

Germany  
Full Rating Report

# Genossenschaftlicher FinanzVerbund

## Ratings

<b>Foreign Currency</b>	
Long-Term IDR	A+
Short-Term IDR	F1+
Individual Rating	B
Support Rating	1
Support Rating Floor	A+
<b>Sovereign Risk</b>	
Foreign-Currency Long-Term IDR	AAA
Local-Currency Long-Term IDR	AAA

## Outlooks

Foreign-Currency Long-Term IDR	Stable
Sovereign Foreign-Currency Long-Term IDR	Stable
Sovereign Local-Currency Long-Term IDR	Stable

## Financial Data

### Genossenschaftlicher FinanzVerbund

	31 Dec 08	31 Dec 07
Total assets (USDm)	1,426,154	1,490,156
Total assets (EURm)	1,024,763	1,012,263
Total equity (EURm)	52,925	54,052
Net income (EURm)	186.0	3,050.0
Operating ROAA (%)	0.14	n.a.
Operating ROAE (%)	0.01	n.a.
Tier 1 ratio (%)	7.80	7.90

n.a. - Not available

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## Related Research

### Applicable Criteria

- *Global Financial Institutions Rating Criteria* (December 2009)
- *Rating Criteria for European Banking Structures Backed by Mutual Support Mechanisms* (December 2009)

### Other Research

- *DZ Bank AG Deutsche Zentral-Genossenschaftsbank* (June 2010)

## Rating Rationale

- The Issuer Default and Individual ratings of Genossenschaftlicher FinanzVerbund (GFV) are primarily driven by its franchise and diversification, satisfactory and stable underlying profitability, sound asset quality and capitalisation. The GFV is equivalent to Germany's cooperative banking sector ("the sector"). The IDRs are applied to the 1,170 banks that form part of GFV's protection scheme. GFV has a substantial retail franchise with more than 20% of domestic deposits and strong foothold among small corporate and business clients.
- The sector has become increasingly integrated in recent years. It has published consolidated accounts since 2003, has a common strategy and benefits from a group-wide risk management system led by Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR; the National Association of German Cooperative Banks). Although GFV is homogeneous from a credit risk perspective, the local credit cooperatives retain operational autonomy.
- BVR manages the protection scheme providing mutual support, which Fitch Ratings considers particularly strong, albeit falling short of a legally binding cross-guarantee. The scheme and its support fund are designed to protect all member banks' viability. Although the fund's obligations to support members are not clear cut and the latter's mandatory annual contributions to it are capped, many member institutions, including major banks, have received support. No creditor has lost money in the scheme's more than 70-year history.
- Reported profitability is fairly modest, but underlying earnings are comparable with those of European cooperative groups. Net interest revenue remains central, but efforts are being made to cross-sell products and increase commission revenue. However, the group's inefficiency poses a greater structural challenge. Asset quality is sound but deteriorating; nevertheless, Fitch expects increased monitoring of banks with poorer asset quality to bear fruit. Customer deposits are the main source of funding, making up around 60% of total assets. Liquidity in the sector is good. GFV's capitalisation is satisfactory for its risk profile, but not outstanding. Tier 1 capital is expected to stay around 8%, although Fitch expects rating migration to push the ratio below that mark in 2010. The financial crisis affected GFV severely but manageably; GFV was the one pillar of the German banking system (the others are the private and the public sector banks) that did not need direct state support.

## Support

- All BVR member banks benefit from the strong mutual support mechanism. If this proves insufficient to meet any member's financial obligations, Fitch considers GFV to be of such importance to the German economy that there is an extremely high probability of support from the federal government.

## Key Rating Drivers

- The IDR has a Stable Outlook, reflecting Fitch's expectation of further group integration and continued fundamental financial stability. Upside is limited, reflecting the difficult operating environment. Potential downside in the short term depends on the ultimate losses on the group's securitisation investments, and in the medium term on GFV's success in addressing its inefficiency.

## Profile

FinanzVerbund has about 16.2 million members and 30 million clients.

- Integrated financial services group comprising 1156 primary banks and 14 central entities
- Protection scheme ensured that co-operative banks were the only pillar of the German banking system that did not receive state support during financial crisis

## Profile

GFV is not a legal entity in itself but a group of 1,170 entities (at end-March 2010) that forms Germany's cooperative sector. It is the largest consolidated banking group in Germany by equity. All entities are obliged to be members of BVR, a private-law entity ("eingetragener Verein"), and the sector's strategic centre.

Consolidation in the sector has been steady, as indicated by the fall in the number of primary banks to 1,156 at end-March 2010 (from 11,795 at end-1957). Seventeen of the sector's regional clearing banks were merged into DZ BANK AG Deutsche Zentral-Genossenschaftsbank (DZ BANK, see the most recent Credit Analysis on this entity, published on 24 December 2007 and available at [www.fitchresearch.com](http://www.fitchresearch.com)). WGZ-BANK AG Westdeutsche Genossenschafts-Zentralbank (WGZ BANK) is the only regional clearing bank remaining. Of the remaining 14 entities that fulfil central tasks the majority are banks. For further details on the group's structure, see Annex 2.

## Protection Scheme

There is no legally binding cross-guarantee system in the sector, unlike in some other European cooperative networks. However, all deposit-taking BVR member banks participate in the mutual support fund – legally a segregated BVR trust – operated by BVR and funded by its members as stipulated in BVR's by-laws and protection scheme's statute. BVR itself is not a member of the support fund and therefore does not benefit directly from the "Verbundrating" (rating for a group of banks backed by mutual support).

The scheme guarantees all non-bank deposits of GFV members and, by protecting the viability of all member banks, effectively also backs all their other obligations ("Institutsschutz"). Although the fund's legal obligation to support troubled members is ambiguous and the mandatory contributions of its members are capped, many member institutions, including major banks, have received support. No creditor has lost money or been paid late in the more than 70-year history of the mechanism. For further details on the support scheme see Annex 8.

## Presentation of Accounts

GFV started reporting under IFRS in 2007. GFV is not required to produce consolidated accounts under German GAAP or IFRS; as a result the annual report is reviewed by auditors but without an opinion.

Balance-sheet capital and annual profit in 2007 benefitted from the accounting change. GFV's joint capital position ("Verbundkapital") increased from EUR37.8bn to EUR54.4bn, driven by the inclusion and disclosure of 340f HGB (German Code of Commercial Law) and 340g HGB reserves and specific reserves for GFV's building society. Net profit, among other measures, increased in 2007 from EUR2.2bn to EUR3.1bn due to mark-to-market gains on financial instruments, reversal of contributions to 340f and 340g HGB reserves, and insurance provisions.

Fitch views the change to IFRS accounting as positive, as it makes GFV's results more comparable with those of its international peers. However, as GFV does not report quarterly or half-year results and its accounts are aggregated numbers adjusted with plausible assumptions about intra-group exposures, its transparency still lags behind international standards.

## Performance

Underlying profitability is sound but also reflects that profit maximisation is not an objective for a cooperative banking group. Like many cooperative networks (eg Groupe Banque Populaire, Rabobank and Crédit Agricole), Germany's primary cooperative banks have a track record of fairly stable profitability over a long period. However, the financial crisis in 2008 had a substantial adverse impact on

- Underlying profitability stable
- Short-term challenges: Rising impairments in SME, restructuring of the real estate bank, some legacy risks in securitisation investments

GFV. All business segments were affected, including the local co-operative banks. However, despite the write-downs on Iceland, Lehman Brothers and ABS investments, the local co-operative banks still generated sufficient profit to compensate for the losses. The insurance business was also able to contain the negative impact from its investment income.

GFV returned to solid profitability in 2009 due to still-low loan impairment charges at the co-operative banks combined with higher credit spreads on small corporate and business loans, mark-to-market gains in the investment portfolios of the central banks, more activity in their capital markets businesses and above all a favourable yield curve, paired with strong growth in sight deposits (up EUR30bn). In addition, the group did not suffer in 2009 from “one-off” events (specifically the problems in Iceland and the collapse of Lehman Brothers) as it had in 2008.

### Prospects

GFV’s strength is its national, diversified business mix including banking, insurance and asset management. This mix is unique in the German banking system in terms of range, depth and level of integration, and concentration. However, the prospects in most businesses are subdued for 2010, particularly in light of limited growth prospects in Germany and rising risk costs. However, the local co-operative banks should continue to benefit from the steep yield curve (see Annex 3), absent an unexpected sharp rise in interest rates. This should balance the higher insolvencies and impairments that can be expected from the banks’ SME loan portfolio. The central banks should continue to benefit in their capital markets activities from the volatile environment.

The EUR56bn bond portfolio (at end-December 2008), excluding the insurance company) in the group’s trading book adds mark-to-market volatility to the 2009/2010 results. DZ Bank continues to have pockets of potentially higher credit risks, such as its relatively large securitisation portfolio, commercial real estate (through its subsidiary Deutsche Genossenschafts-Hypothekenbank AG, rated ‘A+’) and shipping (through its subsidiary DVB Bank SE, rated ‘A+’), which could lift impairments above expectations due to rising insolvencies for German corporates.

Beyond these short-term issues GFV’s risk-return profile is facing structural challenges, as set out in the paragraphs below.

### *Impact of Direct Banking*

Pricing and market shares in co-operative banks’ core products are under attack from the direct banking model. With its substantial and entrenched retail banking franchise, the cooperative sector has so far had a significant advantage over its private peers. Although the savings bank sector continues to dominate the German retail banking market, it is not as integrated and homogeneous as the cooperative sector and faces considerable challenges due to its troubled Landesbanken.

GFV does, however, face increasing competitive pressure in its core retail banking products, specifically term deposits, savings and mortgages, from banks including ING Diba and Deutsche Postbank (rated ‘A’). ING Diba’s direct banking model in particular poses a fundamental threat to the co-operative banks, which have missed out on establishing a national brand in this specific field.

Business models that offer the basic banking products more competitively priced or even “free” (current account) via direct channels will continue to take market share from the leading incumbents and re-price these products until a “natural” saturation of this product package is reached.

### *Impact of Pressure on Net Interest Income*

GFV is dependent on net interest income, which despite the current improvement resulting from the steep yield curve will remain under pressure in the medium term.

- Structural challenges: attack on core products, gaining a larger share of customers’ business, reducing inefficiencies

In this context, co-operative banks have problems balancing this pressure on interest income by closing the gap with the large private banks selling “investment” advice/products.

Retail customers in Germany often have several banking relationships. Most have their current accounts, deposits, savings and mortgages with co-operative and savings banks, but securities (shares and bonds) are disproportionately sold by their competitors. Although most co-operative banks see the benefits of operating as a homogeneous unit and cross-selling insurance, certificates, consumer credit, and asset management products (funds), in none of these products does GFV have similar market shares to those it has in savings/deposits or mortgages; in investment products like shares or bonds the gap is particularly significant (see Annex 4).

### *Structural Inefficiencies*

GFV suffers from inefficiencies due to its organisational structure and in taking full advantage of its client base. GFV’s net interest income is dominated by the local banks’ contributions (more than 80%). However, the local banks do not cover their administrative expenses and risk costs with their main income source. They do not generate profits by applying their capital and balance despite holding dominant market shares, especially in Germany’s rural areas. Instead the local banks’ annual profits are made by selling payment services, or products for their insurance, asset management and other partners within the group. Another source of commission and fee income is securities trades and custodial services. Due to this revenue composition and the banks’ relatively high cost base, Fitch believes that the group will be forced to approach its overhead expenses with more ambition in order to avoid a squeeze on its profits by subdued growth prospects in the domestic market.

However, the group’s decentralised decision-making process limits progress in this field. Because yield curve and credit margins are driven by market forces, efficiency remains one of the areas where GFV has room to improve and where it could control the process. GFV’s cost inefficiencies are therefore also unexploited opportunities, which if approached with more determination could improve the quantity and quality of its profits.

Another area where GFV could gain is its large number of customers and growing number of members. The group’s own analysis shows that members are generally more profitable than non-members, buying more products and being more loyal. A 2:1 ratio of customers to members highlights GFV’s growth potential within its customer base but also exposes its vulnerability. Non-members are not only less profitable but have low product penetration, making them relatively easy targets for competitors.

### *Appetite for European Expansion Reduced*

GFV has not ruled out the possibility of playing a role in European cooperative banking, although in the short to medium term this is more likely to be in the form of joint ventures and cross-participations than mergers or acquisitions. Fitch believes that there is little appetite among local banks to support international expansion of the group’s central banks even though the financial crisis that began in 2008 might produce opportunities: for example, the troubled Austria-based Volksbanken Group (rated ‘A’/‘F1’) is seeking for a strategic partner.

### **Risk Management**

The risk management system within the German cooperative sector is continuously reinforced in order to detect potential problems at local banks earlier and reduce the number of forced mergers between troubled banks and healthy neighbours. The enhanced tools and the benign economic environment until 2008 led to significant improvements in 2003-2007. However, the improved risk monitoring is experiencing

- Despite further improvements, still room for improvement of centralised risk-management systems

its first stress test in the face of the economic downturn that began in 2008, and rising unemployment and insolvencies (for further details on the risk management infrastructure see Annex 2).

Fitch views the potential downside risks at the local banks as quite limited. Most banks have balance sheets of less than EUR1bn and are concentrated on their retail, business and small corporate clients, meaning that loan granularity for the aggregated group is high (see charts in Annex 4). Only 10 of the retail banks have a balance sheet above EUR5bn. Berliner Volksbank and Deutsche Apotheker und Aerztebank (apobank), a co-operative bank active across Germany and focused on the medical professions, with balance sheets with total assets of EUR9.6bn (end-December 2008) and EUR41.2bn (end-December 2008), respectively, are outliers with very large balance sheets.

Fitch expects GFV to successfully conclude work on several projects to adapt to challenges for its risk management systems, such as their exclusion of the central banks, the limited intensity or specialisation of its coverage of the few large co-operative banks, and the strong bias toward quantitative analysis in its monitoring process, which leaves little room for qualitative elements like strategy and management quality. Market risks are not aggregated across the group and therefore are not measured and monitored by BVR.

### **Credit Risk**

Credit risk dominates GFV's risk profile. The areas of potential risk in the current environment are set out below.

#### *Business and Small Corporate Clients*

Although the local banks have the largest volume of customer loans within GFV (69% of the EUR548bn customer loans), Fitch expects the rise in aggregate impairments to be well covered by the local banks' pre-provisioning profits, even if the economy recovers less than expected. The portfolio's high level of granularity (68% of loans are less than EUR250,000), geographical diversification and industry composition, with only one area of concentration, in the relatively stable agricultural sector, suggest that future impairments should be determined by systemic trends. In addition, with almost no asset price inflation in the real estate sector since 2000, absent high-risk credit products (eg credit cards, and non-conforming mortgage lending) and improved risk management at the local banks (for example, higher transparency through internal ratings) the likelihood of impairments reaching considerably higher levels than during the previous recession at the beginning of the millennium is limited (detailed information on the local banks' loan portfolio composition and impaired loans is available in Annex 5).

#### *Central Group Entities*

Other contributors to GFV's credit risk profile are the central banks, the building society, the insurance group's investment portfolio, the three mortgage banks, the leasing company and the consumer finance unit. Fitch believes that the potential for unexpected losses is highest in the shipping, commercial real estate and leveraged loan portfolios. Details of these portfolios are discussed to some extent in the most recent Credit Analysis on DZ BANK Group. However, the loss content of these specific portfolios even under plausible stress scenarios should be manageable due to the group's consolidated capital base and its recurring earnings. The aggregated amount of these potentially more risky portfolios is estimated at around the size of the Group's total capital.

#### *Securitisation Portfolios*

Uncertainty exists regarding the level of ultimate losses in the group's securitization portfolios, especially at DZ BANK Group and apobank. Further deterioration in the underlying asset classes, specifically CDO, CMBS, and non-prime areas of RMBS and European CMBS cannot be ruled out. Fitch is less concerned

about the ultimate loss content of these assets than about increased capital charges due to further rating migration for DZ BANK and apobank. However, due the size of the aggregated securitisation portfolio, around EUR30bn at end-H109, Fitch will closely monitor the performance of this portfolio. In this context, the group's exposure to CDOs and US securitisations with non-traditional residential mortgages (subprime and Alt-A) was an estimated EUR6bn (fair value) at end-H109. BVR has provided support to apobank in form of loss guarantees below EUR500m for the more troubled securitisation investments, which suffered due to rating migration and higher capital charges.

### *Securities*

As part of its strategy to maintain strong liquidity but also because growth of domestic deposits outpaced domestic loan growth for years before the crisis, GFV has always held a large securities portfolio. At end-2008 this was around EUR238bn or 23% of the group's balance sheet (including investment securities from the insurance portfolio). Although credit quality remains high, the sheer size of the portfolio incorporates the potential for event risks across a wide spectrum of asset classes and regions. In addition, in this context GFV expanded its credit derivatives business significantly in the years before the crisis, mainly via the central banks (see also the most recent Credit Analysis on DZ BANK).

### **Market Risk**

Market risk is not managed on an aggregated basis at GFV. DZ BANK measures and monitors the bank's market risks and its consolidated group (see also the most recent Credit Analysis on DZ BANK); the same is true for the other centralised product providers in the group, which are not consolidated by DZ BANK (eg, WGZ BANK or R+V Versicherung). However, this decentralisation of market risk management does not impede Fitch's view of GFV as an economic unit because the larger, decentralised entities are the main contributors of market risk, specifically interest rate and credit spread risk, and to a lesser extent currency risks. Furthermore, the largest entity, DZ Bank Group, is analysed separately.

Risks from credit spread widening are becoming more relevant as a result of the uncertainty in the credit markets for local co-operative banks because although they report under German GAAP co-operative banks report the majority of their securities in the "liquidity reserve" (German GAAP phrase), which forces them to trail volatile market prices with their evaluation of their securities. In addition, co-operative banks' interest income is exposed to changes in the yield curve, especially one that is flat or inverse. Although the likelihood of material interest rate rises over the short term are very remote, the potential impact on the co-operative banks' net interest income would be substantial. Other forms of market risk are negligible at the local banks' level.

## **Funding and Capital**

### **Funding**

Unlike many large European banking groups GFV's balance sheet is liability driven, a disadvantage in the years before the crisis that began in 2008 but a since potential major benefit. Until 2007 the group was seeking assets, investing its ample liquidity in a large securities portfolio (up 30% in 2003-2007). If the group needed to deleverage this would not affect its customer franchise, especially the domestic small corporate and business customers.

The primary banks maintain short-term deposits with their regional central bank (either DZ BANK or WGZ BANK), equivalent to at least 7.5% of their deposits; this is not a legal obligation but rather a recommendation that all banks follow. As central clearing banks, DZ BANK and WGZ BANK manage group liquidity.

GFV's balance-sheet structure is shaped by a large number of customer deposits, the vast majority originated through the group's large branch network, access to

- Diversified funding base
- Stable funding sources cover customer loans and financial institutions
- Capitalisation satisfactory, albeit not exceptional

secured funding products, especially covered bonds, and a large investment-grade rated securities portfolio. Due to this stable and solidly funded balance-sheet structure GFV is better positioned than several of its domestic competitors, which are in need of restructuring or are more dependent on wholesale funds. At end-2009 customer deposits exceeded customer receivables by about EUR 92bn.

### Capital

GFV is not required to report a regulatory capital ratio for the entire group. It voluntarily reports its consolidated capital ratios according to the regulatory framework (Solvency Regulation), including capital charges for market risk and operational risk (7.8% core capital ratio and total capital ratio of 12.3% at end-2008). In this context, most of GFV's loans are at the local co-operative banks, which calculate the regulatory risk weighting according to the standardised approach. This is one reason why GFV's regulatory capitalisation appears weaker than that of other European co-operative banking groups such as Credit Agricole or Rabobank, which use the internal ratings-based approach for a larger proportion of their balance sheets. In this context, GFV applies relatively high charges for operational risk compared with, for example, German universal banks of similar size or complexity.

Fitch's adjusted "core capital" of around EUR46,393m (see Annex 7 for calculation, which is based on public and non-public data) results in a Fitch core capital ratio of 9.4% and a leverage ratio of around 21 (deducting derivatives) for 2008.

Fitch believes that GFV's capitalisation is sound, in light of:

- shortcomings in the aggregation of risk components from the various parts of the group (ie market risks from local banks reduced to negligible currency risks and ignoring the material interest rate risk);
- legacy risks in some pockets of DZ Bank Group's securitisation, commercial real estate or leveraged loan business; and
- the structural threats to GFV's future earnings potential and capital generation.

These structural threats are balanced by:

- the diversification of the groups' businesses, earnings and assets, which is unique among German banks, and not reflected in the aggregation of risk-weighted assets; and
- the still-modest deterioration of Germany's business environment compared with that of other European states.

In addition, the preliminary 2009 results suggest that GFV was able to strengthen its capital position, balancing the rising risk costs.

## Annex 1: Profile and Strategy

The management of BVR, the strategic centre of GFV, aims to retain the group's position as number two in German retail banking, and increase its market share from about 20%. GFV aims to be placed first in terms of customer satisfaction based on the unique ownership structure at the level of the primary banks. It strives to focus on standardised products in order to reduce its cost/income ratio to below 65%. This target is very ambitious in light of a more or less flat revenue stream.

GFV differentiates itself from its domestic competitors by combining local presence, "personal membership" (as individuals own stakes in the primary banks) and close cooperation throughout the sector. In order to strengthen the strategic alignment of its members and to increase the awareness of the group's structural efficiency problem BVR is pushing the development and implementation of controlling tools.

The primary banks are responsible for all sales activities in their territories; they are organised into five regional associations that are responsible for auditing the banks. Each primary bank has to make its own decisions on whether to keep all its functions in-house or to outsource part or all of its non-sales activities.

The two central clearing banks and the sector's four real estate lenders, Bausparkasse Schwäbisch Hall AG (BSH), Deutsche Genossenschafts-Hypothekenbank AG, Münchener Hypothekenbank eG and WL-Bank WESTFÄLISCHE LAND-SCHAFT Bodenkreditbank AG (WL Bank), providing to some extent competing banking products to the primary banks, leading to duplication and overlap of activities. Fitch believes that these organisational inefficiencies will remain for the foreseeable future. The most important non-bank product providers are Union Asset Management Holding AG (asset manager), R+V Versicherung AG (insurance), VR Leasing AG (leasing) and TeamBank AG (consumer finance). More detail about these four entities and BSH is given in most recent Credit Analysis on DZ BANK.

The consolidated accounts report the results of four business segments:

- "Banks" includes the group's business activities with corporate clients and mainly represents the activities of DZ BANK, WGZ BANK, VR Leasing and DVB Group.
- "Retail" includes the business of the local co-operative banks but also DZ Privatbank (Switzerland), TeamBank AG and the private banking operations in Luxembourg. The segment represented around 64% of total assets at end-2008. As local players, the primary banks offer standard retail products through their 13,571 branches. Although the number of branches has been falling yoy, the number of self-service outlets has been growing.
- "Immobilien" (real estate) includes the activities of the specialised real estate lenders Deutsche Genossenschafts-Hypothekenbank AG, WL Bank, Muenchener Hypothekenbank and BSH.
- "Versicherung" (Insurance) reflects the operations of R+V Versicherung, the group's insurance subsidiary.

BVR has set up a framework for a single economic group that combines the distribution capabilities of the legally and commercially autonomous primary banks with the product expertise of the central institutions. Key elements of BVR's framework include a management board, a central committee responsible for the restructuring of troubled member banks ("Zentraler Ausschuss der Sicherungseinrichtung"), the publication of consolidated financial accounts, a unified risk management infrastructure based on a mutual risk strategy and a group risk monitoring system. The central restructuring committee consists of elected representatives from primary and central entities. All decisions on the restructuring of individual member banks, however, are made by BVR's management board.

## Annex 2: Support Mechanism

BVR runs a mutual support fund (“Sicherungseinrichtung”) as a protection scheme for GFV. The members are obliged to make annual cash contributions of up to 0.2% in of “loans and advances to non-bank customers” and to guarantee an additional 0.4% (“Nachschusspflicht”). Each member’s annual contribution varies from 80% to 140% of its pro rata amount, depending on the quality of its member bank’s risk profile as determined by the group’s internal classification model (see *Risk Management* above). Interest income earned on the capital is kept in the fund.

Interest income earned on the accumulated cash contributions of the member banks is kept in the fund. Contributions in excess of the mandatory ones described above are voluntary unless BVR’s general meeting of members (“Mitgliederversammlung”) amends the by-laws to increase the level of mandatory contribution; this would require a 75% majority and six weeks’ notice. Should the fund be required to pay out more than the “Nachschusspflicht” (eg in the case of the failure of one of the larger member banks), timeliness of payment could become an issue. Legally, the fund would be entitled to let the bank collapse and only provide further support once it had been replenished. In reality, however, Fitch would expect the fund to borrow against its future cash flow to ensure timely payment or arrange timely support from another source (eg members of GFV might provide subordinated debt directly to the troubled entity).

The scheme guarantees all non-bank deposits of GFV members and, by protecting the viability of all member banks, effectively also backs all their other obligations (“Institutsschutz”). Although the fund’s obligations to support members are not clear cut and the latter’s mandatory annual contributions are capped, many member institutions, including major banks, have received support. No creditor has lost money or been paid late in the more than 70-year history of the mechanism.

Under the terms of the protection scheme’s statute, BVR is not legally obliged to support any banks that run into trouble, even though it has a moral responsibility to do so and may be held responsible in court, in accordance with the principle of equal treatment. In 1993, a federal court ruled that – irrespective of explicit wording in the statute that excludes such an obligation – the support provided over many years has created an obligation to support members in the event of need.

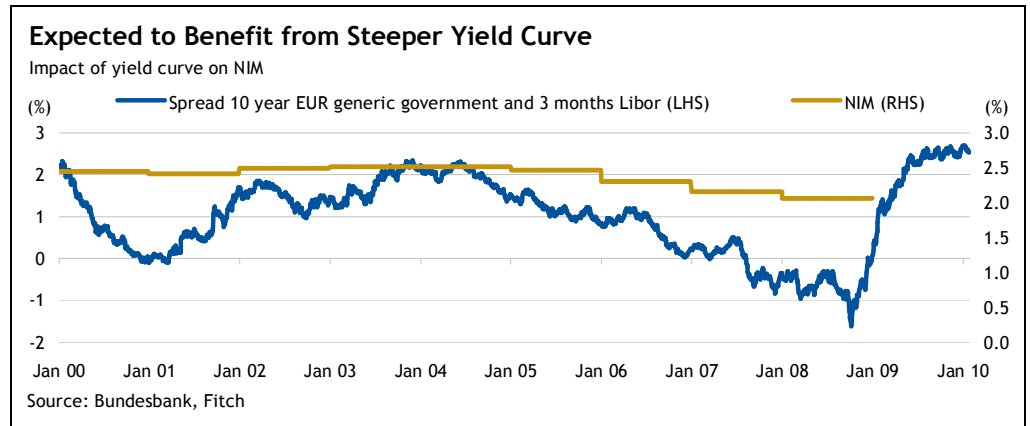
Germany’s banking regulator supervises the protection scheme. Members of the scheme are exempt from the otherwise mandatory membership of Germany’s legal deposit insurance scheme (“Entschädigungseinrichtung deutscher Banken”). DZ BANK and WGZ BANK consider all primary banks in the sector to be identical risks. Fitch expects the regulator to allow DZ BANK to apply identical probabilities of default to all primary banks upon the implementation of Basel II. There is no legally binding cross-guarantee system in the sector, unlike in some other European cooperative networks. However, all deposit-taking member banks participate in the mutual support fund – legally a segregated BVR trust – operated by BVR and funded by its members as stipulated in BVR’s by-laws and protection scheme’s statute. BVR itself is not a member of the support fund and therefore does not benefit directly from the “Verbundrating” (rating for a group of banks backed by mutual support).

Subject to the two-year notice period, member banks can exit BVR and its protection scheme. They are then no longer entitled to use the sector’s logo but all obligations created during their membership would remain in force. BVR can terminate the membership of any bank that fails to monitor risks sufficiently. However, BVR’s protection scheme covers all obligations the expelled bank enters into up to one month after the announcement that its membership has ended.

There are four key elements of the system:

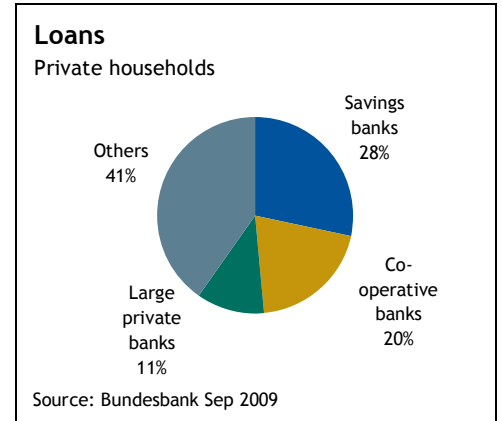
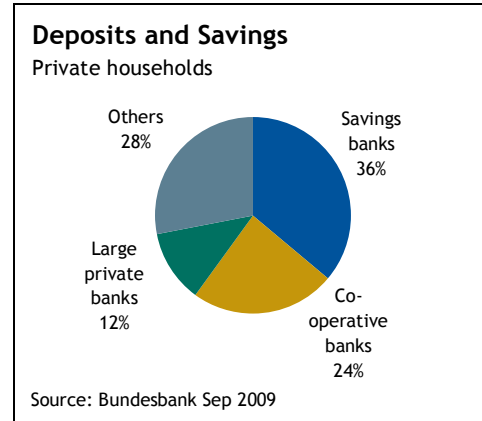
- **The BVR Support Mechanism:** The risk monitoring system combines two capital ratios, three profitability ratios (ROA, cost/income and provisioning/income) and three asset-quality ratios (uncollateralised problem loan exposure as a percentage of operating profit and as a percentage of equity, the largest exposure to a single industry as a percentage of total loans). These data are provided annually by the banks and are taken from auditor's reports. The results of this internal classification constitute the basis for systematic preventive and turnaround management of member banks. To provide BVR with an early warning of any potential financial problems within the group, the member banks are internally categorised as "without apparent risks" (rated B or above), "showing some risks" (rated B-) or "increased risks" (rated C or D). Regular back-testing has shown that banks that needed to be bailed out had been identified as apparent risks. Banks rated B or above are only required to provide a predefined set of data, while banks rated B- or below have to make more detailed information available. When a bank is rated B- or below BVR may: require special audits; attend extraordinary board meetings; or make recommendations to the board and the supervisory board on what action should be taken. These banks have to present a turnaround plan for business development that could result in a possible crisis; this plan, if accepted, will be closely monitored by GFV's auditors and BVR. BVR is recalibrating its monitoring system, as multi-year averages of "probability of failure" and "loss given failure" were below expectations. Management regards this as at least partially due to improved preventative measures.
- **VR Rating System:** This internal credit rating system was designed by BVR in co-operation with the central banks. It has been made available to all member banks. The rating systems for SMEs have been in use at primary banks since 2002. The system for retail clients has recently been rolled out during 2004-2009. The rating system is compliant with Basel II guidelines.
- **VR Control:** This is a present value-based risk management system that incorporates a series of controlling instruments. The primary objective of this system, which is used by many (but still not all) banks in the sector, is to manage income, costs and risks by business sector, enabling optimal risk/return portfolio structures.
- **Risk Transfer:** The central banks' products "VR Circle" and "WGZ-LOOP" allow the synthetic diversification of risk. Standard Meta, which is another central bank product, is an internet-based tool available to primary banks to apply for standardised deficiency guarantees. Such risk transfer does not affect the local banks' client relationships. So far GFV has not exploited the opportunities created by centralised portfolio management to better diversify its exposures. It trusts that the granularity of most of its business and the natural regional diversification are sufficient to prevent undue risk concentration.

**Annex 3**

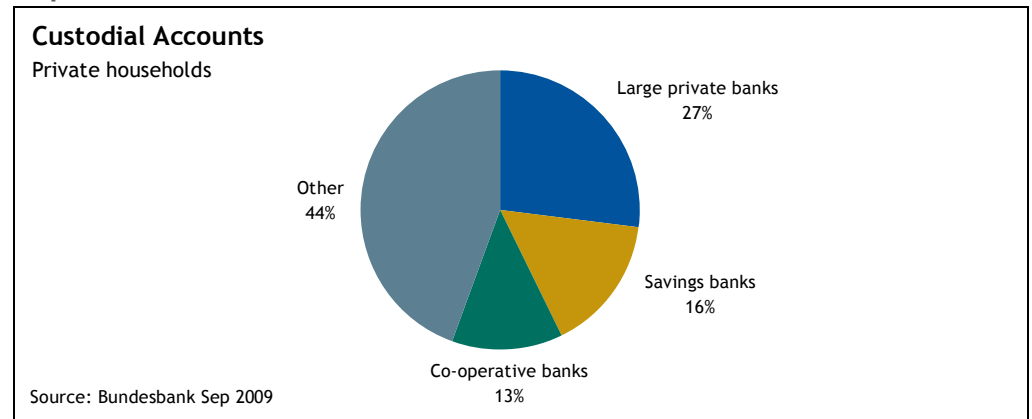


**Annex 4**

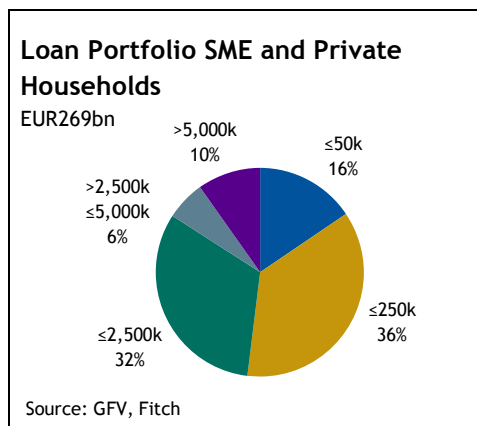
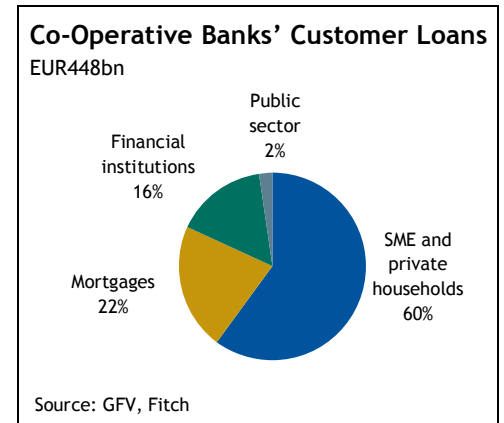
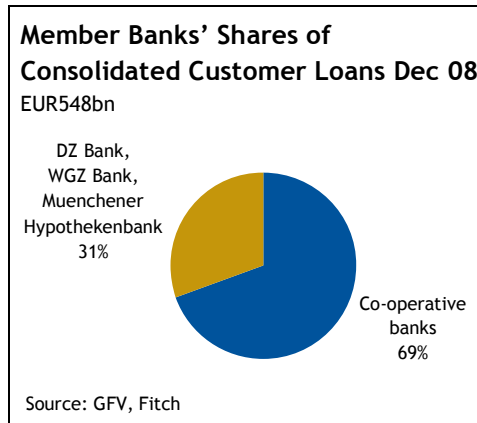
**Strong Position in Retail Deposits and Loans**



**Gap in Investment Portfolios**



**Annex 5**



The table *Asset Quality* below shows those primary bank loans that are classified in accordance with the internal rating scheme (BAG Hamm's loans have not been classified).

**Table 2: Asset Quality<sup>a</sup>**

(EURbn)	2008	2007
Watchlist loans	2.77	3.12
Impaired loans requiring specific provisions	4.1	4.63
Total watchlist and impaired loans	6.9	7.8
Total specific loan loss reserves	3.82	4.36
Reserve coverage of impaired loans (%)	93	94
Reserve coverage of watchlist and impaired loans (%)	55	56

<sup>a</sup> All figures net of collateral values  
Source: BVR, Fitch calculations

Within the sector a "bad" bank structure, BAG Hamm, has been set up by converting one failed primary bank into a work-out specialist. This entity is involved in wind-down and turnaround management on behalf of the support mechanism. For obvious reasons, BAG Hamm is a major beneficiary of funds from the mechanism.

## Annex 6

### Segmental Reporting 2008

(EURm)	Retail 2009 <sup>a</sup>	Bank 2008	Retail 2008	Real estate 2008	Insurance 2008	Total 2008 <sup>c</sup>
Net interest income	15,226	1,831	13,388	1,327		15,946
Fee income	3,925	470	4,846	-235		4,708
Trading income	n.a.	-1,519	157	-11		-1,366
Insurance	n.a.				231	231
Valuation adjusted for financial investments	n.a.	-515	-2,682	-649		-3,802
Administrative costs	-13,399	-1,584	-12,970	-582		-14,771
Pre-provisioning profit	6,400	-1,317	2,739	-150		946
Provisions	-2,707	-343	-737	-254		-1,589
Operating profit	3,722	-1,660	2,002	-404		-652
Pre-tax profit	3,000	-1,407	2,469	-396	229	77
Segmental assets	690,000	329,106	683,121	189,468	55,800	1,024,763
Segmental liabilities		317,594	631,207	184,487	53,108	971,540
Cost/income ratio (%)	70	>100	80.2	>100		89.9

<sup>a</sup> Retail 2009. Preliminary German GAAP results of the local co-operative banks only

<sup>b</sup> Including EUR2,400 allocation to HGB 340 f reserves but also write backs on securities of EUR1,380m

<sup>c</sup> Total = Retail + Wholesale + Other - Consolidation between segments. Figures for 2008 are under IFRS

n.a. - Not available

Source: Annual report

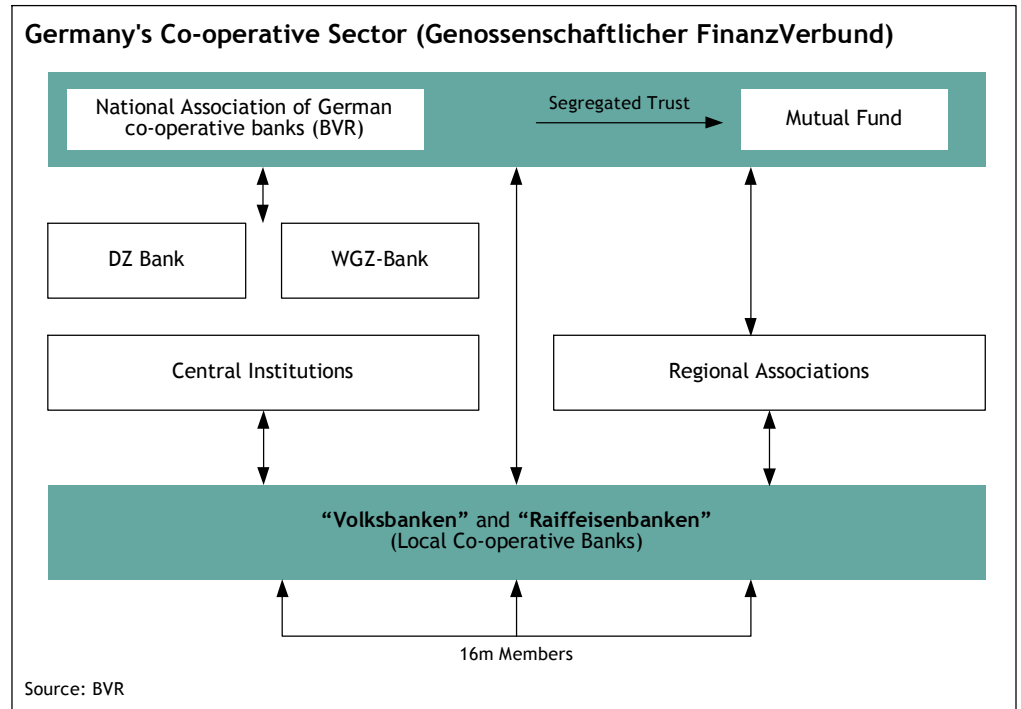
**Annex 7**

**Fitch Core Capital**

GFV reporting	Fitch's adjustments for "core capital" calculation	Fitch's core capital
EUR38.442m core capital according to annual report		
	- EUR2,180m hybrids counting as equity	
	- EUR124mn goodwill	
	- EUR400mn intangibles	
	- EUR1,438mn deferred tax assets	
	<b>Deductions total</b>	<b>- EUR4,142m</b>
	<b>340 f reserves</b>	<b>+ EUR 12,093m</b>
	<b>Fitch core capital</b>	<b>EUR46,393m</b>

Note: EUR2,950m loss-absorbing minority interest included  
Source: AR GFV 2008, Fitch

**Annex 8**



**Genossenschaftlicher FinanzVerbund**

Income Statement

	31 Dec 2008			31 Dec 2007	
	Year End	Year End	As % of	Year End	As % of
	USDm	EURm	Earning	EURm	Earning
	Original	Original	Assets	Original	Assets
1. Interest Income on Loans	57,753.8	41,499.0	4.23	39,133.0	4.02
2. Other Interest Income	n.a.	n.a.	-	n.a.	-
3. Dividend Income	n.a.	n.a.	-	n.a.	-
<b>4. Gross Interest and Dividend Income</b>	<b>57,753.8</b>	<b>41,499.0</b>	<b>4.23</b>	<b>39,133.0</b>	<b>4.02</b>
5. Interest Expense on Customer Deposits	n.a.	n.a.	-	n.a.	-
Missing	n.a.	n.a.	-	n.a.	-
6. Other Interest Expense	35,561.9	25,553.0	2.60	23,245.0	2.39
<b>7. Total Interest Expense</b>	<b>35,561.9</b>	<b>25,553.0</b>	<b>2.60</b>	<b>23,245.0</b>	<b>2.39</b>
<b>8. Net Interest Income</b>	<b>22,191.9</b>	<b>15,946.0</b>	<b>1.63</b>	<b>15,888.0</b>	<b>1.63</b>
9. Net Gains (Losses) on Trading and Derivatives	-1,901.1	-1,366.0	-0.14	62.0	0.01
10. Net Gains (Losses) on Other Securities	-4,374.1	-3,143.0	-0.32	-1,376.0	-0.14
11. Net Gains (Losses) on Assets at FV through Income Statement	-917.1	-659.0	-0.07	-50.0	-0.01
12. Net Insurance Income	591.5	425.0	0.04	672.0	0.07
13. Net Fees and Commissions	6,552.1	4,708.0	0.48	4,931.0	0.51
14. Other Operating Income	732.0	526.0	0.05	575.0	0.06
<b>15. Total Non-Interest Operating Income</b>	<b>683.3</b>	<b>491.0</b>	<b>0.05</b>	<b>4,814.0</b>	<b>0.49</b>
16. Personnel Expenses	12,063.2	8,668.0	0.88	8,952.0	0.92
17. Other Operating Expenses	8,493.5	6,103.0	0.62	6,169.0	0.63
<b>18. Total Non-Interest Expenses</b>	<b>20,556.7</b>	<b>14,771.0</b>	<b>1.51</b>	<b>15,121.0</b>	<b>1.55</b>
19. Equity-accounted Profit/ Loss - Operating	n.a.	n.a.	-	n.a.	-
<b>20. Pre-Impairment Operating Profit</b>	<b>2,318.6</b>	<b>1,666.0</b>	<b>0.17</b>	<b>5,581.0</b>	<b>0.57</b>
21. Loan Impairment Charge	2,211.4	1,589.0	0.16	1,251.0	0.13
22. Securities and Other Credit Impairment Charges	n.a.	n.a.	-	n.a.	-
<b>23. Operating Profit</b>	<b>107.2</b>	<b>77.0</b>	<b>0.01</b>	<b>4,330.0</b>	<b>0.45</b>
24. Equity-accounted Profit/ Loss - Non-operating	n.a.	n.a.	-	n.a.	-
25. Non-recurring Income	n.a.	n.a.	-	n.a.	-
26. Non-recurring Expense	n.a.	n.a.	-	n.a.	-
27. Change in Fair Value of Own Debt	n.a.	n.a.	-	n.a.	-
28. Other Non-operating Income and Expenses	n.a.	n.a.	-	n.a.	-
<b>29. Pre-tax Profit</b>	<b>107.2</b>	<b>77.0</b>	<b>0.01</b>	<b>4,330.0</b>	<b>0.45</b>
30. Tax expense	-151.7	-109.0	-0.01	1,280.0	0.13
31. Profit/Loss from Discontinued Operations	n.a.	n.a.	-	n.a.	-
<b>32. Net Income</b>	<b>258.9</b>	<b>186.0</b>	<b>0.02</b>	<b>3,050.0</b>	<b>0.31</b>
33. Change in Value of AFS Investments	-2,294.9	-1,649.0	-0.17	-879.0	-0.09
34. Revaluation of Fixed Assets	1,280.4	920.0	0.09	273.0	0.03
35. Currency Translation Differences	n.a.	n.a.	-	n.a.	-
36. Remaining OCI Gains/(losses)	n.a.	n.a.	-	n.a.	-
<b>37. Fitch Comprehensive Income</b>	<b>-755.7</b>	<b>-543.0</b>	<b>-0.06</b>	<b>2,444.0</b>	<b>0.25</b>
38. Memo: Profit Allocation to Non-controlling Interests	n.a.	n.a.	-	n.a.	-
39. Memo: Net Income after Allocation to Non-controlling Interests	258.9	186.0	0.02	3,050.0	0.31
40. Memo: Common Dividends Relating to the Period	n.a.	n.a.	-	n.a.	-

Exchange rate

USD1 = EUR0.71855

USD1 = EUR0.67930

**Genossenschaftlicher Finanzverbund**  
Balance Sheet

	31 Dec 2008			31 Dec 2007	
	Year End	Year End	As % of	Year End	As % of
	USDm	EURm	Assets	EURm	Assets
	Original	Original	Original	Original	Original
<b>Assets</b>					
<b>A. Loans</b>					
1. Residential Mortgage Loans	298,323.0	214,360.0	20.92	201,163.0	19.87
2. Other Mortgage Loans	n.a.	n.a.	-	n.a.	-
3. Other Consumer/ Retail Loans	n.a.	n.a.	-	n.a.	-
4. Corporate & Commercial Loans	n.a.	n.a.	-	n.a.	-
5. Other Loans	464,159.8	333,522.0	32.55	323,400.0	31.95
6. Less: Reserves for Impaired Loans/ NPLs	16,872.9	12,124.0	1.18	13,298.0	1.31
<b>7. Net Loans</b>	<b>745,609.9</b>	<b>535,758.0</b>	<b>52.28</b>	<b>511,265.0</b>	<b>50.51</b>
<b>8. Gross Loans</b>	<b>762,482.8</b>	<b>547,882.0</b>	<b>53.46</b>	<b>524,563.0</b>	<b>51.82</b>
9. Memo: Impaired Loans included above	n.a.	n.a.	-	n.a.	-
10. Memo: Loans at Fair Value included above	n.a.	n.a.	-	n.a.	-
<b>B. Other Earning Assets</b>					
1. Loans and Advances to Banks	77,524.2	55,705.0	5.44	54,283.0	5.36
2. Trading Securities and at FV through Income	120,655.5	86,697.0	8.46	120,880.0	11.94
3. Derivatives	45,246.7	32,512.0	3.17	18,639.0	1.84
4. Available for Sale Securities	n.a.	n.a.	-	n.a.	-
5. Held to Maturity Securities	n.a.	n.a.	-	n.a.	-
6. At-equity Investments in Associates	4,034.5	2,899.0	0.28	2,756.0	0.27
7. Other Securities	305,596.0	219,586.0	21.43	218,448.0	21.58
<b>8. Total Securities</b>	<b>475,532.7</b>	<b>341,694.0</b>	<b>33.34</b>	<b>360,723.0</b>	<b>35.64</b>
9. Memo: Government Securities included Above	n.a.	n.a.	-	n.a.	-
10. Investments in Property	n.a.	n.a.	-	n.a.	-
11. Insurance Assets	66,962.6	48,116.0	4.70	46,474.0	4.59
12. Other Earning Assets	n.a.	n.a.	-	n.a.	-
<b>13. Total Earning Assets</b>	<b>1,365,629.4</b>	<b>981,273.0</b>	<b>95.76</b>	<b>972,745.0</b>	<b>96.10</b>
<b>C. Non-Earning Assets</b>					
1. Cash and Due From Banks	23,586.4	16,948.0	1.65	15,622.0	1.54
2. Memo: Mandatory Reserves included above	n.a.	n.a.	-	n.a.	-
3. Foreclosed Real Estate	n.a.	n.a.	-	n.a.	-
4. Fixed Assets	14,443.0	10,378.0	1.01	10,278.0	1.02
5. Goodwill	172.6	124.0	0.01	38.0	0.00
6. Other Intangibles	384.1	276.0	0.03	241.0	0.02
7. Current Tax Assets	7,911.8	5,685.0	0.55	5,676.0	0.56
8. Deferred Tax Assets	2,001.3	1,438.0	0.14	445.0	0.04
9. Discontinued Operations	n.a.	n.a.	-	n.a.	-
10. Other Assets	12,025.6	8,641.0	0.84	7,218.0	0.71
<b>11. Total Assets</b>	<b>1,426,154.1</b>	<b>1,024,763.0</b>	<b>100.00</b>	<b>1,012,263.0</b>	<b>100.00</b>
<b>Liabilities and Equity</b>					
<b>D. Interest-Bearing Liabilities</b>					
1. Customer Deposits - Current	232,660.2	167,178.0	16.31	157,015.0	15.51
2. Customer Deposits - Savings	251,420.2	180,658.0	17.63	195,737.0	19.34
3. Customer Deposits - Term	305,559.8	219,560.0	21.43	189,349.0	18.71
<b>4. Total Customer Deposits</b>	<b>789,640.2</b>	<b>567,396.0</b>	<b>55.37</b>	<b>542,101.0</b>	<b>53.55</b>
5. Deposits from Banks	141,585.1	101,736.0	9.93	87,512.0	8.65
6. Other Deposits and Short-term Borrowings	n.a.	n.a.	-	n.a.	-
<b>7. Total Deposits, Money Market and Short-term Funding</b>	<b>931,225.4</b>	<b>669,132.0</b>	<b>65.30</b>	<b>629,613.0</b>	<b>62.20</b>
8. Senior Debt Maturing after 1 Year	n.a.	n.a.	-	n.a.	-
9. Subordinated Borrowing	6,721.9	4,830.0	0.47	4,600.0	0.45
10. Other Funding	169,650.0	121,902.0	11.90	129,254.0	12.77
<b>11. Total Long Term Funding</b>	<b>176,371.9</b>	<b>126,732.0</b>	<b>12.37</b>	<b>133,854.0</b>	<b>13.22</b>
12. Derivatives	55,447.8	39,842.0	3.89	21,051.0	2.08
13. Trading Liabilities	93,802.8	67,402.0	6.58	106,746.0	10.55
<b>14. Total Funding</b>	<b>1,256,847.8</b>	<b>903,108.0</b>	<b>88.13</b>	<b>891,264.0</b>	<b>88.05</b>
<b>E. Non-Interest Bearing Liabilities</b>					
1. Fair Value Portion of Debt	n.a.	n.a.	-	n.a.	-
2. Credit impairment reserves	400.8	288.0	0.03	492.0	0.05
3. Reserves for Pensions and Other	6,525.6	4,689.0	0.46	5,732.0	0.57
4. Current Tax Liabilities	840.6	604.0	0.06	674.0	0.07
5. Deferred Tax Liabilities	1,134.2	815.0	0.08	774.0	0.08
6. Other Deferred Liabilities	4,197.3	3,016.0	0.29	3,189.0	0.32
7. Discontinued Operations	n.a.	n.a.	-	n.a.	-
8. Insurance Liabilities	67,086.5	48,205.0	4.70	45,324.0	4.48
9. Other Liabilities	10,713.2	7,698.0	0.75	7,291.0	0.72
<b>10. Total Liabilities</b>	<b>1,347,746.2</b>	<b>968,423.0</b>	<b>94.50</b>	<b>954,740.0</b>	<b>94.32</b>
<b>F. Hybrid Capital</b>					
1. Pref. Shares and Hybrid Capital accounted for as Debt	4,337.9	3,117.0	0.30	3,168.0	0.31
2. Pref. Shares and Hybrid Capital accounted for as Equity	414.7	298.0	0.03	303.0	0.03
<b>G. Equity</b>					
1. Common Equity	70,852.4	50,911.0	4.97	50,563.0	5.00
2. Non-controlling Interest	4,105.5	2,950.0	0.29	3,186.0	0.31
3. Securities Revaluation Reserves	-1,253.9	-901.0	-0.09	296.0	0.03
4. Foreign Exchange Revaluation Reserves	-4.2	-3.0	0.00	-1.0	0.00
5. Fixed Asset Revaluations and Other Accumulated OCI	-44.5	-32.0	0.00	8.0	0.00
<b>6. Total Equity</b>	<b>73,655.3</b>	<b>52,925.0</b>	<b>5.16</b>	<b>54,052.0</b>	<b>5.34</b>
<b>7. Total Liabilities and Equity</b>	<b>1,426,154.1</b>	<b>1,024,763.0</b>	<b>100.00</b>	<b>1,012,263.0</b>	<b>100.00</b>
8. Memo: Fitch Core Capital	n.a.	n.a.	-	n.a.	-
9. Memo: Fitch Eligible Capital	n.a.	n.a.	-	n.a.	-

Exchange rate

USD1 = EURO.71855

USD1 = EURO.67930

**Genossenschaftlicher FinanzVerbund**

Summary Analytics

	31 Dec 2008		31 Dec 2007	
	Year End		Year End	
	%		%	
	Original	Original	Original	Original
<b>A. Interest Ratios</b>				
1. Interest Income on Loans/ Average Gross Loans	7.74	n.a.		
2. Interest Expense on Customer Deposits/ Average Customer Deposits	n.a.	n.a.		
3. Interest Income/ Average Earning Assets	4.25	n.a.		
4. Interest Expense/ Average Interest-bearing Liabilities	2.85	n.a.		
5. Net Interest Income/ Average Earning Assets	1.63	n.a.		
6. Net Int. Inc Less Loan Impairment Charges/ Av. Earning Assets	1.47	n.a.		
<b>B. Other Operating Profitability Ratios</b>				
1. Non-Interest Income/ Gross Revenues	2.99	23.25		
2. Non-Interest Expense/ Gross Revenues	89.86	73.04		
3. Non-Interest Expense/ Average Assets	1.45	n.a.		
4. Pre-impairment Op. Profit/ Average Equity	3.11	n.a.		
5. Pre-impairment Op. Profit/ Average Total Assets	0.16	n.a.		
6. Loans and securities impairment charges/ Pre-impairment Op. Profit	95.38	22.42		
7. Operating Profit/ Average Equity	0.14	n.a.		
8. Operating Profit/ Average Total Assets	0.01	n.a.		
9. Taxes/ Pre-tax Profit	-141.56	29.56		
<b>C. Other Profitability Ratios</b>				
1. Net Income/ Average Total Equity	0.35	n.a.		
2. Net Income/ Average Total Assets	0.02	n.a.		
3. Fitch Comprehensive Income/ Average Total Equity	-1.02	n.a.		
4. Fitch Comprehensive Income/ Average Total Assets	-0.05	n.a.		
5. Net Income/ Av. Total Assets plus Av. Managed Assets	n.a.	n.a.		
<b>D. Capitalization</b>				
1. Fitch Eligible Capital/ Fitch Adjusted Weighted Risks	n.a.	n.a.		
2. Tangible Common Equity/ Tangible Assets	4.99	5.27		
3. Tangible Common Equity/ Total Business Volume	4.99	5.27		
4. Tier 1 Regulatory Capital Ratio	7.80	7.90		
5. Total Regulatory Capital Ratio	12.30	12.80		
6. Fitch Eligible Capital/ Tier 1 Regulatory Capital	n.a.	n.a.		
7. Equity/ Total Assets	5.16	5.34		
8. Cash Dividends Paid & Declared/ Net Income	n.a.	n.a.		
9. Cash Dividend Paid & Declared/ Fitch Comprehensive Income	n.a.	n.a.		
10. Net Income - Cash Dividends/ Total Equity	0.35	5.64		
<b>E. Loan Quality</b>				
1. Growth of Total Assets	1.23	n.a.		
2. Growth of Gross Loans	4.45	n.a.		
3. Impaired Loans(NPLs)/ Gross Loans	n.a.	n.a.		
4. Reserves for Impaired Loans/ Gross loans	2.21	2.54		
5. Reserves for Impaired Loans/ Impaired Loans	n.a.	n.a.		
6. Impaired Loans less Reserves for Imp Loans/ Equity	-22.91	-24.60		
7. Loan Impairment Charges/ Average Gross Loans	0.30	n.a.		
8. Net Charge-offs/ Average Gross Loans	0.03	n.a.		
9. Impaired Loans + Foreclosed Assets/ Gross Loans + Foreclosed Assets	n.a.	n.a.		
<b>F. Funding</b>				
1. Loans/ Customer Deposits	96.56	96.76		
2. Interbank Assets/ Interbank Liabilities	54.75	62.03		

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