# Fondo de Titulización de Activos SANTANDER EMPRESAS 2

## SME loans / Spain

*This pre-sale report addresses the structure and characteristics of the proposed transaction based on the information provided to Moody's as of November 2006. Investors should be aware that certain issues concerning this transaction have yet to be finalised. Upon conclusive review of all documents and legal information as well as any subsequent changes in information, Moody's will endeavour to assign definitive ratings to this transaction. The* ***definitive*** *ratings may differ from the* ***provisional*** *ratings set forth in this report. Moody's will disseminate the assignment of definitive ratings through its Client Service Desk. This report does not constitute an offer to sell or a solicitation of an offer to buy any securities, and it may not be used or circulated in connection with any such offer or solicitation.*

**Estimated Closing Date**

14 - December 2006

**Lead Analyst**

Alberto Barbáchano
Assistant Vice President – Analyst
+34 91 702-6601
*Alberto.Barbachano@moodys.com*

**Backup Analyst**

Antonio Tena
Associate Analyst
+34 91 702-6681
*Antonio.Tena@moodys.com*

**Investor Liaison**

New York

Brett Hemmerling
Investor Liaison Specialist
+1 212 553-4796
*Brett.Hemmerling@moodys.com*

**Client Service Desk**

London: +44 20 7772-5454
*csdlondon@moodys.com*

Madrid: +34 91 702-6616

**Monitoring**

*monitor.abs@moodys.com*

**Website**

www.moodys.com

## PROVISIONAL (P) RATINGS

| Series | Rating | Amount (million) | % of Notes | Legal Final Maturity | Coupon |
|---|---|---|---|---|---|
| A1 | (P)**Aaa** | €1,300.10 | 44.83 | Jun. 50 | 3mE + [ • ]% |
| A2 | (P)**Aaa** | €1,365.00 | 47.07 | Jun. 50 | 3mE + [ • ]% |
| B | (P)**Aa2** | €84.10 | 2.90 | Jun. 50 | 3mE + [ • ]% |
| C | (P)**A2** | €62.30 | 2.15 | Jun. 50 | 3mE + [ • ]% |
| D | (P)**Baa3** | €59.50 | 2.05 | Jun. 50 | 3mE + [ • ]% |
| E | (P)**Ba1** | €29.00 | 1.00 | Jun. 50 | 3mE + [ • ]% |
| F | (P)**Ca** | €53.70 | 1.85 | Jun. 50 | 3mE + 0.50% |
| Total | | €2,953.70 | | | |

*The ratings address the expected loss posed to investors by the legal final maturity. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.*

* *In Moody's opinion, the structure allows for timely payment of interest and ultimate payment of principal at par on or before the rated final legal maturity date on Classes A/B/C/D/E, and for ultimate payment of interest and principal at par on or before the rated final legal maturity date on Class F.*

## OPINION

### Strengths of the Transaction

- Credit enhancement provided by the excess spread, a reserve fund and the subordination of the notes.
- Excess spread-trapping mechanism through an 12-month "artificial write-off".
- Interest rate swap provided by Banco Santander Central Hispano (SCH, rated **Aa3**/**P-1**/**B**) guaranteeing an excess spread of 0.65% plus the servicing fee if SCH is replaced as servicer.
- Notes are fully sequential.
- Relatively good seasoning and well diversified pool in terms of geography.
- Less concentrated pool than its predecessor (Santander Empresas 1), although there are some exposures which exceed €10 million.
- 100% of the loans pay via direct debit.

### Weaknesses and Mitigants

- Only 19.24% of the pool is backed by first-lien mortgage guarantees – the weighted average current loan-to-value is 87.69%.
- Historical information has been provided although not in a format that would satisfy Moody's requirements.
- The deferral of interest payments on each of Series B, C, D and E benefits the repayment of the series senior to each of them, but increases the expected loss on Series B, C, D and E themselves. The reserve fund and the subordination have been sized accordingly to account for this higher expected loss.

## STRUCTURE SUMMARY *(see page 4 for more details)*

| | |
|---|---|
| Issuer: | Fondo de Titulización de Activos SANTANDER EMPRESAS 2 |
| Structure Type: | Senior/Mezzanine/Subordinated floating-rate notes |
| Seller/Originator: | Banco Santander Central Hispano (SCH, **Aa3**/**P-1**) |
| Servicer: | Banco Santander Central Hispano (SCH, **Aa3**/**P-1**) |
| Interest Payments: | Quarterly in arrears on each payment date |
| Principal Payments: | Series A1, B, C, D and E will amortise on a pass-through basis on each payment date. Series A2 will star amortise once the Series A1 is fully amortised and not before 20/11/2008 |
| Payment Dates: | 20 February, 20 May, 20 August, 20 November<br>First payment date: 21 May 2007 |
| Credit Enhancement/Reserves: | Excess spread<br>Reserve fund<br>Subordination of the notes<br>Guaranteed Investment Contract (GIC) account |
| Hedging: | Interest rate swap covering the interest rate risk |
| Interest Rate Swap Counterparty: | Banco Santander Central Hispano (SCH, **Aa3**/**P-1**) |
| Paying Agent: | Banco Santander Central Hispano (SCH, **Aa3**/**P-1**) |
| Note Trustee (Management Company): | Santander de Titulización S.G.F.T.; S.A (SdT) |
| Arranger: | Santander de Titulización S.G.F.T.; S.A (SdT) |
| Lead Managers: | Citigroup, Merrill Lynch International, SCH |

## COLLATERAL SUMMARY (AS OF 13 NOVEMBER 2006) *(see page 7 for more details)*

| | |
|---|---|
| Receivables: | Loans to Spanish Small, Medium and Big Enterprises |
| Total amount: | €3,071,949,880 |
| Number of Contracts: | 21,198 |
| Number of Borrowers: | 20,536 |
| Geographic Diversity: | Madrid (25.82%), Andalusia (12.13%), Catalonia (13.39%) |
| WA Remaining Term: | 6.32 years |
| WA Seasoning: | 1.47 years |
| Interest Basis: | 100% floating |
| WA Interest Rate: | 3.96% |
| Delinquency Status: | No loans more than 30 days in arrears at the time of securitisation |

## TRANSACTION SUMMARY

***Cash securitisation of loans granted to small, medium and big enterprises in Spain***

This is the second securitisation of this type by Banco Santander Central Hispano SA (SCH). The previous issuance, Santander Empresas 1, closed in November 2005 for an amount of €3.1 billion (not rated by Moody's). Santander Empresas 2 is a cash securitisation backed by a portfolio of loans to Spanish small, medium and big enterprises and self-employed borrowers that has been originated by SCH in its ordinary course of business.

According to the bank's internal classification, the distribution by type of customer as of November 2006 was as follows:

Table 1:

| | | |
|---|---|---|
| Enterprise | 913,635,195 | 29.74% |
| SME | 648,759,935 | 21.12% |
| Micro-enterprise | 602,448,993 | 19.61% |
| Big enterprise | 546,244,918 | 17.78% |
| Self employed | 360,860,837 | 11.75% |
| | 3,071,949,880 | |

The *Fondo* will issue seven series of notes to finance the purchase of the loans (at par):

- A mezzanine Series E, rated (P)**Ba1**
- A mezzanine Series D, rated (P)**Baa3**
- A mezzanine Series C, rated (P)**A2**
- A mezzanine Series B, rated (P)**Aa2**
- A senior tranche composed of two (P)**Aaa**-rated series: a subordinated Series A2, and a senior Series A1
- In addition, the *Fondo* will issue a (P) **Ca**-rated Series F to fund a cash reserve that will be used to cover any potential shortfall on interest or principal payments to the rest of series

Apart from the cash reserve, each series of notes is supported by the series subordinated to it and the securitised pool excess spread. The transaction also incorporates a swap agreement that will partially hedge the *Fondo* against the risk derived from having different index reference rates and reset dates on the assets and on the notes.

In addition, the *Fondo* will benefit from a [€** million] subordinated loan provided by SCH to fund the up-front expenses, the costs of issuing the notes, and the gap between the interest payments received from the pool and the amount of interest due to the notes on the first payment date.

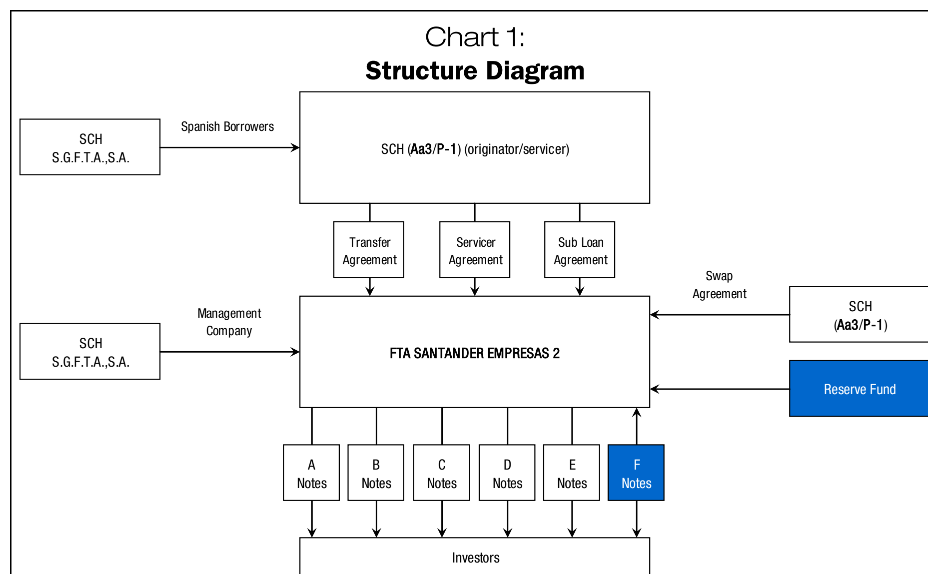
The provisional pool consists of 21,198 debtors and 20,536 loans. Of the pool, 19.24% is secured by first-lien mortgage guarantees over different types of properties.

Moody's based the provisional ratings primarily on: (i) an evaluation of the underlying portfolio of loans; (ii) historical performance information; (iii) the swap agreement partially hedging the interest rate risk; (iv) the credit enhancement provided through the Guaranteed Investment Contract (GIC) account, the pool spread, the cash reserve and the subordination of the notes; and (v) the legal and structural integrity of the transaction.

# STRUCTURAL AND LEGAL ASPECTS

***Standard SME capital structure, incorporating the following key features: deferral of interest based on default and funding of the reserve fund through the issuance of a series of notes***

Chart 1:
**Structure Diagram**




***Interest rate swap guaranteeing the interest rate of the notes plus 65 bppa of excess spread and covering the servicing fee in case of the replacement of SCH as servicer***

According to the swap agreement entered into between the issuer and SCH, on each payment date:

– The issuer will pay the amount of interest actually received from the loans.

– SCH will pay the same amount as it receives from the *Fondo*, although this will be:

  - floored at an amount equal to the sum of the weighted average coupon on the notes plus 65 bppa, over a notional calculated as the daily average outstanding amount of the loans not more than 90 days in arrears; and
  - capped at an amount equal to the sum of the weighted average coupon on the notes plus 65 bppa, over a notional equal to the outstanding amount of the loans.

Additionally, the swap will cover the servicing fee if SCH is substituted as servicer.

The excess spread thus provided through the swap agreement constitutes the first layer of protection for investors. In the event of SCH's long-term rating being downgraded below **A1**, within 30 days SCH will have to (1) collateralise its obligations under the swap in an amount sufficient to maintain the then current rating of the notes, or (2) find a suitably rated guarantor or substitute.

***Reserve fund fully funded at closing from the proceeds of the issue of the Series F notes to cover potential shortfall in interest and principal***

The reserve fund is designed to help the fund meet its payment obligations. Initially funded with the proceeds from the issuance of the Series F notes, it will be held at SCH. The reserve fund will be used to protect Series A, B, C D and E notes against interest and principal shortfall on an ongoing basis. At every point in time, the amount requested under the reserve fund will be the lesser of the following amounts:

1) 1.85% of the initial balance of the notes
2) The higher of the following amounts:
   - 2.50% of the outstanding balance of loans
   - 0.90% of the initial balance of the notes

Amortisation of the reserve fund will cease if either of the following scenarios occurs:

- The arrears level (defined as the percentage of non-written-off loans more than 90 days in arrears) exceeds 1.00%.
- The reserve fund is not funded at its required level on the previous payment date.
- Net acumulated losses > 1.0%

n addition, the reserve fund will not amortise during the first 24 months of the life of the transaction

***GIC account guarantees an annual interest rate equal to the index reference rate of the notes***

The treasury account will be held at SCH. The proceeds from the loans, amounts received under the swap agreement and the reserve fund will be deposited in the treasury account.

Moody's has set up some triggers in order to protect the treasury account from a possible downgrade of SCH's short-term rating. Should SCH's short-term rating fall below **P-1**, it will have to perform one of the following actions in the indicated order of priority within 30 days:

- Find a suitably rated guarantor or substitute.
- Collateralise its payment obligations under the treasury account in an amount sufficient to maintain the current rating of the notes.
- Invest the outstanding amount of the treasury account in securities issued by a **P-1**-rated entity.

SCH guarantees through the GIC account an annual yield on the amounts deposited in the treasury account equal to the index reference rate of the notes.

***Payment structure allocation***

On each quarterly payment date, the *Fondo's* available funds (principal and interest received from the asset pool, the reserve fund, amounts received under the swap agreement and interest earned on the transaction accounts) will be applied in the following simplified order of priority:

- Fees and expenses, excluding servicing fee (except in the case that SCH is replaced as servicer of the loans)
- Any amount due under the swap agreement (except termination payments if SCH defaults under the swap agreement)
- Interest payment to Series A notes
- Interest payment to Series B notes
- Interest payment to Series C notes
- Interest payment to Series D notes
- Interest payment to Series E notes
- To redeem the notes sequentially
- Interest payment to Series B notes (if deferred)
- Interest payment to Series C notes (if deferred)
- Interest payment to Series D notes (if deferred)
- Interest payment to Series E notes (if deferred)
- Replenishment of the reserve fund
- Interest payment to Series F
- Principal payment to Series F
- Termination payments if SCH defaults under the swap agreement
- Junior expenses including servicing fee

In the event of liquidation of the *Fondo*, the payment structure will be modified with the sole aim of ensuring that any amount due to a series is repaid before any payment to a subordinated series is made.

***12-month "artificial write-off" mechanism***

- The transaction structure for Series A, B, C, D and E benefits from an "artificial write-off", which traps available excess spread to cover losses (if any). This type of "artificial write-off" is hidden in the definition of Principal Due, which is the difference between the A, B, C, D and E notes outstanding and the outstanding performing loans (loans less than 12 months in arrears).

***Class A Amortisation***

The amount retained as principal due will be used for the repayment of Class A in the following order of priority:

1. Amortisation of Series A1 notes
2. Series A2 notes will start to amortise on the payment date equal to the later of:
   (i) once Series A1 notes are fully amortised
   (ii) 20/11/2008.

Nevertheless, the amount retained as principal due will be pro-rata distributed among Series A1 and A2,if the amount of loans more than 3 months and less than 12 months in arrears exceed [1.50%] of the outstanding balance of the portfolio.

***Series F amortisation***

The Series F notes will amortise, on each payment date, for an amount equal to the difference between the outstanding amount of the Series F notes and the reserve fund's required amount on the current payment date.

***Interest deferral trigger based on defaults***

– The payment of interest on the Series B, C, D and E notes will be brought to a more junior position if, on any payment date, the following criteria are met:

Table 2:

| | |
|---|---|
| Series B: | – The accumulated amount of written-off loans is higher than 8.5% of the initial amount of the asset pool<br>– Series A are not fully redeemed |
| Series C: | – The accumulated amount of written-off loans is higher than 6.5% of the initial amount of the asset pool<br>– Series A and B are not fully redeemed |
| Series D: | – The accumulated amount of written-off loans is higher than 5.0% of the initial amount of the asset pool<br>– Series A, B and C are not fully redeemed |
| Series E: | – The accumulated amount of written-off loans is higher than 4.25% of the initial amount of the asset pool<br>– Series A, B, C and D are not fully redeemed |

## COLLATERAL

As of November 2006, the provisional portfolio comprised 21,198 loans and 20,536 debtors. The loans have been originated by SCH in its normal course of business, and comply with the following criteria:

- All loans follow SCH's standard underwriting and credit-scoring criteria
- All loans have been formalised under public deed
- Only 0.56% of the loans incorporate any type of balloon payments or deferred payments of interest
- 100% of the principal of the loans has been drawn
- None of the loans are to real estate developers or lease contracts
- No final maturity date exceeds June 2046
- All loans are denominated in euros
- No loans will carry any amounts more than 30 days past due
- No loans have breached any of the loan agreements

The loans have been originated between 1990 and April 2006, with a weighted average seasoning of 1.47 years and a weighted average remaining term of 6.32 years. The longest loan matures in June 2046.

Around 19.24% of the outstanding of the portfolio is secured by a mortgage guarantee over different types of properties. The weighted average loan-to-value (WA LTV) distribution, according to the mortgage rank (taking into account only the main guarantee if the loan is secured by more than one mortgage), is as follows:

Table 3:

| | % | WA LTV |
|---|---|---|
| First-lien mortgages | 100% | 87.69% |

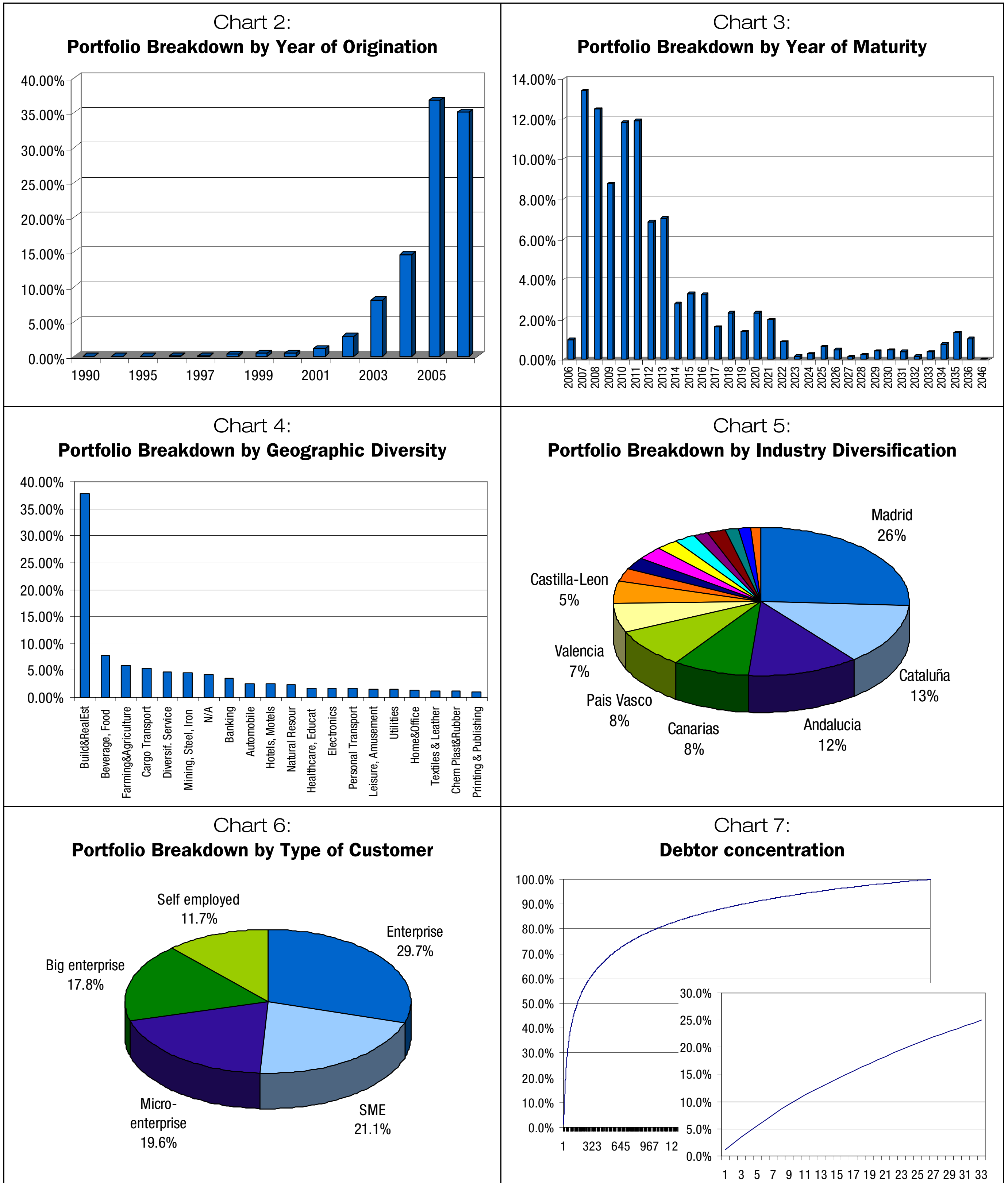
The remaining 80.76% is secured by personal guarantees.

Geographically, the pool is concentrated in Madrid (25.82%), Andalusia (12.13%) and Catalonia (13.39%). Around 37.85% of the portfolio is concentrated in the "buildings and real estate" sector, according to Moody's industry classification. In terms of debtor concentration, the pool includes exposures up to 1.2% of the issuance amount.

***Limitations on the renegotiation of the loan***

Any renegotiation of the terms and conditions of the loans is subject to the management company's approval. Under exceptional circumstances, the management company authorises SCH to renegotiate the interest rate or maturity of the loans without requiring its approval. However, SCH will not be able to extend the maturity of any loan beyond June 2046. Moreover, the renegotiation of the maturity of the loans is subject to various conditions, of which the following are the most significant:

- The global initial amount of loans on which the maturity has been extended cannot be greater than 10% of the initial amount of the pool.
- The frequency of payments cannot be decreased.
- The amortisation profile cannot be modified.



## ORIGINATOR, SERVICER, AND PAYING AGENT AND MANAGEMENT COMPANY

Banco Santander Central Hispano (SCH, rated **Aa3**/**P-1**/**B**) is the largest banking group in Spain, with total assets of around €729 billion (€450 billion ex-Abbey) as of June 2005. The bank enjoys impressive market shares and a strong competitive position across all banking segments, and has a particularly dominant position in the domestic mutual funds business, with 26% of the market and an 18% share in domestic individual pension funds at year-end 2002. In other areas, the group holds the following shares: 21% in assets, 16% in loans and 19% in customer funds.

SCH embarked a few years ago on a successful European diversification strategy with a specific focus on consumer finance through its subsidiary Santander Consumer Finance SA (rated **Aa3**/**P-1**). The aim was to become one of the leading financial groups in Europe and reduce its reliance outside Spain on its Latin American franchise. SCH realised its ambition of becoming the largest financial group in the Iberian peninsula with the acquisition in 2000 of Banco Totta y Açores (rated **A1**/**P-1**/**C+**), Portugal's fourth-largest banking group. More recently, SCH became one of Europe's largest financial groups by market value with the acquisition in 2004 of Abbey National (rated **Aa3**/**P-1**/**B**), the UK's sixth-largest bank and second-largest mortgage lender, for €12.5 billion. Going forward, there is a possibility of further acquisitions as the bank seeks to strengthen its European consumer finance franchise. On the banking side, however, in light of SCH's current focus on the relaunch of Abbey, major cross-border deals seem unlikely for the time being.

***Servicer***

SCH will act as servicer of the loans, and will transfer the proceeds from the loans to the treasury account on a weekly basis.

In the event of SCH being declared bankrupt, failing to perform its obligations as servicer or being affected by a deterioration in its financial situation, either it or the management company will have to designate a suitable new institution as guarantor of SCH's obligations under the servicing agreement, or even as a new servicer. Otherwise, the management company itself would step in as servicer of the loans.

If SCH is involved in an insolvency process or if the management company considers it appropriate for any other reason, the management company may require SCH to notify the relevant debtors about the transfer of the *Fondo* loans. Should SCH fail to comply with this obligation within five business days, the notification would then be carried out by the management company.

***Paying Agent***

SCH will act as paying agent of the *Fondo*. In the event of SCH's short-term rating falling below **P-1**, it will have to be replaced in its role of paying agent by a suitably rated institution within 30 days.

***Management Company***

Santander de Titulización is an experienced company in the Spanish securitisation market, managing *Fondos* exclusively related to SCH group assets. It is fully owned by SCH group. Currently it manages 32 securitisation funds.

## MOODY'S ANALYSIS

***Moody's used a Monte Carlo simulation to derive the default distribution in the portfolio, based on mean default estimations***

Given the number of assets and the size of the exposures in the portfolio (see section entitled *Collateral*), Moody's decided to derive the gross loss distribution curve using a two-factor Monte Carlo approach, rather than assuming that it follows a given general density law.

Two basic parameters needed to be assessed as main inputs for the model:

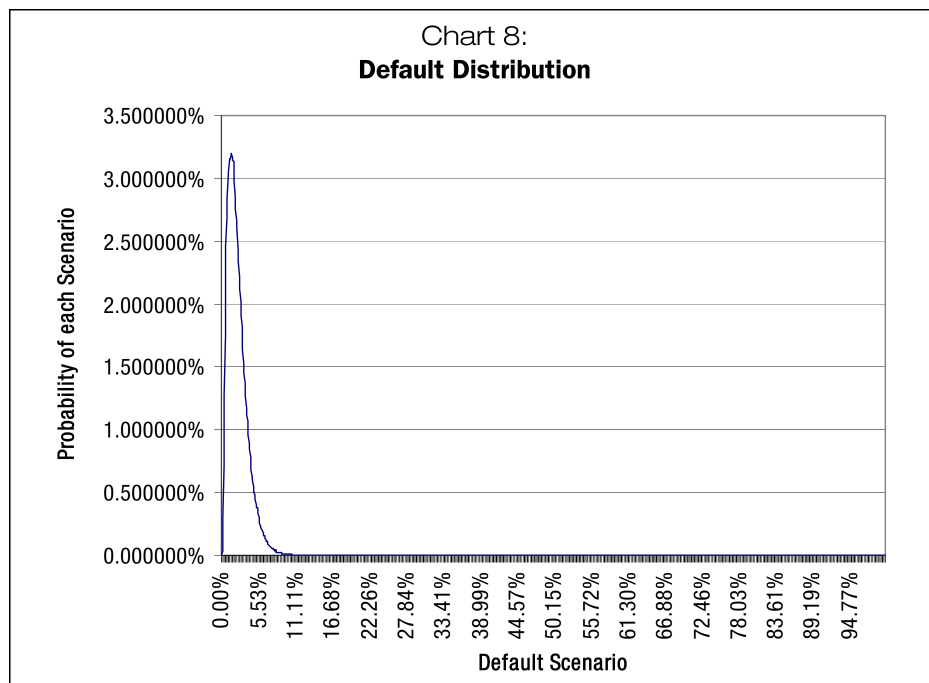
- The gross loss contribution of each single entity
- The correlation structure among the different industries represented in the portfolio

As regards the default probability assumed for the underlying obligors, and given that the originator did not provide Moody's with historical information satisfactory for our analysis, Moody's decided to base its analysis on (1) historical information received from the originator for FTPYME Santander 1, (2) statistical information from the Spanish SME loan market; (3) performance of various SME deals including its predecessors; and (4) other qualitative aspects. It is important to note that a loan has been considered as 'defaulted' after 90 days past due. Assumptions for recoveries, delinquency and prepayments were also derived using the same sources of information.

As regards the correlation structure that takes into account the portfolio specificities, Moody's split the portfolio into 33 groups, and, with the purpose of reflecting the diversity shown by the exposures in the securitised portfolio, Moody's made different assumptions, both for the asset correlation within one group and for that between assets in different groups (the two factors in the Monte Carlo model).

The Monte Carlo simulation was then run, incorporating each exposure's size, default probability and implied asset correlation, thereby giving an outcome equal to the default probability distribution for the portfolio.

Chart 8:
**Default Distribution**




On the basis of this distribution as well as other assumptions for recoveries, delinquency and prepayments, and in order to allocate losses to the notes in accordance with their priority of payment and relative size, Moody's built a cash flow model that reproduces all deal-specific characteristics. The sensitivity to a variation in the initial assumptions was also tested. Weighting each default scenario's severity result on the notes with its probability of occurrence, Moody's calculated the expected loss level for each series of notes which, combined with each series' expected average life, is consistent with the provisional ratings assigned.

***Structural Analysis***

Moody's considers how the cash flows generated by the collateral are allocated to the parties within the transaction, and the extent to which various structural features of the transaction may themselves provide additional protection to investors, or act as a source of risk. In addition, Moody's ensures that the transaction is not affected by the bankruptcy of the originator or the servicer of the portfolio.

***Legal Analysis***

Moody's verifies that the legal documents correctly reflect the structure of the deal, as well as the assumptions made in its analysis.

## RATING SENSITIVITIES AND MONITORING

***The rating of the notes depends on the portfolio performance and counterparty ratings***

In its capacity as management company, Santander de Titulización will prepare quarterly monitoring reports with respect to the portfolio and payments to the notes. These reports will detail the amounts received by the issuer during each collection period and will provide portfolio data. Moody's will monitor this transaction on an ongoing basis to ensure that it continues to perform in the manner expected, including checking all supporting ratings and reviewing periodic servicing reports. Any subsequent changes to the rating will be publicly announced and disseminated through Moody's Client Service Desk. For updated monitoring information, please contact monitor.madrid@moodys.com

## RELATED RESEARCH

***Visit moodys.com for further details***

**Pre-Sale Report**

– FTPYME Santander 1, Fondo de Titulización de Activos, April 2005 (SF55279)

**Rating Methodology**

– FTPYMES: Moody's Analytical Approach to Spanish Securitisation Funds Launched Under Government's FTPYMES Programme, October 2003 (SF27063)

– Moody's Approach to Jointly Supported Obligations, November 1997 (SF5941)

**Special Report**

– Moody's Spanish SME Loan-Backed Securities Index, April 2004 (SF35231)

– Structural Features in the Spanish RMBS Market – Artificial Write-Off Mechanisms: Trapping the Spread, January 2004 (SF29881)

– Moody's Approach to Rating ith-to-Default Basket Credit-Linked Notes, April 2002 (SF13090)

*To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.*

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