

# Credit Analysis

## Moody's International Public Finance

October 2009

### Eurofima

Supranational

#### Summary Rating Rationale

The Aaa issuer and debt ratings assigned to Eurofima (European Company for the Financing of Railroad Rolling Stock) reflect its strong support mechanisms and guarantee criteria, financing contracts secured by collateral rolling stock, and sound liquidity position.

Eurofima's mission is to provide its European shareholder railways with competitive funding for renewals or modernisation of their rolling stock. The organisation does not seek to maximise profits, which tend to be very stable and predictable over time. Profit, after a maximum dividend allocation of 4%, is retained and kept as reserves to strengthen capital. Eurofima maintains adequate and stable liquidity in the form of reserves and funds for general risks, totalling CHF750.3 million at the end of 2008. Eurofima benefits from timely access to substantial additional funds through its 80% callable capital from its members (equivalent to CHF2.08 billion) and several uncommitted credit lines. The ratio of subscribed capital-to-total borrowings was 10% at the end of 2008 – in line with the previous year. Eurofima operates under rigid governance practices aimed at minimising key risks – from credit to liquidity, and from operational to financial.

#### Rating Outlook

The outlook is stable. Eurofima's rating is well positioned in its category given the very high stability of its financial performance over time, the high predictability of its financial planning, and the strong support by the Member States. Over the medium term, Moody's expects continuity in the prudent management and investment decisions seen in the past.

#### Table of Contents:

Summary Rating Rationale	1
Rating Outlook	1
Issuer Overview	2
Significant Role in Financing European Railways	2
Key Rating Considerations	2
Institutional Framework	2
Financial Position and Performance	4
Debt and Liquidity	5
Portfolio Management	6
Governance and Management Factors	7
Rating History	7
Annual Statistics	8
Moody's Related Research	9

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This Credit Analysis provides an in-depth discussion of credit rating(s) for Eurofima and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website. [Click here to link.](#)



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## Eurofima

## Issuer Overview

Eurofima is a supranational organisation established by a Convention, signed and ratified by 25 countries, including the Republic of Montenegro, whose government joined in October 2006. To qualify for membership in Eurofima, a State must be a member of the International Transport Forum (formerly European Conference of Ministers of Transport or ECMT); if the previous condition is not fulfilled, all existing Eurofima members are required to give their approval on any new member.

Established in 1956 as a joint stock company, Eurofima is governed by the Convention, its Articles of Association (Statutes), and – in a subsidiary manner – by the laws of the Swiss Confederation. Any change to the original text of the initially signed Convention requires approval by all Member States, whose relationships are governed by the Basic Agreement ("*Accord de Base*").

## Significant Role in Financing European Railways

Eurofima was established to provide its shareholder railways with competitive funding for renewals or modernisation of their rolling stock and the company continues to play a key role in this regard. The organisation does not seek to maximise profits, but rather to obtain financing under the best possible conditions for its shareholder railways.

To enter into equipment financing contracts with the individual participating railways, Eurofima borrows the necessary funds in the capital markets and advances these to the railways holding the title to – or securing interest in – the rolling stock until the equipment financing contract has been fully paid. Only on payment of the final instalment of a contract does the title on the rolling stock pass to the railway. Although Moody's believes that the rolling stock collateral enhances asset quality, we also believe that the actual seizure of a defaulting railway's rolling stock may prove a difficult task in practice.

By the end of 2008, total equipment financing was CHF35.5 billion (book value), an increase from CHF34.2 billion in 2007 (CHF29.7 billion before adoption of new accounting policies). The 2007 year-end report has been restated to permit comparability under the adoption of new accounting policies close to IFRS accounting principles. In particular, the equipment financing contracts are measured at the fair value (or at amortised costs where the fair value option is not applicable). Equipment financing represents the largest single asset, accounting for 88% of Eurofima's balance sheet at the end of 2008. The asset quality remains very high, with neither credit losses nor overdue payments.

## Key Rating Considerations

### Institutional Framework

#### Strong support mechanisms

Moody's has assigned Eurofima the highest possible credit ratings for long- and short-term borrowings, based principally on the several levels of support it enjoys:

- If a railway company's liabilities are not direct government liabilities, the Member State must guarantee the equipment financing contracts.
- Shareholders provide a joint guarantee in proportion to each country's participation in the registered capital and for a maximum of that stated amount.
- A grandfathering clause<sup>1</sup> in the Convention assures continuity in the guarantee for existing liabilities should a Member State quit the organisation.
- An automatic guarantee is applied to new investments and financing contracts made by shareholder railways.<sup>2</sup>

<sup>1</sup> Article 13 of the Convention

<sup>2</sup> Article 5 of the Convention

## Eurofima

Eurofima's membership guarantee scheme has never been investigated formally by the EU. However, given that any EU rulings would not be applied retroactively, any outcome would not affect the outstanding debts.

### Eurofima membership mainly comprises highly rated countries

According to Moody's, as at the end of September 2009, only 3 of the 25 Member States were rated non-investment grade, thereby underscoring Eurofima's creditworthiness. In addition, 14 were rated Aa or higher. However, in the past 10 years, the increase in the number of countries that have signed and ratified the Convention has resulted in a greater number of members with ratings of A or lower.

Although Eurofima is committed to increasing its membership, particularly among countries from Central and Eastern Europe, the organisation is not obliged to lend to new members; rather, it assesses each application on a case-by-case basis. Lending to the non-investment grade participants (Turkey, Montenegro and Bosnia and Herzegovina) or participants not rated by Moody's is limited – i.e. less than 1% in 2009.

### Ownership Structure (as of 30 June 2009)

Shareholders	Abbreviations	Rating of Country*	Equity Stake
Deutsche Bahn AG	DB AG	Aaa	22.60
French National Railways	SNCF	Aaa	22.60
Ferrovie dello Stato S.p.A.	FS	Aa2	13.50
SNCB Holding	SNCB	Aa1	9.80
NV Nederlandse Spoorwegen	NS	Aaa	5.80
RENFE Operadora	RENFE	Aaa	5.22
Swiss Federal Railways	SBB	Aaa	5.00
Železnice Srbije	ŽS	--	2.24
Swedish State Railways	SJ	Aaa	2.00
Luxembourg National Railways	CFL	Aaa	2.00
ÖBB-Holding AG.	ÖBB	Aaa	2.00
Portuguese Railways	CP	Aa2	2.00
Hellenic Railways	OSE	A1	2.00
České dráhy, a.s	ČD	A1	1.00
Hungarian State Railways Ltd.	MÁV	Baa1 Neg	0.70
Željeznična spoločnosť Slovensko, a.s.	ŽSSK	A1	0.50
HŽ Putnički prijevoz d.o.o.	HŽ	Baa3	0.20
Slovenske Železnice d.o.o	SŽ	Aa2	0.20
Bosnia and Herzegovina Railways	ŽBH	B2	0.20
Bulgarian State Railways Ltd.	BDZ	Baa3	0.20
Javno pretprijatie Makedonski Železnici-Infrastruktura (**)	MŽI	--	0.08
Makedonski Železnici-Transport AD (**)	MŽT	--	0.02
Željeznički Prevoz Crne Gore A.D.	ŽCG	Ba3 Neg	0.06
Turkish State Railways	TCDD	Ba3 Pos	0.04
Danish State Railways	DSB	Aaa	0.02
Norwegian State Railways	NSB	Aaa	0.02

Note: \* Sovereign Rating List September 2009 - National Currency Government Bond Ratings.

\*\* Macedonia split into two companies in 2007.

In addition, to have representatives on the decision-making Board of Directors, a Member State needs to have attained a participation of at least 2% in Eurofima's share capital.

## Eurofima

### Privatisations have not led to increased credit risk, as government guarantees apply

Eurofima's objective is to obtain the lowest financing cost possible for the acquisition of railroad rolling stock on behalf of its shareholders, or for other railways when a Member State acts as guarantor. If a shareholder is a public limited company, its Member State must guarantee the equipment financing contract. Although these guarantees are self-executory (i.e. they can operate on a stand-alone basis), they cannot be unilaterally disposed by Eurofima. They are intended to be a mutual undertaking with the relevant Government.

Over the past few years, Eurofima has developed a clear and workable procedure for dealing with the privatisation of shareholders. Privatised railways may remain shareholders of Eurofima, provided their governments continue to guarantee their obligations to the organisation and remain signatories to the Convention. Privatisation does not affect the existing guarantees for outstanding obligations.

### Financial Position and Performance

#### Eurofima continues to maintain a stable performance

Given that Eurofima does not seek to maximise profits, its profitability is low. Eurofima earns no net interest income on its equipment financing contracts refinanced by borrowings, and interest and principal receipts generally match debt service. Net earnings derive from earnings on the investment portfolio and annual commissions paid by the borrowing railways on equipment financing contracts.

In 2008, Eurofima's net profit was up 10.1% from 2007, at CHF48.4 billion, largely reflecting a higher net interest income that more than offset a decline in revenues from other financial operations. The results, which were achieved notwithstanding significant growing costs, were roughly 2% above the budget for 2008.

Eurofima has three key sources of revenues: net interest income, net commission income and net income from other financial operations. As stated above, net interest income was the main contributor to revenue growth, reaching CHF37.9 million in 2008 from CHF27.9 million in 2007, well above the CHF31.9 million budgeted. The key reasons for the increase were higher interest rates, and more favourable credit spreads combined with diminished costs of funding. This item was cautiously projected to be slightly lower in 2009, at CHF33.9 million, before bouncing back to CHF43.3 million in 2010, which Moody's considers achievable, taking into account a certain degree of prudence.

Net commission income slightly increased in 2008, to CHF16.8 million from CHF16.5 million in 2007; this source of revenue, traditionally very stable over time, is projected to decline to around CHF15-16 million in 2009-10 due to lower new volumes in financing contracts. At the same time, the recent update of Eurofima's commission structure, whereby commission rates applied to members vary according to the perceived creditworthiness of each country, should partially offset the projected decline in volumes.

The last component, net income from other financial operations, is more volatile, as evidenced by a drop in 2008, to CHF2.6 million from CHF7.2 million in 2007, reflecting Eurofima's closure of all positions that could potentially present some risks. Expectations are for a further reduction to around CHF2 million in 2009-10.

On the cost side, general administrative expenses were up 14.1% in 2008 from 2007, partially due to costs related to the transition to the new accounting system, as well as personnel expenses. The adoption of the new accounting mechanism, whereby certain costs are now accounted for in the profit and loss accounts instead of being charged to the provisions resulted in higher costs. Operating costs are expected to decrease in 2009.

Eurofima's net profits for 2009 are projected to be down 10-11% compared to 2008; however, a sustained growth trend is expected to restart in 2010, which Moody's considers sufficiently cautious.

#### Allocation of profit to reserves

The company's policy for allocating each year's profit focuses primarily on building capital resources by adding to its ordinary and special reserve, and only then paying dividends to shareholders (statutorily not exceeding

## Eurofima

4% of paid-in capital). There are no restrictions on the use of the special guarantee reserve and it was used in the past to increase paid-in capital. At the end of 2008, Eurofima's reserves amounted to CHF501 million.<sup>3</sup> Furthermore, the adoption of a new fund for general risks worth CHF249.4 million under the equity – which replaces all existing provisions, particularly for country and swap risks – provides greater flexibility, as it is not earmarked *a priori* for specific items.

### Debt and Liquidity

#### Indebtedness shield from the current marked turmoil – Eurofima benefited from the flight to quality phenomenon

To finance the equipment financing contracts extended to the national railways, Eurofima raises funds in the international markets in the form of public bond issues, issuance under the debt issuance programme and commercial paper. In light of Eurofima's dependence on the capital markets, availability of diversified funding sources is important to its funding strategy, and this is evident in its funding profile. Eurofima is currently 100% risk-weighted according to the existing Basel I Bank for International Settlements (BIS) recommendations.<sup>4</sup> Eurofima's assembly periodically sets annual borrowing limits (€4 billion – including short-term borrowing – for 2009).

In 2008, Eurofima mirrored 2007 issuances with another CHF4 billion drawn from the capital markets (mainly linked to the MTN programme), further diversifying its funding sources. Such volumes have been in line with Eurofima's projections and have not been adversely affected by deteriorating marked conditions. The company benefited from unchanged investor demand, as it was perceived as a secure port in time of crisis. Moody's notes a preference of short-to-medium term issuances over the long-term issuances of the recent past, which accommodate investors' preferences at the short end of the maturity scale.

In the first six months of 2009, new financing amounted to CHF0.47 billion, reflecting lower investment programmes by national railways, which is likely to be extended to approximately CHF2 billion by the end of the year and should constitute the reference level for the following years. Borrowings for equipment financing contracts were slightly less than CHF34 billion at the end of 2008. This amount is projected to progressively decline going forward due to yearly reimbursements exceeding new borrowings.

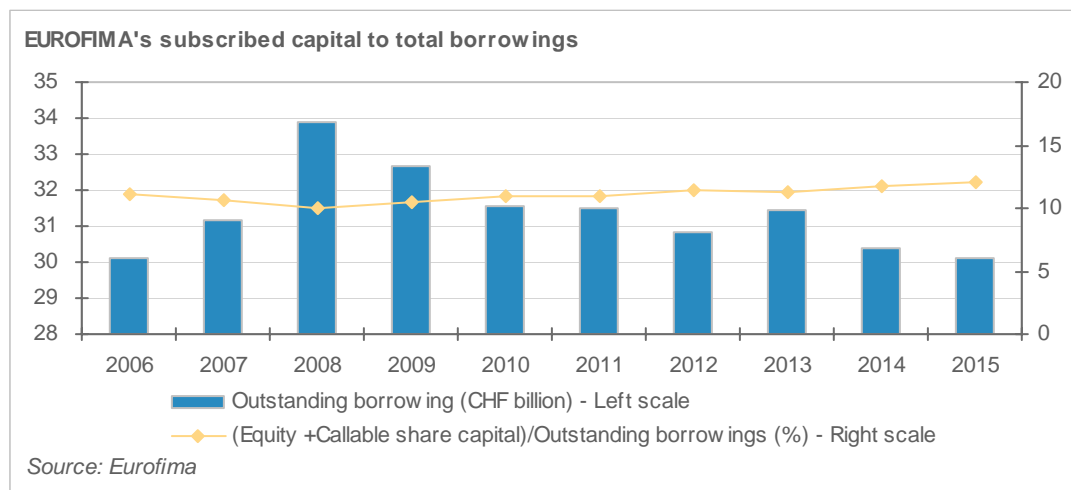
Although US dollars, Swiss francs and Australian dollars remain the main currencies, Eurofima aims for diversification – hence, the use of different currencies such as Turkish lira, Mexican pesos or South African rand in recent years. In 2008, it issued a bond in New Zealand dollars (a NZD275 million “Kauri” bond).

Closing out all positions, especially currency positions, has led the company to make fairly active use of derivatives (mainly swaps), usually to long maturities that hedge the long-term equipment financing on the balance sheet. Market risk and credit risk management guidelines governing derivatives activity are conventional, well administered and broadly effective. By accepting only highly rated financial counterparties, Eurofima significantly minimises its counterparty risk. The exposures are marked-to-market daily.

<sup>3</sup> This includes reserves (ordinary + guarantee reserves).

<sup>4</sup> BIS issues recommendations; it is then up to national regulators – and, if necessary, national legislatures – to convert these recommendations to rules.

## Eurofima



### Eurofima's good liquidity would limit negative effects in the unlikely event of difficulties in accessing the market

Eurofima is totally dependent on the capital markets for funding and therefore has strict liquidity management regulations to ensure that the institution is not negatively affected by interruptions in the capital markets. Liquidity in excess of operating target was CHF1.443 billion as of June 2009. Lending and funding are fully matched and, additionally, approximately 8.3% of the balance sheet consists of subscribed share capital, a fund for general risks and reserves. The rest of Eurofima's reserves are non-paid-in capital from the 25 countries that have ratified the Convention (totalling CHF2.08 billion). This should enable Eurofima to stay away from the capital markets for a period of approximately 12 months and still be able to continue its usual business of providing new financing for rolling stock at a level that matches that of the past five years.

In 2008, Eurofima updated its CP programme, increasing it to €2 billion from US\$1 billion, with the aim of further improving its cost of funding. Since May 2008, the use of the CP programme progressively shrunk toward €200 million also in light of the company's preference of short term issuances.

Eurofima's investment policy is extremely conservative in that it allows investments in highly rated plain vanilla bonds only. Although this means that the yields of these reserves are not very high, the overall risk of the portfolio is relatively low. Eurofima has not deemed it necessary to obtain committed back-up lines given its liquidity management. Nonetheless, lines from banks have been approved verbally and funds would be available in the event of need.

## Portfolio Management

### No losses on Eurofima's loan portfolio

In Eurofima's nearly 51 years of existence, it has never suffered a loss as a result of not being able to collect on its loans.

In general, Eurofima finances up to 95% of the estimated total value of the contracted equipment. In the event that a railway fails to pay an instalment when due, it must pay penalty interest of an amount determined at the time of payment failure. At the end of 2008, no amount was overdue. If instalments become three months overdue, the railway can be declared in default, the contract can be cancelled and the railway must then return the rolling stock to Eurofima. Eurofima has preferred creditor status, which means it is to be paid in priority and in full.

## Eurofima

The portion of equipment financing contracts belonging to non-investment grade and not rated countries by Moody's represents a very small percentage of the portfolio (well below 1%). Despite this modest proportion, Eurofima's fund for general risks covered nearly 1.1x the total amount in 2008 (CHF227.2 million). Of note is the use of Credit Support Annexes (CSA) since 2006, to hedge against swap counterparty risk. This mechanism provides for the posting of collateral by the swap counterparty once Eurofima's exposure exceeds a given threshold. Roughly 52% of Eurofima's swap book contained CSA in July 2009, up from 40% at the end of 2008.

### Adequate capitalisation

Eurofima's subscribed share capital is CHF2.6 billion, of which 20% is paid-in. The unpaid portion can be requested at any time. Given Eurofima's low risk profile, Moody's views the company as being adequately capitalised.

Shareholder railways whose countries have Aaa or Aa ratings represented around 93% of capital as at the end of 2008, while non-investment grade countries represented only a very small portion of capital. Equity plus callable share capital – which tend to remain extremely stable and oscillate within a very narrow band – together represented around 10% of total borrowings in 2008.

### Governance and Management Factors

Eurofima's financial statements are provided annually on a timely basis and include a comprehensive set of economic and financial information, as well as extensive information regarding debt and contingent liabilities. These annual accounts are both approved by the General Assembly and audited by an independent auditing agent.

Internal control and supervision are carried out by (i) the General Assembly, which establishes borrowing caps, (ii) the Board of Directors, through quarterly meetings, and (iii) five internal auditors, through twice-yearly meetings.

Moody's views Eurofima's approach to asset/liability management positively, with the organisation controlling financial risk by maintaining a close match between assets and liabilities. Refinancing, interest rate and foreign exchange risks are managed in closed positions, except for treasury operations where some mismatches occur.

Management has focused on operational risk for several years, given Eurofima's small organic size and the "mono-line" nature of its business. This has resulted in the establishment of administrative guidelines and controls to ensure uninterrupted management during crises. The controls also ensure that the staff is cross-trained and therefore able to assume other tasks should the need arise.

### Rating History

Date	Rating
December 1994	Aaa
February 1998	P-1

Eurofima

## Annual Statistics

Cash Flow Statement<sup>5</sup>

CHF Millions	2007	2008
Net FX amount cash flow	-0.0	-0.0
Net interest cash flow	31.4	30.0
Net operational cash flow	-6.5	-30.7
Commission and fees received	17.8	17.3
Dividend paid	-20.7	-20.7
<b>Net cash flow from operating activities</b>	<b>22.0</b>	<b>-4.2</b>
<b>Lending</b>		
<i>Net cash flow from equipment financing</i>	-1,929.1	-2,863.0
<b>Financial investments</b>		
<i>Purchase of debt securities</i>	-911.9	-538.7
<i>Redemptions</i>	999.3	504.6
<i>Sales of debt securities</i>	133.3	198.2
<i>Net cash flow from placement with credit institutions</i>	-102.4	-240.3
<i>Net cash flow from other financial investments</i>	-65.8	0.0
<b>Other items</b>		
<i>Net movements in other assets</i>	0.0	0.0
<i>Net movements in fixed assets</i>	0.0	0.0
<b>Net cash flow from investing activities</b>	<b>-1,876.6</b>	<b>-2,939.3</b>
Issues of new debt	7,805.7	8,385.3
Redemptions	-6,194.9	-5,422.0
Net cash flow from credit institutions and customers	-33.1	63.5
Net cash flow from derivative financial instruments	464.4	-199.0
Paid-in capital	0.0	0.0
<b>Net cash flow from financing activities</b>	<b>2,042.0</b>	<b>2,827.9</b>
Exchange rate difference	22.7	-109.4
Others	0.8	3.6
<b>Increase/decrease in cash and cash equivalents</b>	<b>210.9</b>	<b>-221.4</b>
Cash and cash equivalents at beginning of period	637.8	848.7
<b>Cash and cash equivalents at end of period</b>	<b>848.7</b>	<b>627.3</b>

<sup>5</sup> Numbers are rounded to the first decimal point.

Eurofima

## Moody's Related Research

### Rating Methodologies:

- The Application of Joint Default Analysis to Regional and Local Governments, December 2008 (99025)
- Regional and Local Governments Outside the US, May 2008 (107844)

*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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