

Belgium/Netherlands  
Special Report

# Benelux Banks: Semi-Annual Review and Outlook

## Troubled Waters Continue

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### Overview

The profitability of the major Benelux banks continued to suffer in H109. KBC Bank ('A'/Stable) posted a large loss owing to significant write-downs of its CDO exposure, and while the other major banks posted operating profits, performance ratios remain well below the pre-crisis highs (with the exception of Rabobank ('AA+'/Stable), which has sailed through relatively unscathed).

The crisis continues to affect profitability of the major banks, which are likely to remain under pressure for the rest of 2009 and into 2010. Before the crisis, Benelux banks benefited from an extremely benign credit environment, where loan impairment charges were low and lending was priced accordingly. While the rise in loan impairment charges should be manageable, it comes on top of decreasing revenue generation, which has been affected by margin pressure (especially in the Netherlands) stemming from high interest rates – paid to attract customer deposits – and lower commission income on asset management services and other market-related activities, as well as impairments on the investment portfolio.

The landscape of the Benelux banking system has been permanently changed following the financial crisis. Fortis Bank ('AA-'/Negative) was hit especially hard and has since been nationalised and divided into several parts. In addition – although not linked to the crisis *per se* – ABN AMRO Bank ('AA-'/Stable) is also being split up, following its purchase by an RBS-led consortium, which includes Banco Santander ('AA'/Stable) and the Dutch state. Moreover, all banks are concentrating on their core franchises in terms of geographies, clients and products. Accordingly, banks are pruning their activities, especially abroad. Thus, the Benelux banks are becoming much less international.

The Benelux banks have benefitted from unprecedented state support, addressing funding, capital and asset guarantees. This has enabled them to ride out the financial and economic storm. However, this situation is not sustainable, and they will have to become self-supporting sooner or later as state assistance is retracted.

Given the importance of the state support schemes, Fitch Ratings has raised the Support Rating Floors on the major Benelux banks. This limits the Issuer Default Rating (IDR) downgrades for those banks whose IDRs were at their Support Rating Floor. At publication, the IDRs of six Benelux banks were at their Support Rating Floors: Dexia ('A+'/Stable), Dexia Bank Belgium ('A+'/Stable), Dexia Banque Internationale à Luxembourg ('A+'/Stable), Fortis Bank (Nederland) ('A+'/Stable), ING Bank ('A+'/Stable), and KBC Bank ('A'/Stable). However, Rabobank, which has been the best performing major bank, is rated above its Support Rating Floor, with its Long-Term IDR driven by its intrinsic financial strength.

Fitch has taken a number of negative rating actions on the Benelux banks in the past 18 months and the agency does not expect many more rating changes in the near term. Any upward rating potential for the Long-term IDRs of those banks that are now rated at their Support Rating Floor – after receiving significant government support – is extremely limited in the short to medium term and is subject to evidence of stabilisation in the operating environment and an improvement in banks' profitability (combined with gradual emancipation from state support, which Fitch expects will take time). Fitch considers there to be more scope for changes in Individual ratings in the medium term.

## Outlook

While there is a lot of healthy competition, the Benelux market is very concentrated (the top-five banks in Belgium and the Netherlands account for more than 80% of banking assets); over-banking is therefore not a problem. In addition, most banks still operate bancassurance, having an insurance subsidiary or an insurance company within the group. Moreover, the retail segment remains positive and has a significant amount of accumulated wealth. Nevertheless, Fitch expects profitability to remain under pressure in the medium term, with performance ratios well below the pre-crisis highs.

There are major uncertainties regarding the economy and the evolution of the GDP. The euro-zone is expected to be in recession throughout 2009 and perhaps into 2010. Current Fitch GDP estimates for the Netherlands are: -5% in 2009 and -0.2% in 2010; and for Belgium: -3.7% in 2009 and -0.2% in 2010. Thus, loan impairment charges will be on the rise, along with impaired loans. In H109, impairment charges as a percentage of loans exceeded their long-term average of approximately 0.30% for the major banks and this is expected to continue even after the recession. The much lower cost of risk recorded in 2007 and early 2008 were unsustainable. During previous crises, impairments have been higher on the banks' international loan portfolios (which often represent a significant proportion of total assets) compared to their domestic portfolios and this crisis should be no exception. Moreover, increases in impaired lending have mainly stemmed from corporate lending, whereas the quality of retail loans (largely in the form of residential mortgages) has been good. While more pain is expected from corporate exposures, some deterioration might also occur in residential mortgage exposures, as unemployment is expected to rise. Nevertheless, Fitch expects the quality of residential mortgages to remain sound, even if some deterioration occurs (see also *Housing Market/Real Estate Sector* below). Overall, loan quality is expected to continue to compare well internationally and remain lower than in many Western European countries. Nevertheless, impairment charges as a percentage of pre-impairment operating profit looked high in H109 for the major banks, as operating profits continued to suffer.

While net interest income has been on the increase in the first six months of 2009 – from the more positive yield curve – the effect has been partly dampened by the high yields banks have been paying on deposits. Indeed, the search for retail funding is expanding across all Benelux banks, as they seek to limit their reliance on wholesale markets. However, domestic funding is limited, while a significant portion of bank lending is overseas. Thus, banks are expected to reduce their international lending.

In addition, the reputations of certain large banks have been seriously damaged by the crisis, and they are now having to fight hard to regain their lost share of the retail deposit market. Moreover, those banks with significant state capital have been accused by those without of charging higher rates on deposits. This price war has been more aggressive in the Netherlands; in Belgium a cap exists on the price banks can pay on savings deposits (which is linked to the ECB rate).

Furthermore, commissions will remain low as assets under management (AUM) have declined and are now being invested in safer, albeit less remunerative, asset classes. Brokerage activity has also declined, leading to lower trading volumes. Finally, negative pressure is expected on trading results. While banks have taken advantage of the amendments to IAS39, moving certain assets to categories that do not require marking-to-market, this is not possible for all asset classes (notably derivatives and assets originally designated at fair value through profit and loss). Banks could therefore continue to suffer from additional write-downs of toxic assets, with monoline exposures throwing up additional problems (as in certain cases, the value of this insurance protection has become increasingly worthless).

As revenues are weak, banks are paying much more attention to operating expenses. They are exiting or winding down unprofitable activities and trimming the costs of their core businesses; they are also taking advantage of the crisis to reduce staff numbers and limiting flexible remuneration. The hope is that by the end of the crisis, they will be more efficient and poised to benefit from improvements in the operating environment.

The major Benelux banks have stopped investing in structured finance assets and have made significant write-downs on these investments. While the banks' exposures appear adequately written down, further impairments cannot be ruled out in H209 and 2010. Structured finance exposures, and the corresponding write-downs, were very large at the major Benelux banks and contributed to the need for capital injections and asset guarantees. The notable exception was Rabobank, which had a relatively small exposure to toxic assets and has not required any state capital injections.

The significant capital injections received by the major Benelux banks have helped them to post good capital ratios. Tier 1 capital ratios are usually close to 10% (or higher in some cases). Rabobank continues to have the highest solvency ratios (with a target Tier 1 ratio of 12%), which is all the more impressive as it has not benefited from any state capital injections. Given the continuing operating and economic pressures, Fitch views these strong capital levels as appropriate.

### **Housing Market/Real Estate Sector**

While falling real estate values are generating nervousness across several European countries, this remains, in Fitch's opinion, less of a threat to the large Benelux banks. Some correction in residential property prices is expected, but a major fall has been ruled out. There is no sub-prime market in the Benelux.

In the Netherlands, real estate prices were roughly flat in 2008 and in August 2009 had fallen by close to 6% year-on-year. The housing market in the Netherlands is supported by certain key characteristics: in particular, interest payments on mortgages are fully tax deductible, which fuels demand and encourages people to borrow more than they need. Thus, while the personal sector credit-to-GDP ratio is higher than the EU average, this sector has significant savings, and thus the level of net financial liabilities is quite low. Moreover, there is a limited supply of homes, leading to increased demand. Finally, loans are mostly extended at fixed rates, generating stable repayment instalments. Nevertheless, the loan-to-value (LTV) ratio can be high in the Netherlands and while the average LTV ratio on loans outstanding is less than 50%, on new contracts it can exceed 100%. As a result, certain first-time buyers who have recently started work – with relatively low incomes and low job security – could be comparatively vulnerable.

In Belgium, prices were also roughly flat in 2008, but have so far fallen by less than 5% in 2009. The housing market in Belgium is also supported by a number of key characteristics: firstly, it has one of the highest ownership rates in Europe (76%), second only to Spain. This figure is not new and reflects the cultural focus on owning one's own home as soon as possible. Demand is also supported by steady population growth, partly through immigration, including EU civil servants and related employees who have settled in Brussels. Furthermore, Belgian individuals are less indebted than some of their European counterparts, with personal borrowings-to-GDP below the EU average. Belgium has also historically had one of the highest household savings rates in Europe. Finally, LTV ratios have generally remained conservative – even for new loans – while mortgages are usually fixed rate.

### **Changing Landscape**

The landscape of the Benelux banking market has changed significantly post crisis. Banks are retreating to a 'back to basics' approach, concentrating on their core

franchises in terms of geographies, clients and products. This trend is compounded by the focus on retail funding, which means that the days of being able to increase lending and investment activities without deposits are gone. Accordingly, banks are pruning their activities, especially abroad. Thus, Benelux banks are becoming much less international.

Of the major Benelux banks, Fortis was most affected by the recent crisis, having been nationalised and divided into several parts. Majority stakes in Fortis' Belgian and Luxembourg operations were subsequently sold to BNP Paribas, but the Dutch operations remain fully-owned by the Netherlands. Dexia has also reduced the scope of its activities, selling some of its international subsidiaries (notably its US financial guarantor FSA), and is currently working on a plan to better focus its business model.

Although not linked to the crisis *per se*, ABN AMRO Bank is also being split up following its purchase by an RBS-led consortium, which includes Banco Santander and the Dutch state. RBS – which fully consolidates ABN AMRO Bank – will retain what remains of the bank once the various operations have been transferred to the two other consortium members. ABN AMRO Bank's assets have already significantly declined, as certain activities have been transferred to the members of the consortium. The final major step in this process involves the transfer of the Dutch state-acquired activities to a newly created Dutch bank. Once this has been completed (planned for early 2010), ABN AMRO will be renamed RBS NV and the newly created Dutch bank will be renamed ABN AMRO Bank NV; the ABN AMRO brand is part of the Dutch state-acquired business. Moreover, the Dutch state has expressed its intention to merge this new Dutch bank with another Dutch state-owned bank, Fortis Bank (Nederland); the integration process should commence by end-2010, subject to the completion of measures imposed by the EU to reduce the dominant position of the resulting entity in the Dutch market.

### State Support Schemes for Benelux Banks

Like many of their European counterparts, the Benelux governments have been keen to ensure the solvency of their banking systems. The states have therefore taken significant and constructive measures towards stabilising market conditions for banks, with a view to restoring confidence in the banking systems over time. These measures – which address three distinct areas: funding, capital and asset guarantees – have helped banks overcome an extremely challenging economic situation and will remain in place over the remainder of 2009 and beyond.

Nevertheless, these are not long-term solutions. It is expected that sooner or later the states will begin retracting this support, and banks will once again have to stand on their own two feet. Fitch believes the first step in this process involves those banks that benefitted from state-guaranteed funding programmes issuing without guarantees; the agency has seen limited evidence of this to date. However, a future challenge may arise owing to the fact that the various states now own a significant portion of bank capital structures.

### Funding

The Benelux banks are benefiting from state-guaranteed financing assistance. In the Netherlands, the authorities have established a programme to provide up to EUR200bn of guarantees for new senior bank debt issued until 31 December 2009, with a maximum five-year maturity. The facility is available to all Dutch banks, or subsidiaries of foreign banks with substantial operations in the Netherlands, deemed 'sufficiently capitalised' by the Dutch Central Bank (DNB). The cost for the banks is based on historical credit default spreads, with an additional 50bp; maturities of

less than one year have a fixed fee of 50bp. To date, almost EUR50bn has been issued and more is expected before the capital markets recover. Rabobank remains

the only major Dutch bank that has avoided issuing state-guaranteed debt. However, a number of smaller banks with good funding bases have also avoided issuing state-guaranteed debt (such as F. Van Lanschot Bankiers N.V. ('A-'/Stable), Friesland Bank N.V. ('A-'/Stable), etc.). No specific state-guaranteed financing programmes have been set up in Belgium or Luxembourg. While the Belgian government has stated that it could offer a guarantee to all systemically important Belgian banks, none have yet taken advantage of this option. In addition, the states of Belgium, Luxembourg and France have issued a joint – but not several – guarantee to Dexia for an amount of EUR100bn (60.5% Belgium, 3.0% Luxembourg, and 36.5% France) for commercial paper and bond issues, with a maximum maturity of four years valid until 31 October 2010.

While state guarantees are allowing banks to attract longer-term funding than is the case with ECB facilities, these measures are creating a certain reliance on those states involved. Indeed, without these guarantees, it would be more difficult for banks to refinance themselves, especially for term issues (not only in terms of availability of funds but also from a cost perspective). A number of European states have already extended their guaranteed schemes beyond the original maturities and Fitch expects the same to occur in the Netherlands, where a formal scheme is in place. Nevertheless, such guarantees are not a long-term solution, as the states will sooner or later seek to retract this assistance. Thus, at some point in the future, banks will have to manage without any guarantees.

The capital markets are still recovering from the shock of the crises and few banks are keen to rely on them as they did prior to the credit crunch. That said, there is clear evidence that banks have recently been able to raise limited funds in the capital markets. However, non-guaranteed issues have generally only been short-term. Moreover, long-term non-guaranteed issuances are being secured in the form of covered bonds (eg with Dexia, ING Bank, and ABN AMRO bank) or, to a limited extent, RMBS (eg Fortis Bank Nederland). However, Rabobank has even been able to issue unsecured perpetual hybrid capital. Nevertheless, as long as it remains economically attractive to use state-guarantee programmes, some banks will avail themselves of this option (and are likely to do so until the funding cost differential between guaranteed and non-guaranteed debt narrows).

### Capital

Some of the capital received has been in the form of shares, which have led to increased state ownership. As a result, five banks have direct state ownership: ABN AMRO Bank, Fortis Bank, Fortis Bank Nederland, Dexia, and BGL SA. As the other capital injections have been in the form of hybrid securities, they have not translated into state ownership (as regards KBC Group, ING Group and SNS REAAL). Whatever the form of capital received, Fitch considers the government's 'hold' over these banks to be firm. Rabobank remains the only major Benelux bank that has not received any state capital (although a number of smaller, well capitalised banks have also not required any state capital).

Unlike the case for guaranteed funding, the exit strategy for those states which have injected capital into banks is much more complicated. Each scenario may take a slightly different path, involving either: a) a break-up of the institution; or b) a more gradual process, as the bank's fundamentals improve and the state opportunistically sells off shares (or the banks begin reimbursing the states directly). The first approach (a) is illuminated by Fortis Bank: the bank was broken into three parts according to country – Fortis Bank Nederland in the Netherlands, Fortis Bank in Belgium, and BGL SA in Luxembourg. As mentioned above, majority stakes in the Belgian and Luxembourg banks were sold to BNP Paribas, although the Dutch bank remains fully owned by the Dutch state. The second approach above (b) is expected to be followed by many other banks and will likely take years to materialise. However, Fitch does not foresee any state being interested in long-term ownership of banks.

**Table 1: State Capital Injections into Benelux Banks**

	Capital Received (EURbn)	Date of announcement	Source	Form
Fortis Bank	4.7	29 Sep 08	Belgian State	Share capital
	4.7	6 Oct 08	Belgian State	Share capital
Fortis Bank total	9.4			
Fortis Bank Netherland (Holding)	16.8	3 Oct 08	Dutch State	Share capital
BGL SA	2.5	29 Sep 08	Luxembourg State	Share capital
KBC Bank	2.25	15 Oct 08	Belgian State	Hybrid securities
	2.0	22 Jan 09	Region of Flanders	Hybrid securities
	1.25	14 May 09	Region of Flanders	Hybrid securities
KBC Bank total	5.5			
ING Bank	5.0	20 Oct 08	Dutch State	Hybrid securities
SNS Bank	0.156	13 Nov 08	Dutch State	Hybrid securities
Dexia	1.0	30 Sep 08	Belgian State	Share capital
	1.0	30 Sep 08	Belgian regions	Share capital
	0.5	30 Sep 08	Belgian local authorities	Share capital
	3.0	30 Sep 08	French State	Share capital
	0.4	30 Sep 08	Luxembourg State	Convertible
Dexia total	5.9			

Source: Bank press releases

### Asset Guarantees

No formal asset relief programme is in place in any of the Benelux countries and authorities have acted on a case-by-case basis; so far, four groups have benefited from asset guarantees, all of which were granted during 2009: Dexia, ING, KBC, and ABN AMRO Bank. In the case of Dexia, the Belgian and French states have together guaranteed part of a USD16.5bn portfolio of US ABS of various quality inherited from FSA. Of these assets, USD12bn benefit from the state guarantee covering any loss exceeding EUR4.5bn. Thus, Dexia is only liable for a first-loss piece of USD4.5bn, which has already been taken into account into its solvency ratio. In the case of ING, the Dutch government assumed 80% of the economic risk of Alt-A RMBS, written down to 90% of its gross value (EUR21.6bn). As a result, if the portfolio incurs further impairments, ING is affected for only 20%. In the case of KBC, the Belgian state provided a guarantee covering 90% of the default risk beyond a first loss of EUR3.2bn on a notional CDO amount of EUR20bn, in exchange for a EUR1.2bn premium and other commitment fees. The Belgian state will therefore compensate KBC for 90% of the losses incurred above the first loss amount, either in cash or via the subscription of new KBC shares. The asset relief instrument granted to ABN AMRO Bank is basically a credit default swap on a pool of EUR34.5bn prime Dutch residential mortgages, which allows for a risk weighted assets reduction of EUR19bn, with a consequent capital relief of EUR1.7bn. The instrument is structured so that the bank bears a first loss tranche of yearly losses of EUR69m, and losses exceeding this amount are shared between the bank (5%) and the Dutch state (95%).

### State Support and the European Commission (EC)

Unlike other European countries, state capital injections and asset guarantees in the Benelux have largely taken place on an ad hoc basis, as individual measures taken on individual entities. The reason is that there was no national EC-approved scheme in place at a relatively early stage of the crisis when banks entered into difficulties. Accordingly, a subsequent restructuring or viability plan must be submitted for EC assessment and approval within six months after the rescue package is adopted. Because the EC is generally in favour of a horizontal approach which benefits entire sectors – as opposed to measures favouring individual entities

– it has opened a number of investigations to ensure that the measures provided do not constitute state aid.

A key implication of this highly political process, involving the banks, the states, and the EC, has been the application by the latter of the ‘burden sharing’ concept. This takes the form of forced coupon deferral on outstanding hybrids, for banks under investigation of having received state aid (as is the case for KBC Bank, see press release “*Fitch Downgrades KBC Bank’s Hybrid Instruments; Places them on RWN*”, published 7 August 2009; and for Dexia, see press release “*Fitch Downgrades Two of Dexia’s Hybrid Instruments to ‘CCC’; Maintains RWN*”, published 12 October 2009). Fitch has also downgraded the outstanding hybrid securities of a number of other European banks (including in the Benelux). While these may not yet have deferred on their coupons, Fitch believes precedents have been set. As such, subsequent cases are increasingly expected to be treated in a comparable manner (see Fitch’s special report “*Burden Sharing and Bank Hybrid Capital Within the EU*”, published 20 August 2009).

### Recent Developments

In early October 2009, the DNB requested emergency regulation to be applied to DSB Bank N.V. (DSB), a small Dutch bank (end-2008 total assets: EUR7.8bn, equity: EUR243m) providing mortgages, consumer loans, savings and insurance products to retail clients. The DNB decision came as DSB suffered significant outflows of customer deposits and after the unsuccessful attempt of a consortium of five groups (Rabobank, ABN AMRO Bank, ING Group, Fortis Bank Nederland and SNS REAAL) to rescue it.

The deposit guarantee scheme (DGS), administered by the DNB, covers all deposits (other than subordinated ones) up to EUR 100,000 per account holder. Fitch understands that the DGS is about to be activated for DSB depositors. Banks participating to the DGS will have to contribute to the scheme according to their size and this will have an impact on large banks’ income statements in particular. Meanwhile, those banks that had initially attempted to rescue DSB have created a safety network to support clients’ access to payment transactions and money withdrawal, which are blocked as a result of the emergency regulation procedure.

**Results Summary for Major Benelux Banks H109**

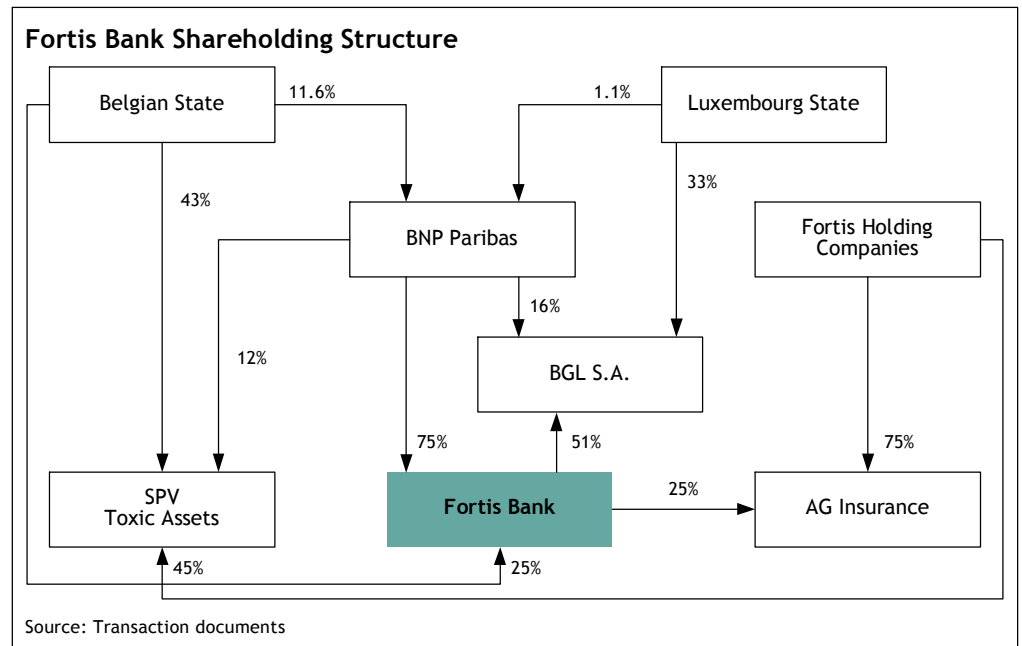
(EURm)	ING Bank NV		Rabobank Group		Fortis Bank		KBC Bank		Dexia	
	H109	2008	H109	2008	H109	2008	H109	2008	H109	2008
Total assets	911,972	1,034,689	615,361	612,120	496,285	586,777	303,570	318,550	592,477	651,006
Total equity	28,803	24,121	31,175	29,949	17,947	15,143	9,694	10,088	7,892	4,422
Net interest income	6,364	11,370	3,885	8,517	2,269	4,116	2,395	4,151	2,961	6,244
Total non-interest operating income	1,533	3,240	2,372	3,161	1,547	844	-2,008	-306	360	1,070
Total operating income	7,897	14,610	6,257	11,678	3,816	4,960	387	3,845	3,321	7,314
Operating expenses	5,076	10,175	3,695	7,611	2,847	6,192	2,309	4,443	1,771	3,847
Pre-impairment operating profit	2,821	4,435	2,562	4,067	969	-1,232	-1,922	-598	1,550	3,467
Loan impairment charges	1,625	1,280	1,119	1,189	715	1,061	885	760	737	1,132
Other credit impairment charges	583	2,385	n.a.	n.a.	67	6,859	80	629	33	4,689
Equity-accounted profit/loss (operating)	n.a.	n.a.	n.a.	-26	n.a.	52	5	2	22	-1
Operating profit	613	770	1,443	2,852	187	-9,100	-2,882	-1,985	802	-2,355
Other income and expenses	-388	-237	0	0	-9	-2,132	-93	486	0	-1,522
Profit before tax	225	533	1,443	2,852	178	-11,232	-2,975	-1,499	802	-3,877
Taxes	19	-170	127	98	98	184	-224	-216	193	-629
Net income	206	703	1,316	2,754	80	-11,416	-2,751	-1,283	609	-3,248
Operating ROAE (%)	4.7	3.3	9.5	9.8	2.3	-37.1	-58.8	-16.8	30.0	-23.4
Net interest margin (%)	1.40	1.15	1.35	1.54	1.07	0.75	1.63	1.35	0.98	1.03
Cost/Income (%)	64.3	69.6	59.1	65.2	74.6	124.8	596.6	115.6	53.3	52.6
Loan impairment charges/average gross loans (%)	0.56	0.22	0.52	0.30	0.65	0.40	1.13	0.48	0.41	0.41
Loan impairment charges/ pre-impairment operating profit (%)	57.6	28.9	43.7	29.2	73.8	n.m.	n.m.	n.m.	47.5	32.7
Impaired loans/gross loans (%)	n.a.	1.43	1.84	1.53	n.a.	2.41	n.a.	3.03	1.01	0.95
Tier 1 ratio (%)	8.7	7.5	13.0	12.8	12.1	10.7	10.7	9.6	11.3	10.6
Total capital ratio (%)	11.6	10.2	13.5	13.0	17.7	18.7	13.8	13.2	13.0	11.8
Tangible common equity/tangible assets (%)	2.90	2.10	4.49	4.31	3.18	2.25	2.52	2.48	0.97	0.34

**Ratings**

Long-Term IDR	A+	AA+	AA-	A	A+
Short-Term IDR	F1+	F1+	F1+	F1	F1+
Individual Rating	B/C	A	D	C/D	C/D, RWN
Support Rating	1	1	1	1	1
Support Rating Floor	A+	A+	WD	A	A+
Outlook	Stable	Stable	Negative	Stable	Stable

Source: Fitch and banks' presentations

**Appendix**



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