

Analysis

Moody's Global Sovereign

June 2008

Corporación Andina de Fomento

Rating Rationale and Outlook

Moody's A1 rating for the long-term debt issued by the Corporación Andina de Fomento (CAF) and the P-1 rating assigned to its short-term obligations reflect a history of strong support from its primary shareholders - Colombia, Peru, Ecuador, Bolivia and Venezuela accounted for 87% of CAF's paid-in capital at the end of 2007- through periods of political and economic turmoil in the region. Some of the privileges afforded to CAF when operating within the primary shareholder countries include: exemption from taxes; immunity from expropriation; free convertibility and transferability of assets; exemption from any restriction on assets; and exemption from public sector debt restructurings and moratoria.

CAF's mission is to support sustainable development and economic integration among its shareholder countries by helping them make their economies diversified, competitive and more responsive to social needs. This is achieved by financing economic and social infrastructure projects, encouraging foreign investment and capital markets development, promoting the expansion of regional trade and exports and supporting the development of small and medium-size enterprises. The two largest industry concentrations in CAF's loan portfolio are infrastructure and social development (a category that includes water, education, and health and social services lending). Together these account for 76% of CAF's loan portfolio.

CAF's financial policy guidelines are in line with those of other MDBs and its ability to operate within their framework is a key credit strength. Its gearing ratio ceiling is 4.0:1 and its leverage ratio ceiling is 3.5:1; currently CAF is comfortably under these maximums. The Corporation's credit origination policies are fundamentally conservative and are reflected in the historically healthy asset quality.

The rating outlook for CAF is stable. Upward rating pressure could occur with the increase in shareholders whom Moody's considers to be investment grade; currently Chile, Mexico, Spain and Trinidad and Tobago are the only four members governments rated investment grade by Moody's. Similarly, downward rating pressure could be a result of one or more of CAF's largest borrowers defaulting and being unwilling or unable to meet their obligations to the Corporation.

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Organization Structure and Strategy

CAF was established in 1970 to promote sustainable economic development and regional integration for its five original member countries: Bolivia, Colombia, Ecuador, Peru and Venezuela. Its principal activity is to provide loans to finance projects, working capital and trade activities in its shareholder countries. The five countries mentioned above are both "A" and "B" shareholders, which means they are allowed to appoint to the Board of Directors one principal director and one alternate director per type of share. The other twelve member countries—Argentina, Brazil, Chile, Costa Rica, Dominican Republic, Jamaica, Mexico, Paraguay, Panama, Spain, Trinidad and Tobago and Uruguay—hold series "C" shares, which entitle them to elect two principal directors and two alternates amongst themselves to serve on the Board of Directors. Commercial banks from the five founding countries also are able to be members and hold series "B" shares; currently fifteen banks are members.

Current Strategy

CAF offers its products to its member states and to the public and private financial institutions and corporations that operate within them. Available products include short-, medium- and long-term loans, co-financing arrangements, guarantees and selected equity investments. The majority of its loan operations are to the public sector, which accounts for 78% of CAF's loan book.

The Corporation has reactivated in 2006 a Compensatory Financing Fund, which will be used to reduce interest rates for the financing of social infrastructure and rural projects (which include water, health, sanitation, education and rural and community development) as well as the financing of regional infrastructure integration. CAF in the past has not been able to offer concessionary loans such as those offered by, for example, the International Development Association, part of the World Bank Group.

The Corporation is expanding gradually beyond its original core countries. An amendment to CAF's Constitutive Agreement, once fully approved, will allow any Latin American country to become a full member, a process Argentina, Brazil and Uruguay have already begun. In 2007 agreements were signed with these countries for contributions to paid-in capital for a total amount of approximately \$1.1 billion, to be paid in the next 5 years, as well as \$300 million in callable capital. The subscribed additional ordinary capital will allow these countries to become full members of CAF if certain conditions are met. The addition of these countries as full members will greatly increase the Corporation's capitalization and assist in further expanding CAF's activities to other Latin American countries beyond the Andean region. Already in 2007, of \$122 million in capital contributions only \$27 million was made by the five core shareholders. CAF is negotiating with several other countries, including Italy and Guatemala, to join as shareholders.

Profitability

2007 was another profitable year for the Corporation, as net income increased 25.0% to \$401 million dollars¹. Total interest income increased 12% to \$823 million with interest from loans accounting for the vast majority of that growth. Total interest expense growth marginally outpaced total interest income growth, rising 13.7%. The Corporation made a \$23.1 million release of provisions in 2007. In 2006 it set aside \$19 million in provisions for loan losses in 2006.

Return on average assets was 3.5% in 2007, the highest the Corporation has posted since the early 1990s. The net interest margin (net interest income as a percentage of average earning assets) was 3.6% in 2007 the same as in 2006. As seen in prior years, CAF's asset sensitive balance sheet benefited from solid loan growth as well as an increasing proportion of equity funding its loans.

¹ Net income includes \$75.7 million of extraordinary revenues. Excluding extraordinary revenues net income amounted to \$325 million, a similar figure to the \$321 million posted in 2006.

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Asset/Liability Management and Liquidity

CAF asset/liability management seeks to minimize liquidity, interest rate and exchange rate risks. Loans are made almost exclusively on a floating rate basis and repriced assets tend to exceed floating rate liabilities. CAF's loan and liability portfolios are fairly well diversified in terms of tenors with concentrations in the one-to-two year maturities and the five-years-and-over categories. Its access to the markets allows it to opportunistically lock in funding costs for its longer term project financings.

CAF also benefits from market diversification. The Corporation issues bonds and notes in the local markets of some of its member countries (Peru, Venezuela, Colombia and Mexico) as well as in the United States, Europe and Japan. Fifty nine percent of its bonds are denominated in US dollars and 17% are denominated in Euros. Bonds comprise the lion's share of total liabilities (54% of total liabilities at year-end 2007) with short-term funding accounting for 33%. Management estimates that CAF's yearly issuance needs are in the neighborhood of \$1 billion; in 2007 the Corporation issued \$718 million.

CAF's Ample Liquidity

CAF's liquidity is conservatively managed, underpinning its P-1 commercial paper rating. The Corporation's broad access to the capital markets attests to its superior performance which has resulted in favorable funding costs, investor appetite for a range of medium and long tenors as well as good secondary market trading for its debt issuances.

Liquid assets have averaged 19% of total assets during the past three years. CAF's internal policy is to maintain sufficient liquidity to cover 25% of its total financial liabilities, and 80% of liquidity must be invested in investment grade instruments and concentrated in the short-term. Guidelines also require that at a minimum liquidity should cover the greater of 35% of debt service plus expected disbursements over the next twelve months, or 45% of the undisbursed total of committed project loans.

Asset Quality

By country, CAF's largest credit exposures are to Ecuador, Peru and Colombia which together account for 59% of the total loan portfolio. The concentration of loans is typical of regional multilateral development banks. For CABEL the top three (Guatemala, Honduras and Costa Rica) account for 76% of loans outstanding; for the IDB the same figure is 54% (Brazil, Argentina and Colombia are the largest recipients) and for the ADB the top three (Indonesia, China, and India) represent 71% of loans outstanding. In addition to asset concentration risk, all of the Latin American-focused institutions take on more credit risk than other MDBs (with the possible exception of the African Development Bank) as the majority of their loans are made to countries Moody's rates as non-investment grade.

By sector, CAF's lending is concentrated in infrastructure projects (transportation, telecommunications, electricity, gas and water) which represent 43% of its total loan portfolio. CAF shares this sectoral focus with ADB and CABEL, as infrastructure loans account for about 40% of both of their loan books. CAF places a heavy emphasis on social development loans-- education, health social services and structural reforms--which account for 33% of loans and also on financial intermediaries (18.3% of its portfolio). These are the top three loan sectors for CAF and represent 95% of its loans outstanding.

Credit quality remained strong with non-performing loans averaging below 0.5% in the past five years. CAF traditionally has a very low level of non-performing loans, reflecting its preferred creditor status. The Corporation maintains a loan loss allowance of 2.4% of total loans, in line with US GAAP accounting rules, which provides a solid cushion against potential credit losses.

Loan approvals in 2007 are another indication of growing importance of non-core countries in CAF's operations. In 2003 loan approvals to non-core countries represented 14% of all approvals; this number rose to 31% last year. Disbursed loans to non-core nations rose to 15% of all loans in 2007, from 8% in 2000. Both are likely to continue growing in the near future.

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Capital Adequacy

As of December 31, 2007 authorized capital was \$5.0 billion, of which \$3.1 billion is to be paid-in and \$1.9 billion is callable. Paid-in capital equaled \$2.0 billion and subscribed callable capital \$1.1 billion. The Andean nations account for 87% of paid-in capital and 81% of callable capital. The remainder is provided by non-Andean members such as Brazil, Spain, Argentina and Mexico as well as the fifteen private banks who are members. The Extraordinary Shareholders' Assembly that took place in March of this year approved an increase in authorized capital from US\$5 billion to US\$10 billion as a result of the expansion of operations that the Institution has been executing in support of Latin American development and in line with its increased membership, both recent as well as expected.

CAF's capital base is protected by the operational limits the Corporation has put in place. The gearing policy limits the sum of loans, equity securities and guarantees to net worth to 4.0:1; as of December 2007 the ratio was 2.4:1, well under the maximum. Similarly, its leverage (financial liabilities/net worth) is capped at 3.5:1 and was only 2.0:1 at year-end 2007. Since 1992 CAF's policy has been to maintain a minimum BIS capitalization level of risk-weighted assets; over that time it has consistently exceeded that target. As of year-end 2007, shareholders' equity was \$4.1 billion, up 11.8% for the year, resulting in a BIS ratio of 36.3%. This ratio is especially notable given that CAF follows a conservative policy of risk-weighting all government-guaranteed or related credits according to Basel II guidelines.

CAF's risk asset coverage ratio is among the lowest of any MDB rated by Moody's, though the trend is moving in the right direction. The ratio has remained around 45% for the last three years. At its current level, CAF's risk asset coverage ratio is lower than those reported by most other multilaterals rated by Moody's (i.e. IDB: 162.1%; CABEI 48.3%; ADB: 274.0%); CAF's ratio reflects that its loans are overwhelmingly made to countries that Moody's rates below investment grade.

Corporación Andina de Fomento

Corporación Andina de Fomento (CAF)

BALANCE SHEET (US\$M)	2007	2006	2005	2004	2003	2002
ASSETS						
Cash and Cash Equivalents	3.74	9.00	1.74	2.75	2.45	1.74
Interbank Deposits and Investments	434.89	563.87	593.15	540.51	700.74	702.14
Investment Securities	1,982.53	1,357.75	1,193.45	1,184.08	954.86	670.08
Trading Securities	882.73	1,001.62	1,105.57	1,017.72	637.86	540.48
Held to Maturity Securities	1,099.80	356.13	87.89	166.36	317.00	129.60
Repurchase Agreements	0.00	0.00	0.00	0.00	25.00	25.00
Liquid Assets	2,421.16	1,930.62	1,788.34	1,727.34	1,658.06	1,373.96
Gross Loans	9,547.99	8,097.47	7,346.98	7,104.12	6,597.24	6,062.41
Bolivia	1,040.04	1,024.29	981.64	929.21	854.07	662.10
Colombia	1,633.00	1,619.53	1,899.52	1,701.89	1,540.30	1502.40
Ecuador	2,149.45	1,370.79	1,230.54	1,224.22	1,206.40	1,120.2
Peru	1,804.85	1,801.74	1,712.26	1,649.82	1,384.73	1278.70
Venezuela	1,469.84	1,723.52	1,134.68	1,197.05	1,144.72	1072.60
Other	1,450.81	557.57	388.00	403.62	463.01	426.50
Adjustments made on hedging activities	0.00	0.03	0.34	(1.68)	4.02	(0.18)
Loan commissions net of origination costs	46.94	59.98	57.02			--
Interest Receivables	231.51	226.53	181.94	151.05	135.20	143.17
Reserves For Loan Losses	168.26	188.61	161.63	181.80	209.77	196.34
Net Loans	9,332.79	7,848.88	7,128.33	6,922.32	6,387.48	5,866.06
Risk Assets	11,750.21	9,770.50	8,914.93	8,646.91	8,043.08	7,238.28
Investment in Other Entities	74.32	93.43	114.65	112.14	115.03	117.23
Fixed assets (Net)	23.82	23.93	10.99	12.61	10.33	9.88
Other assets	513.60	316.11	258.09	660.51	486.52	48.89
Total Assets	12,597.19	10,439.49	9,482.33	9,585.97	8,817.62	7,584.19
Note: Non-Performing Loans	0.03	0.20	1.33	19.96	10.92	29.34
LIABILITIES						
Deposits	1,521.05	449.80	386.42	205.35	278.17	228.43
Commercial Paper	888.25	773.35	710.27	712.41	673.21	501.02
Repurchase Agreement	0.00	0.00	0.00	0.00	0.00	0.00
Short Term Borrowing	398.93	339.26	443.71	529.19	465.99	546.43
Bonds	4,199.52	4,152.48	3,846.93	3,987.23	3,974.26	3,590.80
Short-term	137.13	499.59	294.38	723.67	640.02	489.88
Long-term	4,062.39	3,652.89	3,552.56	3,263.55	3,334.24	3,100.92
Adjustments made on hedging activities	437.62	209.68	214.17	587.49	317.74	(312.33)
Bonds Outstanding (Net)	4,637.14	4,362.16	4,061.11	4,574.72	4,292.00	3,278.46
Loans and Other Financial Obligations	808.31	558.65	488.36	567.87	411.23	463.48
Short-term	191.29	104.88	76.84	99.03	82.28	119.50
Long-term	617.02	453.77	411.52	468.84	328.95	343.98
Adjustments made on hedging activities	0.18	0.49	1.61	7.09	7.29	0.27
Loans and Other Financial Obligations (Net)	808.49	559.14	489.97	574.96	418.52	463.75
Accrued Interest and Commissions	153.94	136.88	110.95	95.86	98.18	106.14
Other Liabilities	62.09	126.19	42.74	100.85	211.40	406.24
Total Liabilities	8,469.88	6,746.77	6,245.17	6,793.33	6,437.46	5,530.47

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	2007	2006	2005	2004	2003	2002
SHAREHOLDER'S EQUITY						
Capital Stock	2,014.75	1,870.62	1,681.89	1,498.68	1,318.56	1,170.52
Paid-in Capital	234.36	256.71	239.52	220.07	173.46	112.09
Reserves	1,477.41	1,244.75	1,032.51	866.14	752.61	644.00
Retained Earnings	400.80	320.65	283.24	207.75	135.53	127.11
Total Shareholders' Equity	4,127.31	3,692.73	3,237.16	2,792.64	2,380.16	2,053.72
Total Liabilities and Shareholders' Equity	12,597.19	10,439.49	9,482.33	9,585.97	8,817.62	7,584.19

INCOME STATEMENT (US\$M)

Interest Income	789.99	696.61	522.15	355.36	304.82	321.42
Loans	700.40	600.78	462.72	327.36	279.09	292.91
Investments and Time Deposits	89.59	95.83	59.43	27.99	25.74	28.51
Interest Expense	408.64	358.72	250.71	155.77	129.76	140.89
Net Interest Income	381.34	337.89	271.44	199.58	175.07	180.53
Net Commissions	32.10	37.63	26.37	20.81	18.06	23.18
Commission Income	37.39	42.98	31.24	25.90	25.55	30.87
Commission Expense	5.29	5.35	4.87	5.09	7.50	7.69
Dividends and Equity Sales	16.94	5.13	13.36	8.14	5.09	4.47
Net Other Income	(1.44)	5.61	0.24	0.49	0.48	(1.70)
Other Income	10.87	5.77	0.58	0.71	2.69	1.05
Other Expense	12.31	0.16	0.33	0.23	2.20	2.75
Gross Operating Revenue	428.94	386.26	311.40	229.01	198.70	206.47
Operating Expense	51.20	46.41	42.64	38.12	34.78	32.81
Pre-Provision Profit (PPP)	377.75	339.84	268.76	190.89	163.92	173.67
Provisions for loan losses	(23.13)	19.00	(14.50)	(18.56)	25.25	41.50
Impairment charge for Equity Investments	0.08	0.19	0.02	1.69	3.13	5.06
Cum. Effect of Change in Acctng for Derivatives and Hedges	0.00	0.00	0.00	0.00	0.00	0.00
Net Income	400.80	320.65	283.24	207.75	135.53	127.11

RATIOS

Asset Quality (%)						
NPLs / Gross Loans	0.00	0.00	0.02	0.28	0.17	0.48
NPLs / Prev. Yr. Gross Loans	0.00	0.00	0.02	0.30	0.18	0.54
Reserve Coverage / NPLs [1]	560,857	94,778	12,134	911	1,921	669
Reserves / Gross Loans	1.76	2.33	2.20	2.56	3.18	3.24
NPLs / (Share Eq. + Loan Loss Res.)	0.00	0.01	0.04	0.67	0.42	1.30
NPLs / Pre Prov. Profit	0.01	0.06	0.50	10.46	6.66	16.90
Provisions / Avg. Gross Loans	-0.26	0.25	-0.20	-0.27	0.40	0.72
Loan Growth (In US\$)	17.91	10.22	3.42	7.68	8.82	11.13

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	2007	2006	2005	2004	2003	2002
Profitability (%)						
ROAA	3.48	3.22	2.97	2.26	1.65	1.77
ROAE	10.25	9.25	9.39	8.03	6.11	6.55
NIM	3.54	3.62	3.09	2.39	2.29	2.63
Total Oper. Exp. / Total Oper. Revs.	11.94	12.02	13.69	16.65	17.51	15.89
Net Commission and Fee Inc. / Gross Op. Rev.	7.48	9.74	8.47	9.09	9.09	11.22
Net Commission and Fee Inc. / Tt. Op. Exp.	62.70	81.08	61.83	54.58	51.91	70.65
PPP / Total Avg. Assets	3.28	3.41	2.82	2.07	2.00	2.41
PPP / Risk Wtd-BIS-Assets	4.26	3.84	3.07	2.28	2.16	2.57
Net-Int. Income / Avg. Gross Loans	4.32	4.38	3.76	2.91	2.77	3.13
Debt Ratios (%)						
PPP Before Interest Expense / Interest Expense	192.44	194.74	207.20	222.55	226.33	223.26
Liquid Assets / Short-term Liabilities	77.19	89.10	93.55	76.11	77.49	72.88
Loans / Bonds (Net) +Loans and Other Financial Oblig. (Net)	175.33	164.54	161.43	137.95	140.05	162.00
Bonds (Net) / Total Equity	112.35	118.13	125.45	163.81	180.32	159.64
Total Liabilities / Total Assets	67.24	64.63	65.86	70.87	73.01	72.92
Capital Adequacy (%)						
BIS Risk Assets (US\$M)	8,861	8,861	8,862	8,648	8,099	7,094
Equity / Risk Assets	35.13	37.79	36.31	32.30	29.59	28.37
Equity / Total Assets	32.76	35.37	34.14	29.13	26.99	27.08
BIS Tier 1 Ratio	38.79	38.79	38.79	34.61	31.83	28.95
BIS Total Capital Ratio [2]	36.3	40.9	40.59	36.47	34.30	31.30
Risk asset coverage ratio (Useable equity + CC of Aaa/Aa rated members)/ loans to non-IG countries	45.32	48.07	46.78	42.13	39.11	37.18
Liquidity (%)						
Liquid Assets / Total Assets	19.22	18.49	18.86	18.02	18.80	18.12
Liquid Assets / Deposits	159.18	429.22	462.80	841.19	596.05	601.49
Loans / Total Assets	75.79	77.57	77.48	74.11	74.82	79.93
Loans / Deposits	627.72	1,800.25	1,901.30	3,459.59	2,371.64	2,654.00
Loans / Equity	231.34	219.28	226.96	254.39	277.18	295.19
Project, Trade, and Corporate Financing (%)						
Bolivia	10.89	12.65	13.37	13.06	13.01	10.92
Colombia	17.10	20.00	25.85	23.96	23.35	24.78
Ecuador	22.51	16.93	16.75	17.23	18.29	18.48
Peru	18.90	22.25	23.31	23.22	20.99	21.09
Venezuela	15.39	21.28	15.44	16.85	17.35	17.69
Other	15.19	6.89	5.28	5.68	7.02	7.04

[1] 2005-2007 reflect significant drop in non-performing loans.

[2] Ratio calculated according to new Basle II methodology.

Corporación Andina de Fomento

Moody's Related Research

Special Comments:

- A Guide to Moody's Sovereign Ratings, July 2006 (98177)
- A Quantitative Model for Local Currency Government Bond Ratings, September 2003 (79404)
- A Quantitative Model for Foreign Currency Government Bond Ratings, February 2004 (81176)

Rating Methodologies:

- Piercing the Country Ceiling: An Update, January 2005 (91215)
- Revised Foreign-Currency Ceilings to Better Reflect Reduced Risk of a Payments Moratorium in Wake of Government Default, May 2006 (97555)

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Report Number: 109491

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