



CRITERIA FOR SECURED BOND EXPECTED LOSS
CREDIT RATINGS

Table of Contents

Scope of the Criteria	3
Summary of the Criteria Changes	3
Introduction	3
Assumed Average Recovery Rate	4
Calculating the Recovery Rate	4
International Scale Ratings	6
Partial Guarantees	6
Legal Opinions	7
GLOSSARY OF TERMS/ACRONYMS	8

Scope of the Criteria

1. The 'Criteria for Secured Bond Expected Loss Credit Ratings' is exclusively applied when assigning an Expected Loss ('EL') rating to listed or unlisted debt obligations, specifically when distinguishable security or collateral has been pledged to the holders of the debt, which improves their recovery prospects after an event of default (relative to unsecured senior claims).
2. The 'Criteria for Secured Bond Expected Loss Credit Ratings' can therefore only be applied to issue/programme credit ratings. However, unlike other issue credit ratings, 'Secured bond' or 'EL' ratings also factor in expectations of post default recoverability from a specific collateral pool, along with the issuer's creditworthiness.
3. GCR will typically assign 'EL' ratings to specific debt instruments that benefit from security coverage in the event of an issuer default. However, where a secured debt programme has adequate provisions limiting the nature of issued debt to senior secured obligations, that rank *pari passu* and share equally in the security pool, GCR may provide a programme rating.
4. The rating scale and symbols used when assigning 'EL' ratings are the same as those for issuer ratings (albeit secured bonds carry an additional 'EL' suffix), but the two are not comparable.
5. Importantly, the criteria below only refer to the recovery criteria element of a 'Secured bond' rating. To see how GCR will accord an issuer credit rating, please visit the specific sector at <https://gcratings.com/criteria/>.

Summary of the Criteria Changes

6. The criteria have been updated to include elements of Sustainability. For an overview on our thoughts regarding how ESG has been applied throughout the GCR Ratings Framework see the article titled 'How GCR Integrates Environmental, Social and Governance (ESG) into Issue(r) Credit Ratings'.

Introduction

7. When rating secured debt instruments the 'EL' rating can be applied to reflect both the issuer credit rating and our expectations of recoverability (from the assigned collateral) on that specific issue. Recoveries are made possible by the advantage of having distinct security ceded for the benefit of the secured lender. Contractual arrangements that enable the cession of security give rise to structural enhancements which improve the expected recovery post default, relative to unsecured debt.
8. The ratings of secured bonds are derived by applying a notching approach, starting from the long-term national scale issuer credit rating of the intended issuer of such bonds (see paragraph 20 for the approach to international scale ratings). In determining the appropriate number of rating notches to be applied, GCR compares the estimated overall recovery rate after a potential default of the issuer with the assumed

average corporate senior unsecured debt obligation recovery rate. If overall estimated recoveries are higher than the assumed average recovery rate, a notching uplift may be applicable in line with the recoveries notching table detailed below (Table 2). However, where relevant, the credit quality of the transaction parties facilitating structural enhancements (e.g., partial guarantee providers) relating to the transaction is also considered.

9. Typically, secured bond ratings will change in line with changes to the issuer credit rating, even assuming there are no changes in the recovery assumptions. However, this may change in two scenarios. Firstly, if the issuer credit rating moves to very low or near default levels and we still consider the recovery assumptions to be strong. Secondly, if the issuer defaults but we expect the entity to carry on as a going concern post restructuring or exchange. In this case, the revised 'EL' rating would typically reflect an expected post default issuer credit rating alongside the recovery expectations of the issue. If the recovery assumptions change, then the notching between the issuer credit ratings and expected loss ratings will typically also change.

Assumed Average Recovery Rate

10. International credit rating agency transition and default or recovery studies indicate that the long-term average recovery rate on defaulted senior unsecured debt obligations is approximately 40%. Note must be taken that the data supporting these studies is mainly derived from observations in the US market and other developed markets where rated debt issuance typically takes place. For other jurisdictions different average recovery rates on senior unsecured debt may be expected. Therefore, assumed recovery rates may be changed from the assumed 40% on a case-by-case basis by GCR's rating committee, if there is ample statistical evidence over time, within that market. Such assumptions will be published in a jurisdictional supplement.

Calculating the Recovery Rate

11. The notching uplift is a function of the expected (stressed) recovery proceeds from the security or other enhancements, relative to the aggregate exposure of the bondholders in a default scenario.
12. The aggregate bondholders' exposure is determined by adding the principal amount outstanding, expected legal and recovery costs, as well as the aggregate assumed missed interest payments (incl. any penalty/default interest). The missed interest is calculated using the relevant benchmark rate(s) for the jurisdiction plus the applicable margin, aggregated over the period assumed until the realisation of recoveries.
13. Security pools can be a mixture of assets, or just one type of specific asset. When assessing the security/enhancements, GCR will apply haircuts depending on the assets and typically within a 2-year liquidation window.

14. The assumed nominal value of funds recovered from the underlying security may be adjusted for the impact of inflation, subject to the time provided to realise liquidation proceeds. Furthermore, we may adjust the value of the security for ESG considerations, including the following:

- a) Transition Risks: This could arise from technological, regulatory, or legislative changes that challenge the value of underlying collateral. GCR could also include challenges and opportunities arising from the shift towards sustainable and responsible business practices of the originator.
- b) Physical / Social Risks: GCR will examine the securities exposure to, and preparedness for/ management of, potential environmental or social risk exposures that can cause harm, damage or disruption to distribution channels, the loan book, related parties, or other balance sheet assets. Furthermore, GCR will reflect any legal, regulatory, or reputational risks associated with weak environmental or social practices by the originator.

15. In addition to the expected recoveries from different types of securities that are haircut according to the guidance provided in Table 1, GCR will only incorporate cash flows from income generating assets in the recovery calculation where provisions to cede the relevant cash flows and associated bank accounts are included in the transaction documentation.

Table 1: Security Haircuts

Type of Security	Description	Haircut
Cash in Hand/Short-Term Liquid Assets	Cash in hand, reserve account (with higher rated counterparty) or overnight deposits in banks or money market funds.	0%
Listed Equities	Local or international exchange equities	See Criteria for Rating Investment Holding Companies for stress
Local Currency Government Bonds	Local currency bonds of the country of the issuer's jurisdiction	5%
Other Interest-Bearing Securities	All interest-bearing securities, in local or hard currency.	From 5% (AAA National Scale) to 100% (CCC National Scale). With potential additional haircuts for subordinated or hybrid debts or related party debts. Additional haircuts may be used for exotics or if markets have poor secondary market liquidity for those notes.
Unlisted Equity	Private equity, joint-venture or mezzanine positions in related entities	See Criteria for Rating Investment Holding Companies for stress
Loan Book Receivables	Self-originated or loan book purchases	Either a fire sale value or stressed credit losses, depending on the term, tenor and characteristics of the loan book.
Residential Real Estate (RRE)	Tenanted residential real estate.	Jurisdiction specific 10-year peak to trough independent estimate of residential real estate over the maturity horizon of the debt. In the absence of market data, a minimum haircut of 37.5% is applied
Income Producing Commercial Real Estate	Commercial real estate with ring-fenced cash flows	See above. In the absence of market data, a minimum haircut of 37.5% is applied
High Volatile Commercial Real Estate/Land	Empty buildings, land, or construction	See above or 2x RRE in absence of data
Machinery and Equipment	Moveable	Jurisdiction specific stresses will be decided based on secondary market pricing

16. Where possible and applicable, GCR will only rely on independent asset valuations or audit opinions for the base values to which haircuts are applied. In the absence of such independent opinions, additional haircuts may be applied.
17. The rating committee may use its discretion to apply additional haircuts to certain types of assets where recoverability is considered to be inherently reduced, such as related party or cross jurisdictional loans. In specific cases, the proposed security may not be given any recovery credit due to complexity, illiquidity, or a combination of both (e.g., patents).
18. After calculating stressed recoveries from the security pool as a proportion of the aggregate bondholders' exposure, GCR relies on Table 2 to provide guidance on the appropriate number of notches to uplift the issue rating from the starting point of the issuer credit rating.
19. GCR's rating committee may use its discretion to decide the appropriate number of notches to uplift the issue rating when recovery prospects are within a range of 2.5% from the turning point. Furthermore, if recoveries are considerably below 50%, negative notching may be deemed to be appropriate for the 'EL' rating of the issue/programme.

Table 2: Recovery Prospects and Associated National Scale Notching

Recovery Prospects	National Scale Notching
95% to 100%	+4
80% to <95%	+3
70% to <80%	+2
60% to <70%	+1
50% to <60%	
<50%*	Equal to Issuer Credit Rating/Senior Unsecured Issue Ratings

*If recoveries are considerably below 50%, negative notching may be applied for the 'EL' rating of the issue/programme.

International Scale Ratings

20. When assigning international scale ratings, GCR will map across from the national scale to the international scale using the Anchor Credit Evaluator. See the [Criteria for the GCR Ratings Framework](#) for more details on the anchor credit evaluator. Consequently, all secured bonds must be supported by a national scale issuer credit rating, even if the secured bond is accorded on an international scale.

Partial Guarantees

21. When there is a partial guarantee, we look at the counterparty strength of the guarantor (which could act as a cap to the rating), the level of security provided, and the terms of the partial guarantee.
22. Like the GCR guarantee guidelines, to receive credit, partial guarantees should be unconditional and irrevocable. However, unlike general obligation or full value guarantees, they may have slightly more room on timeliness.

Legal Opinions

23. Credit is only given to structural enhancements if a satisfactory transaction-specific legal opinion is analysed. As a minimum, GCR expects the legal opinion to include capacity language in respect of transaction parties, a description of the security and an opinion that transaction documentation is legal, valid, binding, and enforceable against the relevant transaction parties.
24. In the event that the security is shared with other creditors (e.g., senior or *pari passu* ranking parties, or parties that have subrogation rights), GCR expects this to be described in the legal opinion as this may influence the calculation of the estimated overall recoveries. GCR also expects confirmation from the issuer in writing that the underlying security is not dual ceded to another party.

GLOSSARY OF TERMS/ACRONYMS

Agency	An insurance sales office which is directed by an agent, manager, independent agent, or company manager.
Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Assets	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Bond	A long-term debt instrument issued by either a company, institution, or the government to raise funds.
Bondholder	Investor of capital market securities.
Capacity	The largest amount of insurance available from a company. In a broader sense, it can refer to the largest amount of insurance available in the marketplace.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing, and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Cede	To transfer all or part of a risk written by an insurer (the cedant or primary company) to a reinsurer.
Cession	Amount of the insurance ceded to a reinsurer by the original insuring company (cedant) in a reinsurance transaction.
Claim	1. A request for payment of a loss, which may come under the terms of an insurance contract (insurance). 2. A formal request or demand (corporate finance).
Collateral	Asset provided to a creditor as security for a loan or performance.
Contract	An agreement by which an insurer agrees, for a consideration, to provide benefits, reimburse losses or provide services for an insured. A 'policy' is the written statement of the terms of the contract.
Coverage	The scope of the protection provided under a contract of insurance.
Credit Rating Agency	An entity that provides credit rating services.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit	A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company
Creditor	A credit provider that is owed debt obligations by a debtor.
Creditworthiness	An assessment of a debtor's ability to meet debt obligations.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Default	A default occurs when: 1.) The Borrower is unable to repay its debt obligations in full; 2.) A credit-loss event such as charge-off, specific provision or distressed restructuring involving the forgiveness or postponement of obligations; 3.) The borrower is past due

	more than typically 90 days on any debt obligations as defined in the transaction documents; 4.) The obligor has filed for bankruptcy or similar protection from creditors.
Distribution Channel	The method utilised by the insurance company to sell its products to policyholders.
Enforceable	To make sure people do what is required by a law or rule et cetera.
Environment	The surroundings or conditions in which an entity operates (Economic, Financial, Natural).
Equity	Equity is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Expected Loss	Losses that a bank expects to bear over a certain period (generally a year). These losses are a consequence of doing business, namely the bank's role as financial intermediary.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Going Concern	An accounting convention that assumes a company will continue to exist and trade normally for the foreseeable future. In practice this is likely to mean at least for the next 12 months.
Guarantee	An undertaking in writing by one person (the guarantor) given to another, usually a bank (the creditor) to be answerable for the debt of a third person (the debtor) to the creditor, upon default of the debtor.
Guarantor	A party that gives the guarantee.
Haircut	The percentage by which the market value of an asset is reduced. The size of the haircut reflects the expected ease of selling the asset and the likely reduction necessary to realised value relative to the fair value.
Hybrid	A form of security that has characteristics of various types of transaction or product.
Illiquid	Markets or financial instruments are described as being illiquid if there are few buyers and sellers. Assets may also be considered illiquid. It may be difficult, or even impossible, to find a reliable price for an illiquid security.
Income	Money received, especially on a regular basis, for work or through investments.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
International Scale Rating	An opinion of creditworthiness relative to a global pool of issuers and issues.
Irrevocable	Not able to be changed, reversed, recovered and final.
Issue Ratings	See GCR Rating Scales, Symbols and Definitions.
Issuer Ratings	See GCR Rating Scales, Symbols and Definitions.
Issuer	The party indebted or the person making repayments for its borrowings.
Joint Venture	A project or other business activity in which two persons or companies partner together to conduct the project.
Legal Opinion	An opinion regarding the validity and enforceable of a transaction's legal documents.
Lender	A credit provider that is owed debt obligations by a debtor.

Liquid Assets	Assets, generally of a short term, that can be converted into cash.
Liquidation	Liquidation is the process by which a company is wound up and its assets distributed. It can be either compulsory or voluntary. It can also refer to the selling of securities or the closing out of a long or short market position.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Loan	A sum of money borrowed by a debtor that is expected to be paid back with interest to the creditor. A debt instrument where immovable property is the collateral for the loan. A mortgage gives the lender a right to take possession of the property if the borrower fails to repay the loan. Registration is a prerequisite for the existence of any mortgage loan. A mortgage can be registered over either a corporeal or incorporeal property, even if it does not belong to the mortgagee. Also called a Mortgage bond.
Loss	1. A tangible or intangible, financial or non-financial loss of economic value. 2. The happening of the event for which insurance pays (insurance).
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Nominal Value	The value of a security set by the entity that issues it. It is unrelated to market value. Also known as face value or par value.
Notching	A movement in ratings.
Obligation	The title given to the legal relationship that exists between parties to an agreement when they acquire personal rights against each other for entitlement to perform.
Originator	An entity that created assets and hold on balance sheet for securitisation purposes.
Pari Passu	Side by side; at the same rate or on an equal footing. Securities issued with a pari passu clause have rights and privileges that are equivalent to those of existing securities of the same class.
Pledge	An asset or right delivered as security for the payment of a debt or fulfilment of a promise, and subject to forfeiture on failure to pay or fulfil the promise.
Pool	An organisation of insurers or reinsurers through which particular types of risk are underwritten and premiums, losses and expenses are shared in agreed-upon amounts.
Pricing	A process of determining the price of a debt security.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Private	An issuance of securities without market participation, however, with a select few investors. Placed on a private basis and not in the open market.
Proceeds	Funds from issuance of debt securities or sale of assets.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Ranking	A priority applied to obligations in order of seniority.
Real Estate	Property that consists of land and / or buildings.

Receivables	Any outstanding debts, current or not, due to be paid to a company in cash.
Recovery	The action or process of regaining possession or control of something lost. To recoup losses.
Reputational Risk	The risk of impairment of an entity's image in the community or the long-term trust placed in it by its shareholders as a result of a variety of factors, such as performance, strategy execution, the ability to create shareholder value, or an activity, action or stance taken by the entity.
Reserve	(1) An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders. (2) An amount allocated for a special purpose. Note that a reserve is usually a liability and not an extra fund. On occasion a reserve may be an asset, such as a reserve for taxes not yet due.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Secondary Market	The secondary market is where securities are bought and sold once they have been issued in the primary markets.
Secured Debt	Debt backed with or secured by collateral to reduce lending risk and thus the interest rate charged.
Securities	Various instruments used in the capital market to raise funds.
Security	One of various instruments used in the capital market to raise funds.
Senior Unsecured Debt	Securities that have priority ahead of all other unsecured or subordinated debt for payment in the event of default.
Senior	A security that has a higher repayment priority than junior securities.
Structural Enhancement	This may be provided as credit enhancement or as various other methods to enhance the security of a transaction such as performance triggers, short revolving periods et cetera.
Tenor	The time from the value date until the expiry date of an instrument, typically a loan or option.
Transaction	A transaction that enables an Issuer to issue debt securities in the capital markets. A debt issuance programme that allows an Issuer the continued and flexible issuance of several types of securities in accordance with the programme terms and conditions.
Unconditional	Not subject to any conditions.
Valuation	An assessment of the property value, with the value being compared to similar properties in the area.

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