as well as any particular risks that a specific jurisdiction faces. The ranges at each rating level are shown in the table below.

TIMING OF DEFAULT

Another conservative measure Fitch uses to stress a post-default scenario for any asset class is the "front-ending" of the usual default curve applicable for that asset class. Instead of the usual seven-year curve, Fitch would consider the following curves:

Default Curve

Country Ceiling	Default Curve Period
A	Six Years
BBB	Five Years
BB	Four Years
B	Three Years

Source: Fitch

In addition to the above, a key determinant of the vulnerability to macroeconomic stresses and hence, by implication, to political interference is the nature of the underlying assets.

- For further insight into Fitch's approach to rating emerging market securitisations above the country ceiling, see "Existing Asset Securitisation in Emerging Markets – Sovereign Constraints" dated 20 March 2006 and available at www.fitchratings.com. For related research available at the same web address see "Political Risk Insurance and Structured Finance" dated 22 December 2005, "The Role of Multilaterals in Structured Finance" dated 15 March 2006 and "Country Ceiling Ratings and Rating Above the Sovereign" dated 17 June 2004. ■

MONEY MARKET AND BOND FUND RATINGS

MONEY MARKET AND BOND FUNDS

Fitch's money market fund ratings offer retail and institutional investors an objective means of assessing and comparing funds to determine the underlying credit quality and safety of principal. Fitch has two fund rating scales that are always used in combination:

- Credit ratings, ranging from 'AAA' for the most creditworthy to 'CCC', assessing a portfolio's overall credit quality.
- Volatility ratings, reflecting the impact of interest rates, credit spreads, liquidity and leverage on a fund's market price and total return. Volatility ratings are represented on a scale or 'V1+' through 'V10', with 'V1+' indicating the least volatility in price and total return and 'V10' the most. The 'V1+' rating is reserved for funds that are structured to exhibit stable net asset values. Money market funds generally receive 'V1+' and 'V1' volatility ratings.

Fitch analyses the key factors contributing to a money market fund's safety of principal. Foremost among these are the policies and procedures governing its investment style. Factors considered include credit quality, diversification, maturity, liquidity, shareholder composition and redemption activity. Fitch analyses each of these factors to ensure conformity with its ratings guidelines. Equally important is an assessment of the money manager's experience, organisation, credit selection process, distribution process and the adequacy of internal controls and systems. Portfolios are reviewed weekly to ensure that ratings remain current.

Bond funds are conceptually similar to money market funds, but investing in longer-dated financial instruments. Internationally, the bond fund market has moved away from focusing on domestic government bonds to more diversified portfolios. A wide variety of funds with different approaches and investment styles are now available to investors, with funds investing in government bonds, corporate bonds, hedged and un-hedged

international and sovereign bonds, aggregate products with exposure to investment-grade credits and inflation-linked bonds. In addition there are pure credit funds investing in investment-grade and speculative-grade corporates, emerging sovereigns as well as asset-backed securities ("ABS").

Fitch rates bond funds in the same manner as money market funds, similarly assigning a credit rating and a volatility rating. Fitch assigns ratings at the request of a fund's management and after inspecting all relevant material, performing a review and interviewing management. To ensure that ratings are current and accurate, Fitch monitors rated bond funds monthly, checking their portfolio composition, management practices and investment environment, and reviews how changes may affect the ratings.

For a more detailed explanation of Fitch's approach to rating money market and bond funds, see "*European Money Market Fund Ratings*", dated 6 March 2006 and "*International Bond Fund Ratings*" dated 13 May 2005. Both reports are available on Fitch's website at www.fitchratings.com.

BOND FUND RATINGS METHODOLOGY

Fitch's bond fund credit ratings are an assessment of a fund's overall credit quality. The ratings result from an evaluation of several factors, including the credit quality of the assets and counterparties, the diversification of assets in the portfolio, management strength and operational capabilities.

When assessing a fund's credit quality, Fitch evaluates the default probability associated with the securities in the overall portfolio using an internally developed quantitative model based on historical default curves. For each long-term rating category, a credit factor is defined based upon a 10-year default study. Each rated security in the portfolio is weighted according to the factor associated with it and the fund's credit rating itself is a simple weighted-average score of all of the securities in the portfolio. As a result, the credit quality of the bond fund will be the same as the

weighted-average default probability of the portfolio of securities in the fund and therefore the same as that of a similarly rated debt instrument. The credit rating also reflects the benefits of the fund maintaining a well-diversified asset portfolio.

Fitch believes that credit ratings alone do not reflect all of the underlying risks in bond portfolios and do not always address the largest risks bond fund investors face. Volatility factors go beyond assessing the risks addressed by traditional credit ratings, answering questions such as:

- How sensitive is a fund to changing interest rates and what can an investor expect if interest rates rise dramatically in the near future?
- What are the other risks faced by the fund, given its objectives, investment strategy and portfolio composition: e.g. does the fund use leverage or invest in foreign currencies?

Volatility ratings are based primarily on the weighted-average risk-adjusted duration of the assets held in the portfolio. The volatility rating is a measure that incorporates risks from factors such as interest rates, credit spreads, prepayment risk on the underlying assets, currency risk and the extent to which derivatives are used by the fund. The volatility rating scale reflects the increased risk of funds holding long-term assets with long durations or high percentages of derivative securities by placing them in the highest volatility categories, ranging from 'V5' through 'V10'.

In addition to its quantitative analysis, Fitch meets with fund management to develop a thorough understanding of the fund's investment policies, strategies and practices. Fitch also evaluates the historical performance and volatility of fund returns, as well as the choice of benchmarks, although newly launched funds without such history can be rated too.

BOND FUND RATINGS APPLIED TO TRADABLE CREDIT BASKETS

Tradable credit baskets ("TCBs") are static, unlevered portfolios of corporate ►

MONEY MARKET AND BOND FUND RATINGS

Continued from page 4

► bonds or other types of securities that allow investors to gain broad credit exposure in a highly liquid, untranchcd form.

TCBs may be organised as custodial receipts, trusts or special purpose vehicles, and are designed to offer exposure to a fixed portfolio of credits (either cash funded or synthetically) differentiated by maturity, rating category, jurisdiction and industry group. These products allow investors to increase or decrease their corporate credit risk in a more efficient and less expensive way (rather than trading individual bonds) and offer diversification benefits in a single transaction. These advantages contribute to the growing attractiveness of TCBs and related products.

TCBs differ from traditional cash funded, market value collateralised debt obligations ("CDOs") in that they are:

- untranchcd and, as such, do not have a first loss position;
- not overseen by a designated investment manager; and
- intended to be pass-through investments in the underlying bonds.

Given these differences and their unique structures, application of bond fund ratings to TCBs is more appropriate. Bond fund ratings are an assessment of the underlying portfolio. That said, bond fund ratings are not an explicit rating on any liabilities issued off the back of the underlying asset portfolio and do not address their timely interest or principal payments.

As is the case with rating money market and bond funds, Fitch provides two ratings for TCB funds – a credit rating for credit risk and a volatility rating for price

and total return volatility risk. The fund credit ratings address the overall credit quality of a portfolio, from 'AAA' for the most creditworthy to 'B' for speculative. Fund volatility ratings describe the relative impact of changing interest rates and general market conditions on a fund's markets price and total return.

Fitch disaggregates a fund's total risk into each of these components by evaluating each security holding. Bond portfolios are subjected to various interest rate scenarios and probable market conditions using established modelling techniques. Resultant durations indicate the degree of potential variability in prospective fund price and performance.

Unlike traditional bond funds, TCBs are not actively managed and, therefore, do not receive the benefits of a fund manager continually maintaining the credit quality of the portfolio by selling bonds that may be experiencing credit deterioration.

Credit ratings assigned to TCBs are largely based on the weighted-average credit quality of the underlying bonds and may change as the credit quality of the underlying bonds change. Fitch looks to its own public ratings in assigning a rating to the underlying assets in the fund. The removal of any underlying bond from the portfolio due to a default or downgrade below a pre-specified level should keep the assigned credit ratings relatively stable.

Volatility ratings for TCBs are substantially the same as for traditional bond funds, except for the permanence of the assigned volatility rating. As with any debt security with a finite maturity, it is expected that the market risk exposures of TCBs will decline as the maturity date nears. Therefore, the volatility rating

assigned is expected to improve (i.e. lower volatility rating) over time.

Once rated, TCB underlying holdings and transactions are monitored monthly. The surveillance is designed to ensure the credit quality and variability of market risks are consistent with Fitch's original assessment. This ongoing surveillance also provides investors with reassurance concerning the continued accuracy of the rating, especially during periods of market turmoil.

For more detail, see the report "*Bond Fund Ratings Applied to Tradable Credit Baskets*" dated 3 May 2002, available at www.fitchratings.com.

BOND FUND RATINGS APPLIED TO ACTIVELY MANAGED LOAN PORTFOLIOS

Conceptually, it would be possible to apply the bond fund ratings methodology to asset portfolios other than bonds, e.g. a loan-backed fund, as well as to dynamic portfolios managed by an asset manager. However, the credit rating of such a fund would have to explicitly address the timely payment of interest and principal, unlike bond fund ratings, which are not explicit ratings of liabilities. If the loans in such a fund were to be of a very short-term nature, the volatility rating could be 'V1+' or it may even be possible to dispense with a volatility rating. Fitch would have to carefully assess the credit quality and repayment capability of each borrower to whom the fund has lent money.

Nevertheless, given the flexibility of Fitch's bond fund ratings methodology, it can be expected Fitch ratings would be able to assign credit ratings to funds where the underlying assets comprise loans instead of bonds. ■

APPENDIX: FITCH PUBLICLY RATED SECURITISATIONS IN SOUTH AFRICA – RATINGS UPDATE

National

Issuer	Class/Series	Long-Term	Short-Term
Accelerator Fund 1 (Pty) Ltd			
Secured Floating-Rate Notes	A1	AAA(zaf)	
Secured Floating-Rate Notes	A2	AAA(zaf)	
Secured Floating-Rate Notes	A3	AAA(zaf)	
Secured Floating-Rate Notes	B	A-(zaf)	
Secured Floating-Rate Notes	C	BBB-(zaf)	
Asset-Backed Arbitrated Securities (Pty) Ltd			
Asset-Backed Commercial Paper			
ABACAS Premier Series (Series 1)	1		F1+(zaf)
ABACAS Global Corporate Series (Series 2)	2		F1+(zaf)
Blue Granite N° 1 (Pty) Limited			
Secured Floating-Rate Notes	A1	AAA(zaf)	
Secured Floating-Rate Notes	A2	AAA(zaf)	
Secured Floating-Rate Notes	A3	AAA(zaf)	
Secured Floating-Rate Notes	B	AA(zaf)	
Blue Titanium Conduit Limited			
Asset-Backed Commercial Paper			F1+(zaf)
Equipment Rental Securitisation N° 1 (Pty) Ltd			
Secured Floating-Rate Notes	A	AAA(zaf)	
Secured Floating-Rate Notes	B	A(zaf)	
Secured Floating-Rate Notes	C	BBB(zaf)	
Fresco 1			
Secured Fixed-Rate Notes	A	AAA(zaf)	
Secured Fixed-Rate Notes	B	AA(zaf)	
Secured Fixed-Rate Notes	C	A(zaf)	
Secured Fixed-Rate Notes	D	BBB(zaf)	
Secured Fixed-Rate Notes	E	BB(zaf)	
Growthpoint Note Issuer Company (Pty) Limited			
Secured Floating-Rate Notes	A1	AAA(zaf)	
Secured Floating-Rate Notes	B1	AA-(zaf)	
Secured Floating-Rate Notes	C1	A-(zaf)	
Secured Floating-Rate Notes	D1	BBB(zaf)	
HomePlan Financial Solutions (Pty) Ltd			
Secured Floating-Rate Notes	A	AAA(zaf)	
iNdwa Investments Limited			
Asset-Backed Commercial Paper			F1+(zaf)
NBC Future Guard (Pty) Limited			
Secured Floating-Rate Notes	A	AAA(zaf)	
Secured Floating-Rate Notes	B	BBB(zaf)	
Procul (Pty) Ltd			
Secured Fixed-Rate Notes	A	AAA(zaf)	
Secured Floating-Rate Notes	A	AAA(zaf)	
Sanlam Home Loans 102 (Pty) Limited			
Asset-Backed Commercial Paper			F1+(zaf)
Sanlam Home Loans 103 (Pty) Limited			
Secured Floating-Rate Notes	A1	AAA(zaf)	
Secured Floating-Rate Notes	A2	AAA(zaf)	
Secured Floating-Rate Notes	A3	AAA(zaf)	
Secured Floating-Rate Notes	B1	AA(zaf)	
Secured Floating-Rate Notes	B2	AA(zaf)	
Synthesis Funding Limited			
Asset-Backed Commercial Paper			F1+(zaf)
Thekwini Fund 3 (Pty) Limited			
Secured Floating-Rate Notes	A1	AAA(zaf)	
Secured Floating-Rate Notes	A2	AAA(zaf)	
Secured Fixed-Rate Notes	A3	AAA(zaf)	
Secured Floating-Rate Notes	B	A(zaf)	
Secured Floating-Rate Notes	C	BBB(zaf)	

APPENDIX: FITCH PUBLICLY RATED SECURITISATIONS IN SOUTH AFRICA – RATINGS UPDATE

Continued from page 6

National

Issuer	Class/Series	Long-Term	Short-Term
The Thekwini Fund 4 (Pty) Limited			
Secured Floating-Rate Notes	A1	AAA(zaf)	
Secured Floating-Rate Notes	A2	AAA(zaf)	
Secured Fixed-Rate Notes	A3	AAA(zaf)	
Secured Floating-Rate Notes	B	A(zaf)	
Secured Floating-Rate Notes	C	BBB(zaf)	
The Thekwini Fund 5 (Pty) Limited			
Secured Floating-Rate Notes	A1	AAA(zaf)	
Secured Floating-Rate Notes	A2	AAA(zaf)	
Secured Fixed-Rate Notes	A3	AAA(zaf)	
Secured Floating-Rate Notes	B	A(zaf)	
Secured Floating-Rate Notes	C	BBB(zaf)	
The Thekwini Warehousing Conduit (Pty) Limited			
Asset-Backed Commercial Paper	Senior		F1+(zaf)
Asset-Backed Commercial Paper	Mezzanine		F1(zaf)
Asset-Backed Commercial Paper	Junior		F2(zaf)

Source: Fitch

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