

## Ratings

Category	Moody's Rating
Outlook	Negative(m)
Bank Deposits	Baa2/P-2
Bank Financial Strength	D+

## Contacts

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## Key Indicators

Volvofinans Bank AB	[1]2009	2008	[2]2007	2006	2005	[3]Avg.
Total assets (SEK billion)	24.07	25.38	25.87	24.94	25.26	[4]-1.28
Total assets (EUR billion)	2.35	2.31	2.74	2.76	2.69	--
Total capital (SEK billion)	3.19	3.07	2.84	2.91	2.93	[4]1.37
Return on average assets	0.66	0.97	0.89	0.88	0.73	0.82
Recurring earnings power [5]	0.91	1.15	1.24	1.21	1.05	1.11
Net interest margin	0.95	1.50	1.44	1.34	1.17	1.28
Cost/income ratio (%)	54.40	52.11	48.06	47.42	44.42	49.28
Problem loans % gross loans	1.39	0.85	0.31	0.28	0.21	0.61
Tier 1 ratio (%)	14.04	12.84	11.35	9.79	8.96	11.40

[1] As of December 31. [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] Compound annual growth rate. [5] Preprovision income % average assets.

## Opinion

### SUMMARY RATING RATIONALE

Moody's rates Volvofinans Bank AB ("Volvofinans") D+Baa2/P-2. The assigned D+ bank financial strength rating (BFSR), which translates into a baseline credit assessment (BCA) of Baa3, reflects its market leadership in automotive financing in Sweden, solid asset quality to date and good operating efficiency. The rating also recognises the negative impact that (i) a volatile Swedish automotive market is having on Volvofinans' profitability; and (ii) tougher capital market conditions are having on its wholesale funding profile.

Volvofinans's long-term global local currency (GLC) deposit rating is Baa2 based on Moody's assessment of systemic support for Volvofinans, as well as to a limited degree the support provided by the entities' parents. The low level of systemic support stems from Volvofinans inclusion in the support packages in Sweden. In terms of parental support, the company is 40% owned by the Swedish government pension fund, AP6 who also provide the chairman of the board of Volvofinans, with 50% ownership held by the Volvo dealers, who are also the main users of the bank. As a result, there is one notch uplift in the GLC deposit rating from Volvofinans's D+ BCA.

### Credit Strengths

- Market leadership in automotive financing in Sweden despite intense competition
- Strategic importance for the Swedish Volvo dealer network
- Increasing diversification of income streams, including other car brands than Volvo and activities other than automotive finance (primarily credit card services)
- Good operating efficiency, which is vital to its strategic role
- Solid asset quality to date derived from the fact that most of its credit risk is owned by dealers

## Credit Challenges

- Reliance on wholesale funding, of which almost 40% is short term
- Managing pressure on its profitability and asset quality derived from weak automotive sales and the deteriorating financial profiles of Volvo dealers
- Industry concentration risk in the automotive sector
- Uncertainties surrounding the future of the Volvo brand associated with acquisition by Geely Holding Company
- Managing the higher credit risk related to unsecured credit card receivables

## Rating Outlook

On 10 May 2010, Moody's downgraded Volvofinans's BFSR to D+ from C- and the long-term deposit rating to Baa2 from Baa1. The outlook on the bank's D+ BFSR is stable, whereas on the Baa2 long-term rating is negative, due to expected funding and earnings pressure and also D+ can track to Ba1. Moody's also confirmed the Prime-2 short-term deposit rating.

### What Could Change the Rating - Up

At present, we do not view the bank's BFSR or GLC deposit ratings as enjoying upside potential, given the current negative outlook on the GLC deposit ratings and continued volatile funding markets.

### What Could Change the Rating - Down

The BFSR could be adversely affected if credit quality weakens to a greater extent than we assume in our base case, which would exert pressure on the bank's earnings and capitalisation or if the franchise value diminishes.

## Recent Results and Company Events

In March 2010, negotiations between Ford Motor Company and Geely Holding Co over the sale of Volvo Car Corporation entered its final stages and a finalisation of the sale is now expected in the third quarter of 2010. As part of the preparations for the sale, Ford Credit's 10% ownership interest in Volvofinans Bank was transferred to Volvo Cars Corporation.

Volvofinans reported a pre-tax profit for the first three months of 2010 of SEK 56 million, up 56% year-on-year. The increased profitability was mainly driven by increased net interest income and leasing income following a stabilisation of the funding markets.

Volvofinans only reports capital adequacy figures for the parent company (as the Group does not include a financial corporate group according to Swedish FSA rules). Its capital adequacy is satisfactory, with a Tier 1 ratio of 14.2% and total capital ratio of 15.3% (both according to Basel II) at end March 2010.

## DETAILED RATING CONSIDERATIONS

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

### Bank Financial Strength Rating

The assigned D+ BFSR is two notches lower than the C outcome generated by Moody's BFSR scorecard reflecting Moody's concerns on the vulnerability of Volvofinans funding model and expected continued earnings pressures.

#### Qualitative Rating Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

Volvofinans offers consumer finance loans and leasing contracts to private and corporate customers purchasing vehicles through Volvo dealers. In addition, it provides credit card services to more than one million customers. The company's franchise is underpinned by its widely recognised brand name and sustained market leadership in vehicle finance in Sweden for many years, despite operating in a niche market. Volvofinans's business model is built upon a strong financial incentive for the Volvo dealers, who own 50% of the company, to distribute Volvofinans's financial products.

The Swedish network of Volvo dealers comprises 69 dealerships, 200 sales outlets and around 8,500 employees. At year-end 2009, Volvofinans financed over 50% of the sales of new cars by Volvo dealers in Sweden and 49% of new Volvo trucks (excluding sales through Volvo Truck Centre). Volvo's car sales have maintained a relatively stable market share in Sweden of approximately 20% over the past ten years. The market share of Volvo trucks is over 40%. Volvo dealers have since 2007 been able to sell other car brands in addition to Volvo and Renault. This should help to improve both franchise value and earnings stability for Volvofinans going forward due to a broadening of the business.

Volvofinans also finances fleet financing and administration services (all car types in the fleet, not specifically Volvos and Renaults) and the issuance of credit cards (Volvo Cards) that are largely used to pay for fuel and car servicing.

With the imminent sale of Volvo Cars Corporation to Geely Holding Co, there are uncertainties with regards to the future of the Volvo Car brand. Moody's notes that although Swedish Volvo dealers have diversified their product offering to include other brands, they remain heavily dependent on the sale of Volvo Cars.

The overall score for Volvofinans' franchise value is C-, reflecting its good market position in Sweden and relatively stable earning sources. The score is constrained by low earnings diversification.

## Factor 2: Risk Positioning

Trend: Neutral

In Moody's opinion, Volvofinans has a unique ownership structure for a vehicle finance company in Europe. The company is 50% owned by Volverkinvest, the investment vehicle owned by 69 Volvo dealers in Sweden, with 40% held by Swedish state-owned pension fund AP6 and the remaining 10% by Volvo Cars Corporation. Moody's notes that the chairman of the board of Volvofinans is also a member of AP6.

Overall, Volvofinans's risk management practices are good. Volvo dealers have to use Volvofinans' credit scoring model before providing a loan. For more information, see the asset quality discussion below.

Market risk appetite is low as (i) Volvofinans is careful to eliminate mismatching between lending and funding interest periods; (ii) foreign currency risk related to foreign funding is hedged using interest and currency swaps; and (iii) the company does not have any equity risk. At year-end 2009, the company's interest-rate risk in relation to a 100-basis-point parallel shift in interest rates was SEK52.7 million, corresponding to 1.8% of Tier 1 capital.

Volvofinans's overall risk positioning is scored C- and is constrained by its high industry concentration risk related to the auto industry and by its funding profile.

## Factor 3: Regulatory Environment

All Swedish financial institutions are subject to the same score on regulatory environment. Refer to the Moody's latest Banking System Outlook for Sweden for a detailed discussion of the regulatory environment.

## Factor 4: Operating Environment

Trend: Neutral

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

## Quantitative Rating Factors (50%)

### Factor 5: Profitability

Trend: Weakening

Volvofinans does not seek to maximise profits for itself, but rather to provide financing products that support sales of Volvo and Renault cars and trucks. The Volvo dealerships assume the credit risk for vehicle financing and are therefore entitled to a larger portion of the net interest margin. Volvofinans revises its interest margins on a monthly basis to enable it to meet its ROE targets, while at the same time taking dealer margins and higher funding costs into consideration. For the credit card business, Volvofinans assumes all the credit risk and the margins from this business are therefore higher.

2009 proved to be a challenging year for Volvofinans. Its high reliance on market funding and its short funding profile (as described in the liquidity section below) exposed it to volatility in capital markets, resulting in increased funding costs and reduced net interest margin (0.95% in 2009; 1.5% in 2008). Further, weakness in the Swedish new car sales market (-17% year-on-year) led to decreased financing activities, resulting in a reduction of the loan portfolio (fell 9% year-on-year). However, income from its credit cards operations were less affected by macroeconomic conditions and increased as a proportion of total operating income.

The score for profitability is D, but with a weakening trend to reflect higher funding costs.

### Factor 6: Liquidity

Trend: Weakening

Volvofinans's liquidity policies can be summarised as follows: (i) in a winding up scenario, the sum of total funding, equity and available credit facilities shall always exceed 100% of the existing asset portfolio; (ii) the bank shall have a daily surplus liquidity of SEK500-SEK1,500 million; (iii) loans due in any individual week must not exceed 15% of unutilised credit facilities; (iv) long-term funding, including equity, shall be a minimum of 55% of total funding; and (v) 100% of outstanding volume of commercial paper (CP) and other short-term maturing debt must be covered by committed back-up facilities. Furthermore, Moody's notes that Volvofinans's back-up facilities do not contain material adverse change (MAC) clauses.

Although its deposit base has grown rapidly over the past year to SEK1.9 billion at year-end 2009 (SEK0.7 billion in 2008), the company remains heavily dependent on wholesale funding. Its funding structure at the end of 2009 was divided between customer deposits (around 10% of total funding), interbank funding (around 20%), and market funding (around 65%). Volvofinans also has a liquidity line from its owners, AP6, and Volvo dealers of SEK1.2 billion, which at year-end 2009 remained undrawn. At year-end 2009, around 40% of market funding was in short-term maturities. The company has issued paper through its Nordic CP programme, Euro CP programme and MTN programme in addition to bank funding (bilateral and syndicated). Liquid assets accounted for 6% of total assets at year-end 2009.

Volvofinans's funding model, with its heavy reliance on market funding, proved to be vulnerable during the financial crisis, forcing the bank to join the Swedish government's guaranteed funding program. This vulnerability was further exacerbated by the short-term nature of its funding profile, making the bank heavily dependent on a liquid funding market. Moody's notes, however, that Volvofinans has not issued any government guaranteed debt since July 2009 following a stabilisation of financial markets.

Volvofinans' liquidity management is scored D- with a weakening trend.

### Factor 7: Capital Adequacy

Trend: Neutral

Volvofinans has an adequate level of capitalisation, with a reported Tier 1 ratio for the parent company of 14.0% based on Basel II as of year-end 2009 (2008: 12.8%). For Basel II purposes, the company applies the standard approach.

The score for capital adequacy is A.

Factor 8: Efficiency

Trend: weakening

Volvofinans exercises good control of operating and financial costs as efficiency is essential to its competitiveness. The finance company's costs are low in part because it does not need to support a branch network. The increased cost of market funding and resulting drop in net interest income put pressure on its efficiency, which weakened in 2009, as reflected by a rise in its cost-to-income ratio to 54% from 52% in 2008.

The score for cost efficiency is C, but we assign a weakening trend to reflect the downward pressure on profitability stemming from a higher funding costs.

Factor 9: Asset Quality

Trend: Neutral

Credit risk for vehicle financing is very low because Volvo dealers assume the credit risk and have formally agreed to buy back any problem loans. Should a dealer fail, Volvofinans has

the power to directly contact the borrowers and repossess the car. Borrowers remain personally liability if the forced sale of the car does not cover the loan.

The underlying loan portfolio is well diversified and does not pose concerns when measured against the finance company's Tier 1 capital. However, Volvofinans's industry exposure does not benefit from diversification as it is almost exclusively centred on the auto industry.

Volvofinans's problem loans relate only to its credit card receivables, as any credit losses relating to vehicle finance are absorbed by dealerships given that they assume the credit risk for that product. However, as credit card receivables have grown so have problem loans (YE2009: 7.5% problem loans; YE2008:6.6%). We however note that credit card lending accounts on average less than 7% of Volvofinans' total lending and that Volvofinans charges a higher rate of interest for this type of lending to account for the higher credit losses.

As a result of these factors, the score for asset quality is B+.

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

Moody's assigns GLC deposit ratings of Baa2/P-2 to Volvofinans Bank AB.

The GLC deposit ratings are supported by the finance company's baseline credit assessment of Baa3 and receive a one notch of uplift due to our assessment of a low probability of systemic support in case of need as well as to a limited degree the support provided by its parents.

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

The Foreign Currency Deposit ratings of Volvofinans Bank AB are unconstrained given that Sweden has a country ceiling of Aaa.

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

The Foreign Currency Debt ratings of Volvofinans Bank AB are unconstrained given that Sweden 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. Bank Financial Strength Ratings 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 Bank Financial Strength Ratings include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although Bank Financial Strength Ratings 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 Bank Financial Strength Rating 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, Moody's Bank Deposit Ratings are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, and 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 GLC 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 case a stress situation occurs and the degree of dependence between the issuer rating and the LCDC.

#### 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. AAaa 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 a high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be reminded 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 obligations 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

#### Volvofinans Bank AB

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
<b>Qualitative Factors (50%)</b>						<b>C</b>	
<b>Factor: Franchise Value</b>						<b>C-</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>					x		
<b>Factor: Risk Positioning</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>		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-</b>	<b>Neutral</b>
<b>Economic Stability</b>		x					
<b>Integrity and Corruption</b>	x						
<b>Legal System</b>	x						
<b>Financial Factors (50%)</b>						<b>C-</b>	
<b>Factor: Profitability</b>						<b>D</b>	<b>Weakening</b>

PPP % Avg RWA- Basel II				1.21%			
Net Income % Avg RWA- Basel II				0.96%			
<b>Factor: Liquidity</b>						<b>D-</b>	<b>Weakening</b>
(Mkt funds-Liquid Assets) % Total Assets					77.45%		
Liquidity Management				x			
<b>Factor: Capital Adequacy</b>						<b>A</b>	<b>Neutral</b>
Tier 1 ratio (%) - Basel II	12.81%						
Tangible Common Equity / RWA- Basel II	12.81%						
<b>Factor: Efficiency</b>						<b>C</b>	<b>Weakening</b>
Cost/income ratio				58.53%			
<b>Factor: Asset Quality</b>						<b>B+</b>	<b>Neutral</b>
Problem Loans % Gross Loans		0.82%					
Problem Loans % (Equity + LLR)	7.19%						
<b>Lowest Combined Score (15%)</b>						<b>D-</b>	
<b>Economic Insolvency Override</b>						<b>Neutral</b>	
<b>Aggregate Score</b>						<b>C</b>	
<b>Assigned BFSR</b>						<b>D+</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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