

**Credit Opinion: DVB Bank AG**

**DVB Bank AG**

Frankfurt, Germany

**Ratings**

<b>Category</b>	<b>Moody's Rating</b>
Outlook	Stable
Bank Deposits	A1/P-1
Bank Financial Strength	C
Senior Unsecured	A1
Subordinate -Dom Curr	A2
Other Short Term -Dom Curr	P-1
<b>Parent: DZ BANK AG Deutsche Zentral-Genossenschaftsb.</b>	
Outlook	Stable(m)
Bank Deposits	Aa3/P-1
Bank Financial Strength	C-
Senior Unsecured	Aa3
Subordinate -Dom Curr	A1
Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	P-1

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**Key Indicators**

**DVB Bank AG**

	[1]2006	2005	2004	2003	2002	5-Year Avg.
Total assets (EUR billion)	10.87	10.86	9.28	9.07	9.30	[2]2.76
Total capital (EUR billion)	1.21	1.12	0.93	0.90	0.73	[2]12.10
Return on average assets	0.83	0.56	0.38	0.78	0.32	0.42
Recurring earnings power [3]	1.13	0.72	0.74	0.49	0.30	0.51
Net interest margin	1.27	1.19	1.12	1.15	0.93	1.04
Cost/income ratio (%)	47.91	58.69	56.79	76.75	84.56	72.07
Problem loans % net loans	0.01	0.17	0.37	0.00	0.00	0.11
Tier 1 ratio (%)	6.70	6.80	6.70	6.80	5.80	6.22

[1] As of June 30. [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 DVB Bank AG (DVB), which translates into a Baseline Credit Assessment of A3. The rating derives from DVB's focused and well executed strategy of being a specialised lender to the transport finance industry, and its improving, but moderate, risk-adjusted profitability and economic capitalisation. The BFSR also takes into account the bank's established position in cyclical and competitive industries.

DVB's long-term global local currency (GLC) deposit rating is A1, based on the bank's own Baseline Credit Assessment of A3 and on Moody's assessment of a very high probability of group support from the Association of German Co-operative Banks (Bundesverband der Deutschen Volksbanken und Raiffeisenbanken or BVR), and a low probability of systemic support.

Under Moody's joint default analysis (JDA) methodology, our support assessment - as highlighted above - gives DVB's GLC deposit rating a two-notch uplift from its A3 Baseline Credit Assessment. The short-term rating is Prime-1.

Prior to the implementation of Moody's BFSR/JDA methodology on 11 May 2007, the ratings of DVB were A2/Prime-1.

### **Credit Strengths**

- Solid franchise and market expertise in the international transport industry
- The bank has reached its target to become a fully integrated corporate finance specialist in the transport industry
- Asset quality has demonstrated considerable resilience to difficult operating environment, besides a certain comfort in any event because of secured lending
- Financial fundamentals increasingly reflect the bank's successful transformation into a specialised lender, with acceptable risk-weighted returns and efficiency

### **Credit Challenges**

- Risk-adjusted profitability and economic capitalisation have improved, but risk-absorption capacity remains somewhat vulnerable to a meltdown scenario in the shipping or aviation industries
- In addition to the inherent industry concentration, some limited single risks exist, represented by unsecured exposures
- DVB's liquidity profile is modest, since the bank's funding predominately relies on wholesale funds

### **Rating Outlook**

The outlook on all ratings is stable.

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

We acknowledge that DVB has, over time, successfully completed its transformation process into a specialised corporate finance bank, including the elimination of all legacy risks in its German transport and corporate finance portfolio. This should result in a further strengthening of its financial fundamentals in the medium term, which would justify a higher BFSR. We view positively DVB's increased expansion into corporate finance and advisory activities - including the bank's active management of collateralised assets - mezzanine and equity financing, but we caution that undue growth in unsecured credit exposure could limit the upside potential for the BFSR.

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

DVB's BFSR is vulnerable to event risk, which would most likely be linked to a meltdown scenario in the shipping or aviation industries.

### **Recent Results**

As at year-end 2006, DVB's total assets were about EUR 11.1 billion which is up 2% from one year before. Net income rose by 65.7% to EUR 90 million while the Cost-to-Income ratio fell to 47.9% at the end of 2006 from 58.7% at December 2005.

### **DETAILED RATING CONSIDERATIONS**

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

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

Moody's assigns a C BFSR to DVB Bank AG, in line with Moody's bank financial strength rating scorecard. Key

positive elements driving Moody's BFSR scorecard outcome include its solid franchise and market expertise in the international transport industry and its ample geographical diversification. The BFSR also takes into account the bank's improving cost efficiency and low risk profile, demonstrated in particular by its sound asset quality. Key elements constraining the BFSR are the improving but still modest profitability indicators, and the strong dependence on wholesale funding, reflected in a weak liquidity ratio.

The BFSR was upgraded to C from C- in May 2007 in conjunction with the application of Moody's updated bank financial strength rating methodology.

#### Qualitative Rating Factors (50%)

##### Factor 1: Franchise Value

Trend: Neutral

DVB has a focused and well executed strategy of being a specialised lender to the transport finance industry. DVB's has a well established market position in shipping and aviation finance and is also an important player in land transport finance, primarily railroads.

Following the acquisitions of portfolios and teams in shipping and aviation, DVB has successfully transformed itself from a domestic lender to the SME market into an international transport finance specialist and is now a well-known player in the international transport industry. DVB is active in lending, structured finance and corporate finance products. In addition DVB is using its deep know-how and sector expertise to establish itself as an asset manager in investment funds, focusing on assets in the aviation or shipping sector.

DVB's franchise value is somewhat constrained by the cyclical nature of its core business lines and the highly competitive and fragmented market of aviation and ship finance. The volatile characteristics of the aviation and shipping industry could potentially affect the bank's risk-return profile and make the bank's financial fundamentals somewhat less predictable, particularly when compared to those of banks with more diversified earnings spread over a greater number of businesses and industries. However, based on DVB's experience in and deep knowledge of the transport sector, we consider the bank to be well positioned to withstand negative cyclical developments. DVB's returns have proved to be stable in recent years, and continues to grow in line with its better entrenched position as a transport finance specialist.

DVB's activities are of a global nature and well diversified in geographical terms. The bank has significant operations in many major markets and owns a worldwide network of branches and representative offices in the major centres for aviation and ship finance. Markets outside Germany account for more than 90% of its customers and exposure. The overall score for Franchise Value is C.

##### Factor 2: Risk Positioning

Trend: Neutral

DVB's has a sound risk profile. DVB performs good risk management practices, supported by an improved IT platform and updated risk management systems.

The nature of bank's business determines the existence of notable credit risk concentration. From an industry point of view, the shipping industry - accounting for more than half of the portfolio - is, by far, the largest concentration. Borrower concentration is also high compared to less specialised banks. However, these concentrations are mitigated by the secured nature of DVB's lending practices. More than 95% of DVB's loan portfolio is collateralised and the quality of the collateral is sound, as confirmed by the absence of any actual losses of principal in the core businesses over recent years.

Market risk is confined almost exclusively to interest rate risk and foreign exchange, as equity and trading risks are minimal. The vast majority of derivatives represent interest rate swaps and FX forwards used for hedging. DVB's scorecard outcome for Risk Positioning is C-.

##### Factor 3: Regulatory Environment

All German banks are subject to the same score on regulatory environment. This factor does not address bank-specific issues; instead, it evaluates whether regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control.

##### Factor 4: Operating Environment

Trend: Neutral

This factor is also common to all German banks. Moody's assigns a B score for the overall operating environment. However, due to the substantial portion of DVB's profits deriving from outside the home country, we consider a blended operating environment score for each sub-factor reflecting the bank's overall operating environment based on its profit mix. The adjusted overall operating environment is still B, positively affected by the bank's operations in the USA, UK, Norway and Japan but outweighed by the negative impact of Korea, Greece and Hong Kong.

#### Quantitative Rating Factors (50%)

##### Factor 5: Profitability

Trend: Improving

The bank's recurring earning power and profitability have clearly improved in 2006 and, on a risk-weighted basis, are now more-or-less in line with other German banks, although still lagging behind its European peers.

DVB's revenues are still dominated by net interest income derived from its lending operations. The bank's average interest margin improved in recent years, partially reflecting the favourable environment in one of the bank's core market - the shipping industry. Margins might come under pressure when the cycle in shipping turns, but based on DVB's expertise and position we consider the bank to be well equipped to anticipate negative trends in the market well in advance. Based on its well-established client relationships, DVB should also be less vulnerable to margin pressure than other more opportunistic players that enter the aviation or shipping market.

Since 2004 DVB has intensified its efforts to become a fully integrated corporate finance house for its selected industries through strengthening its corporate finance and capital market activities (through its DVB Capital business unit). This has entailed extending the bank's customer lending relationships into higher-margin products and services, such as structured finance, syndication, advisory services, mezzanine lending and equity sourcing. We view this revenue diversification positively and note that DVB's corporate finance activities are developing successfully as demonstrated in 2005 and 2006 when DVB made considerable progress in generating commission income in corporate finance. The overall score for Profitability is D.

##### Factor 6: Liquidity

Trend: Neutral

DVB's liquidity position is modest, reflecting the bank's dependence on wholesale funding, with interbank and capital market funding dominating. However, to improve its liquidity DVB holds a portfolio of liquid securities, predominately bank bonds, and has access to committed un-drawn back-up facilities. In 2004 the bank has ceased providing the liquidity clearing functions for the Sparda Banks, which are typically highly liquid retail banks that provided DVB with relatively stable interbank deposits until the end of 2004. Nonetheless, DVB is a member of the co-operative banking sector (BVR) and, as such, could in our opinion rely on short-term funds provided by BVR members in case of need. The D+ score for liquidity reflects in our view the more modest liquidity position of the bank.

##### Factor 7: Capital Adequacy

Trend: Neutral

DVB's capital increase, which took place in October 2005, helped the bank to stabilise its capital levels. Total capital ratio fell to 9.7% at the end of 2006 (2005: 10.2%) while the core capital ratio remains at 6.8% - all ratios are in accordance with German regulatory guidelines of the German Banking Act (Kreditwesengesetz or KWG).

We view DVB's economic capital position and consequently its risk-absorption capacity as having clearly improved, given the increased level of core profitability and reserves. However, the bank's financial robustness and flexibility would benefit from a higher economic capitalisation, particularly since it remains vulnerable due to the highly cyclical markets. In this context, continuing strong portfolio growth, or a strengthening of the US dollar against the euro could again put pressure on its regulatory capital levels. This problem occurs mainly as the bank's assets are denominated in US dollars and DVB's funding is euro-based. The bank is therefore aiming to further diversify its funding structure and will target mainly the Asian markets to attract a new investor base.

DVB is aiming for the Advanced Approach under Basel II. Given its high share of secured lending and its low levels of defaults or losses, the bank expects a positive impact on its regulatory capital levels in the future. The score for the bank's Capital Adequacy is C+.

##### Factor 8: Efficiency

Trend: Improving

We acknowledge DVB's efforts and its success in achieving its targeted cost-to-income ratio of no more than 50%

(49.9% at the end of 2006), together with a continuing diversification into new products and asset classes. However, compared to other specialised lenders, such as ship financiers or mortgage banks, this cost-to-income ratio might appear relatively high, and it will be difficult for the bank to achieve the very low cost-to-income ratios of those secured long-term lenders specialising in financing only one asset class. Based on the three-year average figure, DVB scores C for Efficiency.

#### Factor 9: Asset Quality

Trend: Neutral

The score for Asset Quality highlights one of the strengths of the bank. DVB's loan portfolios in its core businesses of shipping and aviation have been demonstrating considerable resilience in a depressed market environment, thanks primarily to the bank's good level of diversification in the various sub-segments of these two industries and also by geographical areas. Additionally, more than 95% of DVB's loan portfolio in these segments is collateralised and the quality of the collateral is sound, as confirmed by the absence of any actual losses of principal in the core businesses over recent years.

Strong collateral has helped DVB avoid losses, despite its exposure to sectors with larger bankruptcies between 2001 and 2003, especially in the aviation industry. In the past years, little loan-loss provisioning has been required in DVB's ship financing business, which is indicative of the bank's strong expertise in its core business fields. Although these industries are highly volatile, the bank has been able to withstand the challenges thanks to a successful strategy through which it prioritises the assets and contractual covenants in its credit decisions, thus taking less comfort from the creditworthiness of the airline or ship owner. However, we would take a cautious view of any larger positions of unsecured credit exposure or equity positions. The bank scores B for Asset Quality

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

Moody's assigns a global local currency (GLC) deposit rating of A1 to DVB Bank AG.

The GLC deposit rating is supported by DVB's Baseline Credit Assessment of A3, as well as by the ratings of its underlying support providers:

- The C- BFSR of its major shareholder (DZ Bank Deutsche Zentral-Genossenschaftsbank AG), which translates to a Baa1 Baseline Credit Assessment;
- The creditworthiness of the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), sector;
- Germany's Aaa local-currency deposit ceiling (LCDC).

The bank thus receives a two-notch uplift from its Baseline Credit Assessment, bringing the GLC rating to A1.

Based on DVB's membership of the BVR Moody's assesses the probability of co-operative sector support for the bank in the event of a stress scenario as high. The bank's membership of the FinanzVerbund provides DVB with two forms of sector-specific support: the Garantiefonds (a support fund that is maintained by annual contributions from member banks) and the Garantie-Verbund (a further contractually defined support agreement, which invariably takes the form of a performance guarantee in favour of a co-operative bank in difficulty).

Moody's assessment of a low probability of parental assistance results from DVB's ownership structure, whereby DZ Bank holds a stake of 93.21%. However, despite the majority ownership we see hardly any indications that support would be provided, since there is no strategic fit of the two banks' business models and only limited management involvement from DZ Bank and no reference to the parent's brand name or logo.

The probability of systemic support is judged to be low. This is based on DVB's small national market share and minimal importance to the German paying system. Germany is characterised as a medium support country.

#### **Notching Considerations**

In line with Moody's notching guidelines published in April 2007, DVB's dated subordinated debt is rated at A3, i.e. one notch below the bank's senior debt rating.

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

Moody's foreign currency deposit ratings for DVB are A2/Prime 1, stable.

#### **Foreign Currency Debt Rating**

Moody's foreign currency debt ratings for DVB are A2/Prime 1, stable.

## 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 Ratings

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**
**DVB Bank AG**

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
<b>Qualitative Factors (50%)</b>						<b>C</b>	
<b>Factor 1: Franchise Value (20%)</b>						<b>C</b>	<b>Neutral</b>
<b>Market Share and Sustainability</b>			<b>x</b>				
<b>Geographical Diversification</b>	<b>x</b>						
<b>Earnings Stability</b>					<b>x</b>		
<b>Earnings Diversification [2]</b>							
<b>Factor 2: Risk Positioning (20%)</b>						<b>C-</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>		<b>x</b>					
- Risk Management			<b>x</b>				
- Controls	<b>x</b>						
<b>Financial Reporting Transparency</b>		<b>x</b>					
- Global Comparability	<b>x</b>						
- Frequency and Timeliness		<b>x</b>					
- Quality of Financial Information			<b>x</b>				
<b>Credit Risk Concentration</b>	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
<b>Liquidity Management</b>			<b>x</b>				
<b>Market Risk Appetite</b>	<b>x</b>						
<b>Factor 3: Regulatory Environment (5%)</b>						--	--
<b>Factor 4: Operating Environment (5%)</b>						<b>B</b>	<b>Neutral</b>
<b>Economic Stability</b>			<b>x</b>				
<b>Integrity and Corruption</b>		<b>x</b>					
<b>Legal System</b>	<b>x</b>						
<b>Financial Factors (50%)</b>						<b>C-</b>	
<b>Factor 5: Profitability (7,9%)</b>						<b>D</b>	<b>Improving</b>
<b>PPP % Avg RWA</b>				1.00%			
<b>Net Income % Avg RWA</b>				0.67%			
<b>Factor 6: Liquidity (7,9%)</b>						<b>D+</b>	<b>Neutral</b>
<b>(Mkt funds-Liquid Assets) % Total Assets</b>					45.97%		
<b>Liquidity Management</b>			<b>x</b>				
<b>Factor 7: Capital Adequacy (7,9%)</b>						<b>C+</b>	<b>Neutral</b>
<b>Tier 1 ratio (%)</b>			6.77%				
<b>Tangible Common Equity % RWA</b>		6.76%					
<b>Factor 8: Efficiency (3,5%)</b>						<b>C</b>	<b>Improving</b>
<b>Cost/income ratio</b>			55.22%				
<b>Factor 9: Asset Quality (7,9%)</b>						<b>B</b>	<b>Neutral</b>
<b>Problem Loans % Gross Loans</b>	--	--	--	--	--		
<b>Problem Loans % (Equity + LLR)</b>	--	--	--	--	--		
<b>Lowest Combined Score (15%)</b>						<b>D+</b>	

<b>Economic Insolvency Override</b>						<b>Neutral</b>	
<b>Total Scorecard Implied BFSR</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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