



Moody's Investors Service

## Credit Opinion: **GarantiBank International N.V.**

Global Credit Research - 28 Aug 2009

Amsterdam, Netherlands

### Ratings

Category	Moody's Rating
Outlook	Negative
Bank Deposits	Baa1/P-2
Bank Financial Strength	C-
Subordinate -Dom Curr	Baa2
<b>Parent: Türkiye Garanti Bankası</b>	
<b>AS</b>	
Outlook	Rating(s) Under Review
Bank Deposits -Fgn Curr	B1/NP
Bank Deposits -Dom Curr	*A3/P-2
Bank Financial Strength	C-

\* Placed under review for possible downgrade on August 3, 2009

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### Key Indicators

#### GarantiBank International N.V.

	[1]2008	2007	2006	2005	2004	Avg.
Total assets (EUR billion)	3.63	3.39	2.86	2.28	1.91	[2]15.62
Total capital (EUR billion)	0.33	0.30	0.26	0.21	0.21	[2]11.01
Return on average assets	0.99	1.12	0.92	0.99	1.26	1.06
Recurring earnings power [3]	1.45	1.47	1.44	1.59	1.79	1.55
Net interest margin	1.55	1.46	1.53	1.86	1.98	1.68
Cost/income ratio (%)	41.05	39.85	44.29	45.52	44.44	43.03
Problem loans % gross loans	0.94	0.24	0.26	0.21	0.65	0.46
Tier 1 ratio (%)	9.92	11.00	10.70	14.00	17.39	12.60

[1] As of December 31. [2] Compound annual growth rate. [3] Preprovision income % average assets.

### Opinion

#### SUMMARY RATING RATIONALE

Moody's assigns a Bank Financial Strength Rating (BFSR) of C- to GarantiBank International N.V. (GBI), which translates into a Baseline Credit Assessment (BCA) of Baa2. The rating reflects GBI's role as a niche player in the competitive segment of international trade and commodity finance and its good financial fundamentals. Less positively, it also takes into consideration the bank's significant exposure and concentrations to emerging markets, particularly the risks associated with the Turkish market and the CIS countries in a context of worsening economic conditions.

GBI's Baa1 long-term global local currency (GLC) deposit rating is based on its intrinsic creditworthiness as well as Moody's expectation of a very high probability of support in case of need from the parent, Türkiye Garanti Bankası A.S. (A3 on review for possible downgrade/P-2/C- domestic currency and B1/NP foreign currency). The debt and deposit ratings thus enjoy a one-notch uplift from the Baa2 BCA.

#### Credit Strengths

- An established franchise with a good competitive position, albeit in the relatively narrow niche of trade finance
- Resilient funding profile as demonstrated during the financial crisis
- Overall short-term maturity of the assets providing some flexibility to the bank in a downturn

#### **Credit Challenges**

- Significant exposure to emerging markets and especially to Turkey and the CIS countries, which together represent 66% of the bank's assets and off-balance sheet liabilities
- Potential volatility of revenues linked to treasury activities as well as commodity finance and exposure to emerging markets, although GBI's treasury revenues have historically shown little volatility
- Risk concentrations, both geographic and in terms of counterparties
- Limited earnings diversification
- Deteriorating asset quality, albeit from historical good level

#### **Rating Outlook**

The outlook on the BFSR and long-term ratings is negative. This reflects the deterioration in economic conditions in GBI's markets, which, combined with the bank's significant borrower concentrations and high exposure to emerging markets, exposes it to an increasingly volatile revenue base and to pressure on its asset quality.

#### **What Could Change the Rating - Up**

Given the negative outlook, Moody's views any upgrade of the BFSR as unlikely in the foreseeable future.

#### **What Could Change the Rating - Down**

Factors that would likely exert downward pressure on the BFSR include:

- Significant deterioration in credit underwriting conditions or standards in trade and commodity finance leading to an increased credit risk cost and/or a weakening in asset quality
- Increases in borrower, sector risk and geographic concentrations, in related-party lending ratios as well as in emerging market exposures
- An increased dependence on volatile earnings, especially treasury revenues, and a resulting higher market risk appetite
- A weakening of the capital ratios lowering the bank's loss absorption capacity

#### **Recent Results and Developments**

For full-year 2008, consolidated net profit was stable at EUR 35 million compared with 2007, while consolidated pre-provision profit rose to EUR 53 million from EUR 46 million in 2007. GBI's total consolidated assets increased to EUR 3.627 billion at 31 December 2008 from EUR 3.395 billion at 31 December 2007, with shareholders' funds rising to EUR 252 million from EUR 217 million.

For the first half of 2009, net profit declined to EUR 13 million from EUR 18 million in H1 2008 mainly due to the decrease in net interest income and the increase in value adjustments to receivables. Total assets were almost stable at EUR 3.633 billion from EUR 3.627 billion at end-June 2008 and shareholders' equity increased to EUR 265 million from EUR 252 million at end-June 2008.

#### **DETAILED RATING CONSIDERATIONS**

As with other banks, because of the recent change to Basel II, data is not entirely consistent over the last three years. As a consequence, detailed considerations for GBI's currently assigned ratings are based only on the latest financial report available under Basel II, which has year-end 2008 figures.

#### **Bank Financial Strength Rating**

Moody's assigns a Bank Financial Strength Rating (BFSR) of C- to GarantiBank International N.V. (GBI). The rating reflects GBI's role as a niche player in the competitive segment of international trade and commodity finance and its strong financial fundamentals, while also taking into consideration the bank's significant exposure and concentrations to emerging markets, particularly the risks associated with the Turkish market and the CIS countries in a context of worsening economic conditions.

As a point of reference, GBI's BFSR of C- is two notches lower than the C+ outcome of Moody's bank financial strength scorecard. We view the C- rating as an appropriate measure of the bank's financial strength given its geographic mix of earnings and assets, and the still high level of credit risk concentration. We also believe the scorecard fails to capture the higher capital requirements applicable to GBI in light of its size and business mix and risk concentrations as well as the deteriorating operating environment in the countries in which the bank is active.

#### **QUALITATIVE RATING FACTORS (50% WEIGHTING)**

FACTOR: FRANCHISE VALUE

Trend: Neutral

GBI is a Netherlands-based niche commercial bank specialising in trade and commodity finance.

The bank has three business units:

(i) international trade finance

(ii) private banking,

(iii) structured finance created in 2008 through the combination of activities in shipping and project finance (previously carried out by the international trade finance business unit) and Islamic finance, a new activity for the bank.

The activities of these business units are supported in terms of revenues by a treasury unit and by direct retail banking deposit-taking.

Additionally, GBI has developed a retail network in Romania with the intention of selling it to a joint venture of Dogus AS and General Electric Capital Corporation. The sale, subject to regulatory approvals, has been delayed and is expected to be effective at the end of 2009.

Trade finance accounted for 52% of revenues in 2008 vs. 61% in 2007, while treasury -- including the spread generated by direct retail deposit-taking activities -- and private banking accounted for 27% (vs. 22%) and 15% (vs. 17%), respectively. The new structured finance division contributed 6% of the bank's revenues. Although treasury activities are mainly designed to serve clients, a stable 20% of the trading gains stem from proprietary trading. The key trade finance business has a limited (albeit growing) presence outside the relatively narrow niche of trade finance related to Turkey (46% of the trade finance volumes). We note, however, that GBI's client franchise has proven to be resilient and that the bank has been successful in developing well-established and efficient processes.

The breakdown of GBI's revenues and costs is as follows:

- Turkey (43%),

- Europe excluding the Netherlands (29%),

- the CIS (17%) and

- the Netherlands (9%).

The overall franchise value score of D reflects GBI's narrow niche business profile resulting in limited earnings stability and diversification as well as constrained market share.

#### FACTOR: RISK POSITIONING

Trend: Neutral

GBI's related-party exposures have increased slightly to 15% of shareholders' equity at year-end 2008 from 11% in 2007. However, these are much lower than past levels -- 68% in 2006, 49% in 2005 and 66% in 2004 --. The reduction is an overall positive development in our view.

Nonetheless, credit risk concentrations are still significant, with the top 20 bank and corporate credit exposures with a rating lower than A3 still amounting to multiples of the Tier 1 capital. The Turkish and CIS bond exposure -- which respectively represent 66% and 33% of GBI's interest-bearing securities -- are sizable in terms of concentration risk, although this has been falling over time. As a mitigating factor (further explained in the fifth paragraph in this section), Moody's notes that almost half of the bond portfolio will expire before the end of 2010.

We closely monitor GBI's exposure to Russia. We note that it is on a declining trend since the beginning of 2009. However, it remains an area of concern since we view the credit outlook of this country as negative, reflecting concerns over major structural weaknesses that became particularly apparent during the Russian stock market crisis in September 2008. For more information on this issue, please refer to Moody's latest Banking System Outlook on Russia published in September 2008.

We assess the bank's risk management and financial disclosure as weak, based on:

(i) the fact that reporting on doubtful loans and/or non-performing loans is not in line with international standards;

(ii) the limited nature of its regular public financial information disclosure, especially on non-performing loans, risk-weighted assets and capital adequacy, and

(iii) the absence of a veto for the chief risk officer on the bank's credit limits and commitments

However, we note positively that GBI is one of the five Dutch banks that were ready for the Basel II internal ratings based approach in 2008.

Indeed, GBI has well-established credit monitoring processes and practices and selective credit selection. In general, the control culture appears to be tight. Turkish and other sovereign bond position risks are limited, not only by nominal limits applying to the trading and investment books, but also through tighter currency position risks aimed at minimising outright currency mismatches. Moody's also notes the overall short-term maturity of the bank's assets allowing it to adapt its credit policy when the economic

environment deteriorates as shown by the contraction of GBI's credit portfolio by 26% between 30 September 2008 and 31 December 2008.

Liquidity risk management appears prudent, with the bank able to use its experience of the banking crisis that affected Turkey in 2000 and 2001. Although Moody's cautions that deposits at foreign-owned banks may be subject to higher volatility during times of crisis, during the current financial crisis GBI's retail deposits from Germany and the Netherlands have in fact proved sticky and have been well-monitored in order to determine the size of the liquidity reserve and the extent of bilateral facilities. The latter have been regularly tested for availability, while the subordinated bond issuance has also added to funding diversification. Customer deposits remain the bank's main source of funding (67%) followed by interbank funds (28%) and, to a lesser extent, market funds (2%).

GBI's overall score of D- for risk positioning is largely driven by the bank's large borrower concentration in emerging markets.

Factor: Regulatory Environment

Please refer to Moody's Banking System Outlook on the Netherlands, published in July 2009, to obtain a detailed discussion of the regulatory environment

FACTOR: OPERATING ENVIRONMENT

Trend: Weakening

Our score for the operating environment in the Netherlands is A with a weakening trend and this score is typically used in our analysis of all Netherlands-based banks. However, in the case of GBI, we use a lower score that is based on the estimated weighted average of our scores for the countries that significantly contribute to its assets and revenues. This adjusted score of D incorporates the importance of Turkey in GBI's activities (for which our operating environment score is D with a weakening trend) as well as the growing weight of the CIS (especially Russia, for which our operating environment score is E+ with a weakening trend).

QUANTITATIVE RATING FACTORS (50% WEIGHTING)

FACTOR: PROFITABILITY

Trend: Weakening

With a risk-weighted recurring earnings power ratio of 2.81% in 2008, GBI's risk-adjusted pre-provisions profitability is adequate, reflecting the relatively high margin of structured and trade finance businesses and the spreads on Turkish government bonds and treasury activities. In accounting terms, the revenue mix in 2008 evolved towards a lower proportion of net interest income (35% of operating revenues vs. 47% in 2007), in line with the decrease in the bank's loan portfolio and the increase in funding costs, while fee and commission income represented a stable 25% of operating income and trading profit 16%. Risk-weighted assets (RWAs) rose significantly to EUR 2.141 billion at end-2008 under Basel II from EUR 1.692 billion at end-2007 under Basel I, mainly to the change of the weighting methodology.

The ratio for net income on risk-weighted assets decreased to 1.86% in 2008 from 2.10% in 2007 due notably to the significant increase in RWAs.

The decrease in the bank's net profit in the first half of 2009 to EUR 12.8 million from EUR 18.13 million in H1 2008 was due to lower net interest income and a significant increase in negative value adjustments to receivables. Moody's cautions that GBI's 2009 profitability could potentially be further challenged by the worsening of the economic environment in the countries in which it operates.

The score of B, with a weakening trend, is in line with our perception of GBI's risk-weighted profitability.

FACTOR: LIQUIDITY

Trend: Neutral

GBI's liquidity is relatively strong thanks to its resilient direct retail deposit base. In 2008, the bank was successful in maintaining and even increasing its customer deposit base. The loan-to-deposit ratio fell to 50% at year-end 2008 from 57.8% in 2007, also as a result of the contraction in the bank's loan portfolio.

GBI's ratio of liquid assets to total assets was high at 66% in 2008, up from 62% in 2007. Moody's cautions, however, that the ratio includes interest-bearing securities representing 15% of the total assets. This portfolio mainly comprises securities from emerging countries (chiefly Turkey and Russia), which may prove less liquid than expected in a stress situation.

The overall liquidity score is B-.

FACTOR: CAPITAL ADEQUACY

Trend: Neutral

GBI's Tier 1 ratio was on a declining trend until 2007: 17.4% in 2004, 14.0% in 2005, 10.7% in 2006, 11% in 2007 (under Basel I), and has seen a slight improvement in 2008 (9.92% compared to 9.42% under Basel II in 2007). In addition, in our assessment of GBI's capital adequacy, Moody's also takes into account the following considerations:

- (i) The higher minimum capital ratios requirements of the Dutch regulator applicable to GBI and similar banks, meaning that the "headroom" over the regulatory requirement is lower than might appear;
- (ii) The increase in RWAs as calculated under Basel II, arising from the fact that Turkish interbank and sovereign exposures no

longer benefit from the current favourable treatment of Turkey (20% for interbank, 0% for sovereign) on the grounds that it is an Organisation for Economic Cooperation and Development country;

(iii) Rapid growth in RWAs under the current basis of calculation, which weighs on the capital adequacy score; and

(iv) The forthcoming operational risk charge and risk concentrations under the second pillar of Basel II.

Nonetheless, Moody's views positively the fact that GBI has made significant efforts in terms of Basel II implementation as well as its adoption of the internal ratings based approach to the credit risk calculation. GBI also opted for the standardised approach to market risk and for the basic indicator approach to operational risk.

Furthermore, we note that GBI has been taking measures to bolster capital adequacy, in particular by forgoing the payment of a dividend to the parent in the 2008 financial year, an action that was repeated from the year before and should continue in the future. That said, the bank's capital generation capacity has not offset the significant increase in its RWAs in 2008. Moody's will continue to monitor the development of capital adequacy ratios closely, especially in view of the current market conditions to make sure that the bank benefits from a sufficient capital buffer to potentially absorb increasing losses resulting from the likely worsening of its asset quality.

It is our understanding that GBI intends to sell its retail network in Romania to a joint venture of Dogus AS and General Electric Capital Corporation by the end of the year. Moody's notes that this disposal will have positive implications for GBI's capital adequacy.

The overall score of B+ is in our view an appropriate measure of GBI's capital adequacy. Although Moody's expects the bank's capital generation capacity to decrease, the trend is neutral to take into account the planned disposal of GBI's retail network in Romania.

#### FACTOR: EFFICIENCY

Trend: Neutral

GBI has benefited from scale efficiencies in processing trade finance, while, at the same time, management has maintained strict control over expenses in recent years, resulting in a significant improvement in efficiency ratios. The cost-to-income ratio has been kept at low levels for the past three years (44% in 2006, 40% in 2007 and 41% in 2008).

Therefore, the score for efficiency is A.

#### FACTOR: ASSET QUALITY

Trend: Weakening

GBI's tight credit selection, based in particular on a dual counterparty risk and transaction risk scoring system, has historically contributed to very low credit losses. Asset quality ratios have improved in recent years, partly as a result of the bank's withdrawal from consumer finance in 2004. Although ratios deteriorated somewhat in 2008, they remain at a satisfactory level: problem loans represent 0.94% of gross loans at YE2008, according to Moody's calculations.

Moody's, however, expects the bank's asset quality to deteriorate further in 2009 as a result of the deterioration in economic conditions globally and more specifically in the emerging countries where GBI operates.

The score for asset quality is B+ with a weakening trend.

#### **Global Local Currency Deposit Rating (Joint Default Analysis)**

Moody's assigns a Baa1 long-term global local currency (GLC) deposit rating to GBI. This rating is supported by the bank's Baseline Credit Assessment (BCA) of Baa2 as well as by Moody's assessment of a very high probability of parental support extended by Türkiye Garanti Bankası A.S. (A3 on review for possible downgrade/P-2C - domestic currency and B1/NP foreign currency), its 100% shareholder. GBI does not benefit from systemic support.

#### **Notching Considerations**

In line with Moody's notching guidelines published in April 2007, GBI's subordinated debt is rated at Baa2, i.e. one notch below the bank's senior debt rating.

#### **Foreign Currency Deposit Rating**

GBI's foreign currency deposit ratings of Baa1/Prime-2 are not constrained by the Dutch country ceiling for foreign currency deposits and are thus at the same level as the local currency ratings.

#### **ABOUT MOODY'S BANK RATINGS**

##### Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honour its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and

relative fragility of the financial system, and the quality of banking regulation and supervision.

#### Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's baseline credit assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

#### National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

#### Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

#### Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

#### About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating Factors

### GarantiBank International N.V.

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
<b>Qualitative Factors (50%)</b>						<b>D+</b>	
<b>Factor: Franchise Value</b>						<b>D</b>	<b>Neutral</b>
<b>Market Share and Sustainability</b>				x			
<b>Geographical Diversification</b>			x				
<b>Earnings Stability</b>					x		
<b>Earnings Diversification [2]</b>							
<b>Factor: Risk Positioning</b>						<b>D-</b>	<b>Neutral</b>
<b>Corporate Governance [2]</b>							
- Ownership and Organizational Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
<b>Controls and Risk Management</b>			x				
- Risk Management				x			

- Controls	x						
<b>Financial Reporting Transparency</b>						x	
- Global Comparability				x			
- Frequency and Timeliness						x	
- Quality of Financial Information						x	
<b>Credit Risk Concentration</b>	--	--	--	--	--	--	
- Borrower Concentration	--	--	--	--	--	--	
- Industry Concentration	--	--	--	--	--	--	
<b>Liquidity Management</b>				x			
<b>Market Risk Appetite</b>				x			
<b>Factor: Operating Environment</b>							<b>A Weakening</b>
<b>Economic Stability</b>	x						
<b>Integrity and Corruption</b>	x						
<b>Legal System</b>	x						
<b>Financial Factors (50%)</b>							<b>B</b>
<b>Factor: Profitability</b>							<b>B Weakening</b>
<b>PPP % Avg RWA - Basel II</b>		2.81%					
<b>Net Income % Avg RWA - Basel II</b>		1.86%					
<b>Factor: Liquidity</b>							<b>B- Neutral</b>
<b>(Mkt funds-Liquid Assets) % Total Assets</b>	- 33.11%						
<b>Liquidity Management</b>				x			
<b>Factor: Capital Adequacy</b>							<b>B+ Neutral</b>
<b>Tier 1 ratio (%) - Basel II</b>		9.92%					
<b>Tangible Common Equity / RWA - Basel II</b>	11.55%						
<b>Factor: Efficiency</b>							<b>A Neutral</b>
<b>Cost/income ratio</b>	41.00%						
<b>Factor: Asset Quality</b>							<b>B+ Weakening</b>
<b>Problem Loans % Gross Loans</b>		0.94%					
<b>Problem Loans % (Equity + LLR)</b>	3.48%						
<b>Lowest Combined Score (15%)</b>							<b>B-</b>
<b>Economic Insolvency Override</b>							<b>Neutral</b>
<b>Aggregate Score</b>							<b>C+</b>
<b>Assigned BFSR</b>							<b>C-</b>

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral



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