

Property/Casualty
Insurers
U.S. and Canada
Credit Analysis

ProAssurance Corp.

Ratings

Security Class	Rating
Long-Term IDR	BBB+
PACO Assurance Company, Inc. Podiatry Insurance Co. of America	
ProAssurance Casualty Company ProAssurance Indemnity Co. Inc. ProAssurance National Capital Insurance Company ProAssurance Specialty Ins. Co. ProAssurance Wisconsin Ins. Co. Insurer Financial Strength	A

Rating Outlook

Stable

Financial Data

ProAssurance Corp.		
Financials	Date	\$ Mil.
Net Income	9/30/09	137
Equity	9/30/09	1,649
Debt and Hybrids	9/30/09	50

Analysts

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Related Research

Applicable Criteria

- *Insurance Rating Methodology, Dec. 29, 2009*
- *Non-life Insurance Rating Criteria (Global), March 2, 2007*

Other Research

- *Review & Outlook 2009–2010 U.S. Property/Casualty Insurance, Dec. 8, 2009*
- *Property/Casualty Industry Loss Reserve Adequacy — At A Crossroads, Nov. 2, 2009*

Rating Rationale

- ProAssurance Corp. and its subsidiaries' (collectively referred to as PRA) ratings were recently affirmed based largely on the solid capital position of PRA's operating subsidiaries, as well as consistent profitability, financial and operating flexibility, and a highly experienced management team.
- PRA has an established reputation for providing quality service and expertise in risk management in the medical professional liability line, as well as a strong track record of aggressively defending nonmeritorious claims, which enhances customer loyalty and reduces fraud.
- PRA reported a calendar-year GAAP combined ratio of 79.1% through Sept. 30, 2009. However, on an accident-year basis the company reported a 106% combined ratio, or 4 percentage point deterioration over the prior year. The \$108 million of favorable reserve development primarily related to accident years 2002–2006.
- Fitch's current ratings also consider the company's inherent underwriting volatility as a monoline writer that operates in one of the industry's most unpredictable lines of business.
- Rates in the medical professional liability market have peaked and the operating environment has become more competitive. Fitch Ratings believes that PRA has maintained reasonable pricing discipline during past competitive operating cycles.

Key Rating Drivers

- Fitch believes that the company will likely increase its operating leverage over the next 12–18 months through increased writing and/or an acquisition. Fitch notes the company's management is very prudent with its resources and will only deploy capital for an acquisition that compliments the company's profile and creates long-term shareholder value. If the company were to make an acquisition, Fitch would review its current ratings to determine if there is any potential ratings impact.
- Fitch expects PRA to maintain reasonable financial leverage. As of Sept. 30, 2009, the company had approximately 3% leverage. Fitch notes that the company has room in its current rating to increase financial leverage. Fitch's long-term rating expectations anticipate that financial leverage will return to the mid 20% range and coverage will be in the 4x–7x range.
- Fitch views PRA's loss reserve position as adequate and notes that the company does have a history of favorable reserve development. Fitch does not anticipate reserve development in excess of 5% of prior year's surplus in a given year.
- Fitch believes that PRA will maintain pricing discipline as the market starts to soften. Failure to do so would put negative pressure on the ratings.

Fitch believes that the current strong levels of capital, as evidenced by an operating leverage of 0.41x, is unsustainable. Fitch anticipates these ratios will gradually return to a longer run average.

Key Rating Issues

Strong Capital Position Solidifies Rating

Fitch views PRA’s capital position, based on traditional capital measurers such as operating leverage and the National Association of Insurance Commissioners’ risk-based capital (RBC) ratio as very strong and was a key component to the recent ratings affirmation.

Leverage

(x)

	2008	2007	2006	2005	2004
Net Premium Written/PHS	0.41	0.51	0.69	0.75	1.35
Net Leverage	2.77	3.17	3.86	3.90	5.24
Gross Leverage	3.08	3.56	4.32	4.43	6.19
NAIC RBC Ratio ^a (%)	430	424	307	229	186

^aFigure was taken from lead operating subsidiary. PHS – Policyholders’ surplus.
Source: Highline Data.

While the above table shows dramatic improvement in various capital metrics, Fitch believes that the current low levels are unsustainable. Fitch anticipates that over time these ratios will gradually return to a longer run average range. However, if these metrics were to be sustained at current levels, positive rating pressure might exist.

Fitch notes that while it anticipates the company to increase its operating leverage, management will do so at a cautious and measured pace. The company’s balance sheet strength prepares the company to take advantage of a hardening market, though Fitch believes that a hardening market will not happen in 2010.

Fitch notes that consolidated policyholders’ surplus has grown significantly over the past five years. This growth is a function of acquisitions, public stock offerings, and growth of retained earnings from profitable operations.

Mergers and Acquisitions Likely to Continue

On April 1, 2009, PRA completed its acquisition of Podiatry Insurance Company of America (PICA) for \$120 million and \$15 million in premium credits to eligible PICA policyholders beginning 2010. The PICA Group, based in Nashville, TN, is the nation’s leading provider of professional liability to doctors of podiatric medicine, insuring approximately 9,800 podiatric physicians in 47 states and the District of Columbia. PICA insures other healthcare professionals and also provides errors and omissions (E&O) insurance for a small, but growing, number of independent insurance agents.

PRA also picked up Georgia Lawyers for \$4.6 million in the first half of 2009. Total legal E&O premiums for 2008 were just under \$8 million.

Since 2004, the company has been involved in seven merger and acquisition (M&A) transactions, including the \$400 million sale of Michigan Educators Employee Mutual Insurance Company (MEEMIC), a former Michigan based auto insurance subsidiary, to GMAC Insurance Holdings, Inc.

Fitch notes that PRA’s management team has been relatively judicious in reviewing possible acquisitions to make sure that the target company fits into the company’s long-term strategic plan and that the purchase price is reflective of the company’s true value.

Over the past several years many small insurers and risk retention groups have formed to help alleviate some pricing pressure for physicians. Unfortunately, many of these plans provided temporary rate relief but failed to charge a sufficient premium to sustain long-term performance. As these companies start to show signs of weakness or even insolvency,

PRA completed its acquisition of PICA on April 1, 2009.

PRA may be able to pick up smaller books of business as opposed to a large transaction.

Please refer to the Company Profile section of this report for further details on the company's recent M&A transactions.

Strong Calendar Year Profitability

Fitch views PRA's profitability favorably and in line with current rating expectations. Underwriting performance, as measured by the combined ratio, has improved in recent years. The improvement is due mainly to a nationwide drop in frequency, less aggressive pricing competition aided by lack of entry of a large national carrier, and, to a certain extent, tort reform in certain states.

Fitch also notes that the strong calendar year combined ratios for the past three to four years have been helped by large favorable reserve development. While favorable reserve development is an indication of reserve strength, it can mask problems in underwriting results, therefore Fitch also looks at accident year results when assessing a company's profitability.

Profitability

(\$ Mil.)

	3Q09	3Q08	2008	2007	2006	2005	2004
Revenue, Excluding Realized Gains (Losses)	484	472	618	712	739	647	598
Premiums Earned	364	350	459	534	583	543	520
Pretax Realized Gains (Losses)	5	(41)	(51)	(6)	(1)	1	8
Pretax Net Investment Income	113	122	158	171	150	99	76
Pretax Operating Income	189	177	299	242	178	108	46
Net Income	137	101	178	168	236	113	73
% Return on Common Equity	11.9	10.5	13.3	14.2	25.1	16.5	12.6
Combined Ratio (%)	79.1	82.5	68.0	85.8	94.2	97.1	104.8
Points from Prior Year Reserve Development	(32.2)	(26.4)	(40.3)	(19.7)	(6.2)	(4.2)	(1.7)

Note: U.S. GAAP.

Source: Highline Data, company SEC filings.

Fitch believes that PRA's accident year underwriting results will be maintained or improve over the near term.

While accident year results have increased slightly over the last 5 years Fitch believes that this range will be maintained on a go forward basis. Fitch recognizes that the low interest rate environment has put a renewed focus on companies underwriting results to generate an adequate return on equity.

Although it appears that pricing in the medical professional liability market has peaked, Fitch notes that PRA has shown pricing discipline during past operating cycles. PRA's favorable comparison is reflective of its focused and disciplined underwriting approach that emphasizes long-term profitability as opposed to top-line growth.

While ProAssurance does write a number of large hospitals and physician groups, management has generally avoided an over-reliance on these type insureds as they have experienced the greatest price competition and do not play into the company's strengths. Furthermore, the company's good geographic mix and lack of dependence on specific markets allows for the withdrawal or pull back from overly competitive or difficult local markets.

Claims

Fitch views PRA's handling of nonmeritorious claims as a key component to building long-term loyal relationships with its policyholders in addition to lowering overall costs. Fitch believes that PRA tries more cases than any other medical professional liability insurer and has a favorable outcome approximately 80% of the time. ProAssurance is also committed to reaching a reasonable settlement in cases where there is merit and settles approximately 10% of the claims against its policyholders.

PRA operates 16 regional claims and offices. The company believes that local knowledge allows it to be more effective in evaluating claims.

Peer Analysis

PRA's closest peers in Fitch's rated universe are The Doctors Company (TDC) and FPIC Group, Inc. (FPIC), both medical professional liability carriers. TDC and FPIC have insurer financial strength (IFS) ratings of 'A' and 'A-', respectively, and both have Stable Outlooks.

The table below shows that ProAssurance's underwritings results have approximated or bettered the industry results over the last five years. Fitch anticipates that this trend will continue on a go forward basis.

Peer Analysis

(%)

	2008	2007	2006	2005	2004
ProAssurance					
Loss Ratio	47.2	65.3	73.5	80.4	82.4
Expense Ratio	21.0	19.6	16.6	14.0	16.9
Combined Ratio	68.2	84.9	90.1	94.4	99.3
Net Written Premium Growth	(13.9)	(0.5)	(2.9)	(30.9)	6.9
FPIC Insurance Group					
Loss Ratio	57.7	48.9	66.8	73.7	83.6
Expense Ratio	31.2	43.9	24.9	19.4	14.1
Combined Ratio	88.9	92.8	91.7	93.1	97.7
Net Written Premium Growth	26.8	(42.5)	(11.7)	30.8	34.5
The Doctors Company Group					
Loss Ratio	48.1	55.3	52.1	61.8	81.0
Expense Ratio	21.1	21.3	19.5	18.2	17.9
Combined Ratio	69.2	76.5	71.6	80.0	98.9
Net Written Premium Growth	18.1	1.3	11.9	(3.1)	32.1
Medical Professional Liability Market					
Loss Ratio	57.4	62.9	71.7	82.8	93.2
Expense Ratio	19.3	19.0	17.8	17.3	15.4
Combined Ratio	76.7	81.9	89.5	100.1	108.6
Net Written Premium Growth	(4.4)	(4.0)	6.6	6.7	4.8

Note: Statutory data.

Source: Highline Data.

Market Share

Rank	Company	2008 Market Share (%)	Direct Combined Ratio (%)
1	Medical Liability Mutual Group	7.4	87.8
2	Berkshire Hathaway	6.7	77.1
3	The Doctors Company Group	6.0	46.4
4	American International Group	5.4	33.6
5	Continental Casualty Group	4.8	71.6
6	ProAssurance Corp Group	4.1	53.0
7	Physicians Reciprocal Insurers	3.4	88.4
8	ISMIE Group	3.2	74.6
9	ProMutual Group	2.7	65.9
10	MAG Mutual Insurance Group	2.6	66.3
11	MCIC Vermont Inc RRG	2.4	102.4
12	Norcal Group	2.3	56.5
13	State Volunteer Mutual Insurance Co	2.2	68.3
14	FPIC Insurance Group	1.7	69.1
15	Zurich Insurance Group	1.7	88.2

Source: Highline.

The market share data shows that PRA is one of the largest stand-alone medical professional liability insurance carriers in the country. Fitch believes that PRA will maintain its dominant market share in the medical professional liability insurance industry but notes that no specific market share target is associated with its ratings.

Company Profile

Alabama-based PRA is a publicly traded holding company with operating subsidiaries engaged in providing medical professional liability insurance and, to a small degree, professional liability coverage to lawyers.

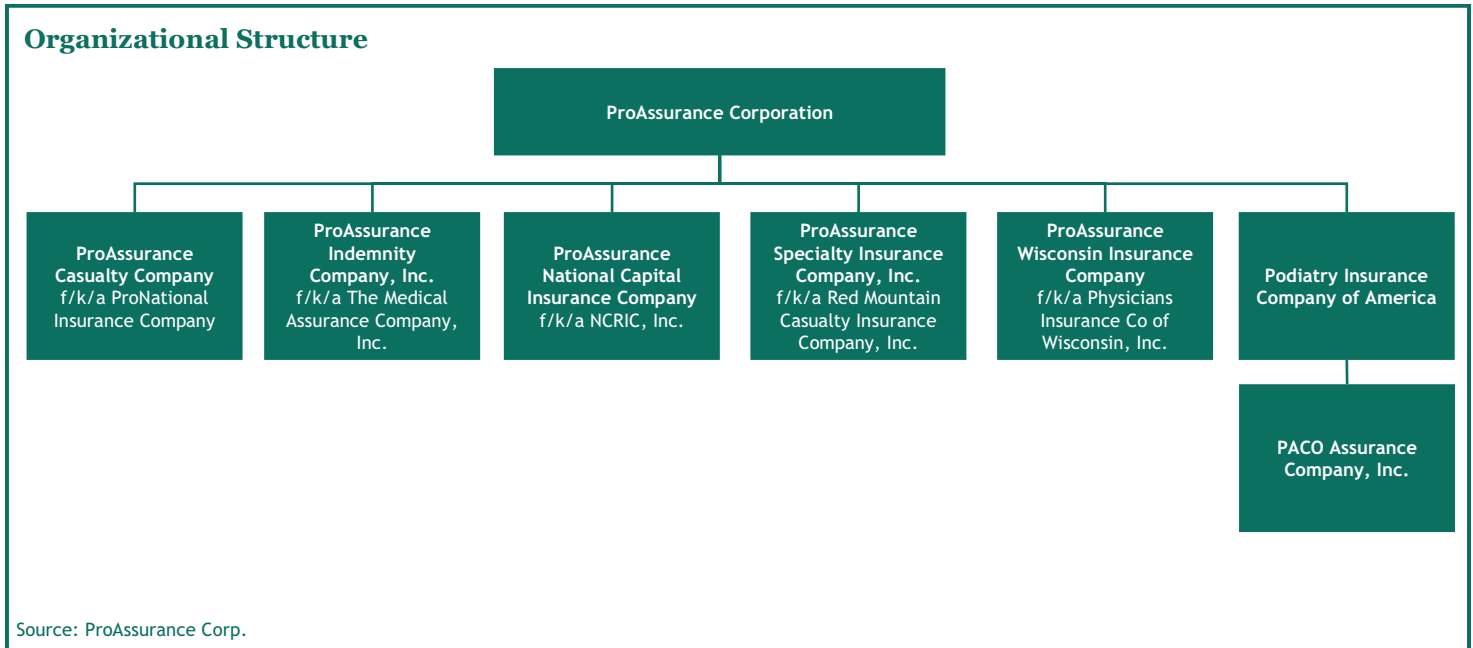
PRA's predecessor company, Medical Assurance, Inc., was founded as a mutual company by physicians in Alabama during 1976 and it is currently the leading writer of medical professional liability insurance in that state. Following a demutualization, the company became public in 1991.

PRA was established in June 2001 as a result of Medical Assurance's combination with Professionals Group Inc., whose lead insurance company — ProNational Insurance Company (now known as ProAssurance Casualty Company) — was formed in 1980 to write medical professional liability insurance in Michigan, and it is currently one of the leading writers in the state.

Medical professional liability products are largely marketed to sole practitioners, small physician groups, dentists, and small to midsize hospitals and facilities, which value PRA's quality service and risk management expertise.

PRA employs an underwriting strategy that is generally aimed at serving local markets where the company's reputation for providing value-added services and strong customer support has been established. Large physician groups and facilities generally utilize larger brokers, with the result being that decisions are made more on price than service; thus, they are not a target for PRA, although the company does insure several large groups and hospitals.

In the latter part of 2002, PRA established an excess and surplus lines insurer, Red Mountain Casualty Insurance Company (now known as ProAssurance Specialty Insurance Company), in an effort to benefit from the limited capacity and improving pricing environment in medical professional liability insurance; to potentially retain customers that no longer qualified for its standard/preferred rates; and to better enable the company to still write groups of doctors if any of the members fell outside of PRA's standard/preferred underwriting guidelines. Risks are generally referred to ProAssurance



Specialty Insurance Company from other PRA companies or specialized agents. Fitch views ProAssurance Specialty Insurance Company as key to PRA’s operating flexibility given its excess and surplus status.

In March 2004, PRA purchased the rights to offer renewal professional liability policies to OHIC Insurance Company’s non-Ohio and Wyoming hospital, and healthcare facility clients. This transaction allowed PRA the opportunity to expand its professional liability business among its existing footprint, as well as expand into the contiguous state of Wisconsin.

In August 2005, PRA closed the National Capital Reciprocal Insurance Company (NCRIC, now known as ProAssurance National Capital Insurance Company) transaction that was initiated in February 2005 for \$69.6 million in stock. NCRIC increases PRA’s presence in the Mid-Atlantic region, particularly in the District of Columbia, Delaware, Virginia, and, to a lesser extent, Maryland.

In January 2006, MEEMIC Holdings, PRA’s Michigan-based auto insurance subsidiary, was sold to GMAC for \$325 million. Prior to the sale, PRA was allowed to dividend out \$75 million in capital, raising the total compensation received from the sale of MEEMIC to \$400 million.

In July 2006, PRA acquired PIC WI (now called ProAssurance Wisconsin Insurance Company) in a stock-for-stock transaction valued at \$100 million. This transaction noticeably improved PRA’s footprint into Wisconsin, a target growth state of management; allowed PRA to increase existing market share in Midwestern states; and expanded ProAssurance’s footprint into the upper Midwest and Nevada.

Refer to the Key Rating Issues section of the report for detail on ProAssurance’s recent acquisitions of PICA and Georgia Lawyers.

PRA has a history of growing through acquisitions, and Fitch anticipates further acquisitions going forward. Fitch will evaluate any proposed acquisition to determine what, if any, affect it may have on current ratings.

Products

Fitch believes that PRA’s long-duration commercial lines products exhibit a high degree of

PRA has a history of growing through acquisitions, and Fitch anticipates further acquisitions going forward. Fitch will evaluate any proposed acquisition to determine what, if any, affect it may have on current ratings.

risk from a reserving perspective and pricing perspective but also exhibit a high degree of pricing flexibility. While most of PRA's business is written in the standard market, ProAssurance Specialty Insurance Company does provide the company with pricing flexibility.

Target Markets

Fitch believes that PRA's target markets are highly competitive but well-diversified on a customer and geographic basis. The company's target markets include physicians and small physician practices. PRA writes some large physician groups and facilities where risk managers and insurance buyers make purchase decisions on factors other than price.

Distribution Channels

Fitch believes that PRA uses a tailored distribution strategy that balances independent agents and direct marketing depending on geography; however, the majority of business is placed through independent agents.

Fitch believes that PRA has long-term relationships with independent distribution sources that are effective in sourcing and retaining business. While this is a positive, independent agents by definition lack loyalty to any single insurance carrier and, thus, also pose a risk to the company. As of year-end 2009, approximately 69% of gross written premium was generated by independent agents with no single agency accounting for more than 10% of total direct written premiums.

Financial Analysis

Profitability

Please refer to the Key Rating Issues section of this report for further information on profitability.

Capitalization

Please refer to the Key Rating Issues section of this report for further information on capital.

Investments and Liquidity

(\$ Mil.)

	3Q09	3Q08	2008	2007	2006	2005	2004
Cash and Invested Assets	3,820	3,466	3,516	3,607	3,463	2,592	2,431
% Fixed Income	93	88	85	90	92	93	93
% Equities	0	0	0	0	0	0	1
% Mortgages and Real Estate	—	—	—	—	—	—	1
% Cash and Short-Term	4	9	13	7	6	5	3
% Other	2	3	3	2	1	2	2
Investment Yield (%)	4.1	4.6	4.4	4.8	4.9	3.9	3.4

Note: U.S. GAAP.

Source: Highline Data, company SEC filings.

Investments and Liquidity

PRA employs a conservative investment philosophy that is focused on generating current investment income through the purchase of medium-term bonds. Common stock investments are minimal, though they may take on a bigger, but relatively manageable, role in the future as the company's capital base grows.

PRA maintains a good liquidity position, evidenced by strong operating cash flows and a modest liquid-assets-to-liabilities ratio. Fitch believes short-term liquidity is adequate for the current rating.

Reserve Adequacy and Development

Fitch views PRA's loss reserve position as adequate and views the reserving process as well-managed and conservative based on historical results, discussions with management, and results of Fitch's internal loss reserve model.

PRA's management has a policy to litigate nonmeritorious claims and policyholders have consent to settle rights where allowed by law. ProAssurance does attempt to reach reasonable settlements in cases where true negligence is evident. This approach serves to minimize frivolous or fraudulent lawsuits as well as increase customer loyalty. Premiums for all states are reviewed at least annually to ensure proper pricing; key states may be reviewed more often and loss reserves are reviewed twice yearly.

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Reserve Adequacy and Development

(\$ Mil.)

	2008	2007	2006	2005	2004
Beginning of the Year Reserves	2,560	2,607	2,224	1,819	1,635
Beginning of the Year Total Equity	1,255	1,119	765	611	546
Prior Accident Year (PAY) Reserve Development	(185)	(105)	(36)	(23)	(9)
PAY/Beginning of Year Reserves (%)	(7.2)	(4.0)	(1.6)	(1.3)	(0.5)
PAY/Beginning of the Year Total Equity (%)	(14.8)	(9.4)	(4.7)	(3.8)	(1.6)

Note: U.S. GAAP.

Source: Highline Data, company SEC filings.

Fitch's current ratings reflect PRA's strong reserve adequacy. If reserves were to adversely develop in excess of 5% of prior year's surplus, Fitch would further scrutinize the current rating.

Financial Leverage and Balance Sheet Quality

PRA maintains good financial flexibility that reflects its very low financial leverage, strong interest coverage ratios and, in recent periods, access to the capital markets.

Capital Structure

(\$ Mil.)

	Due	Interest Rate	3Q09 (\$)	3Q09 Equity Credit Adj. %
Trust Preferred	2034	LIBOR + 3.85%	23	6
Surplus Notes	2034	LIBOR + 3.85%	12	3
Notes Payable	2019	LIBOR + 0.7%	14	14
Surplus Notes	2012	U.S. Prime Rate	0.5	0
Total	—	—	50	24

Source: Company filings.

PRA completed the conversion of all of its outstanding convertible debentures, whose aggregate principal amount was \$107.6 million in July 2008. Approximately 2.6 million common stock shares were issued, of which approximately 2.1 million were reissued Treasury shares and 450,000 were newly issued.

Fitch notes that existing \$23 million trust preferred debt and \$12 million surplus notes, which mature in 2034, can be called as early as May 2009 the first call date. Fitch believes management will explore all of its financing needs at that time to determine if it will call the remaining debt.

As of Sept. 30, 2009, PRA's debt to capital was 2.9%, or 1.2% when adjusted for equity credit. PRA's financial leverage as of Sept. 30, 2009 on a tangible debt-to-capital basis was 3.2% unadjusted for equity credit and 1.3% when adjusted for equity credit.

PRA's TFC ratio was minimal and Fitch's rating anticipates that this ratio will be manageable going forward.

Fitch has developed a nonrisk-adjusted leverage ratio called total financing and commitments (TFC) ratio. The TFC ratio simply measures a company's capital exposure to all financial commitments. The TFC takes a broad definition of financial commitments and includes traditional items such as debt but also incorporates off-balance sheet items such as notional derivative exposure and debt guarantees. While Fitch believes the TFC ratio is a more comprehensive measure of leverage, the agency also believes that TFC is a measure of a company's exposure to reliance on capital markets to fund operations, a risk that was amplified given the recent financial crisis of 2009. All things being equal, the lower the ratio, the more favorable the metric.

PRA's TFC ratio was minimal and Fitch's rating anticipates that this ratio will be manageable on a go forward basis.

Currently factored into Fitch's rating expectations over the near to intermediate term is for financial leverage to remain at or below the mid 20% range.

Financial Leverage and Balance Sheet Quality

(\$ Mil.)

	3Q09	3Q08	2008	2007	2006	2005	2004
Total Capital	1,699	1,391	1,459	1,419	1,298	932	762
% Total Debt	3	4	2	12	14	18	20
% Preferred Equity	—	—	—	—	—	—	—
% Minority Interest	—	—	—	—	—	—	—
% Common Equity	97	96	98	88	86	82	80
% Total Debt/Tangible Capital	3.2	4.4	2.5	11.6	13.8	17.9	19.9

Note: U.S. GAAP.

Source: Highline Data, company SEC filings.

Debt-Servicing Capabilities

PRA's principal source of funds to service its fixed-income securities are dividends from its operating companies. The maximum allowable dividend PRA's subsidiaries could give in 2008 without regulatory approval is \$191 million, an amount well in excess of the company's \$3.5 million interest expense.

Additionally, management currently maintains a meaningful cash cushion at the holding company that will potentially allow for its operating subsidiaries to retain earnings to support organic growth over the near to intermediate term.

Debt-Servicing Capabilities

(\$ Mil.)

	YTD						
	3Q09	3Q08	2008	2007	2006	2005	2004
Interest Expense	3	6	7	12	11	9	7
Operating EBIT/Interest Exp.(x)	72.6	31.3	44.4	21.2	17.1	13.1	8.1
Operating EBIT/Interest Exp. and Preferred Div.(x)	72.6	31.3	44.4	21.2	17.1	13.1	8.1
Cash Flow from Operations	16	142	165	244	183	324	374

Note: U.S. GAAP.

Source: Highline Data, company SEC filings.

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