

Mortgage  
Netherlands  
New Issue

# NIBC Bank NV Mortgage Covered Bonds

## Ratings

Covered Bonds	Amount (EURm)	Final Maturity	Rating
Series 1	350	May 2011	AAA

## Key Data

	Mar 08
Cover assets (EURm)	400
Covered bonds (EURm)	350
Available overcollateralisation (OC) (%)	14.3
Maximum asset percentage (%)	90.5
Residual weighted-average asset maturity (years)	26.7
Residual weighted average liability maturity (years)	3.0
D-Factor (%)	14.1

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## Related Research

- [Fitch Launches New Covered Bonds Rating Methodology](#)
- [Covered Bonds rating Criteria - Stop or Continue](#)
- [Underwriting Practices and Criteria in the Dutch Mortgage Market \(Netherlands RMBS\)](#)
- [Dutch Residential Mortgage Default Model Criteria](#)
- [Counterparty Risk in Structured Finance Transactions: Hedge Criteria](#)
- [Commingle Risk in Structured Finance Transactions: Servicer and Account Bank Criteria](#)

## Rating Rationale

Fitch Ratings has assigned a 'AAA' rating to the first covered bonds to be issued under the EUR7bn covered bond programme of NIBC Bank N.V. (NIBC or the issuer, rated 'A-'/'F2', Outlook Negative).

Under the programme, NIBC can periodically issue covered bonds secured on a dynamic pool of residential mortgages and other eligible assets. The covered bonds are senior unsecured obligations of the issuer, guaranteed by NIBC Covered Bond Company (the CBC), an insolvency-remote company wholly-owned by a foundation (stichting), established solely for the purpose of this programme and with restricted permitted activities. In the event of a default of NIBC under the covered bonds, they will not accelerate, although they would do so upon a CBC event of default. Investors will have a residual unsecured claim against NIBC if the collateral is ultimately insufficient to repay the covered bonds.

At April 1st 2008, the cover pool consisted of 4,685 Dutch mortgage loans to 2,182 borrowers secured on residential properties with an outstanding balance of EUR400m. The loans have a weighted-average (WA) original loan-to-market-value ratio (LTMV) of 88.3%. The WA current indexed LTV stands at 83.3% based on Fitch indexation, which takes into account 50% of any increases in property prices and 100% of any downward movements.

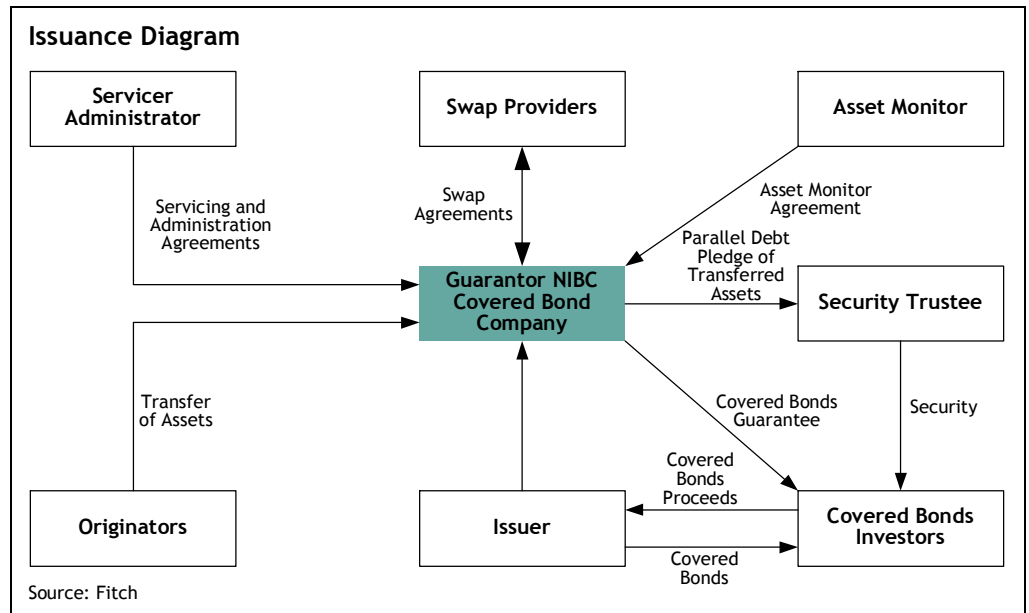
Fitch has assigned a Discontinuity Factor (D-Factor) of 14.1% to the issuer's mortgage covered bonds, as a measure of the likelihood of interruption of payments on the covered bonds at the time of an issuer default. The D-Factor is assigned on a scale of 0%, for perfect continuity, to 100%, which equates the covered bonds' probability of default with that of the issuer. When combined with NIBC's Long-Term IDR of 'A-', this D-Factor enables the covered bonds to be assigned a rating of 'AA+' on a probability-of-default (PD) basis, provided overcollateralisation (OC) is sufficient to sustain a 'AA+' level of stresses. In addition, defaulted covered bonds would benefit from the cover pool, which Fitch reflects through an uplift of up to two notches based on strong recovery expectations, allowing for a 'AAA' rating on NIBC's covered bonds.

OC between the cover pool and outstanding covered bonds is ensured through a dynamic asset cover test (ACT) under which, the asset percentage cannot exceed 90.5%. It therefore provides a minimum of 10.5% OC at any time. The agency formed assumptions about the credit behaviour of the cover pool under a 'AA+' and 'AAA' stress scenario, and tested maturity, interest rate and currency mismatches between the cover pool and covered bonds. The asset percentage was found sufficient to support a 'AA+' rating on a PD basis. Moreover, ample recoveries on defaulted covered bonds, calculated under 'AAA' stresses, enabled the agency to give credit of one notch for recoveries, leading to a final covered bond rating of 'AAA'.

## Highlights

All else being equal NIBC's covered bonds rating could still be maintained at 'AAA' if the issuer was rated as low as 'BBB'.

Although the cover pool currently only consists of Dutch mortgage loans, the issuer aims to include German residential mortgage loans in the near future.



## Key Information

Issuer	NIBC
Guarantor	NIBC Covered Bond Company (CBC)
Administrator	NIBC
Servicer	NIBC
Sub-servicers	Stater Nederland BV and Quion Groep BV
Asset monitor	PricewaterhouseCoopers Accountants NV
Security trustee	Stichting Security Trustee NIBC CBC
Directors	ATC Management BV and NV Algemeen Nederlands Trustkantoor ANT
GIC provider	ABN AMRO Bank NV
Total return swap provider	NIBC
Principal paying agent	Citibank NA
Paying agent	NIBC
Issuer's auditors	PricewaterhouseCoopers Accountants NV

Source: Fitch

## Background

NIBC is a specialised merchant bank providing loan and intermediate finance, advisory services, and structured and risk management products to small and medium-sized corporates and institutional investors in the Benelux region and north-west Europe. It is also active in lending to the Dutch and German residential mortgage market.

NIBC was established as De Nationale Investeringsbank NV by the Dutch Government in 1945, to provide long-term finance for domestic reconstruction and development. Since then, the bank's focus has shifted towards the private sector with a particular emphasis on corporate lending, residential mortgages, equity investments and assets, project and leveraged finance. In 1999, the government sold the bank to two major Dutch public sector pension funds, which in December 2005 sold the bank to a consortium of investors led by JC Flowers & Co, a private equity fund.

During 2007 the bank's performance was affected by the deterioration in the US sub-prime market and subsequent market turmoil. The ratings of NIBC reflect its adequate capital, satisfactory liquidity and sound asset quality. They also take into account the sensitivity of its revenue to the capital markets and its reliance on wholesale funding.

The Netherlands has no specific covered bond legislation, although a covered bond law is planned to be put in place on July 1<sup>st</sup> 2008: as such these bonds will be issued pursuant to a series of contractual arrangements. The issuance diagram illustrates the programme structure. The covered bonds are direct obligations of the issuer and are guaranteed by the CBC, an insolvency-remote company established solely for the purpose of this programme. Under the guarantee, interest and principal payments will be met by the CBC on the occurrence of an issuer event of default, while bondholders will retain an unsecured claim against NIBC if not fully satisfied by the CBC.

## Continuity Analysis

According to Fitch's covered bond rating methodology, covered bonds rated by the agency are assigned a D-Factor between 0% (best) and 100% (worst), which expresses the likelihood of the covered bonds defaulting in the immediate aftermath of a default by the debtor of recourse. The D-Factor has four weighted components: asset segregation (50%), liquidity gaps (30%), alternative management (15%) and covered bond oversight (5%). These four aspects are analysed below in relation to specific aspects of the issuer's covered bond programme.

## Asset Segregation (50% Weight)

Within the asset segregation component, Fitch has examined the degree to which the transfer of assets from the originating bank to the CBC can not be successfully challenged by its creditors upon the originator becoming insolvent or falling under public administration.

The CBC is entirely owned by Stichting Holding NIBC Covered Bond Company. The CBC's activities are limited to owning the receivables, raising funds, issuing the guarantee and entering into derivative and other contracts related to the covered bond programme.

As consideration for granting the guarantee and to allow the CBC to meet its obligations, the initial originators, all wholly-owned subsidiaries of NIBC, have transferred eligible receivables to the CBC as per a guarantee support agreement (GSA) signed between the initial originators, the CBC and the trustee. Further originators will be entitled to join the programme based on the same contractual obligations as for the initial originators. The transfer of eligible receivables is executed through a silent assignment, which does not require perfection via borrower notification. The CBC becomes legal owner of the receivables by registration of the deed of assignment with the Dutch tax authorities.

The CBC has pledged the secured property backing the cover pool, as well as the relevant bank accounts, to the trustee. Since the trustee holds this security in its own name, not as an agent or trustee of the covered bondholders, a parallel debt is in place. This ensures that the pledge works, as the security can be granted to the trustee in its own capacity as creditor of the parallel debt. The trust deed stipulates that the obligations of the CBC to the trustee under the parallel debt must be decreased/increased in line with the obligations of the CBC to the secured creditors.

Furthermore, the agency has analysed the four following points that could, if not properly addressed, hinder the effectiveness of the segregation and the privilege:

- bank mortgages;
- set-off risk;
- existence of other privileged creditors; and
- commingling risk.

For the first two points, NIBC's covered bonds share some of the concerns already seen in Dutch RMBS transactions. In Fitch's view, however, these risks have been addressed satisfactorily by the ACT and the provisions of the GSA.

### *Bank Mortgages*

A unique feature of Dutch mortgages is that they are secured by a bank mortgage, which means that the property provides security not only for the mortgage loans but also, potentially, for all other receivables owned by the relevant originator against the same borrower (residual claims). According to legal advice received by Fitch, the mortgage rights would pass to the CBC as an accessory right following the originators' assignment of the eligible mortgages to the CBC. However, the foreclosure proceeds obtained by enforcing the security may need to be shared on a pro rata basis between the CBC and the holder (the originator) of the residual claims, which would ultimately affect the loss severity of the transferred mortgage loans.

To mitigate this risk, the sellers will undertake in the GSA that they shall not grant or acquire any other claim against a borrower.

Additionally, NIBC has agreed with the CBC that any foreclosure proceeds will be applied in priority to the outstanding balance of the foreclosed loan held by the CBC. Where the agreement is found not to be enforceable, NIBC has undertaken to

compensate the CBC. Receipt of such amount by the CBC is subject to the ability of NIBC to actually make such payments.

## Set-Off Risk

### *Deposit Set-Off*

Currently there is no deposit set-off risk as NIBC is not a deposit-taking bank for individuals. If, in the future, NIBC decides to offer retail deposit taking services, Fitch will review this risk and the mitigants in place, notably a deduction of certain amount under the ACT upon the issuer downgrade below 'A-'. Unlike other Dutch covered bond programmes, there is no borrowers notification based on a rating trigger. However, the originator must notify all Dutch borrowers that their mortgages have been transferred to the CBC upon one of the following events:

- the dissolution, liquidation, bankruptcy or entry into emergency regulations of one of the sellers occurs or of the collection foundation holding the bank account into which payments are made by the borrowers;
- a security trustee notification event occurs which includes:
  - a default made by the CBC in relation to the transaction documents;
  - the dissolution, liquidation, bankruptcy or entry into emergency regulations of the CBC;
- A CBC event of default occurs.

### *Insurance Set-Off*

Another source of set-off risk exists in relation to mortgage products that combine an interest-only mortgage with a payment by the borrower into a savings, investment or life insurance policy (or to a combination of these), with the purpose of accumulating enough cash to repay the loan at maturity. The risk stems from the possibility that if the insuring entity becomes bankrupt, it would be unable to meet its obligations under the policy and, as a result, the borrower could seek to avoid repaying the mortgage loan. For investment mortgages, Fitch considers any set-off risk to be very limited, as policy providers usually hold the investment accounts with bankruptcy-remote special-purpose vehicles.

For savings mortgages, set-off risk is deemed greater, because the savings policy is usually a product which has been tailor-made to match the mortgage loan itself, and is provided by an entity affiliated to the lender. To mitigate this risk, the CBC and the relevant savings providers have entered into a sub-participation agreement. In this instance, savings premiums paid by the borrower are passed on to, and held by the issuer in a savings fund, with the issuer granting a sub-participation to the savings policy provider to the extent of the premiums plus an accrued yield. In the event that the savings provider becomes bankrupt and does not honour its policy obligations and the borrower successfully exercises a right of set-off, the sub-participation to the savings provider is written down to the extent of the set-off exercised and the issuer will be able to retain the savings funds to which the sub-participation related and use these to repay the mortgage loan affected.

In the case of life insurance mortgages, the extent of exposure to set-off risk depends on whether the borrower has freely chosen the insurance company or whether it has been marketed as one product. The borrower's case to invoke set-off risk may be stronger when the loan and the policy have been marketed together at origination. Where the borrower selects the policy provider, Fitch takes the view that any potential set-off risk should be weaker, as the borrower would have been aware of entering into two separate relationships. Conversely, when the insurer has been brought to the table by the originator, there is a greater likelihood that any set-off right claimed by the borrower would succeed.

All rights in relation to insurance policies are usually pledged by the borrower to the originator as additional security. The rights of the originator under the

insurance policy are to be assigned to the CBC and pledged by the CBC to the trustee, to mitigate the risk of the beneficiary rights of the originator not following the transfer of the relevant loans to the CBC. Some uncertainty remains about the effectiveness of that assignment and pledge. To mitigate this, each originator will:

- appoint, in each deed of assignment, the CBC as beneficiary in its place and, to the extent possible, waive its beneficiary rights; and
- at closing, a beneficiary waiver agreement is signed between the originator, the CBC, the trustee and the relevant insurer. Under the agreement, the relevant insurer accepts the appointment of the CBC as beneficiary of the policies and accepts the waiver of the relevant originator, while the originators and insurers agree to use their best efforts to obtain the cooperation of all the borrowers to appoint the CBC as beneficiary.

Insurance set-off risk is mitigated by the fact that a deduction is made in the ACT. The amount of the deduction is re-calculated on a quarterly basis and assumes that all insurance counterparties will default, taking into account the likelihood of set-off to succeed and a recovery percentage of 60% upon default of the insurance companies.

#### *Existence of Other Privileged Creditors*

Total return and interest rate swap counterparties will rank ahead of covered bond investors in a CBC insolvency scenario, while structured swap providers will rank pari passu. Other prior-ranking party claims, such as amounts due to the trustee, agent bank and paying agent, are listed in *Appendix 4*. Fitch has taken these privileged creditors into account in its cash flow analysis.

#### *Commingling Risk*

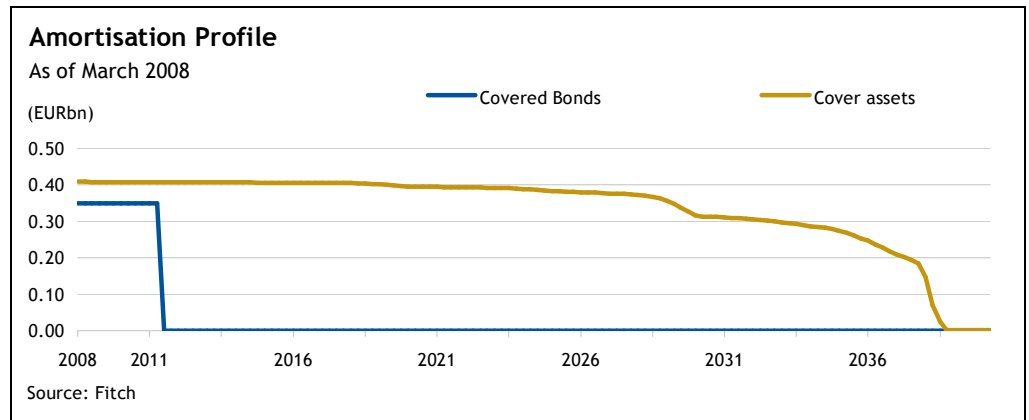
Borrowers make their monthly mortgage payments via a bankruptcy-remote foundation that subsequently transfers the receipts to the CBC. This is a new feature for Dutch covered bond programmes and excludes any commingling risk regardless of whether or not the borrowers are notified. The transaction also includes a reserve fund as of closing. It is sized and adjusted on a monthly basis to cover interest due on the bonds for a full year, including senior costs, on the next payment date.

#### **Liquidity Gaps (30% Weight)**

As is the case for most covered bonds, the maturity profile of the cover assets does not match the bullet maturity of the covered bond. This can create the need for liquidity, especially if the issuer falls under administration just before the maturity of the covered bond. In this case, it may not be possible to raise enough liquidity against the cover pool to repay the covered bonds on a timely basis.

For that reason, the initial series of covered bonds issued by NIBC will be soft bullet bonds with a maturity extension period of up to one year. This gives NIBC or the Trustee 12 months to raise liquidity by securitisation or selling parts of the cover pool.

There is currently no regular secondary market for whole loan sales in the Netherlands. However, Fitch has received confirmation that loan providers have occasionally been approached regarding a purchase of part of their mortgage loan books, indicating that there is a general interest in loan portfolios. Also, it should be noted that the Dutch RMBS market is well developed. Fitch therefore assumes that some appetite for buying Dutch mortgage loans could materialise over the extension period.



### Alternative Management (15% Weight)

This section addresses the risk that the transition to an alternative manager does not take place smoothly enough to avoid a missed payment on the covered bonds following an issuer's insolvency. This could occur if the alternative manager were appointed too late, or if the IT systems of the issuer made it difficult for the new manager to isolate the cover pool and covered bonds from the other assets and liabilities of the bank and to manage the cover pool.

All mortgage loans in the cover pool are serviced by Stater and Quion, two third-party servicers in the Netherlands. As such, this means transfer of data regarding mortgage portfolio is already being practised. Fitch believes that the third-party servicer's systems can clearly isolate the cover pool and covered bonds, and could be used relatively quickly and easily by an appointed substitute manager. However, a substitute manager will have to deal with two third-party servicers, which does require more work.

### Covered Bonds Oversight (5% Weight)

Although the issuer is a regulated financial institution, no specific regulation applies to contractual covered bonds. Therefore, Fitch does not expect any additional involvement of the Dutch regulators for the benefit of the covered bond investors than for other creditors of the bank. Consequently, the agency has not given any oversight credit for the analysis of the D-Factor.

At the end of 2007, the Dutch Ministry of Finance held a consultation period to consider proposals for a Dutch covered bond legal framework. The intention is for the legal framework to be in place by 1 July 2008. The proposals primarily build on existing Dutch legal concepts, as also used in Dutch contractual covered bonds. Fitch believes there could be some benefit in the proposed recognition process through the Dutch Central Bank, and will seek a meeting with the central bank to understand better the focus of its ongoing supervision in safeguarding covered bond holders' interests.

Overall, the issuer has been assigned a D-Factor of 14.1%. This, combined with NIBC's IDR of 'A-', means that the maximum achievable rating of the mortgage covered bonds on a PD basis is 'AA+' (see D-Factor Matrix in *Appendix 5*). The agency tested whether OC calculated on the eligible portion of the cover pool was sufficient to withstand the credit risk of the cover pool as well as the mismatches between the cover pool and the covered bonds in a 'AA+' stress scenario. In a second step, the agency compared the net present value of the entire cover pool, calculated under 'AAA' stress assumptions, to the covered bonds value. Under Fitch's rating approach (see *Appendix 5*), strong stressed recoveries justify an additional notch, allowing the covered bonds to be assigned a final rating of 'AAA'.

**Table 1: Cover Pool Summary** (As of 1 Apr 08)

Pool characteristics	
Outstanding principal balance (EURm)	400
Average current loan per borrower (EUR)	183,318
Number of loan parts	4,685
Number of borrowers	2,182
WA seasoning (months)	33.3
WA remaining maturity of assets (years)	26.7
WA original LTMV	88.3
WA original LTFV (%)	92.9
WA indexed <sup>a</sup> current LTMV (%)	83.3
Oldest loan in portfolio	Apr 1967
Most recent loan in portfolio	Apr 2008
Mortgage type (%)	
Interest only	66.5
Life	20.9
Savings	9.6
Other	3.0
Other characteristics (%)	
Advisor verified	26.0
Self employed	4.0
Non employed	1.4
No income data	0.7
Construction deposits	7.7
NHG loans	15.1
Lien position (%)	
First ranking <sup>b</sup>	100
Interest rate type (%)	
Fixed rate	98.4
Floating rate	1.6
WA interest rate	5.21
Performing loans (%)	
Performing	97.4
0-1 months	1.9
> 1 months	0.7
Regional concentration (%)	
Zuid-Holland	21.5
Noord-Holland	17.8
Noord-Brabant	15.3

<sup>a</sup> Based on Fitch's indexation method, whereby 50% credit is given for property price appreciation

<sup>b</sup> Lower-ranking mortgages can only be included in the portfolio to the extent that a related prior-ranking mortgage is also included in the portfolio  
Source: NIBC/Fitch

## Cover Pool

### Origination and Servicing

#### Underwriting

NIBC has appointed Stater Nederland B.V. (Stater, rated 'RPS2+' and 'RSS3+' and Quion Groep B.V. (Quion, rated 'RPS2' and 'RSS2-' as the sub-servicers. The duties of the sub-servicers include the collection of payments of principal, interest and other amounts in respect of the mortgage loans. Special servicing has been transferred to NIBC for all Stater-serviced loans, which will also carry out special servicing of all Quion mortgage loans from September 2008.

Stater is the sub-servicer for all mortgage loans originated by Hyplinvest B.V., Seyst Hypotheken B.V., Royal Residentie Hypotheken B.V., Capitalum Hypotheken B.V., Huizen Hypotheken B.V., Nieuwegein Hypotheken B.V., Zwaluw Hypotheken B.V., Estate Hypotheken B.V., ATRIOS Hypotheekfonds B.V, Muzen Hypotheken B.V. and Amstelstaete Hypotheken B.V. (together, Sellers A).

Quion is the sub-servicer for all mortgage loans originated by Quion I B.V., Quion III B.V., Quion 14 B.V., Quion 30 B.V., Nationale Hypotheek Maatschappij B.V. and IKS Hypotheken B.V. (together, Sellers B).

Sellers A and B are all wholly-owned subsidiaries of NIBC.

#### Stater

Sellers A originate and distribute via partnerships. These intermediaries, such as mortgage advisers, insurance agents and real estate brokers, submit loan applications to the Stater mortgage system, Stater Hyarchis System (SHS).

The SHS origination system ensures all loans pass through a "rules engine" that filters the loans according to the underwriting criteria. All applicants are automatically checked on the BKR, the national credit register. Supporting documents required include employment references, salary statements and, in the case of self-employed borrowers, an accountant's statement covering the three previous years. Once initially approved, the relevant paperwork is forwarded by the broker, then checked against the transmitted data, and again validated for compliance with criteria. Loans are then agreed on a designated mandate basis by Stater.

Upon acceptance, a loan proposal is sent to the prospective borrower. If the offer is accepted by the borrower, the documentation is then approved by a second underwriter. The file is electronically stored and the paperwork filed by Stater. The relevant information is sent to the notary who finalises the mortgage deed.

#### Quion

Quion has two different operating models, the generic funding model and the specific funding model. In Quion's generic funding model, a group of different mortgage lenders offer identical mortgage products under standardised conditions, competing on interest rates offered. Quion matches a borrower with the mortgage lender offering the lowest interest rate, acting as a mediator. In the generic funding model, the underwriting criteria are set by Quion in consultation with the sellers. In specific funding models, the underwriting rules for mortgage loans are set by the sellers.

Mortgages originated by Quion I B.V., Quion III B.V., Quion 14 B.V. and Quion 30 B.V. are originated under the generic funding model; mortgages originated by Nationale Hypotheek Maatschappij B.V. and IKS Hypotheken B.V. are originated under specific funding models.

In the generic funding model, the mortgage loans are distributed through a network of over 1,750 independent intermediaries and insurance companies.

Quion enters the applications in the mortgage origination system (HYPOS). HYPOS automatically checks the underwriting criteria. If HYPOS gives a STOP advice the application will be declined. The system contains numerous rules for exceptions, however overrules are not allowed for mortgages with a Nationale Hypotheek Garantie (NHG).

Quion will submit an offer to the intermediary in cases where the loan complies with all the underwriting criteria. The borrower must accept, sign and return the offer together with the required documentation. The approved documents are filed and entered into the administration system (HYPAS). The relevant information is sent to the notary who finalises the mortgage deed.

NIBC has outsourced the underwriting and servicing procedures to Stater and Quion, as from 1997 and 1998 respectively.

### *Servicing*

In May 2006, NIBC brought a considerable part of the arrears and foreclosure management process back in house from Stater. Similarly, the Quion arrears and foreclosure management process will also be transferred to NIBC from September 2008. The main goal of these moves is to transform arrears and foreclosure management into one standardised process as well as to improve overall system functionality.

NIBC employs a team of seven full-time employees dealing with arrears of more than 25 days. In order to adequately manage arrears, NIBC has defined four different risk profiles; each profile has its own standardised arrears and foreclosure process. Risk profiles are based on historical payment behaviour and loan to value (LTV).

For further information on the servicing procedures for Stater and Quion, see the Fitch reports entitled "*Stater Nederland B.V.*" (dated 19 March 2008) and "*Quion Groep B.V.*" (dated 1 April 2008), both of which are available at [www.fitchratings.com](http://www.fitchratings.com).

### **Eligibility Criteria**

For a residential mortgage loan to become eligible for inclusion in the cover pool, it must comply with the following criteria, among others:

- the Dutch mortgage receivable and the beneficiary rights relating thereto must be duly and validly existing;
- the Dutch mortgage receivables, the mortgage and the right of pledge, if any, securing such receivable must constitute legal, valid and binding and enforceable obligations of the relevant borrower;
- the originator must not have any other claims against the borrower;
- none of the borrowers can be an employee of the sellers;
- the current loan amount, if not guaranteed by an NHG, cannot exceed 125% of the foreclosure value of the related property at the time of origination (or 130% if the additional 5% is covered by protection insurance); if guaranteed by an NHG, the maximum loan amount is set under the NHG requirements;
- each borrower must be a private individual and a resident of the Netherlands; and
- all payments by borrowers should be made without any deduction or set-off.

Although the initial portfolio consists entirely of Dutch residential mortgages, the programme allows for the inclusion of German residential mortgages and other assets (other than substitution assets) within the cover pool. The transfer of any such assets to the CBC is subject to prior confirmation by the agency that this will not jeopardise the then-existing rating on the covered bonds.

Substitution assets can include:

- exposures to or guaranteed by governments or other public sector entities that are 0% risk weighted under the standardised approach according to the European capital adequacy directive;
- exposures to institutions that qualify for a 10% risk weighting under the standardised approach;
- exposures to institutions that qualify for a 20% risk weighting under the standardised approach; and
- 'AAA' rated RMBS or CMBS tranches.

At inception, no substitute assets will be included in the cover pool.

On each transfer date, the CBC will rely on the representations and warranties given by the relevant originators in respect of the transferred assets. These will include statements that no insolvency or event of default nor any breach of law or contract by the originator has occurred and a confirmation that each loan complies with the eligibility criteria. No search of title was conducted by the issuer, the CBC or the trustee; instead, they relied on these representations and warranties. In the event of a breach of the representations and warranties for a given loan before the service of a notice to pay, the loan will be excluded from the ACT, and as long as no assignment notification event has occurred, the originator must accept the re-transfer of the loan.

### Portfolio Description

At 1 April 2008, the initial cover pool consisted of 4,685 loans made to 2,182 borrowers, with an aggregate outstanding balance of EUR400m. At the same date, some 2.6% of loans were in arrears of up to two months; no loans were in arrears for more than 2 months. Fitch has calculated the pool to have a WA original LTMV of 88.3% and a WA indexed current LTMV of 83.3%. The pool has a WA seasoning of 3.0 years.

### Loan Type

The residential mortgage portfolio consists of linear, annuity, interest-only, investment, insurance, hybrid and savings mortgages. Fitch increases the default probability for non-amortising loans to reflect the higher risk of borrowers facing a payment shock at maturity. Similarly, for investment, hybrid and insurance mortgages, the probability of default is increased to capture the risk that the capital available at maturity may not be sufficient, depending upon the performance of the underlying investment, with no certain return being guaranteed.

Some 66.5% of loans in the cover pool are classed as interest-only, 20.9% are insurance mortgages, 1.1% investment and 1.3% hybrid mortgages.

### Geographical Breakdown

The cover pool is concentrated in the Zuid-Holland (21.5%), Noord-Holland (17.8%) and Noord-Brabant (15.3%) regions. The remainder is spread across other areas within the Netherlands. Fitch believes that these concentrations produce no adverse effect.

### Illiquid Properties

13.1% of the portfolio is considered by Fitch to be secured by particularly high-value properties (higher than EUR500k), which are at risk of greater market value declines (MVDs) owing to the relatively poor liquidity at either end of the market. The agency has increased the MVDs for these loans by up to 25%.

### Affordability

Detailed data regarding the DTI ratio of borrowers was provided by NIBC. The majority of borrowers, 53.1%, have a DTI equivalent to Class 2 (between 20%-30%)

and 40.8% have a DTI equivalent to Class 3 (between 30%-40%). The WA DTI of the pool is 30.2%.

### *Employment Status*

Fitch received employment data for 99.3% of the pool. For the non-employed (1.4%) and self-employed borrowers (4.0%), the default probability was increased.

### *Advisor Verified*

In December 2004, NIBC introduced a product where the borrower's proof of income is assessed exclusively by the intermediaries. These are products for which the applicant in most cases does not provide any standard proof of income but more "informal" documentation (business plans, annual reports, rental contracts, bank or investment statements etc.) generally related to a particular employment or activity status (self-employment, temporary or seasonal work, commission-based work, retirees). The reliability and adequacy of the income information is left to the intermediary who keeps records on borrowers' income for five years. A standardised income statement is filled by the borrower together with the intermediary and signed by the intermediary as proof of income. Advisor-verified mortgages are originated according to similar underwriting criteria as standard products originated by NIBC. Certain underwriting criteria limits are tighter on advisor-verified mortgage products – for example, the maximum OLTfV should not exceed 90%, and the maximum loan amount cannot exceed EUR500,000. Property valuations securing the advisor-verified mortgages are undertaken by two licensed surveyor companies appointed and paid by NIBC with national coverage and the valuation costs are covered by NIBC.

### *Construction Deposits*

7.7% of the cover pool consists of construction loans, where an element of the loan principal has yet to be disbursed to the borrower, dependent upon the fulfilment of certain conditions. The granting of these loans is common practice in the Netherlands. NIBC requires the construction companies to be part of the Garantie Instituut Woningbouw (GIW), Stiwoga, Bouwgarant or Garantie Waarborg. These schemes cover the borrower and the lender in case of default of the construction company; in such instances, another builder from the association would step in and commit to finish the work without extra costs. The schemes also provide a warranty against construction defects. As a result, lenders do not in principle bear any construction risk.

In Dutch RMBS transactions the SPV will fund the construction deposits (that is, the amounts to be paid to a borrower once the construction or renovation of their property has been completed). The construction deposit will be paid into the construction account in the name of the issuer at closing. The issuer will advance the construction amounts to the seller whenever it makes a payment to a borrower. This takes away the risk that upon an originator default the borrower will not receive further advances under his construction loan.

However the covered bond programme lacks this feature as there is no payment from the CBC to NIBC for the transferred mortgage loans. Upon a default of NIBC the borrower will have to seek for additional finance to complete his property. Fitch has taken this additional risk into account in its analysis.

Construction deposits will be paid out to borrowers or constructors within 12 months of loan origination. Any remaining amounts will be used to pay down the mortgage balance.

### *NHG Guarantee Cover*

The NHG covers losses mortgage lenders incur on a loan after the sale or foreclosure of the house. This coverage extends to outstanding principal, unpaid accrued interest and repossession costs, as well as some other costs. Currently, 15.1% of loans in the cover pool are covered by the NHG. Fitch gives credit in its

analysis to the NHG. Payout ratios on the loss amount are stressed and based on historical data provided by NIBC, the guarantee's amortisation profile, and the underwriting and servicing quality of the originator.

### Static Analysis

Fitch has calculated the pool's cumulative weighted-average frequency of foreclosure (WAFF) under a 'AAA' and 'AA+' scenario, based on the initial loan balance, the property value and the DTI of the borrower. The agency has calculated the pool's WA recovery rate (WARR) based on the current balance and value of the loans. Table 2 summarises the outcome from the default model analysis.

### Cash Flow Analysis

On an ongoing basis, NIBC will issue further covered bonds backed by the cover pool, subject to compliance with the ACT. To assign a rating that is higher than the IDR of NIBC, Fitch tested cash flows in a wind-down scenario where, following an NIBC event of default, no further assets would be transferred to the CBC, no new loans would enter the cover pool to replace those that are maturing or non-performing and further issuance of covered bonds would be suspended.

Fitch's covered bonds cash flow model tests whether the cash flows from cover assets, including OC provided by the ACT, would, under the management of a third party, be sufficient to service interest and principal payments on the covered bonds in a full and timely manner. The expected cash flows from the assets were modified to reflect prepayment, delinquency, default and recovery assumptions in a 'AA+' scenario. In addition, the cost of replacing the current servicers was modelled. Mismatches between cover assets and covered bonds have been addressed as outlined below.

### Maturity Mismatches

The redemption profile of the planned covered bonds does not match the amortisation of the cover assets. The assets are amortising, with an average remaining maturity of 26.7 years, while the first series of covered bonds will have a soft bullet maturity of three years.

As a result, temporary liquidity surpluses or shortfalls may arise, which would place a strain on available resources. In the first case, Fitch models any cash not needed to repay liabilities as being reinvested at sub-Euribor rate. In the second case, Fitch assumes that an alternative manager would be able to realise part of the mortgage portfolio within the required timeframe. In calculating the potential sale price, the agency assumes that any purchaser will incorporate 'AAA' loss levels into the portfolio's cash flows. The agency further assumes that a purchaser would perform a discount analysis using a rate at a certain margin over Euribor that equates to their cost of funding the purchase. The resulting discounted figure has been given a further haircut to reflect the potential "firesale discount" that could apply if the assets had to be realised within a relatively tight timeframe.

The first covered bonds issued by NIBC will be soft bullet bonds, with an extension period of up to one year. However, issuance of hard bullet covered bonds may take place in the future, upon confirmation of the rating agencies. The specific terms will be defined in the relevant pricing supplement for each issue.

For soft bullet bonds, in the event of the issuer's failure to pay all amounts due on the maturity date (subject to any applicable grace period), the legal final maturity will be extended, on a monthly basis, up to the extended maturity date. During the extension period, interest will continue to be payable under the covered bonds and the issuer will be allowed to redeem all or part of the then-outstanding principal on any of the monthly payment dates. This increases the time the administrator has in which to find alternative solutions to repay the covered bonds as they become due.

**Table 2: Fitch Default Model Output (%)**

Rating level	WAFF	WARR	WA MVD	EL
AAA	18.79	58.15	39.84	7.32
AA+	16.91	60.77	36.98	6.20

WAFF = Weighted average frequency of foreclosure  
WARR = Weighted average recovery rate  
WA MVD = Weighted average market-value decline  
EL = Expected loss  
Source: Fitch

## Hedging

Some discrepancies may exist between the interest rate yielded by the cover assets and the covered bonds as well as between the currency of the assets and the bonds themselves. To neutralise the potentially adverse effect of such market risks the transaction documents provide that a series of swaps or equivalent hedging techniques be implemented.

If, at any time, a relevant swap counterparty is downgraded below 'A'/'F1', any of the following corrective options are available:

- a suitably rated swap counterparty can be sought;
- a guarantee by a third party with the minimum rating can be obtained; or
- post cash collateral in line with Fitch's criteria.

If the swap counterparty ceases to be eligible, a series of portfolio tests (to be defined at the time this option is chosen) can also be implemented as an alternative measure.

## Interest Rate Risk

To hedge interest rate risk, the CBC will enter into a total return swap (TRS) with NIBC, whereby NIBC will:

- pay to the CBC an amount equal to the outstanding principal balance of all non-defaulted mortgages (plus the outstanding balances of authorised investments and GIC account) multiplied by one-month Euribor;
- in exchange receive all interest received on the loans (including prepayment penalties) plus revenues from the GIC account and authorised investments minus 70 basis points on performing mortgage loans minus servicing fees paid by CBC to the servicer.

If a sale or refinancing of receivables is needed, the prospective purchaser has the option to purchase such receivables with or without the corresponding TRS. If the loans are purchased without the corresponding TRS, this will be terminated in relation to the portion of loans being sold. Should the purchaser decide to purchase the portfolio without the swap, the received must fully repay the related covered bonds plus any swap termination payments that result.

NIBC, which is the TRS swap provider, will have to post collateral as of closing as its rating is below the minimum swap counterparty rating consistent with Fitch guidelines.

If the interest rate payable by the CBC on a series of covered bonds is not indexed to Euribor, basis risk will result from the variance between this rate and the Euribor-based payments of the TRS. Any such risk will be hedged by entering into an interest rate swap agreement whereby the CBC will, on a notional equal to the relevant series of covered bonds, pay Euribor and receive flows based on the relevant interest rate.

Where the covered bonds are issued in a currency other than euros, the CBC will enter into a structured swap to hedge for possible interest and currency risks in the same manner as for the interest rate swap agreement.

## Conclusion

Fitch has assigned a D-Factor of 14.1% to NIBC's covered bonds. This, combined with the issuer's Long-Term IDR of 'A-', allows the covered bonds to be assigned an 'AA+' rating on a probability of default basis. OC taken into account by Fitch is sufficient to withstand the corresponding stress scenarios applied in the agency's covered bond cash flow analysis. In addition OC ensures ample stressed recovery on defaulted covered bonds in a 'AAA' scenario, leading to a final covered bond rating of 'AAA'.

Due to the dynamic nature of the cover assets, the agency will periodically conduct a review of the credit quality of the cover pool, OC and other features that could affect the outstanding covered bonds rating. Cover pool and covered bonds information will be displayed on Fitch SMART covered bonds surveillance tool (available on [www.fitchresearch.com](http://www.fitchresearch.com)), and updated on a regular basis.

**Appendix 1**

**Structural/Legal Summary**

**Table of Events and Relevant Consequences to the Issuer and the Bondholders**

Event	Trigger	Structural consequence	Payer	Acceleration	Timely payments	Full repayment	
Initial (before any of the following events)	No notification event, notice to pay or CBC acceleration notice has been served	The CBC is not entitled to keep any proceeds from the cover pool; these will be retained by the relevant sellers. The issuer makes scheduled payments to the covered bonds out of its own resources. Costs incurred by the CBC are borne by the issuer. Any funds in connection with swap agreements entered into by the CBC are to be paid directly to the issuer. On each CBC payment date, any amount standing to the GIC account is handed back to the issuer, to the extent permitted by the ACT.	NIBC	No	Yes Interest and principal paid on due date.	Yes Interest and principal payments met in full by the issuer.	
Assignment notification event	A CBC event of default occurs. Dissolution, liquidation, bankruptcy or emergency regulations proceedings against the seller or the Collection Foundation. A security trustee pledge notification event occurs	Borrowers are notified to discharge their obligations to a separate account in the name of the CBC. The CBC is entitled to receive all cash flows for its own benefit. Expenses and swaps continue to be settled on behalf of the CBC by the issuer.	NIBC	NO	Yes Interest and principal paid on due date.	Yes Interest and principal payments fully met by the issuer.	
Issuer event of default	Default of the issuer on principal or interest on covered bonds for more than seven or 14 days, respectively. Default of the issuer on any other obligation related to the covered bond programme. The winding-up, liquidation or bankruptcy of the issuer	An issuer acceleration notice and a notice to pay on the CBC are served. On behalf of the CBC, the administrator will apply all cash flows from the cover pool in accordance with the post-notice-to-pay priority of payments. The trustee may commence proceedings against the issuer. If a covered bond series matures within 12 months, the CBC is required to sell sufficient loans to redeem the covered bonds.	CBC	No	Yes Interest and principal met by the CBC. There may be a delay if payment is triggered by an issuer default on principal and interest that remains unremedied for more than seven or 14 days, respectively.	Yes Interest and principal payments met in full by the CBC.	
CBC event of default	Default of the CBC on its obligations under the guarantee for the payment of principal or interest on any covered bond series issued by NIBC that remains unremedied for more than seven or 14 days, respectively. Default of the CBC on any other obligation. The winding-up, liquidation or cessation of the CBC's activities. The guarantee is not in full force and effect. A breach of the amortisation test following the serving of a notice to pay on the CBC	The trustee will serve a CBC acceleration notice on the issuer, copied to the CBC. All covered bonds become immediately due against the CBC. The security becomes enforceable.	CBC	Yes	Each covered bond of each series becomes immediately due and payable at its early redemption amount plus accrued interest.	No Covered bonds either accelerate or a CBC acceleration notice is triggered by the missed timely payment by the CBC.	Depending on the proceeds deriving from the portfolio sale.

Source: Programme documents

## Appendix 2

### Asset Cover Test (ACT) Formula

The ACT is set such that the adjusted aggregate asset amount (defined below) is at least equal to the outstanding balance of all covered bonds in the programme on the relevant calculation date.

The adjusted aggregate asset amount of the portfolio is defined according to the following formula:

$$A + B + C + D - Y - Z$$

where:

**A** corresponds to the lower of:

- the sum of all adjusted current balances of all transferred receivables. The “adjusted current balance” of a transferred receivable is the lower of:
  - the current balance of such transferred receivable minus  $\alpha$ ; or
  - the LTV cut-off percentage of the indexed valuation relating to such transferred receivable, minus  $\beta$ ; and
- the asset percentage of: the sum of the current balance minus  $\alpha$  of all transferred receivables.

The asset percentage cannot exceed 90.5%. Multiplication by the asset percentage ensures that, regardless of the LTV level of the portfolio, a minimum 10.5% OC will always be available.

$\alpha$  and  $\beta$  are adjustments made for insurance, savings and other set-off risks, construction deposits, loans that become non-eligible and loans in arrears for more than 90 days or in default.

**B** equals the aggregate amount of cash standing to the credit of the cash collateral account.

**C** equals the aggregate value of substitute assets in cash.

**D** is equal to the aggregate value of all permitted investments.

Both substitute assets and permitted investments will be accounted for at the market value assessed as at the last business day before an ACT calculation and subject to a further haircut proposed, from time to time, to Fitch.

**Y** is an amount intended to cover for deposit set-off upon loss of A-.

**Z** is an amount intended to address potential negative carry in the transaction caused by holding funds in the covered bond account. It is equal to zero if a TRS is in place, otherwise it is sized by multiplying the aggregate covered bond principal outstanding by the weighted-average remaining maturity and by a negative carry factor corresponding to the difference between the WA margin on covered bonds and the GIC margin.

## Appendix 3

### Amortisation Test

The amortisation test requires the adjusted aggregate asset amount (defined below) to be at least equal to the outstanding balance of all covered bonds in the programme on the relevant calculation date.

For the purposes of the amortisation test, the adjusted aggregate asset amount means:

$$A + B + C - Z$$

where:

**A** is the sum for all loans of the lower of:

- the current balance of such loan minus  $\alpha$ ; or
- the LTV cut-off percentage of the indexed valuation relating to such loan, minus  $\beta$ .

**B** refers to the amount of any cash standing to the credit of the GIC account and the principal amount of any authorised Investments.

**C** means the outstanding principal balance of any substitution assets.

Substitution assets will be valued on a monthly basis and be taken into account for their mark-to-market value at a discount based on a methodology provided by the rating agencies.

**Z** has the same meaning as in the ACT.

## Appendix 4

### Priority of Payments

Depending upon whether the mentioned events of default have occurred, there are different priorities of payment for application of revenue and principal flows received from the assets by the CBC.

### Pre-Notice-to-Pay Priority of Payments

Prior to an assignment notification event and if no notice to pay or CBC acceleration notice has been served, all cash flows from the asset portfolio are kept by the relevant originators and the issuer will bear all expenses incurred by the CBC as consideration for assuming the guarantee. All amounts in relation to swap contracts are paid and received by the issuer. On each covered bond payment date, the administrator on behalf of the CBC must distribute any amount standing on the GIC account to the originators, to the extent permitted by the ACT.

If a notice to pay is served on the CBC due to a breach of the ACT or any of the portfolio tests (if so implemented) but before an issuer or CBC event of default has occurred, the issuer is still responsible for meeting the interest and principal payments on the covered bonds, and all costs, expenses and swaps continue to be settled by the issuer on behalf of the CBC. However, the amounts standing on the GIC account are retained and not distributed to the originators.

### Post-Notice-to-Pay Priority of Payments

Following the occurrence of an issuer event of default and the delivery of a notice to pay and an issuer acceleration notice, the administrator must apply all available revenue funds in accordance to the following priority before the occurrence of a CBC event of default:

- any amounts due to the trustee;
- any taxes owed by the CBC to the tax authorities;
- any remuneration due to the paying agents, registrar, and (plus any applicable VAT), on a pro rata and pari passu basis and to the payment of any other amounts due by the CBC to other third parties;
- any remuneration, pro rata and pari passu, due to the servicer, administrator, account bank (or standby account bank), asset monitor and corporate services providers, plus any VAT when applicable;
- payment to the TRS provider (excluding termination payments if provider defaults);
- payments to the interest rate swap provider and interest to the structured swap providers (excluding termination payments if provider defaults);
- to pay to the trustee the scheduled interest due to the covered bondholders;
- payments to the structured swap provider in relation to principal amounts;
- to pay to the trustee the scheduled principal amount due to the covered bondholders;
- to deposit the remaining funds in the GIC account until the covered bonds are fully repaid or an amount equal to the required redemption amount for each series has been accumulated;
- excluded interest rate swap and structured swap termination payments to the swap providers;
- indemnity amounts to the originators and to the asset monitor; and
- any remaining monies paid to the issuer or if the issuer is insolvent, to any

solvent originator.

### **Post-CBC-Acceleration Notice Priority of Payments**

Following a CBC event of default and service of an acceleration notice on the CBC, available principal and interest receipts are applied according to the following priority:

- any amounts due to the trustee;
- any taxes owed by the CBC to the tax authorities;
- any remuneration due to the agent bank, paying and calculation agents (plus any applicable VAT);
- any remuneration, pro rata and pari passu, due to the servicers, administrator, account bank (or standby account bank), asset monitor and corporate services providers, plus any VAT when applicable;
- payment to the TRS provider (excluding excluded termination payments);
- payment to the interest rate swap provider (excluding excluded termination payments);
- payment, pro rata and pari passu, to the structured swap provider (excluding excluded termination payments) and to the trustee for payment of principal and interest due to the covered bondholders;
- excluded swap termination payments; and
- any remaining monies paid to the issuer or, if the issuer is insolvent, to any solvent originator.

## Appendix 5

### Summary of Fitch Covered Bonds Rating Criteria

Fitch began applying its new rating methodology for covered bonds in February 2007. The ratings are based on probabilities of default and recovery expectations.

Fitch introduced a new concept, the D-Factor, as a measure of the likelihood that the covered bonds would suffer a default as a direct result of the default of their ultimate debtor. D-Factors range from 0% (standing for a perfect continuity of payments) to 100% (default probability of the covered bonds is equated to that of the issuer). The D-Factor is a weighted score of the following system- and issuer-specific elements: segregation of the cover pool (50%); solutions to overcome liquidity gaps upon an issuer default (30%); feasibility of the transition to an alternative cover pool management (15%); and the role of the supervisory authority (5%).

The combination of the IDR and the D-Factor translates into a maximum rating that the covered bonds can achieve on a probability of default basis, provided over-collateralisation between the cover assets and the covered bonds can sustain the corresponding stress scenario. This is tested in Fitch cash flows model, which compares the stressed assets and liabilities profiles in a wind-down scenario. Stresses includes credit losses on the assets, cost of bridging maturity mismatches by disposing of the assets or investing excess cash, adverse variation of interest and currency rates, expenses of a third-party manager.

### Discontinuity Factor Matrix

#### Maximum Achievable Rating Based on the Covered Bonds' Probability of Default

Issuer Default rating	D-factors								
	100%	50%	35%	20%	15%	14.1%	10%	5%	0%
AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
AA+	AA+	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
AA	AA	AA+	AA+	AAA	AAA	AAA	AAA	AAA	AAA
AA-	AA-	AA+	AA+	AAA	AAA	AAA	AAA	AAA	AAA
A+	A+	AA-	AA	AA+	AA+	AAA	AAA	AAA	AAA
A	A	AA-	AA	AA+	AA+	AAA	AAA	AAA	AAA
A-	A-	A+	AA-	AA	AA+	AA+	AA+	AAA	AAA
BBB+	BBB+	A+	AA-	AA	AA	AA+	AA+	AAA	AAA
BBB	BBB	A-	A	AA-	AA-	AA	AA	AA+	AAA
BBB-	BBB-	BBB	BBB+	A	A+	AA-	AA-	AA	AAA
BB+	BB+	BBB-	BBB	BBB+	A-	A	A	AA-	AAA
BB	BB	BBB-	BBB-	BBB	BBB+	A-	A-	AA-	AAA
BB-	BB-	BB+	BBB-	BBB	BBB	BBB+	BBB+	A	AAA
B+	B+	BB	BB+	BBB-	BBB	BBB	BBB	A-	AAA
B	B	BB-	BB	BBB-	BBB-	BBB	BBB	BBB+	AAA
B-	B-	BB-	BB	BB+	BBB-	BBB-	BBB-	BBB+	AAA
CCC+/CCC	CCC	B+	BB-	BB	BB+	BBB-	BBB-	BBB	AAA

Source: Fitch

The assigned rating will further incorporate the effect of stressed recoveries from the cover pool in an event of the covered bonds default. Depending on the assumed recovery percentage, an uplift of up to two notches at investment grade level can be assigned.

## Benefit for Recoveries

Recovery range (%)	Maximum notching	
	Investment grade	Non-investment grade
91-100	+2	+3
71-90	+1	+2
51-70	+1	+1
31-50	-	-
11-30	-1	-1
0-10	-1/-2	-2/-3

Source: Fitch

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