



Moody's Investors Service

Credit Opinion: Aktia Bank p.l.c.

Global Credit Research - 06 Jan 2010

Helsinki, Finland

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A1/P-1
Bank Financial Strength	C

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Key Indicators

Aktia Bank p.l.c.

	[1]2009	[2]2008	2007	2006	2005	[3]Avg.
Total assets (EUR billion)	9.72	9.52	--	--	--	--
Total capital (EUR billion)	0.62	0.55	--	--	--	--
Return on average assets	0.44	--	--	--	--	--
Recurring earnings power [4]	1.00	--	--	--	--	--
Net interest margin	1.75	--	--	--	--	--
Cost/income ratio (%)	53.94	190.35	--	--	--	190.35
Problem loans % gross loans	1.12	0.50	--	--	--	0.50
Tier 1 ratio (%)	9.30	9.30	--	--	--	9.30

[1] As of September 30. [2] Statement period in which the bank switched to Basel II accounting framework. [3] The average calculations are based on Basel I and Basel II data where applicable. [4] Preprovision income % average assets.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of C to Aktia Bank plc, which translates into a baseline credit assessment (BCA) of A3. The rating is supported by Aktia Bank's established - albeit small - franchise, prudent risk and liquidity management and good financial fundamentals, particularly asset quality and capital adequacy. Key elements constraining the BFSR include the bank's limited position in the competitive banking market, which is likely to lead to continued pressure on its profitability and a high borrower risk concentration.

Aktia Bank is the fourth-largest bank in Finland, with a focus on the retail market. In addition, it acts as the central financial institution for independent savings banks and local co-operative banks.

Aktia Bank's long-term global local currency (GLC) deposit ratings of A1/Prime-1 are supported not only by the bank's A3 BCA, but also by the Aaa local currency deposit ceiling of Finland, which we consider the underlying support provider. As a result of Aktia Bank's importance to the Finnish economy, mainly via its role as the central financial institution, Moody's assesses a high probability of systemic support for the bank in the event of a stress situation. Consequently, Aktia Bank's GLC deposit rating benefits from a two-notch uplift from the BCA.

Credit Strengths

- Stable regional franchise and good customer penetration of the bilingual coastal areas of Finland

- Key role as the central financial institution of independent savings banks and local co-operative banks, which has translated into new business opportunities

- Satisfactory capitalisation
- Good asset quality

Credit Challenges

- Maintaining good asset quality across the economic cycle
- High borrower risk concentration and unseasoned loan book given strong loan growth in the past few years
- A small player with a modest national market share
- Pressure on margins and income generation in a competitive operating environment
- Need to improve its cost efficiency
- Increased reliance on market funding

Rating Outlook

The outlook on all of Aktia Bank's ratings is stable.

What Could Change the Rating - Up

Given Aktia's relatively small franchise, an upgrade of the BFSR is unlikely unless there was a significant improvement in the bank's financial fundamentals and/or a change in the size of the franchise. However, the former is unlikely given the weakening economic outlook in Finland.

What Could Change the Rating - Down

Downward pressure on the BFSR could result from deterioration in the bank's asset quality or liquidity position and/or a higher risk appetite in conjunction with increased risks related to the insurance business and/or an erosion of the bank's profitability and market share.

The bank's GLC deposit rating could be downgraded in the event of one of the following scenarios taking place: (i) Aktia Bank's BFSR being downgraded; or (ii) Moody's assessing the probability of systemic support as lower. The current support assessment is supported by the agreement that Aktia Bank acts as the central financial institution for the independent savings banks and local co-operative banks.

Recent Results and Company Events

Aktia Group's organisational structure was changed in late 2008 and early 2009. At the end of September 2008, Aktia Savings Bank transferred banking operations to Aktia Bank. Aktia Savings Bank, which owned all shares in Aktia Bank, ceased to conduct banking operations and continued to operate as the parent company of the Aktia Group. Aktia Bank, which is Aktia Group's banking arm, accounts for 90% of Aktia Group's total assets as at end-September 2009.

Aktia Bank reported pre-tax profit of EUR 43 million in Q1-Q3 2009. The majority of earnings continue to stem from net interest income, which accounted for around 74% of operating income at end-Q3 2009. However, loan loss provisions weighed on the bank's net profitability, accounting for almost 40% of Aktia Bank's pre-provision profit at end-Q3 2009.

Aktia Bank's capitalisation remains good; the Tier 1 and total capital adequacy ratios stood at 9.3% and 15.7%, respectively, at end-September 2009.

Despite the contracting Finnish economy, the bank continues to report good asset quality. Aktia Bank's problem loans (i.e. loans over 90 days past due and individual write-downs) accounted for 1.1% of gross loans at end-September 2009.

As Aktia Bank started its operations on 30 September 2008, no comparative income statement figures are reported for the bank. Disclosed quarterly financials of Aktia Bank cover Q1-Q3 2009 only.

On a group basis, Aktia reported pre-tax profit of EUR 44.4 million for Q1-Q3 2009, up from EUR 37.3 million in Q1-Q3 2008, primarily reflecting improved net interest income which more than offset the increased provisioning levels.

DETAILED RATING CONSIDERATIONS

Detailed considerations for Aktia Bank's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a BFSR of C to Aktia Bank. The main elements underpinning the BFSR are the bank's good liquidity and risk management, good asset quality and satisfactory capitalisation. Key elements constraining the BFSR include its limited market position in the competitive banking market, which is likely to lead to sustained pressure on its profitability, high borrower risk concentration and potential risks related to the insurance businesses.

As a point of reference, the assigned BFSR is at the same level as the C outcome of Moody's bank financial strength scorecard. In Moody's opinion, the C BFSR is an appropriate measure of Aktia Bank's financial strength given the current challenges facing the bank in the highly competitive environment, both in banking and in insurance, as well as slowing economic growth.

Qualitative Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

Aktia Bank's franchise value is underpinned by a good product range, tailored services and its focus on proximity banking. Historically, the bank has had a good position among the Swedish-speaking population, but has recently concentrated on growing its business amongst the Finnish-speaking population.

In 2008, Aktia Group's legal structure was changed. The banking business of Aktia Savings Bank was transferred to Aktia Bank, which was simultaneously converted into a public limited liability company. As a result, Aktia Savings Bank, which owns 100% of the shares in Aktia Bank, ceased to conduct banking operations and has continued as the holding company of the Aktia Group.

Aktia Bank accounted for 90% of Aktia Group's total assets at end-September 2009 and encompasses branch office operations, mortgage lending, corporate finance and fund management activities.

Aktia Bank has more than 70 branches, located mainly in the coastal areas of Finland, around Helsinki and the country's largest inland towns. It is a relatively small player and the fourth-largest bank in the market, which is dominated by three large banks. The bank has gradually improved its market shares - slightly more than 4% in retail mortgages, still not significant in corporate loans and almost 7% in mutual funds at end-September 2009.

The bank remains focused on retail banking, particularly mortgage lending and savings products, as well as SMEs. About 80% of the loan portfolio is to retail customers, 15% to corporates and 4% to housing associations.

In December 2008, Aktia Bank acquired Iceland's Kaupthing Bank's asset management operations in Finland. We note positively Aktia's widening product range in asset management, which should support Aktia Bank's franchise going forward.

In addition to the operations carried out by Aktia Bank, the Aktia Group covers non-life insurance, life insurance and real estate agency activities.

In February 2009, Aktia Bank sold its life insurance operations to its parent company. Aktia Life Insurance now operates as a daughter company within the Aktia Group. The Aktia Group has a market share of almost 4% in life insurance products. In addition, in January 2009, Aktia merged with Veritas Non-Life Insurance. The latter operates as a separate subsidiary within the Aktia Group under the name Aktia Non-Life Insurance. The market share within non-life insurance is around 2%.

Although we view the Group's further expansion in insurance activities as a source of new cross-selling opportunities, we are cautious of the challenges related to integration and intense competition in the Finnish insurance market, which is dominated by a few large players.

Moody's estimates that over 60% of Aktia Bank's earnings stem from more stable sources such as the retail banking and asset management operations. We further note that the earnings volatility will be somewhat reduced as Aktia Bank's insurance operations, whose poor investment performance burdened the bank's profits in 2008, were transferred to its parent company in April 2009.

In light of these factors, the overall score for Aktia Bank's franchise value is C.

Factor 2: Risk Positioning

Trend: Neutral

The bank's risk profile is sound and its risk management practices are in line with its limited risk appetite. The group has an independent risk function which reports to the managing director. In addition, no major control issues have arisen in recent years.

Aktia Bank's largest shareholder is Helsinki Savings Bank Foundation (which holds a 19% stake) and 24 savings bank foundations which collectively hold 48% of its shares. Since end-September 2009, the company has been listed on the Helsinki Stock Exchange. We do not see any corporate governance issues for Aktia Bank and the practices it follows are in line with Finnish regulations. The bank's related-party exposure is insignificant.

The borrower concentration risk - as measured by the 20 largest exposures in relation to Tier 1 capital or pre-provision profit - is high, although somewhat lower than in many other Nordic banks of similar size. Industry concentration risk is relatively well contained due to the bank's dominating focus on the retail sector, which accounted for around 80% of total loans at end-Q3 2009. The largest industry sector is commercial real estate, which represents around 7% of total lending and around 150% of Tier 1 capital.

The bank's liquidity management is good and has improved in recent years. Due to strong historic loan growth, Aktia Bank's reliance on market funding has increased somewhat, but deposits still represent the most important source of funding - around 40% of total funding, compared with over 60% in 2004 and earlier. In regards to market funding, we note that the covered bonds (rated Aa1 by Moody's) issued via the subsidiary Aktia Real Estate Mortgage Bank are included in Aktia Bank's market funding as a whole, although a part of the loans were granted and are managed by independent savings banks and local co-operative banks. Aktia Bank has 70% of votes and 53.7% of shares in Aktia Real Estate Mortgage Bank. Overall, Aktia Bank targets a mixed funding profile comprising deposits, covered bonds and short-term interbank and wholesale funds.

The bank's liquid assets account for 35% of total assets (end-September 2009) and consist mainly of highly rated covered bonds and senior bonds of financial institutions, but also include a small amount (around 2%) of European RMBS instruments. Thanks to its prudent liquidity management, the bank could refrain from raising funds in capital markets for a 12-month period if market conditions were to prevent access to capital markets.

The bank's market risk appetite is limited. Market risk mainly consists of interest risk that the bank actively hedges against potential changes. Conservative limits on interest rate and foreign exchange risks are calculated on the basis of budgeted net interest income and the capital base, respectively. At year - end 2008, a 100-basis-point increase in interest rates would have reduced the net interest income of the banking business for the next 12 months by 5.4% (target maximum -6%).

The bank's equity and currency risks are limited. Moreover, we note that proprietary trading has not resulted in significant volatility in the past.

The overall score for Aktia Bank's risk positioning is C and is constrained by its high credit risk concentration.

Factor 3: Regulatory Environment

For a discussion of the regulatory environment, please see Moody's latest Banking System Outlook on Finland.

Factor 4: Operating Environment

Trend: Neutral

Our assessment of a bank's operating environment is based on a measurement of economic stability, the power and efficiency of the legal system and the level of integrity in the country's business culture. The score for the Finnish operating environment is B+.

Refer to Moody's latest Banking System Outlook on Finland for a discussion of the bank's operating environment.

Factor 5: Profitability

Trend: Weakening

For the first nine months of 2009, Aktia Bank reported pre-tax profit of EUR 43 million. Net interest income stood at EUR 112 million and accounted for 74% of total operating income. The bank's net fee and commission income was almost EUR 28 million and accounted for 18% of total operating income. Net interest margin (in relation to earning assets) was 1.8% at end-Q3 2009, up from 1.6% at end-Q1 2009.

Overall, Aktia Bank's core earnings in the form of net interest and fee & commission income have been stable throughout recent quarters, during which the bank has been operating under its current structure. We note that the results reported for year - end 2008 (only since it was established at end-September 2008) were negative given the EUR 35 million loss from its life insurance operations which were discontinued in April 2009.

Loan loss impairments accounted for almost 40% of pre-provision income for the first nine months of 2009, a level in line with that reported for H1 2009, but substantially higher than the corresponding 10% in Q1 2009.

The profitability ratios on the scorecard, which are expressed in relation to average risk-weighted assets, have been computed using Basel II risk-weighted assets. Therefore, the scorecard reflects only 2008 profitability. The score for Aktia's profitability is E. If we annualise the results for the first nine months for 2009, the scorecard outcome would be C+. However, it remains to be seen if this trend is sustainable.

The weakening trend reflects our view that growth in core banking income will not be evident and asset quality is likely to further weigh on the net profitability given the challenging economic outlook in Finland.

Factor 6: Liquidity

Trend: Neutral

Deposits remain the most important source of funding, but over the past few years, the growth in deposits has been slower than that in lending and for 2009, deposits have actually contracted. This has caused market funding to increase. However, covered bonds represent a growing proportion of market funds and help to diversify the funding sources.

Customer deposits represented almost 40% of total funding at end - Q3 2009. Interbank funds - mainly from independent savings banks and local co-operative banks for which it acts as a central bank - accounted for around 20% of total funding at end - Q3 2009. We note that interbank deposits are typically a more volatile funding source, but co-operation with these banks is deemed to be a mitigating factor. The remaining 40% of total funding comprises market funding.

Covered bonds issued by Aktia Real Estate Mortgage Bank accounted for 47% of Aktia Bank's market funding (EUR 2.2 billion). In addition, a EUR 150 million covered bond with a maturity of three years was issued on 30 October 2009.

As at end-September 2009, liquid assets represented 35% of total assets and mainly comprised of highly rated covered bonds and senior bonds of financial institutions. The liquidity portfolio further mitigates the banks high level of interbank funding.

The bank scores C for liquidity management and D for its liquidity ratio, resulting in an overall liquidity score of C- for 2008 and D+ for Q1-Q3 2009.

Factor 7: Capital Adequacy

Trend: Weakening

At end - September 2009, Aktia Bank's capital ratio stood at 15.7% and Tier 1 at 9.3%. The Tier 1 ratio was unchanged from those levels recorded at year - end 2008. The bank is applying the standard approach when assessing the capital requirements for credit

risk. The bank targets a capital ratio of 12% and a Tier 1 capital of 9%.

An anticipated deterioration in asset quality largely relates to the more challenging outlook for the Finnish corporate sector. To reflect these expectations, we perform scenario analysis to capture the potential impact on asset quality, earnings and capitalisation. The assumptions behind our scenario analysis are described in more detail in a Special Comment entitled "Moody's Approach to Estimating Nordic Banks' Credit Losses" published on 16 July 2009. The results of Moody's scenario analysis showed that Aktia's key credit drivers, in particular its capital adequacy, showed a good resilience to its base scenario, which is the key ratings determinant. This is primarily a reflection of the bank's retail oriented loans (mainly mortgages), which account for nearly 80% of the total loan portfolio.

The score for capital adequacy is B+, but due to the ongoing economic downturn we see a weakening trend.

Factor 8: Efficiency

Trend: Neutral

Historically, Aktia has struggled with its cost efficiency due to its business model and it remains an important factor for the bank to keep under control. Some improvements have taken place in relation to changes in its organisational structure. Cost efficiency at end-September 2009 was 54%, an improvement from around 65% at end-March 2009. We note that the corresponding ratio for 2008 was very high, reflecting losses from its life insurance operations.

The score for efficiency based on 2008 figures is E and that based on Q1-Q3 figures is B. We view the trend as neutral.

Factor 9: Asset Quality

Trend: Weakening

Despite some single-name concentrations, Aktia Bank enjoys relatively good asset quality, reflecting its focus on the retail sector (around 70% of its loan portfolio is related to residential mortgages). In addition, 4% of the loans are to housing associations, which we generally regard as relatively low-risk. Geographically, over half of all mortgage loans are in Southern Finland.

Aktia Bank's total loan book was some EUR 6 billion at end-September 2009, with EUR 2.4 billion of this on the balance sheet of its mortgage company. The mortgage company is consolidated into Aktia Bank's accounts, although parts of the portfolios are actually owned by savings and local co-operative banks. For the nine months ending September 2009, lending growth for Aktia Bank (including loans in the mortgage company) was 11%. (18.6% for 2008).

Aktia Bank's problem loans (i.e. loans over 90 days past due and individual write-downs) accounted for 1.1% of gross loans at end-September 2009. We note that although problem loans remain at low levels, the increase has been rapid (the ratio has more than doubled in less than a year). Around half of those problem loans are covered by loan loss reserves, a ratio that is in line with that of the bank's Nordic peers and that has gradually improved over the recent quarters.

At end-June 2009, the weighted average loan-to-value of Aktia Real Estate Mortgage Bank's loan book was 57%. For the mortgage loans on Aktia Bank's own balance sheet, the loan-to-value ratio was 69%.

The score for asset quality is A for 2008 and B for Q1-Q3 2009 and remains a positive rating factor. However, we do not expect the low level of problem loans to be sustainable throughout the economic cycle and, given recent strong loan growth and the weakening economic outlook in Finland, we see a weakening trend.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a long-term GLC deposit rating of A1 to Aktia Bank.

This rating is supported by (i) the bank's A3 BCA and (ii) the Aaa local currency deposit ceiling of Finland, its underlying support provider. In view of Aktia Bank's moderate market shares in both deposits and loans and its role as the central financial institution to independent savings banks and local co-operative banks, Moody's assesses a high probability of systemic support for the bank in the event of a stress situation, resulting in a two-notch uplift from the A3 BCA.

Foreign Currency Deposit Rating

The A1 foreign currency deposit rating of Aktia Bank is unconstrained given that Finland has a country ceiling of Aaa.

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 honor 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

Aktia Bank p.l.c.

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

- Quality of Financial Information	--	--	x	--	--		
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management			x				
Market Risk Appetite		x					
Factor: Operating Environment						B+	Neutral
Economic Stability			x				
Integrity and Corruption	x						
Legal System	x						
Financial Factors (50%)						C-	
Factor: Profitability						E	Weakening
PPP % Avg RWA - Basel II					0.20%		
Net Income % Avg RWA - Basel II					0.17%		
Factor: Liquidity						C-	Neutral
(Mkt funds-Liquid Assets) % Total Assets				10.87%			
Liquidity Management			x				
Factor: Capital Adequacy						B+	Neutral
Tier 1 ratio (%) - Basel II		10.09%					
Tangible Common Equity / RWA - Basel II	10.09%						
Factor: Efficiency						D	Weakening
Cost/income ratio				74.34%			
Factor: Asset Quality						A	Weakening
Problem Loans % Gross Loans	0.44%						
Problem Loans % (Equity + LLR)	6.39%						
Lowest Combined Score (15%)						E+	
Economic Insolvency Override						Neutral	
Aggregate Score						C	
Assigned BFSR						C	

[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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