

Rating Report

Report Date:
21 December 2011

Previous Report:
7 September 2010



Insight beyond the rating.

Republic of Chile

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Ratings

Issuer	Debt Rated	Rating	Trend
Chile, Republic of	Long-Term Foreign Currency – Issuer Rating	A (high)	Positive
Chile, Republic of	Long-Term Local Currency – Issuer Rating	AA (low)	Positive

Rating Update

On December 20, 2011, DBRS, Inc. (DBRS) confirmed its ratings on the Republic of Chile's long-term foreign debt at A (high) and long-term local currency debt at AA (low), and changed the trends to Positive from Stable. The ratings are underpinned by Chile's sound macroeconomic policy framework, strong public balance sheet and stable political institutions. The Positive trends reflect Chile's sustained strong economic performance and demonstrated capacity to weather adverse shocks.

Expansionary fiscal and monetary policies, in addition to a healthy financial system, mitigated the effects of the global financial crisis and contributed to a rapid recovery. After contracting 1.7% in 2009, the economy expanded 5.2% in 2010 and the Ministry of Finance expects growth of 6.5% in 2011. The sharp rebound in domestic demand was accompanied by strong job creation and gains in real wages. Domestic financing conditions have also been supportive of the recovery, with credit expanding 7.7% in 2010 and accelerating through the first nine months of 2011. Consensus forecasts point to GDP growth of 4.2% in 2012.

However, in the event the external environment sharply deteriorates, Chile is prepared to provide strong policy support. With \$17.9 billion (7.7% of GDP) saved offshore in sovereign wealth funds and \$14.0 billion (6.0% of GDP) held by the Public Treasury, fiscal savings are above pre-crisis levels. Central government debt amounts to only 10.1% of GDP, one of the lowest debt burdens in either advanced or emerging economies. As a result, the public sector – including the Central Bank – has a net creditor position equivalent to 9.6% of GDP. Furthermore, the fiscal accounts are back in surplus, reaching 2.8% of GDP in the first nine months of the year. (Continued on page 2)

Rating Considerations

Strengths

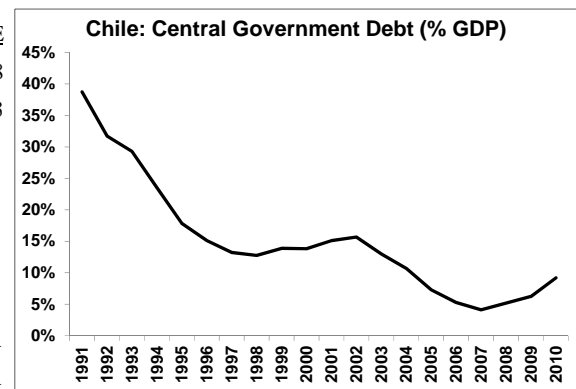
- (1) Sound macroeconomic management
- (2) Low public debt
- (3) Well-developed financial markets
- (4) High national savings
- (5) Strong and stable political institutions

Challenges

- (1) High income inequality
- (2) Quality of education
- (3) Narrow export base
- (4) Low female participation in the labor force

Summary Statistics

For the year ended December 31	2009	2010	2011E	2012E
Nominal GDP (US\$ bn)	161	203	237	238
GDP per capita (US\$)	9,467	11,856	13,710	13,653
Real GDP growth (% change yoy)	-1.7%	5.2%	6.2%	4.2%
Inflation (yearend, %)	-1.5%	3.0%	3.7%	3.0%
Current account bal (% GDP)	1.6%	1.9%	-1.3%	-2.0%
Central government bal (% GDP)	-4.5%	-0.4%	2.2%	-0.4%
Central government debt (% GDP)	6.2%	9.2%	11.0%	10.0%
Net public sector debt (% GDP)	-12.9%	-8.3%	-9.6%	N/A
Gross external debt (% GDP)	41.0%	39.1%	42.0%	N/A





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Rating Update (Continued from page 1)

With a sound banking system and ample foreign currency liquidity, Chile is also well-positioned to manage a potential return to unfavorable financing conditions. Chilean banks are liquid and well-capitalized with high quality capital. Furthermore, their net foreign exchange exposure is moderate and reliance on foreign funding, including parent banks, is relatively limited. In November 2011, the Central Bank held \$38.8 billion (16.6% of GDP) in reserves, up \$12.8 billion from a year prior. This, in addition to fiscal savings, provides Chile with sufficient liquidity to cover all external debt maturing in the next 12 months.

Sound macroeconomic policies, openness to trade and investment and a well-developed financial system have contributed to Chile's strong economic performance and improved living standards. From 1990 to 2010, the economy grew at an average rate of 5.1%, real income per capita more than doubled and poverty declined from 39% to approximately 15%. Moreover, Chile's high national savings rate, which averaged 23.1% of GDP from 1990 to 2010, finances high levels of domestic investment and limits the economy's reliance on net external borrowing.

Despite these positive developments, labor productivity is low compared to advanced economies, and GDP per capita is 45% of the OECD average. Income distribution is among the most unequal in the world, and education outcomes in Chile, although strong by regional standards, rank similarly to Turkey and Russia and below most economies in Central and Eastern Europe.

In addition, Chile is a highly open economy with a narrow commodity-dominated export base. Nearly two-thirds of exports are concentrated in the mining sector, partly the result of a substantial rise of copper prices in recent years. Although Chile's macroeconomic policies are designed to dampen the effect of copper price fluctuations on the real economy, economic growth and fiscal revenues are exposed to the commodity price cycle. China, a key driver of global copper demand and international prices, has quickly become Chile's largest trading partner, accounting for 24.4% of Chile's exports in 2010. A marked slowdown in China would likely have a significant effect on copper prices and, therefore, on economic activity in Chile.

Consensus across the political spectrum on the policy framework is one of Chile's greatest strengths. Sustained commitment to sound macroeconomic management, in addition to further improvements in economic performance, is likely to lead to an upgrade of the ratings.

Foreign Versus Local Currency Ratings

DBRS rates the local currency one notch above the foreign currency debt because Chile has greater flexibility to generate financing in local markets than in foreign markets. The domestic capital markets are relatively deep and well-developed.

Rating Considerations Details

Strengths

(1) Sound macroeconomic management. Chile's policy framework – an independent central bank guided by an inflation-targeting monetary regime, structural fiscal rule, flexible exchange rate and openness to trade and foreign investment – has supported Chile's strong economic performance and enhanced the economy's resilience to shocks.

(2) Low public debt. Central government debt totalled 10.1% of GDP in June 2011, one of the lowest debt burdens among advanced or emerging economies. Furthermore, years of high copper prices and prudent fiscal policy have led to the accumulation of substantial financial assets. As a result, the public sector, including the central bank, is a net creditor.

(3) Well-developed financial markets. Chile's financial system is one of the most developed and diverse in Latin America, with a large investor base, particularly the pension funds, and high degree of integration with international markets. Financial intermediation through the banking system is high by emerging market

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standards, with credit amounting to 78% of GDP in September 2011. Moreover, local capital markets are relatively deep, providing large Chilean firms an alternative source of domestic funding during periods of international market turmoil as well as offering market participants instruments to manage financial risks.

(4) High national savings. The national savings rate averaged 23.1% of GDP from 1990 to 2010. This helps finance Chile's relatively high levels of domestic investment and reduces exposure to volatility in global financial markets.

(5) Strong and stable political institutions. Chile's political institutions provide a stable foundation for economic prosperity. By international standards, Chile has low corruption levels, high government effectiveness and a strong legal system.

Challenges

(1) High income inequality. While real GDP-per-capita has more than doubled since 1990 and successive governments have made steady progress in reducing poverty, Chile continues to suffer from highly unequal income distribution. In 2009, the poorest 20% of the population received 3.6% of national income (not including fiscal subsidies), while the wealthiest 10% received 40.2%.

(2) Quality of education. A better trained and educated workforce could enhance labor productivity and help sustain higher rates of economic growth. Chile has increased public spending on education and reformed the educational system. However, Chilean students' performance on international science, reading and math assessments compare unfavorably with emerging economies in Eastern Europe. DBRS recognizes that improving educational outcomes is a long-term challenge.

(3) Narrow export base. Despite the relatively strong performance of non-mining exports over the last decade, Chilean exports are dominated by commodity-based goods. In 2010, 65% of Chilean exports were concentrated in the mining sector. This exposes the economy to fluctuations in the price of copper.

(4) Low female participation in the labour force. The female employment rate (aged 15-64) increased from 38.0% in 2005 to 46.7% in 2010. Nevertheless, it is still below the OECD average of 56.7%. Higher employment rates would support medium-term economic growth.

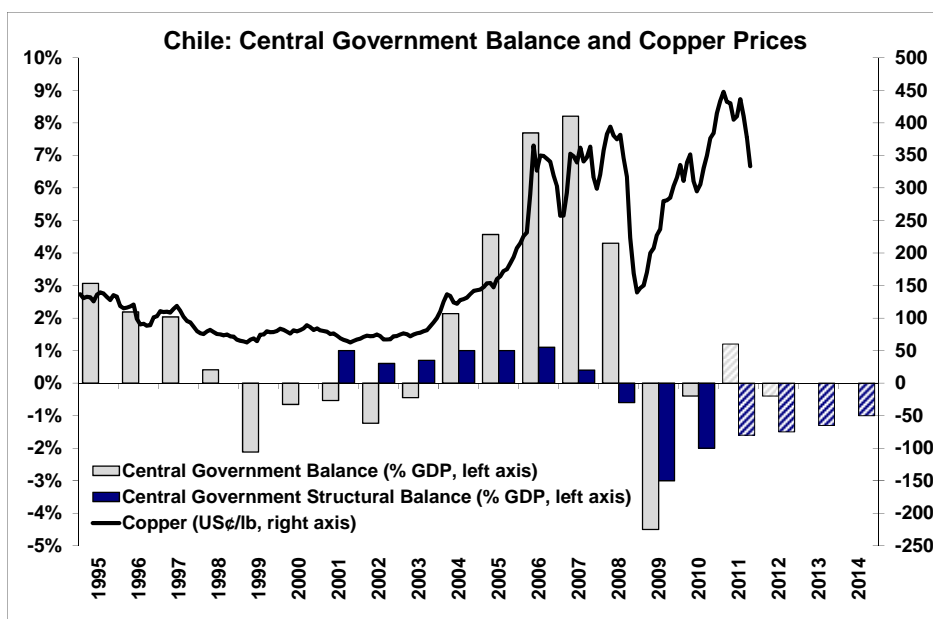
Fiscal Management and Policy

Strong fiscal institutions are a cornerstone of Chile's policy framework and an anchor for the country's macroeconomic stability. This is especially important given the volatility of commodity revenues. Guided by the structural balance rule, Chile ties spending to cyclically-adjusted revenues and directs the government to save any surplus. Structural revenues are estimated based on the long-term reference price for copper (US\$2.59/lb for the 2011 fiscal year) and molybdenum (US\$22.4/lb), as well as GDP growth potential (4.8%). Consequently, fiscal policy is countercyclical, running deficits when growth and commodity prices are below trend, and accumulating surpluses when growth and the external environment are favourable. Chile's rules-based policy has helped mitigate the effect of commodity price fluctuations on the real economy, build a reserve of public savings and provide a credible anchor for fiscal sustainability over the medium term.

After saving the greater part of a copper boom from 2004 to 2008, Chile had significant space to implement strong counter-cyclical fiscal policy in 2009 and carry out reconstruction plans following the February 2010 earthquake without putting a strain on public finances. From 2008 to 2009, the central government balance shifted from a surplus of 4.3% of GDP to a deficit of 4.5% of GDP. Revenues declined by 21%, in real terms, partly driven by the sharp fall in copper-related tax revenues. At the same time, spending rose 17% as the government increased public investment and provided subsidies to low income families. In addition, reconstruction costs are estimated to total \$8.4 billion (4.1% of 2010 GDP) from 2010 to 2013. Instead of utilizing fiscal savings to finance reconstruction, the government relied on a combination of tax changes, budget reallocations and borrowing.

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Note: The structural balance rule was implemented in 2001.
Source: DIPRES, DBRS.

Chile is in a strong fiscal position to weather further adverse shocks. Spurred by economic recovery and high copper prices, the fiscal accounts have rapidly improved. The government expects a surplus of 1.2% of GDP in 2011. However, risks to the year-end forecast are to the upside. In the first nine months of the year, the surplus was 2.8% of GDP, and although spending is likely to accelerate in the fourth quarter, the projected surplus appears conservative. The 2012 budget estimates a small deficit of 0.4% of GDP. Increased structural revenues, as the long-term reference price of copper was adjusted to \$3.02/lb, should fully cover plans to expand social expenditure, especially in the areas of education, health and poverty alleviation.

The government plans to gradually tighten fiscal policy over the next three years, achieving a structural deficit of 1.0% of GDP by 2014. Due to the severity of the global financial crisis, the deficit widened to 3.0% of GDP in 2009 – the largest structural deficit since the rule was introduced in 2001. Progress is being made to narrow the gap. The deficit is expected to reach 1.6% of GDP in 2011, as structural revenues increase and stimulus measures expire. Nevertheless, the fiscal stance as planned will remain moderately looser over the next three years than during the period from 2001 to 2008.

Debt and Liquidity

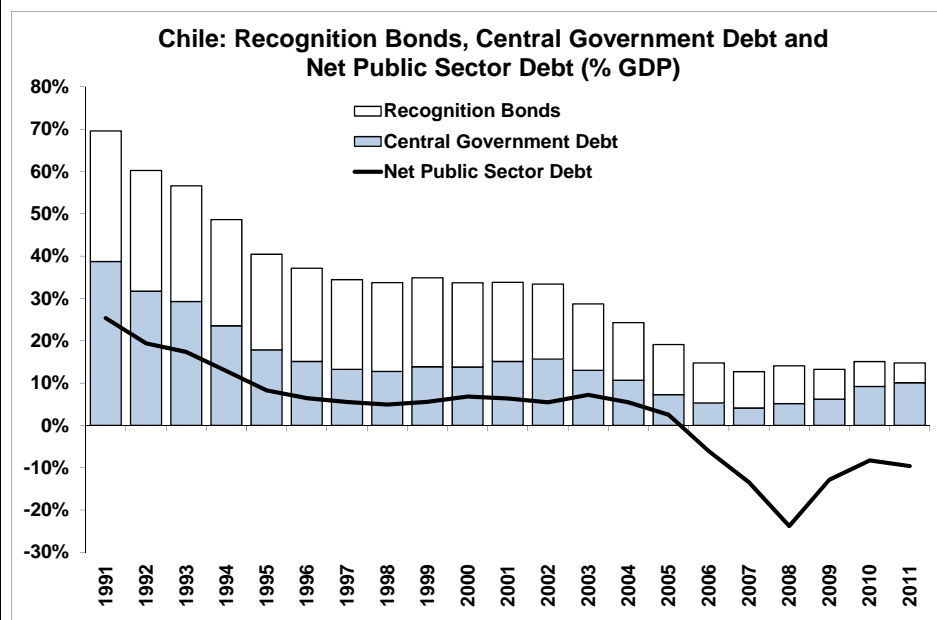
The government has used surpluses generated by high copper prices to pay down debt and accumulate financial assets. Central government debt amounted to 10.1% of GDP in June 2011, one of the lowest debt burdens among advanced or emerging economies. Furthermore, following an \$8 billion withdrawal from the Fiscal and Economic Stabilization Fund (FEES) in 2009 to address the economic downturn, fiscal assets on a nominal basis have surpassed pre-crisis levels. In addition to \$14.0 billion in the Public Treasury, financial assets held abroad include \$13.4 billion in FEES and \$4.5 billion in the Pension Reserve Fund (FRP). As a result, the public sector – including the Central Bank – had a net creditor position equivalent to 9.6% of GDP.

In addition to low debt and large fiscal savings, the public sector balance sheet benefits from Chile’s transition from a pay-as-you-go (PAYG) pension system to a private pension system, a process that began in 1981. Workers who moved to the new system receive a “recognition bond” at the time of retirement representing the value of benefits accrued under the old system. In effect, the transition replaced the implicit liabilities of an underfunded pension system with explicit debt. From 1984 to June 2011, the stock of outstanding recognition bonds declined from 44.1% of GDP to 4.7%. Benefits for those workers who chose to remain in the old system are financed as part of the governmental budget each year, resulting in a perennial operational deficit. This deficit declined from 4.7% of GDP in 1984 to an estimated 2.1% in 2010, and is

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expected to fall below 0.5% by 2035. Unlike most advanced economies, Chile has gradually reduced the implicit and explicit obligations associated with its pension system and lifted a significant burden from the public sector balance sheet.



Note: Recognition Bonds are not included in the central government or net public sector debt figures.
Source: Central Bank of Chile, Finance Ministry, DBRS.

The Chilean economy benefits from strong external solvency and liquidity ratios. Gross external debt increased from \$86.7 billion at the end of 2010 to \$98.5 billion in September 2011 (42% of GDP) but remains within historic norms. The net international investment position, at -5.0% of GDP in third quarter of 2011, has remained relatively stable. Chile is also well-positioned to confront a potential return to unfavorable external financing conditions. In 2011, the central bank conducted sterilized interventions in the foreign exchange market to increase international reserves by \$12 billion. With \$13.4 billion in FEES and \$38.8 billion in reserves, Chile has sufficient liquidity to cover all external debt maturing in the next 12 months.

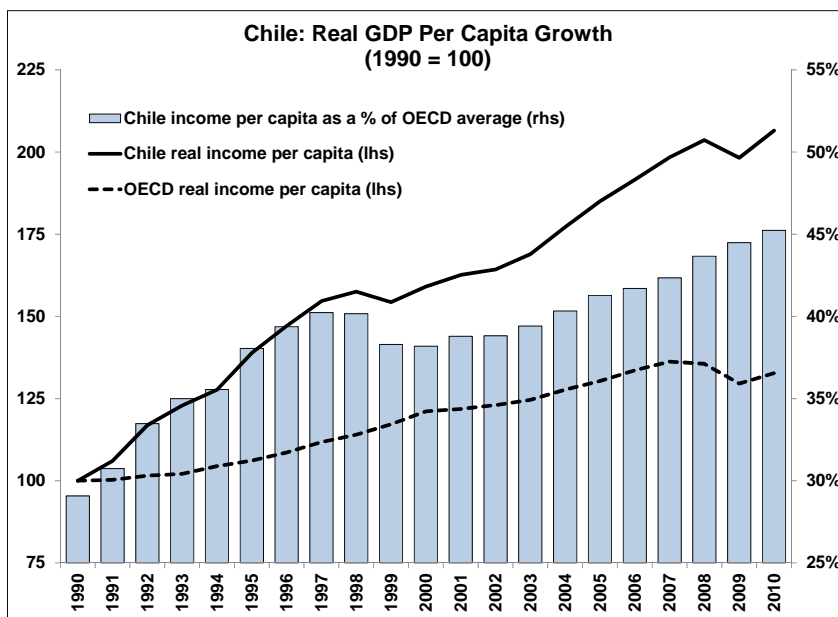
Economic Structure and Performance

Over the last two decades, Chile’s prudent macroeconomic policies, increasing openness to international trade and investment and stable political environment helped sustain strong economic growth and improve standards of living. From 1990 to 2010, the economy grew at an average rate of 5.1% and the poverty rate declined from 39% to approximately 15%. Over the same period, real GDP-per-capita in Chile more than doubled, compared to cumulative increase of 33% in OECD economies. Consequently, income per capita in Chile as a percentage of the OECD average increased from 29% to 45%. However, the pace of convergence has slowed modestly in the last decade, and labor productivity in Chile, measured as output per hour worked, remains well below advanced economies.

Despite significant success in reducing poverty, Chile’s income distribution is among the most unequal in the world. According to the 2009 Chilean National Socio-Economic Characterization Survey, the poorest 20% of the population received only 3.6% of national income, while the wealthiest 10% received 40.2%. The government has increased transfers and social expenditures, but income equality has remained stubbornly high since 1990, creating uneven economic growth and perpetuating disparities in social development. Educational coverage has significantly improved over the last thirty years, but education outcomes do not compare favorably with emerging economies in Eastern Europe or East Asia. Chilean students score below all OECD countries, with the exception of Mexico, on international reading, science and math assessments.

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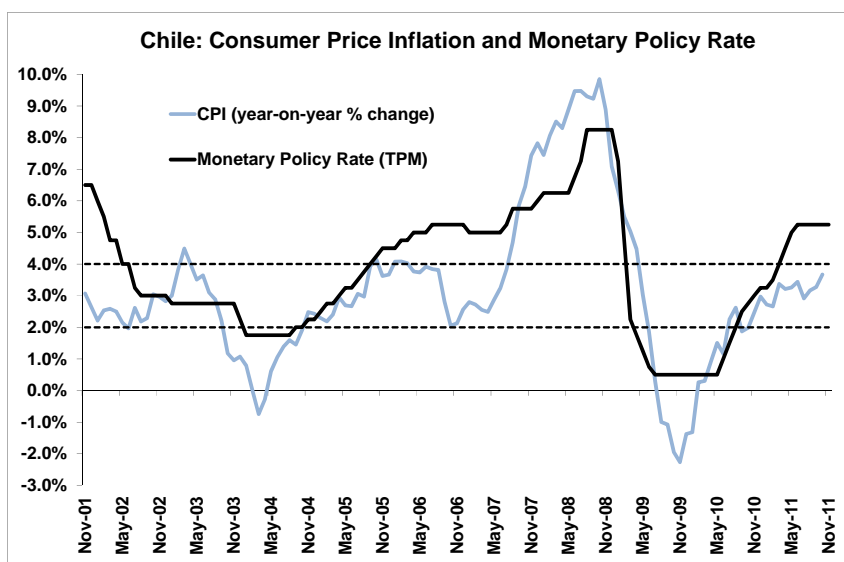


Source: OECD, DBRS.

The employment rate (aged 15-64) in Chile increased over the last five years but remains below other advanced economies at 59.3% in 2010. The increase was primarily driven by rising employment among women. Nevertheless, the female employment rate, at 46.7% in 2010, is 10 percentage points below the OECD average. In addition, the Chilean labor market is characterized by rigidities, such as high firing costs and a relatively high minimum wage, which contributes to the persistence of an informal economy.

Monetary Policy and Financial Stability

An independent central bank, inflation-targeting framework and flexible exchange rate have contributed to macroeconomic and financial stability in Chile. Despite large price shocks over the past two years, monetary policy has anchored inflation expectations around the 3% target over a 24-month horizon.



Source: Central Bank of Chile, DBRS.

Rising international food and energy prices, in addition to strong domestic demand, led Chile's annual inflation to climb well above the target range in 2007 and 2008. With the onset of the global recession and the

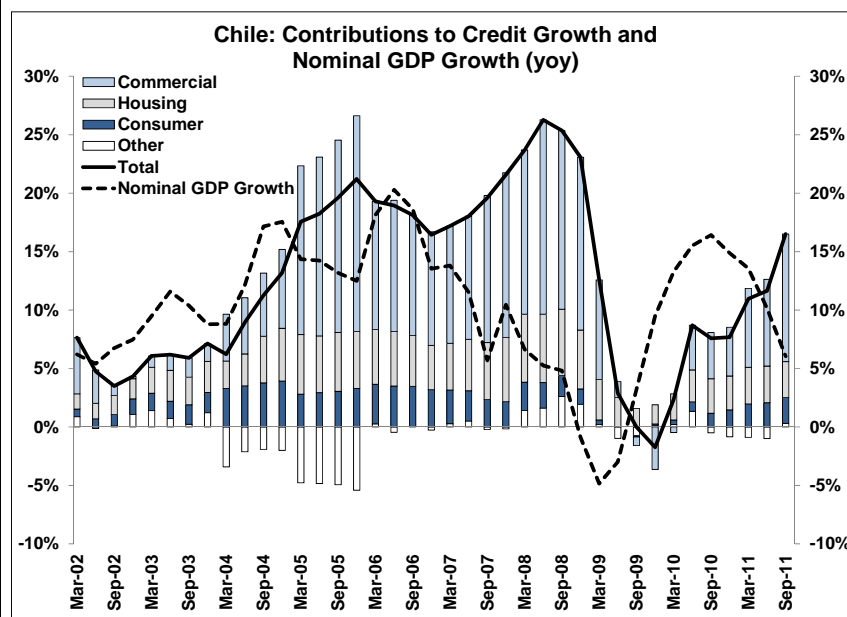
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decline in commodity prices in late 2008, inflationary pressures quickly dissipated. Annual CPI declined from 9.9% in October 2008 to -2.3% in November 2009. In response, the Central Bank cut the policy rate 775 basis points between January 2009 and July 2009, providing a large and rapid stimulus to the economy.

As the output gap narrowed and unemployment declined in 2010, the Central Bank started normalizing monetary policy. The policy rate was raised 475 basis points from July 2010 to June 2011. However, it has been left unchanged in the second half of the year, and the Central Bank signaled in December 2011 that monetary policy could be adjusted if a deterioration in the external environment alters the inflation outlook.

The Chilean banking system demonstrated resilience during the global financial crisis and has been a supporting factor in the recovery. Banks are profitable, liquid and highly capitalized, with high quality capital. Nominal credit growth, which sharply decelerated in 2009, has been growing since February 2010, with the pace accelerating in 2011 and exceeding nominal GDP growth in the second and third quarters of the year. Credit growth has been driven by a rebound in commercial lending and, to a lesser extent, in housing and consumer lending.



Source: Central Bank of Chile, DBRS.

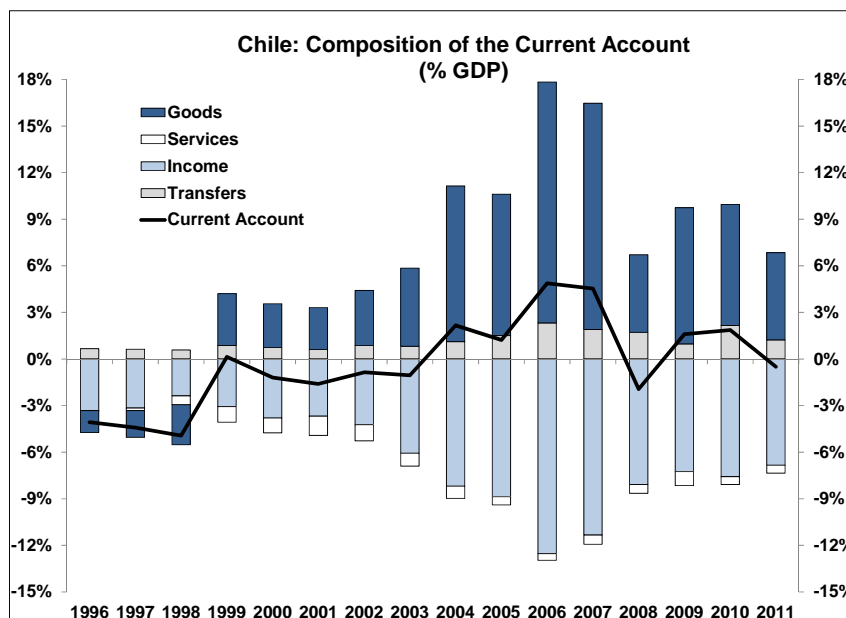
While external volatility could restrict access to funding and affect financial conditions in Chile, banks are adequately prepared to manage potential pressures. Banks’ net foreign exchange exposure is moderate and reliance on foreign funding, including from parent banks, is relatively limited. Furthermore, Chilean banks reduced reliance on European creditors in late 2010 and early 2011 while increasing exposures to U.S, Australian and Canadian banks. Nevertheless, in the face of a sharp deterioration in global financial markets, Chilean banks could still face liquidity pressures. In such a scenario, the Central Bank is well-placed to provide foreign exchange liquidity.

Balance of Payments

Chile’s balance of payments weathered the global financial crisis well, largely as a result of strong fiscal and monetary institutions, a flexible exchange rate and a well-developed and healthy financial system. However, the crisis also highlighted the narrowness of Chile’s export base, with 65% of merchandise exports (excluding free trade zones) concentrated in the mining sector. From September 2008 to September 2009, exports declined 31%, driven by the sharp decline in mining exports. Although Chile is exposed to the commodity price cycle, Chile’s macroeconomic policies are designed to dampen the effect of copper price fluctuations on the real economy.

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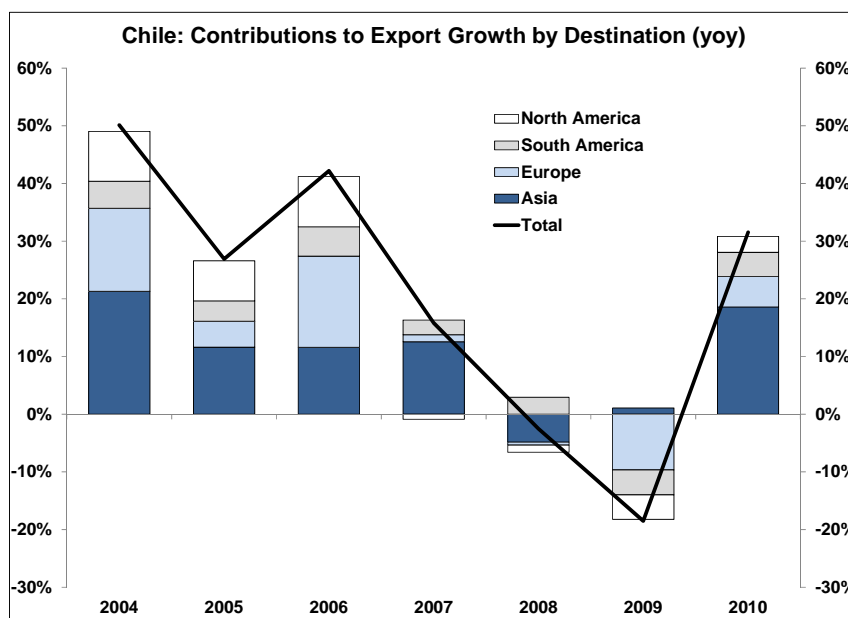
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Note: 2011 is rolling 4 quarters through Q3 2011.

Source: Central Bank of Chile, DBRS.

The current account shifted from a surplus of 1.9% of GDP in 2010 to a small deficit in the third quarter of 2011. Over the same period, the trade surplus narrowed from 7.8% of GDP to 5.6% of GDP, as imports rose 31.5%, reflecting strong domestic demand, and outpacing export growth, which expanded by 21.1%. The trade surplus was offset by the perennial deficit in the income balance, principally driven by profit repatriation by foreign mining companies. On the other hand, the financial account had a small surplus in the third quarter. Net portfolio inflows and foreign direct investment, amounting to 6.0% of GDP, were partially offset by reserve accumulation.



Source: Central Bank of Chile, DBRS.

Strong commodity demand in Asia, particularly China, has supported rapid export growth in Chile and shifted the direction of Chilean trade. From 2005 to 2010, exports to Asia increased from \$15.2 billion to \$34.8 billion, accounting for two-thirds of the growth in Chile's exports. Although exports by destination remain well diversified, China has quickly become Chile's largest trading partner. In 2010, 24.4% of Chile's exports

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went to China, up from 11.6% in 2005. China is a key driver of global copper demand and international prices. A sharp deceleration in China's economic activity would likely have a significant adverse effect on Chile's export sector.

Political Environment

Last election:	December 13, 2009 / January 17, 2010
Next election:	December 2013
Party in power:	Coalición por el Cambio (a coalition comprised of Renovación Nacional and the Unión Demócrata Independiente)
Senate:	Concertación holds 19 of 38 seats
Chamber of Deputies:	Coalición por el Cambio holds 58 of 120 seats

The victory of conservative Sebastián Piñera in the January 2010 presidential run-off elections marked the first loss for the leftist coalition Concertación since the country's return to democracy in 1990. President Piñera won 52% of the vote against former President Eduardo Frei. The alternation of power demonstrates the strengthening foundations of liberal democracy in Chile. Moreover, there is consensus across the political spectrum on Chile's sound macroeconomic policy framework.

Chile is a stable democracy with strong political institutions. By international standards, Chile has low levels of corruption, high government effectiveness and a strong legal system. The 2010 World Bank *Worldwide Governance Indicators* ranked Chile on par, or above, many advanced economies in several categories. Moreover, for the last twenty years, the government has maintained its emphasis on improving social conditions while implementing predictable economic policies and responsibly managing public finances.

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Chile: Selected Indicators

 For the year ended December 31
(\$ billions unless otherwise noted)

	2005	2006	2007	2008	2009	2010
Public Debt Debt						
Central Government Gross Debt	9.4	7.7	7.1	7.3	11.1	20.4
% GDP	7.3%	5.3%	4.1%	5.2%	6.2%	9.2%
Public Sector Gross Debt	31.5	28.3	25.2	27.0	39.8	45.8
% GDP	24.5%	19.4%	14.6%	19.0%	22.3%	20.7%
Net Public Sector Debt	3.3	-8.9	-23.3	-33.7	-22.9	-18.4
% GDP	2.5%	-6.1%	-13.4%	-23.8%	-12.9%	-8.3%
Consolidated Public Sector Gross Debt	38.4	35.8	33.7	36.5	51.5	60.4
% GDP	29.9%	24.6%	19.5%	25.7%	28.9%	27.3%
Domestic Debt						
Central Government	5.1	3.5	3.4	4.4	8.6	16.3
% GDP	4.0%	2.4%	2.0%	3.1%	4.8%	7.3%
External Debt						
Consolidated Public Sector	9.8	11.4	12.8	12.3	13.5	17.4
% GDP	7.6%	7.9%	7.4%	8.7%	7.6%	7.9%
Private Sector	36.4	38.1	43.0	51.4	59.5	69.3
% GDP	28.2%	26.1%	24.8%	36.3%	33.4%	31.3%
Gross External	46.2	49.5	55.7	63.7	73.0	86.7
% GDP	35.9%	34.0%	32.2%	44.9%	41.0%	39.1%
Fiscal Balances (% GDP)						
Revenues	23.8%	25.8%	26.9%	25.5%	20.4%	23.0%
Expenditures	19.3%	18.1%	18.7%	21.2%	24.8%	23.5%
Interest Payments	0.8%	0.7%	0.6%	0.5%	0.5%	0.5%
Interest Payments (% Revenues)	3.5%	2.7%	2.3%	1.9%	2.6%	2.3%
Central Government Primary Balance	5.4%	8.4%	8.8%	4.8%	-4.0%	0.1%
Central Government Balance	4.6%	7.7%	8.2%	4.3%	-4.5%	-0.4%
Balance of Payments & Liquidity						
Current Account Balance	1.4	7.2	7.5	-3.3	2.6	3.8
% GDP	1.2%	4.9%	4.5%	-1.9%	1.6%	1.9%
Trade Balance (% GDP)	9.1%	15.5%	14.6%	5.0%	8.8%	7.8%
Net Foreign Direct Investment (% GDP)	4.1%	3.5%	6.1%	4.2%	3.0%	3.1%
International Reserves	17.0	19.4	16.9	23.2	25.4	27.9
International Investment Position	-32.7	-15.7	0.7	-29.8	-19.0	-10.0
% GDP	-27.6%	-10.7%	0.4%	-17.5%	-11.8%	-4.9%
External Liabilities	124.6	136.7	163.9	172.5	207.7	245.9
External Assets	91.9	121.0	164.6	142.7	188.7	235.9

Sources: Central Bank of Chile, Ministry of Finance, IMF, OECD, DBRS.

Notes: Public Sector includes the central government, municipalities and the Central Bank of Chile. Net public sector is the sum of public sector liabilities and financial assets. Consolidated public sector includes the public sector and state-owned enterprises. Gross external debt is the sum of public and private external debt. Debt figures are converted into dollars using end-of-period exchange rates.



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Ratings

Issuer	Debt Rated	Rating	Trend
Chile, Republic of	Long-Term Foreign Currency – Issuer Rating	A (high)	Positive
Chile, Republic of	Long-Term Local Currency – Issuer Rating	AA (low)	Positive

Rating History

	Current	2010	2009	2008	2007	2006
Long-Term Foreign Currency Debt	A (high)	A (high)	A (high)	A (high)	A (high)	A (high)
Long-Term Local Currency Debt	AA (low)	AA (low)	AA (low)	AA (low)	AA (low)	NR

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