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Realkredit Danmark A/S

CREDIT RATING

Not Rated

Outstanding Rating(s)

Not Rated

Sovereign Rating

Denmark (Kingdom of) AAA/Stable/A-1+

Related Entities

Danske Bank A/S

Counterparty Credit AA-/Stable/A-1+

Certificate of deposit AA-/A-1+

Senior unsecured
Local currency NR

Senior unsecured
Foreign currency AA-

Commercial paper
Local currency NR

Commercial paper
Foreign currency A-1+

Subordinated
Foreign currency A

Danica Pension, Livsforsikringsaktieselskab

Counterparty Credit
Local currency AA-/Stable

Rationale

The 'AAA' senior secured debt rating on the covered bonds (realkreditobligationer) issued by the General Capital Center of Realkredit Danmark A/S covers 86% of the bonds issued by Realkredit Danmark, and applies to all new bonds issued. The rating primarily reflects the realkreditobligationer collateral, coupled with protections afforded by Danish insolvency and banking laws. Realkredit Danmark maintains a segregated, revolving pool of high-quality mortgage assets, on which the holders of realkreditobligationer have a preferential claim. The amount of collateral is sufficient to absorb potential credit losses and pay interest on and repay principal of the realkreditobligationer as they become due, even in the unlikely case of Realkredit Danmark becoming unable to meet its obligations. The quality of the collateral pool and the adequacy of the underlying cash flows are subject to regular surveillance by Standard & Poor's. The rating also reflects the sound quality of Realkredit Danmark's management, control, and expertise.

Realkredit Danmark is a core subsidiary of Danske Bank A/S (AA-/Stable/A-1+), and is Danske Bank's Mortgage Finance business area. Danske Bank is the largest financial

services group in Denmark and is among the leaders in the Nordic region. Realkredit Danmark's total assets represented 25.6% of consolidated Danske Bank group assets of Danish krone (Dkr) 2.27 trillion (€305 billion at Dkr7.44 to €1) at March 31, 2005.

Realkredit Danmark benefits from a strong and effective distribution capability, robust core capitalization, high asset quality, and the concentration of its lending in the relatively low-risk area of residential housing. Profitability has traditionally been moderate due to the low-margin nature of mortgage lending.

Realkredit Danmark's total assets amounted to Dkr581 billion at March 31, 2005, corresponding to a 26.6% market share of gross new mortgage lending and a 33.8% share of outstanding bond debt. The company is a monoline product provider, offering mortgages secured by residential, commercial, agricultural, and industrial properties. Mortgages are funded back-to-back by realkreditobligationer.

Capitalization remains robust. The company's adjusted common equity (ACE)-to-risk assets ratio was 9.97% at March 31, 2005. Loan quality is high: 88% of the loan portfolio has a LTV ratio of less than 60%, and the level of NPLs remains very low. Profitability remains under pressure due to the low interest rate environment, but has held up well in the first quarter of 2005, resulting in a 0.87% annualized return on risk-weighted assets at March 31, 2005, compared with 0.79% in 2004. Preprovision core earnings at Dkr801 million in the first quarter of 2005 were in line with expectations.

Standard & Poor's expects mortgage finance to remain a core strategic business area in the Danske Bank group, providing a steady income stream from low-risk assets. Standard & Poor's also expects Realkredit Danmark's credit fundamentals to remain strong, and will monitor economic risks in Denmark—particularly asset price inflation and increasing household indebtedness—which could affect the level of NPLs.

Profile

With total assets of Dkr581 billion at March 31, 2005, Realkredit Danmark is the second-largest mortgage credit institution in Denmark. It is also the mortgage finance arm of Danske Bank.

With a base of about 500,000 customers, Realkredit Danmark offers mortgages to the private (retail) and corporate markets. The company boasts a broad and innovative product range and constant product innovation is a tool to retain market share in the highly competitive Danish mortgage market.

Managerial and operational integration with Danske Bank has increased substantially over the past three years, and is expected to continue. Danske Bank performs a number of tasks for its mortgage finance subsidiary: these are mainly IT operations and product innovation (which were centralized in Danske Bank at the start of 2002); property administration; portfolio management of own funds (earnings from investment portfolios); human resources; and purchasing and logistics. Realkredit Danmark's risk management is also closely integrated with that of its parent.

Ownership And Legal Status

Realkredit Danmark is a wholly owned subsidiary of Danske Bank A/S. The company is licensed by Finanstilsynet (the Danish Financial Supervisory Authority/DFSA) as a "realkreditaktieselskab", or mortgage credit institution, and regulated under the Danish Financial Business Act and associated laws and regulations.

Strategy

Realkredit Danmark's aim is to be the market leader in Danish mortgage finance. This is to be achieved by combining a high degree of integration with Danske Bank, in all areas that allow economies of scale, with retention of the unique brand of Realkredit Danmark (including its own branch network and sales channels). The multi-brand strategy is needed to cater for the substantial proportion of the client base that is attached to Realkredit Danmark only. Maintenance of the lowest possible cost ratios is critical for success in this low-margin business; the costs-to-core income ratio target is about 30%. Standard & Poor's considers Realkredit Danmark's strategies appropriate and achievable.

Realkredit Danmark has different pricing strategies for the private and corporate markets. On the private market, prices are transparent and fixed, although discounts are offered, whereas on the corporate market, prices are less transparent and variable, and are set using estimates of the risk-adjusted return on capital employed.

Asset Quality

Realkredit Danmark has a very solid track record for asset quality over the past five years and Standard & Poor's expected this favorable trend to continue in the short to medium term. Future performance will remain closely linked to the stability and performance of the Danish economy. For the past decade, the Danish economy has provided ideal conditions for a specialized mortgage lender, with low unemployment, falling interest rates, and a steady growth in lending. Standard & Poor's does not expect this picture to change much in the short to medium term, and consequently bases its rating expectations on sustained low levels of NPLs and limited new provisions needs.

Realkredit Danmark reported net write-backs of Dkr49 million in the first quarter of 2005 compared with net new provisions of Dkr7 million or 00.01% of net loans in 2004. For the six years until 2002, the company reported net write-backs every year.

Increasing leverage in the Danish household sector, however, is a trend that warrants close monitoring, and could present challenges in a less favorable economic environment. Danish economic growth rates are forecast to remain stable out to 2006 at a level above the EU average.

Management is committed to a strong loan portfolio, and Standard & Poor's expects asset quality to be maintained at sound levels. This is due to the strong legal framework within which Realkredit Danmark operates; maintained conservative statutory lending principles; and tight credit-risk management. Danish residential property lending, which makes up 61% of the loan portfolio, still offers good risk-reward trade-offs, despite intense competition and narrow margins.

The statutory provisions governing LTV limits, maturities, and repayment profiles aim to limit credit risk. These limits are not exceeded even if a borrower is highly creditworthy, as the valuation of the property is the determinant of the loan size. LTVs are calculated on a current basis to monitor portfolio risks. By LTV, the total loan portfolio average was 61% at year-end 2004.

The loan portfolio is well diversified throughout Denmark, and roughly reflects the population distribution, although the Copenhagen region accounts for about 40%.

Realkredit Danmark's NPLs decreased marginally to Dkr196 million in 2004, which rounds to only 0% of customer loans. Typically for the Danish market, the coverage (loan-loss reserves to NPLs) ratio was high; at 107% in 2004. Realkredit's asset-quality indicators therefore compare favorably with domestic and regional peers.

Profitability

Realkredit Danmark's profitability reflects the low but stable margin that is characteristic of mortgage lending. Standard & Poor's bases its current ratings on the expectation that this picture will remain broadly unchanged in the coming two to three years. The Danish mortgage market was opened to new entrants in 1993, when margins tightened to about 50 basis points for residential lending. Pricing for commercial real estate and other types of properties may vary slightly more, but, overall, the margins have been very stable since then.

As Danish GAAP already required nonloan financial assets to be marked to market, performance can fluctuate considerably without any change to underlying risk pricing or performance. In addition, Danish regulation requires a very tight balancing of loans and corresponding bonds; most of the volatility in earnings seen in Realkredit Denmark hence arise from its own equity, the investment of which may carry slightly higher market risk levels than the rest of its balance sheet.

Standard & Poor's expects to see improving bottom-line profitability in the medium term owing to higher volumes of retail loans, better efficiency, and a still very low, but slightly rising, provisioning charge.

Operating revenues totaled Dkr4.04 billion in 2004 and Dkr1.1 billion in the first quarter of 2005, suggesting that 2005 will be a comparable year to 2004 in terms of revenue. While the nominal rate of interest and the growth in lending are key determinants of revenue, important contributions also come from fees levied on prepayment activity. The extent to which loans are prepaid is in turn a function of interest rate volatility. Rates fell in 2003 and 2004, creating record levels of prepayments.

Costs were Dkr1.4 billion in 2004, down Dkr216 million, or about 13%, year on year. This decrease was driven by the completion of the IT integration and new-product systems costs. The cost-to-core income ratio improved to 33% in 2004, compared with 38% in 2003. In the first quarter of 2005, the ratio dropped further to 28%. Standard & Poor's expects the company to maintain cost efficiency at around the target level of 30%.

Asset-Liability Management

Realkredit Danmark is fully funded by Danish bonds—realkreditobligationer. The market is one of the oldest in Europe and one of the most liquid in terms of trading. Bonds are an essential part of Denmark's economy, as the issuance and trading of bonds involves everyone who owns real estate.

The traditional mortgage loan is a 30-year fixed-rate callable loan funded by a bond with the same interest rate terms and repayment structure. Prepayment risk is thus eliminated for the issuer, as the borrower has to buy back bonds with the same terms and conditions as his or her loan when prepaying. Adjustable-rate mortgage loans (ARMs), however, have increased in popularity in recent years as nominal interest rates have fallen and the yield curve has provided competitive terms for the borrower. ARMs expose the borrower to some interest-rate risk. Further innovations have been presented over the past few years including interest only loans and loans offering caps against rises in interest rates. All of these new products remain within the strict matching rules for Danish covered bonds.

At the end of the first quarter of 2005, Realkredit Danmark's bonds issued amounted to Dkr545 billion. The introduction of IFRS has meant that holdings of own bonds are netted against the outstanding amount hence the amount of bonds outstanding under the previous regime was Dkr707 billion at March 31, 2005. Although in the past the 30-year callable bond was dominant,

the current picture is very different as new products have been added to meet new customer preferences.

Danish mortgage legislation prohibits the issuing institution from taking interest-rate or currency risk from lending versus funding mismatches (this is referred to as the Balance Principle).

Realkredit therefore takes minimal interest-rate risk on its lending.

On assets other than the mortgage loan portfolio, the maximum interest-rate risk is set at 8% of the company's capital base. The basis for this limit is a one-percentage-point parallel shift of the yield curve. At year-end 2004, 8% of Realkredit Danmark's capital base was equivalent to Dkr2,229 million and its interest-rate risk was Dkr347 million. Currency risk remains very limited, and the regulation stipulates a maximum limit of 0.1% of an institution's capital base.

Capital

Standard & Poor's expects that management will remain committed to its stated regulatory capitalization target of a Tier 1 ratio of about 9.6% (set at year-end 2001), and that capital will be managed in accordance with the economic risk inherent in any particular asset class. Realkredit Danmark's core capital position is robust and the quality of the capital base is high. Capital ratios remain well above the statutory minimum requirement, and compare favorably with domestic and regional peers.

At the end of the first quarter of 2005, Standard & Poor's core capitalization measures—its adjusted common equity (ACE)-to-adjusted assets and ACE-to-risk assets ratios—were 4.95% and 9.97%, respectively, which are considered robust. Realkredit Danmark's shareholders' equity stood at Dkr28.7 billion at the end of the first quarter of 2005, of which share capital accounted for Dkr0.6 billion. Realkredit Danmark had no hybrid capital issuance at this date.

Capital management is closely integrated with that of Danske Bank, and consequently Realkredit Danmark has introduced a RAROC-based risk management and reporting system, which takes account of the risk-adjusted return on capital employed, as a capital management tool.

Table 1

Balance Sheet Statistics										
(Mil. Dkr)	—Year ended Dec. 31—					Breakdown as a % of assets (adj.)				
	2005*	2004	2003	2002	2001 -	2005*	2004	2003	2002	2001
<i>Assets</i>										
Cash and money market instruments	N.A.	12,886	14,914	33,174	35,786	N.A.	1.82	2.30	5.16	5.98
Securities	11,736	170,094	128,075	132,461	106,708	2.02	24.03	19.79	20.61	17.82
Nontrading securities	11,736	170,094	128,075	132,461	106,708	2.02	24.03	19.79	20.61	17.82
Mortgage-backed securities included above	N.A.	162,696	114,334	127,376	97,589	N.A.	22.98	17.67	19.82	16.30
Customer loans (gross)	531,206	517,518	498,497	469,940	449,068	91.36	73.11	77.03	73.13	75.01
Residential real estate loans	N.A.	517,021	498,023	469,479	448,518	N.A.	73.04	76.96	73.06	74.92
All other loans	531,206	497	474	461	550	91.36	0.07	0.07	0.07	0.09
Loan loss reserves	0	421	460	526	521	0.00	0.06	0.07	0.08	0.09
Customer loans (net)	531,206	517,097	498,037	469,414	448,547	91.36	73.05	76.96	73.05	74.93
Earning assets	542,942	700,495	641,473	631,357	591,556	93.38	98.96	99.12	98.25	98.82
Equity interests/participations (nonfinancial)	N.A.	267	248	246	268	N.A.	0.04	0.04	0.04	0.04
Fixed assets	N.A.	676	773	711	717	N.A.	0.10	0.12	0.11	0.12
Derivatives credit amount	N.A.	210	63	395	192	N.A.	0.03	0.01	0.06	0.03

Table 2

Profit And Loss Statement Statistics (cont.'d)										
(Mil. Dkr)	—Year ended Dec. 31—					Adj. avg. assets (%)				
	2005*	2004	2003	2002	2001	- 2005*	2004	2003	2002	2001
Operating revenues	1,107	4,164	4,141	4,173	3,949	0.69	0.61	0.64	0.67	0.77
Noninterest expenses	306	1,382	1,598	1,435	1,319	0.19	0.20	0.25	0.23	0.26
Personnel expenses	N.A.	573	586	601	623	N.A.	0.08	0.09	0.10	0.12
Other general and administrative expense	306	778	1,003	816	675	0.19	0.11	0.16	0.13	0.13
Depreciation and amortization-other	N.A.	31	9	18	21	N.A.	0.00	0.00	0.00	0.00
Net operating income before loss provisions	801	2,782	2,543	2,738	2,630	0.50	0.41	0.39	0.44	0.51
Credit loss provisions (net new)	(49)	7	24	(74)	(33)	(0.03)	0.00	0.00	(0.01)	(0.01)
Net operating income after loss provisions	850	2,775	2,519	2,812	2,663	0.53	0.41	0.39	0.45	0.52
Nonrecurring/special expense	0	0	0	0	115	0.00	0.00	0.00	0.00	0.02
Pretax profit	850	2,775	2,519	2,812	2,548	0.53	0.41	0.39	0.45	0.50
Tax expense/credit	239	653	609	822	621	0.15	0.10	0.09	0.13	0.12
Net income before minority interest	611	2,122	1,910	1,990	1,927	0.38	0.31	0.30	0.32	0.38
Net income before extraordinaries	611	2,122	1,917	1,990	1,927	0.38	0.31	0.30	0.32	0.38
Net income after extraordinaries	611	2,122	1,917	1,990	1,927	0.38	0.31	0.30	0.32	0.38
Core earnings	611	2,122	1,917	1,990	2,014	0.38	0.31	0.30	0.32	0.39
	2005*	2004	2003	2002	2001					
<i>Asset Quality</i>										
Nonperforming assets	N.A.	196	308	252	290					
Nonaccrual loans	N.A.	196	308	252	290					
Net charge-offs	N.A.	46	90	(79)	2					
<i>Average balance sheet</i>										
Average customer loans	524,152	507,567	483,726	458,981	386,185					
Average earning assets	621,719	670,984	636,415	611,457	502,120					
Average assets	644,655	677,517	644,864	620,612	511,081					
Average total deposits	10	17	49	141	196					
Average interest-bearing liabilities	602,139	631,280	601,759	579,030	477,960					
Average common equity	28,306	27,548	26,243	24,251	20,287					
Average adjusted assets	644,655	677,517	644,864	620,612	511,081					
<i>Other data</i>										
Number of employees (end of period, actual) [¶]	741	771	981	1,043	954					
Off-balance-sheet credit equivalents	N.A.	N.A.	1,255	1,151	123					

*Data as of March 31, 2005. Q1 2005 data are audited, consolidated, and prepared according to IFRS. Other data are audited, consolidated, and prepared according to local GAAP. Ratios annualized where appropriate. N.A.—Not available. N.M.—Not meaningful.

Table 3

Ratio Analysis					
	—Year ended Dec. 31—				
	2005*	2004	2003	2002	2001
<i>Segment Analysis</i>					
Customer loans (gross)	10.58	3.82	6.08	4.65	38.44
Loss reserves	(400.00)	(8.48)	(12.55)	0.96	(5.96)
Adjusted assets	(71.46)	9.39	0.71	7.34	41.35
Customer deposits	N.M.	N.M.	N.M.	N.M.	(100.00)
Tangible common equity	12.84	2.28	7.88	8.57	34.68
Total equity	12.84	2.28	7.88	8.57	34.26
Operating revenues	6.34	0.56	(0.77)	5.67	37.74
Noninterest expense	(11.43)	(13.52)	11.36	8.79	2.57
Net operating income before provisions	15.17	9.40	(7.12)	4.11	66.35
Loan loss provisions	N.A.	(70.83)	N.M.	N.M.	N.M.
Net operating income after provisions	22.52	10.16	(10.42)	5.60	61.88
Pretax profit	22.52	10.16	(10.42)	10.36	54.89
Net income	15.17	11.10	(4.02)	3.27	69.33
	2005*	2004	2003	2002	2001
<i>PROFITABILITY (%)</i>					
<i>Interest Margin Analysis</i>					
Net interest income (taxable equiv.)/avg. earning assets	0.56	0.60	0.64	0.58	0.68
Net interest spread	0.56	0.39	0.41	0.35	0.41
Interest income (taxable equiv.)/avg. earning assets	0.56	4.05	4.69	4.70	5.94
Interest income on loans/avg. total loans	N.A.	4.48	5.30	5.56	6.84
Interest expense/avg. interest-bearing liabilities	N.A.	3.67	4.28	4.35	5.52
<i>Revenue Analysis</i>					
Net interest income/revenues	79.31	97.02	98.70	84.47	86.53
Fee income/revenues	3.43	5.16	7.87	7.24	3.34
Market-sensitive income/revenues	12.74	(6.56)	(10.38)	4.27	4.91
Noninterest income/revenues	20.69	2.98	1.30	15.53	13.47
Personnel expense/revenues	0.00	13.76	14.15	14.40	15.78
Noninterest expense/revenues	27.64	33.19	38.59	34.39	33.40
Noninterest expense/revenues less investment gains	27.64	33.19	38.59	34.39	33.40
Expense less amortization of intangibles/revenues	27.64	33.19	38.59	34.39	33.40
Expense less all amortizations/revenues	27.64	32.44	38.37	33.96	32.87
Net operating income before provision/revenues	72.36	66.81	61.41	65.61	66.60
Net operating income after provisions/revenues	76.78	66.64	60.83	67.39	67.43
New loan loss provisions/revenues	(4.43)	0.17	0.58	(1.77)	(0.84)
Net nonrecurring/abnormal income/revenues	0.00	0.00	0.00	0.00	(2.91)
Pretax profit/revenues	76.78	66.64	60.83	67.39	64.52
Net income/revenues	55.19	50.96	46.12	47.69	48.80
Tax/pretax profit	28.12	23.53	24.18	29.23	24.37
	2005*	2004	2003	2002	2001
<i>Other Returns</i>					

Table 3

Ratio Analysis (cont.'d)					
	—Year ended Dec. 31—				
	2005*	2004	2003	2002	2001
Pretax profit/avg. risk assets (%)	1.20	1.03	0.99	1.18	1.23
Net income/avg. risk assets (%)	0.87	0.79	0.75	0.83	0.93
Revenues/avg. risk assets (%)	1.57	1.54	1.63	1.75	1.90
Net operating income before loss provisions/avg. risk assets (%)	1.13	1.03	1.00	1.15	1.27
Net operating income after loss provisions/avg. risk assets (%)	1.20	1.03	0.99	1.18	1.28
Net income before minority interest/avg. adjusted assets	0.38	0.31	0.30	0.32	0.38
Net income/avg. assets + securitized assets	0.38	0.31	0.30	0.32	0.38
Net income/employee (currency unit)	3,232,804	2,422,374	1,887,352	1,992,989	1,948,433
Personnel expense/employee (currency unit)	N.A.	654,110	579,051	601,903	629,929
Cash earnings/avg. tang. common equity (ROE) (%)	8.63	7.82	7.31	8.28	9.62
Core earnings/avg. tang. common equity (ROE) (%)	8.63	7.70	7.30	8.21	9.94
	2005*	2004	2003	2002	2001
<i>FUNDING AND LIQUIDITY (%)</i>					
Customer deposits/funding base	0.00	0.00	0.00	0.00	0.00
Total loans/customer deposits	N.M.	N.M.	N.M.	N.M.	N.M.
Total loans/customer deposits + long-term funds	1847.48	1857.63	1830.22	1861.30	1931.14
Customer loans (net)/assets (adj.)	91.36	73.05	76.96	73.05	74.93
	2005*	2004	2003	2002	2001
<i>CAPITALIZATION (%)</i>					
Adjusted common equity/adjusted assets	4.95	3.94	4.21	3.93	3.88
Adjusted common equity/adjusted assets + securitization	4.95	3.94	4.21	3.93	3.88
Adjusted common equity/risk assets	9.97	10.08	10.34	10.35	9.99
Adjusted common equity/customer loans (net)	5.41	5.39	5.47	5.38	5.18
Internal capital generation/prior year's equity	8.77	7.79	7.59	8.56	11.13
Tier 1 capital ratio	9.70	10.02	10.28	10.27	9.91
Regulatory total capital ratio	9.80	10.08	10.36	10.38	10.06
Adjusted total equity/adjusted assets	4.95	3.94	4.21	3.93	3.88
Adjusted total equity/adjusted assets + securitizations	4.95	3.94	4.21	3.93	3.88
Adjusted total equity/risk assets	9.97	10.08	10.34	10.35	9.99
Adjusted total equity plus LLR (specific)/customer loans (gross)	5.41	5.46	5.56	5.48	5.29
	2005*	2004	2003	2002	2001
<i>ASSET QUALITY (%)</i>					
New loan loss provisions/avg. customer loans (net)	(0.04)	0.00	0.01	(0.02)	(0.01)
Net charge-offs/avg. customer loans (net)	N.A.	0.01	0.02	(0.02)	0.00
Loan loss reserves/customer loans (gross)	N.A.	0.08	0.09	0.11	0.12
Credit-loss reserves/risk assets	N.A.	0.15	0.17	0.22	0.22
Nonperforming assets (NPA)/customer loans + ORE	N.A.	0.04	0.06	0.05	0.06
NPA (excl. delinquencies)/customer loans + ORE	N.A.	0.04	0.06	0.05	0.06
Net NPA/customer loans (net) + ORE	N.A.	(0.04)	(0.03)	(0.06)	(0.05)
NPA (net specifics)/customer loans (net specifics)	N.A.	(0.04)	(0.03)	(0.06)	(0.05)
Loan loss reserves/NPA (gross)	N.M.	214.80	149.35	208.73	179.66

Table 3

Ratio Analysis (cont.'d)		—Year ended Dec. 31—				
		2005*	2004	2003	2002	2001

*Data as of March 31, 2005. Q1 2005 data are audited, consolidated, and prepared according to IFRS. Other data are audited, consolidated, and prepared according to local GAAP. Ratios annualized where appropriate. N.A.—Not available. N.M.—Not meaningful.

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