

## Government-Related Entities Rating Criteria

### Contents

Potential Extraordinary Support .....	2
Analytical Framework .....	2
GRE's Ties with the Gov't.....	3
GRE's Importance to the Gov't.....	4
Gov't's Willingness to Support .....	7
Gov't's Capability to Support .....	7
Determining a GRE's ICR.....	8
Potential Adverse Interventions .....	9
Updates and Modifications .....	9
Related Criteria.....	10

### Summary

*(Editor's Note: We originally published this criteria article on 31 August 2018. We have republished it following our periodic review completed on 30 August 2022.)*

This criteria report describes CSPI Ratings' approach to rating government-related entities (GREs) in the corporate (including project finance), financial institution, insurance and public finance sectors globally. In our opinion, an issuer's affiliation with the government may have a positive, negative or neutral impact on its overall creditworthiness. One of our primary considerations in analyzing a GRE is whether its credit profile may be enhanced by potential extraordinary support from the government in the event of financial distress, or conversely, impaired by potential extraordinary adverse interventions from the government should the government experience financial difficulties.

In either of these scenarios, we differentiate between "extraordinary" support or adverse intervention from those that are ordinary and on-going. We consider potential support or adverse intervention to be extraordinary when it is temporary in nature, occurs during times of financial distress, and applies to specific entities (as opposed to being across entire industries). These criteria focus on our treatment of potential extraordinary support from or adverse intervention by the government, while ordinary and on-going support or adverse intervention is considered in our assessment of an entity's standalone credit profile (SACP). These criteria should be applied and interpreted with our other published criteria.

### Definitions

Throughout this report, we use the term "government" to refer to sovereigns and all sub-sovereign governments.

We generally define GREs as entities that have some degree of ties with or importance to the government, as explained throughout these criteria. We note that GREs are often controlled by a government or a number of governments. Control is typically indicated by direct or indirect majority shareholdings or voting rights in an entity. This would usually imply control over an entity's board of directors and management.

However, for us to consider positive impacts of government affiliation, control is not a necessary condition. We note that there are GREs that are instrumental to a government's effective implementation of policy objectives, even if they are not controlled by the government itself. These entities have a significant impact on the government's proper functioning and, if they fail, may cause substantial damage to the country's or jurisdiction's reputation, economy or social well-being.

On the other hand, for us to consider negative impacts of government affiliation on an entity's creditworthiness (i.e. potential extraordinary adverse intervention), control is a pre-requisite, as we believe, in the vast majority of cases, a government's ability to re-direct an entity's financial resources for its own use is largely determined by its influence over the entity's board and management.

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## Potential Extraordinary Support

This section sets forth our framework for rating GREs that may benefit from potential extraordinary support from the government. As there exist major differences in how GREs interact with their related governments across countries and jurisdictions, the analytical factors in these criteria are not intended to be an exhaustive list. Our rating committees may consider additional factors unique to each entity’s circumstances to derive a final rating outcome.

Depending on the country or jurisdiction, as well as a particular GRE’s relationship with the government, potential extraordinary support may take many forms. Examples of such support include: short-term liquidity facilities, equity capital injections, tax forbearance, and facilitation in debt restructuring. In any case, these forms of support extended during times of a GRE’s financial distress are typically temporary measures targeted at individual entities. More importantly, in order for us to consider potential positive impacts on a GRE’s creditworthiness, we must be satisfied that such potential support will occur prior to default as per our definitions.

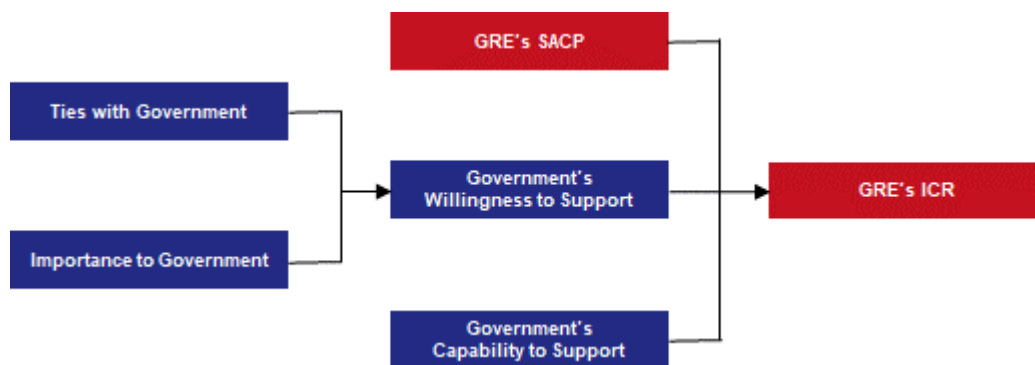
### Analytical Framework

The global-scale issuer credit rating (ICR) that we assign to a GRE that may benefit from potential extraordinary support consists of: (a) the GRE’s standalone credit profile (SACP), as defined by the relevant criteria and; (b) the potential extraordinary support from its related government(s).

We analyze potential extraordinary support by evaluating the government’s willingness to provide support and its capability to provide support. We further examine a government’s willingness to support by assessing: (a) the GRE’s ties with the government and; (b) its importance to the government.

Our analytical framework is summarized in Exhibit 1:

**Exhibit 1: Analytical Framework – Potential Extraordinary Support**



We note that an entity’s GRE status and our view of its related government’s willingness to support are subject to periodic review. Entities that were previously considered to be a GRE may no longer be deemed government-related should circumstances change. In a like manner, an entity that was previously considered non-government related may be deemed a GRE as its status evolves. Examples of these changing circumstances may include: a change in ownership structure as a result of privatization, the emergence of other GREs or private-sector companies that perform similar functions, a significant change in government policy priorities, and substantial growth in a GRE’s commercially-oriented operations.

## GRE's Ties with the Government

The first component in our assessment of a government's willingness to support a GRE is the GRE's ties with the government. In our analysis, we consider a GRE's linkage with its related government in a broad sense and on a forward-looking basis, encompassing:

- **Ownership.** In many cases, government ownership is an important indicator of a GRE's linkage with the government. We generally regard a high level of ownership that is both long-term and strategic in nature to be indicative of a close linkage between a GRE and the government. In our analysis, we place a strong emphasis on the government's prospective shareholding horizon and intent. Imminent plans to privatize all or part of a GRE's operations may reflect increasing likelihood that the GRE will become more public market-reliant in its contingent financing plans going forward.
- **Board and Management.** Our evaluation of a GRE's board of directors and management complements our ownership analysis in assessing the government's influence over the entity. A high degree of government control over an entity's board and management, as evidenced by the appointment of key personnel, may indicate that the GRE's operations are highly intertwined with key government functions. Where applicable, we may also assess the extent to which government-appointed supervisory boards influence a GRE's business affairs.
- **Business Connections.** GREs may be either for-profit or non-profit organizations. In some cases, GREs may fall into both categories if they concurrently perform public-service roles in some areas and conduct commercial activities in others. Our focus is on a GRE's business connections with the government, as reflected by the way the entity sources its business. GREs that are highly dependent on the government to generate revenues, especially those that have monopoly positions in certain sectors, are typically considered to be closely linked with the government.
- **Policy and Support Record.** The linkage between a GRE and its related government may be gauged from the track record of extraordinary support provided to the GRE during times of financial distress. We would assess the timeliness and methods of support extended previously to form an opinion on likely outcomes if the GRE were to experience financial difficulties again in the future. Equally relevant to our analysis is the government's stated policy intent. A clear, publicly communicated statement of potential support would be a sign of strong commitment.
- **Developments and Expectations.** We are cognizant of the fact that a GRE's ties, or perceived ties, with the government may evolve over time as government priorities shift, government administrations change, and the role of GREs is re-defined. More permanent ties with the government may be found in certain GRE sectors such as policy banking, oil and gas, and public utilities. Less permanent linkages may be seen in sectors such as telecommunications, mining, and transportation.

Exhibit 2 summarizes the factors we consider in our evaluation of a GRE's ties with the government. We classify each of these factors as Strong, Moderate, or Limited, according to the qualitative guidelines listed. We adopt a holistic approach in assigning an overall score on a GRE's ties with its related government, rather than prescribing weights to each of the factors. No single factor would necessarily constrain how we consider an entity's overall government ties.

Exhibit 2: Ties with the Government – Rating Factors

GRE's Ties with Government		Scoring Guidelines		
		Strong	Moderate	Limited
Rating Factors	Ownership	The GRE is wholly-owned or close to wholly-owned by the government. There is no indication that the government will reduce its ownership in the foreseeable future.	The government has a majority ownership in the GRE and has no intention to divest its holding to below 50% in the near future.	The government has a minority shareholding in the GRE and has no intention to increase its holdings to majority in the near future.
	Board & Management	The government appoints the board of directors and senior management, and often exchanges its officials with GRE management personnel. The government has absolute control over the GRE's business strategy and operations.	The government appoints the majority of the board of directors and senior management, and has a strong influence over the GRE's business strategy and operations.	The government has the right to appoint some directors to the board, and has some influence on key management personnel appointment. The government is relatively passive in influencing company's business strategy and operations.
	Business Connections	The bulk of the GRE's business originates from direct government contracts or through government-related agencies.	A large portion of the GRE's business originates from direct government contracts or through government-related agencies.	The GRE derives a small portion or none of its business from the government and government-related agencies.
	Policy & Support Record	There is sufficient evidence and an established track record to prove that the government has provided timely and sufficient extraordinary support to the GRE in the event of financial distress; Or there is an established policy to explicitly state that the government will support the GRE in the event of financial distress.  There are no legal barriers or constraints for the government to provide extraordinary support.	The government has provided some extraordinary support in the past, but the track record is not well-established and such support seems to be on an ad-hoc basis; Even though there is no clear policy that the government will support the GRE, some implicit support intention can be reasonably observed.  There are no legal barriers or constraints for the government to provide extraordinary support.	There is limited evidence or track record to show that government has provided any meaningful extraordinary support in the past; There are no explicit policies to demonstrate the potential for support and implicit intentions to support cannot be readily observed.  There may be some legal barriers or constraints for the government to provide extraordinary support.
	Developments & Expectations	Going forward, the GRE's ties with the government are expected to be further strengthened if not already very tight.	Going forward, the GRE's ties with the government are expected to be more or less stable.	Going forward, the GRE's ties with the government are expected to weaken substantially.

### GRE's Importance to the Government

The second component in our assessment of a government's willingness to support a GRE is the GRE's importance to the government. We believe the government's willingness to support a GRE is positively correlated with a GRE's importance. The defaults of highly important GREs may have serious implications on the government's proper functioning, thereby increasing the likelihood of potential extraordinary support. We evaluate a GRE's importance to the government by assessing the following factors:

- **Products and Services Provided.** We believe the fundamental objectives of a government are to maintain law and order, manage the allocation of local resources, promote growth and stability, provide public goods and services etc. Many GREs exist to assist the government in achieving these policy objectives. Generally, we view as more important GREs that are primarily public policy-oriented, compared to those that are more commercially-oriented, particularly those that contribute to the government mainly through the generation of profits and taxes.
- **Replaceability.** In our view, the replaceability of a GRE is a critical determinant of its importance to the government. If a GRE's products and services cannot be easily replaced by those provided by other GREs or private-sector enterprises, we would consider it to have relatively high importance. Even if some products and services may potentially be substituted,

such substitution may entail significant costs, rendering the providers essential. GREs that provide products and services that are sensitive in nature (e.g. military equipment) may also be considered to be highly important.

- **Contribution to the Government.** A GRE's contribution to the government and the local economy is often a readily observable indicator of its importance to the government. Depending on a particular jurisdiction's policy priorities (which may change over time), a government may favor GREs that contribute the most in terms of local employment, taxes, investments, profits, or other similar metrics. In our assessment, we attempt to compare and rank GREs across multiple measures, based on what we believe to be the most relevant to the government in a certain country or jurisdiction.
- **Status within the Political, Social and Legal Systems.** While a GRE's financial contribution to the government could usually be quantified, its status within the broader political, social and legally systems may be more difficult to assess. We focus on factors such as the origin of the GRE, the background of its government-appointed board of directors and management, and the perceived value of a GRE's brand name by the society-at-large. We may also consider the GRE's legal structure and incorporation status to ascertain its standing within the public sector.
- **Financial and Social Impacts of Default.** Lastly, we consider the potential financial and social impacts of a hypothetical default by a particular GRE. Financial impacts may include damage to the local economy, loss of future tax revenues, and spillovers to the GRE's suppliers, customers, creditors, the banking system, and public securities markets. The failure of a GRE, if deemed to be highly important, may also lead market participants to question the government's own creditworthiness. Social impacts may be equally, if not more, relevant to our analysis as a GRE's default may lead to a disruption in the provision of essential public goods and services, cause significant unemployment, tarnish a country or jurisdiction's reputation, and, in the worst case, create social unrest that may impair the government's ability to effectively carry out its core functions.

We note that the first four of the factors above are evaluated based on historical evidence, current observations and our expectations of how they may change in the future. The last factor, which addresses the impacts of a GRE's default, is principally assessed on the basis of our opinion on how a hypothetical scenario will play out.

Exhibit 3 summarizes the factors above, along with our scoring guidelines.

Exhibit 3: Importance to the Government – Rating Factors

Rating Factors	Scoring Guidelines		
	3	2	1
<b>Products &amp; Services Provided</b>	The GRE's single most important objective is to provide public goods and services that are crucial to the local community socially and financially.	Even though the GRE provides some public goods and services, a sizeable portion of its business relates to commercial activities.	The bulk of the GRE's business is commercially-oriented and subject to competition in the marketplace.
<b>Replaceability</b>	The GRE cannot be substituted at all, or its substitution can be extremely costly and time-consuming to the government.	The GRE is replaceable with some effort and cost.	The GRE is easily replaceable by other GREs or private-sector companies.
<b>Contribution to the Government</b>	The GRE is one of the largest contributors in terms of employment, taxes, investments and profits; Or the GRE plays a vital public policy role.	The GRE is a moderate contributor to the government and local economy. The GRE plays a reasonably important role in employment, tax contribution, investments, profits, and public policy.	The GRE does not contribute to any local economic measure or to public policy in a substantial way.
<b>Status within the Political, Social and Legal Systems</b>	There is clear evidence to demonstrate that the GRE is significantly differentiated from its peers and has a special status within the political, social and legal systems.	The GRE is considered to be unique or differentiated in some aspects, but is mostly in the same bracket with its peers.	There is nothing unique about the GRE's status. The GRE is considered to have an average or a lower status compared to its peers.
<b>Financial &amp; Social Impacts of Default</b>	The GRE's potential default may have substantial impacts on social stability and the local economy.	The GRE's potential default may have moderate impacts on social stability and the local economy.	The GRE's potential default may have limited impacts on social stability and the local economy.

We assign a score of “1”, “2”, or “3” to each of the five factors above, representing “Low”, “Medium” and “High” importance based on that particular factor’s guidelines. We may assign scores in increments of 0.5 if we believe a particular factor falls between two importance categories.

After we score each factor, we sum up the individual scores to derive a total score on the GRE’s importance to the government (i.e. each factor is equal-weighted). The total score would correspond to one of five categories, namely “Critical”, “Extremely Important”, “Very Important”, “Moderately Important” and “Limited Importance”, as per Exhibit 4. When the total score falls between the thresholds of two adjacent categories, we will choose to round up or round down in our judgements to better capture the importance to the government.

Exhibit 4: Importance to the Government – Scoring Range

Level of Importance	Total Score
Critical	15
Extremely Important	13 – 14
Very Important	10 – 12
Moderately Important	7 – 9
Limited Importance	5 – 6

Of the five factors we consider, we believe the financial and social impacts of default is the single most important determinant of the government’s willingness to provide extraordinary support in the event of financial distress. Therefore, we use the potential impacts of default as a constraining factor.

If this factor is assigned a score of “1”, the maximum level of importance we would attach to a GRE is “Moderately Important”.

If this factor is not assigned a score of “3”, the maximum level of importance we would attach to a GRE is “Extremely Important”.

## Government’s Willingness to Support

Once we complete the assessments of a GRE’s ties with the government and its importance to the government, we will combine the two results to determine the government’s willingness to support, which is expressed on a 7-point scale, according to Exhibit 5.

**Exhibit 5: Government’s Willingness to Support – Scoring Guidelines**

Government’s Willingness to Support		GRE’s Importance to Government				
		Critical	Extremely Important	Very Important	Moderately Important	Limited Importance
GRE’s Ties with Government	Strong	7 (Almost Certain)	6 (Extremely Strong)	5 (Very Strong)	4 (Strong)	3 (Moderately Strong)
	Moderate	6 (Extremely Strong)	5 (Very Strong)	4 (Strong)	3 (Moderately Strong)	2 (Moderate)
	Limited	5 (Very Strong)	4 (Strong)	3 (Moderately Strong)	2 (Moderate)	1 (Low)

A score of “7” represents our opinion that the government’s willingness to support the GRE is almost certain, in which case we would equalize the GRE’s ICR with that of its related government (subject to the considerations in the “Government’s Capability to Support” section below). Since a GRE has to be deemed to have strong ties with and critical importance to the government in order for us to conclude that the government’s willingness to support is almost certain, we expect a score of “7” to be exceedingly rare.

However, if a government explicitly guarantees at least 80% of a GRE’s debt obligations and if we determine that such guarantees meet our definitions of sufficient and timely support, we may assign a score a “7” to the GRE.

On the other end of the spectrum, a score of “1” represents our view that the government has no or minimal willingness to provide extraordinary support to a GRE in the event of financial stress. In such cases, we would not deem the entity to be a GRE that would benefit from potential extraordinary support and its ICR would likely be equalized with its SACP.

## Government’s Capability to Support

A basic assumption for our GRE rating criteria is that a government’s support willingness is also somewhat constrained by its own credit profile. The weaker a government’s creditworthiness, the lower its propensity to support the GREs that fall under its jurisdiction. For the purposes of this criteria report, we define “governments” as sovereign governments and sub-sovereign governments (i.e. local governments, or “LGs”).

We consider sovereign governments’ capability to provide potential extraordinary support to GREs to be their ICRs.

For cases where LGs do not benefit from support from higher-level governments, we consider their capability to support to be their ICRs, which are typically aligned with their SACPs.

For cases where LGs benefit from support from higher-level governments and we determine that such support could filter down to qualifying GREs, we would consider the LGs’ capability to support to be their ICRs.

For cases where LGs benefit from support from higher-level governments but we determine that such support could not filter down to qualifying GREs (which may be due to policy or budgetary restrictions), we would consider the LGs’ capability to support to be their SACPs. There may be cases where we cannot reasonably assign an SACP to an LG (due to the lack of publicly available data, for instance). In such cases, we would use the LG’s ICR as a starting point and apply downward adjustments as our rating committees deem appropriate given the jurisdiction’s unique characteristics.

As per our sovereign rating and local government criteria, we may assign local-currency and/or foreign-currency ICRs to a government. If a government’s local-currency and foreign-currency ICRs are different, we would typically use the lower of the two as an indication of its capability to support the GREs under its jurisdiction. Our rationale is two-fold. First, we are of the view that governments have an overarching goal to maintain a certain level of credit strength of its own, before allowing financial resources to trickle down to lower-level governments and GREs. Therefore, the lower of a government’s local-currency and foreign-currency ICR effectively represents a weak link in its support capability. Second, at the GRE level, we would generally consider an issuer to be in default if it fails to fulfill any of its financial obligations, regardless of currency

denomination. As such, the potential for cross-default, whether it be contractually enforced, calls for a more conservative treatment of the capability of a GRE's supporting government.

### Determining a GRE's Issuer Credit Rating

In summary, we believe a GRE's overall creditworthiness is a function of its own standalone credit profile, and its related government's support capability and willingness. In our view, these three variables are not independent from each other.

In other words, a GRE's ICR can be expressed as a function of  $f(x, y, z)$ , where  $x$  represents the GRE's SACP,  $y$  represents the government's support capability, and  $z$  represents the government's willingness to support, where the variable  $x$  takes on a value from the data series (aaa, aa+, ... cc),  $y$  takes on a value from the data series (AAA, AA+, ... B-) or (aaa, aa+, ... b-) if the government's SACP applies, and  $z$  takes on a value from the data series (7,6,5,4,3,2,1).

In the vast majority of cases, we will determine a GRE's SACP before we assess its related government's capability and willingness to provide potential extraordinary support. We believe a GRE's SACP conveys valuable information pertaining to the quantum of financial support potentially required, as well as the related government's corresponding contingent liability. However, we may not assign an SACP to a GRE if the government's willingness to support is determined to be almost certain in the event of financial distress (i.e. a score of "7") and; (2) if we believe the government's willingness to support is not subject to transition risk.

Having assessed the government's willingness and capability to support, we adopt either a top-down or bottom-up approach in determining the potential upward adjustment to arrive at a GRE's ICR.

If we believe the government's willingness to support falls on the higher end of the spectrum, we would typically apply a top-down approach, as we believe the GRE's overall creditworthiness would be closer to that of the supporting government. At the extreme, a GRE could be assigned an ICR at the same level as that of the supporting government.

On the contrary, if we believe the government's willingness to support is low, we would generally use a bottom-up approach, which reflects our view that the GRE's overall creditworthiness would more likely be driven by its own SACP. At the extreme, a GRE's ICR could be the same as its SACP (i.e. no support is factored in).

In cases where a GRE's SACP is higher than the ICR of the supporting government, we would typically cap the GRE's ICR at the government's ICR. Nonetheless, we may allow for exceptions if: (1) the GRE's ties with the government are assessed to be limited; (2) there is sufficient evidence to demonstrate that the GRE is capable of insulating itself from potential adverse interventions from the government; and (3) should the GRE's SACP exceed the ICR of a sovereign government, the GRE satisfies our analytical considerations for issuer ratings above the sovereign.

Exhibit 6: Notching Guidelines

Rating differential between GRE's SACP and Government's ICR	Government's Willingness to Support						
	Almost Certain	Extremely Strong	Very Strong	Strong	Moderately Strong	Moderate	Low
≤ 0	SACP or capped	SACP or capped	SACP or capped	SACP or capped	SACP or capped	SACP or capped	SACP or capped
1	ICR	ICR	ICR or ICR-1	SACP	SACP	SACP	SACP
2	ICR	ICR	ICR-1	SACP+1	SACP	SACP	SACP
3	ICR	ICR-1*	ICR-1	SACP+1 or SACP+2	SACP+1	SACP	SACP
>3 and ≤6	ICR	ICR-1	ICR-1 or ICR-2	SACP+3 capped at ICR-2	SACP+2 or SACP+3 capped at ICR-2	SACP+1 or SACP+2	SACP
>6	ICR	ICR-1 or ICR-2	ICR-3 or ICR-4	SACP+4 or SACP+5 capped at ICR-4	SACP+3 or SACP+4 capped at ICR-4	SACP+1 or SACP+2	SACP

\* The GRE's ICR is AAA if the supporting Government's ICR equals to AAA and the GRE's SACP is aa-. The ICR in the table is the ICR of the related government, while the SACP represents the GRE's SACP.

Exhibit 6 shows the notching guidelines based on the government's willingness to support as well as the rating differential between GRE's SACP and the government's ICR, which reflects the fact that the larger the rating differential, the more reliant the GRE is on the support. The GRE's ICR might differ by one notch from the indicated rating in the table, when a gradual



transition in a GRE's ties with or importance to the government results to a weakening or strengthening of the government's willingness to support.

## Potential Adverse Interventions

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Thus far, we have only considered potential extraordinary support, which would apply to most GREs we analyze.

The government's influence on a GRE may not always come in the form of support. Governmental influence may also be in the form of negative intervention, if the government itself falls into financial difficulty and exercises its authority to tap into the financial resources of the GREs under its jurisdiction. Such scenarios would often create significant burdens on the GREs, resulting in a deterioration in their creditworthiness.

Potential adverse intervention may be in the form of additional taxes and levies, special dividends and capital repatriations, government-led mergers and acquisitions to rescue distressed companies with cash financing from the GREs, and regulatory or policy changes that are designed to channel the GREs' financial resources to the government, etc.

When we consider extraordinary adverse intervention to be probable, we would usually lower the GRE's ICR to below its SACP to reflect our expectation that the government's negative influence may result in a weaker credit profile for the GRE. The risk of extraordinary adverse intervention would often rise when the government is in default or under financial distress.

## Updates and Modifications

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We originally published this criteria article on 31 August 2018.

Modifications made following original publication:

- On 31 August 2021, we updated the author contact information.
- On 4 February 2022, we republished this criteria article to include a notching guidelines table (Exhibit 6) and to clarify how we assign scores for Importance to the Government Factors when we consider a particular factor falls between two importance categories. Additionally, we added the "Updates and Modifications" section.

## Related Criteria

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[General Principles of Credit Ratings, 21 November 2017](#)

[Sovereign Rating Criteria, 30 May 2018](#)

[Chinese Local Government Rating Criteria, 29 June 2021](#)

[Global Bank Rating Criteria, 16 August 2019](#)

[Global Insurance Rating Criteria, 7 May 2018](#)

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