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# Analysis

SOVEREIGN  
Europe/M. East/Africa

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## African Development Bank

### Analysis

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#### RATING RATIONALE AND OUTLOOK

The Aaa debt rating assigned to the African Development Bank's (AfDB's) senior debt and Aa1 rating to its subordinated debt primarily reflects its healthy capital position and strong support from its member countries, which include several highly rated non-regional members. Such support has been repeatedly demonstrated by the willingness and ability of both regional and non-regional shareholders to meet the Bank Group's capital replenishment needs to support the expansion of its operations. The ratings are also sustained by AfDB's preferred-creditor status.

Moreover, the AfDB has achieved significant progress in improving its financial operations in recent years, which provides additional ratings support. The AfDB has consistently remained well within its internal borrowing capacity and lending limitations, which are reflected in the healthy capital adequacy and liquidity ratios. AfDB's ratings carry a stable outlook, reflecting the strengthening of capital adequacy, risk asset coverage and provisioning in recent years. Indeed, the AfDB's indicators of risk-adjusted assets are on a par with or compare favourably to those of other Aaa-rated multilateral institutions such as the World Bank, the Inter-American Development Bank and the Asian Development Bank.

Moody's believes that these strengths more than compensate for the Bank's high level of arrears, which reflects the overall challenging political and economic environment of the African continent. Other favourable developments for the Bank include the HIPC (Highly Indebted Poor Countries) debt relief initiative sponsored by the AfDB, the World Bank, the International Monetary Fund (IMF), and the donor community, which provides debt relief to the countries that demonstrate a commitment to maintaining sound macro economic performances and debt service payments.

In June 2002, the AfDB's board of governors approved an exceptional mechanism to clear the arrears of the Democratic Republic of Congo (DRC). This mechanism was part of an internationally coordinated effort to provide critical development assistance to the DRC in its rehabilitation endeavours as it emerged from conflict. The mechanism aimed at clearing DRC's arrears and consolidating the amount due in a restructured 20-year loan that maintained the net present value of the constituent loans, was also designed to safeguard the preferred-creditor status of the Bank and to minimise the risk of moral hazard. The initiative resulted in a substantial reduction of the arrears of the Bank, 60% of which consisted of DRC arrears. Moreover, the DRC reached its HIPC "decision point" and qualified for debt relief under the Initiative in July 2003.

Nevertheless, fewer African countries reached HIPC decision point in 2003, with most of them being conflict or post-conflict countries. The Boards of Directors of the AfDB Group in 2004 approved an internationally-coordinated arrears clearance mechanism for post-conflict countries, aimed at helping such countries to clear their arrears, thereby permitting them to satisfy a condition necessary for reaching HIPC decision point and ultimately enabling the eligible countries to more meaningfully re-engage with the international development community.

In addition, the AfDB's credit policy restricts the Bank's lending activities to borrowers with the highest creditworthiness. Currently, only the 15 most highly rated African countries are eligible to borrow from the Bank's window while the remaining 38 African countries can only obtain development assistance from the African Development Fund (ADF), the concessional window of the African Development Bank group.

## Structure

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The Bank group consists of the AfDB and two concessional windows, the African Development Fund (ADF) and the Nigerian Trust Fund (NTF). The African Development Bank is a regional, multilateral development bank owned by all the 53 African countries. It was created in 1964 to promote the economic development and social progress of its regional member countries. As of 31st December 2003, the subscribed capital of the AfDB amounted to US\$32 billion.

The ADF, established in 1974 as the soft lending window of the Bank group, is primarily financed by the 24 non-African countries that are shareholders of the AfDB, including Canada, the USA, 14 European countries<sup>1</sup>, two Middle Eastern Countries<sup>2</sup>, two South American countries<sup>3</sup> and four countries in Asia.<sup>4</sup>

Following the ninth replenishment of the Fund (ADF-IX) in September 2002 of an amount of US\$ 3.5 billion, the Fund's cumulative resources totalled US\$16.6 billion at the end of 2003. The resources mobilised under this replenishment have been virtually all committed. The negotiations for the Tenth Replenishment (ADF-X), covering the 2005-2007 period, were concluded in December 2004 for a total of US\$ 5.7 billion to be made available for new loan and grant commitments over the next three years.

The NTF is a special fund created in 1976 by agreement between the Bank and the government of Nigeria to provide development financing on terms intermediate between those of the AfDB and ADF to the low-income Regional Member Countries (RMCs) of the Bank Group. Following an accord with the Nigerian government aimed at strengthening the operational effectiveness of the NTF, its operation increased by more than 100% in 2003. On the 31 of December 2003, total NTF resources amounted to US\$545 million.

## Capital Adequacy

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### HEALTHY CAPITAL ADEQUACY AND STRONG MEMBERSHIP SUPPORT UNDERPIN THE BANK'S RATINGS ...

The key factors underpinning the Aaa rating of AfDB are the capital position and the support by member countries, including the several highly-rated non-regional member countries. Such support has been repeatedly demonstrated by the willingness and ability of both regional and non-regional shareholders to meet the Bank Group's capital replenishment needs to support the expansion of its operations. The most recent capital increase was approved in 1998. Further evidence of membership support is the conclusion in December 2004 of the tenth replenishment of the African Development Fund.

The structure of the Bank's subscribed capital with about 10% as paid-in and the balance as callable, compares to most of the other multilateral financial institutions. Callable capital is the unpaid portion of the Bank's subscribed capital subject to call from its members in the event of a need to meet its obligations on borrowed funds or for guarantees chargeable. The Bank has never made a call on capital.

Callable capital as at 30th September 2004 exceeds the stock of borrowings outstanding of US\$ 7.935 billion as at 30 September 2004. It is also a multiple of debt service obligations due over the next five years. The ratio of usable equity to risky assets continued to increase during 2003, reaching 69.2% at the end of the year from 63.4% at end-2002.

### ... AS DO THE INTERNAL CREDIT RISK RATING FRAMEWORK AND PRUDENT CREDIT MANAGEMENT POLICIES

The Bank has also developed an internal sovereign and non-sovereign credit risk rating framework which differs from but has some correlation to the rating scales of rating agencies. Based on its sovereign and non-sovereign credit risk methodology, the Bank determines ratings which are calibrated against expected losses. The capital adequacy policy

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1. Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom

2. Kuwait and Saudi Arabia

3. Argentina and Brazil

4. China, Korea, India and Japan

establishes a cushion against a maximum level of unexpected losses. The capital adequacy framework is the tool used currently by the Bank for strategic policy decisions.

Risk capital, a measure of risk-bearing capacity, is projected to grow by an average of 3-4% per year. Nevertheless, the utilisation of risk capital is projected to remain at levels between 50% and 60%, with a moderate increase anticipated for the coming years following a sharp decrease in the past five years due in large part to loan prepayments.

In addition to a conservative capital adequacy position, bondholders are well protected by prudent leverage ratios. Currently the Bank uses three leverage limits linked to its callable capital:

1. Total debt must not exceed 80% of the total callable capital.
2. Total senior debt must not exceed 80% of the callable capital of non-borrowing member countries.
3. Total debt must not exceed 100% of usable capital, including countries rated Aa2 and above.

At the end of 2003, these ratios were 29.8%, 59.2% and 56.9% respectively, compared to 23%, 41.7% and 41.9% at end-2002.

The AfDB's conservative provisioning policy forms part of an integrated framework of prudent credit management policies that supports the Bank's ratings. Since 1993, the Bank has maintained a programme of annual increases in the general provisioning rate. By the end of 2003, provisions on loan and equities reached US\$724 million.

The risk capital, a measure of risk-bearing capacity, as present in the balance sheet is projected to grow by an average of 3-4% per year. Nevertheless, the utilisation of risk capital is projected to remain at between 50% and 60%, with a moderate increase anticipated for the coming years following a sharp decrease in the past five years.

## Lending Trends

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### **FULFILLING ITS MANDATE: ENHANCING DEVELOPMENT AND REDUCING POVERTY ON THE AFRICAN CONTINENT**

In December 2002, the Boards of Directors of the Bank group approved the Strategic Plan for 2003-2007. The Strategic Plan describes how the Bank intends to direct and execute its activities so as to maximise its contribution towards enhancing development and reducing poverty in the African continent. The Bank Group is therefore participating in diverse initiatives, such as the HIPC debt relief initiative, NEPAD (New Partnership for Africa's Development) which was launched in Abuja, Nigeria, on 23 October 2001, and the Water Initiative. It is also involved in projects that are aimed at enhancing governance. More specifically, the Bank group is supporting the Steering Committees of NEPAD by providing technical assistance in the areas of Infrastructure Development, and Banking and Financial Standards.

Through its financial performance and risk-bearing capacity, the AfDB is able to offer the lowest lending charges to its borrowers. After five years of contraction, the Bank's loan portfolio is expected to grow by an average of 5-6% per year, led mainly by non-sovereign lending. The Bank is aiming for most of the increase in lending to be to the most creditworthy of the countries that are allowed to borrow from the Bank.

### **FOCUS ON DIRECT LENDING TO MOST CREDITWORTHY OF ELIGIBLE BORROWER COUNTRIES**

Under the current credit policy, 15 African countries are currently able to borrow from the Bank. The remaining 38 countries, the poorest countries in the continent, have only access to the concessional funds of the ADF. Among the AfDB eligible countries, several of them are still relatively far from reaching their AfDB borrowing limits, with internal guidelines set at 15% on a risk-adjusted basis of the Bank's maximum sustainable portfolio. In this context, the Bank has been able to increase its lending to the most creditworthy of its borrowers by using an approach that takes into account the riskiness of assets and the required amount of risk capital to support these assets, by devising and offering innovative and more competitive financial products. As a result of the eligibility policy, the proportion of new loans to countries classified as bearing a very low to low risk has been on an increasing trend since 2000, while loans to countries classified as having a moderate, high or very high risk are decreasing.

Other favourable developments for the Bank include the HIPC initiative, which has thus far had a moderating influence on its arrears by encouraging both aspiring countries and those already receiving debt assistance to maintain a good debt service performance. Over time, the deployment of HIPC resources should bring (or keep) the AfDB's weaker borrowers current on their obligations, leading to an improvement in the credit quality of the Bank's loan portfolio.

Total lending and grant operations of the Bank group increased by 10.7% to US\$2.6 billion in 2003. Nevertheless, overall total approvals showed a decline compared to 2002 because of the reduction of debt relief approvals under HIPC which was attributable to the fact that most eligible countries have already reached decision point, with the remaining countries being essentially conflict or post-conflict countries. The 2003 operations continued to stress pri-

ority sectors such as agriculture and rural development, infrastructure (where this is a vital component of rural development or economic integration), and human capital formation. Projects in infrastructure accounted for 42.3% of total lending in 2003, while operations in agriculture and rural development represented 12.3%.

Moreover, like other multilateral banks, the Bank group is developing its co-operation and co-financing with Bretton Woods institutions, UN specialised agencies and bilateral agencies. In 2003, the Bank Group mobilised a total of US\$5.8 billion through co-financing.

At the end of 2003, the gearing ratio was 30.7%. The total value of all loans, guarantees and equity investments is limited to 100% of subscribed capital, reserves and net income. The level of arrears and non-accrual loans of the Bank may fluctuate in response to socio-political and macroeconomic conditions in the regional member countries. However, Moody's views the financial position and structure of AfDB as sufficiently robust to withstand such changes, without impairing its ability to meet its commitments to its bondholders in a timely manner.

At the same time, however, the stock of arrears declined drastically from 61.9% of paid-in capital in 2001 to 40.1% in 2002 thanks to exceptional arrears clearance mechanism designed by the Bank for the Democratic Republic of Congo (DRC). In addition, the Bank in 2004 approved an internationally-coordinated mechanism to help eligible post-conflict countries to clear their arrears to the Bank Group, thereby setting the stage for such countries to benefit from HIPC debt relief assistance and ultimately for them to more meaningfully re-engage with the development community in their reconstruction efforts. Nevertheless, due to the difficult economic and political environment of the African continent, we are expecting the percentage of loans in non-accrual status to remain relatively high.

## **IMPROVED FIELD PRESENCE**

With the objective of better fulfilling its mandate, the Bank has embarked on a program to substantially enhance its field presence through the opening of field offices. The goal is to have a total 25 such offices operating by the end of 2006. Currently, there are 7 offices open and operating.

## **Financial Performance**

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### **OPERATING INCOME COULD BE IMPACTED BY HISTORICALLY HIGH ARREARS LEVEL AND BORROWER PREPAYMENTS**

The two sources of potential financial volatility for the Bank have been the historically high level of arrears due to the difficult political and economic environment in Africa and, more recently, the unprecedented level prepayments of obligations by borrowers.

The Bank's operating income is highly sensitive to the payment performances of borrowing countries, with economic and institutional weaknesses in many African countries having led to payment delays. Loans are placed in arrears when any payment on that loan is 30 days overdue. The Bank places all loans to a borrower country in non-accrual status once any payment on all loans due from that country is six months overdue.

In this context, following the return of Ivory Coast to accrual status in 2002, the operating income for 2002 increased by US\$96.6 million while it declined by US\$52 million in 2003 when the country fell back into arrears. In light of recent political developments in Ivory Coast, we do not expect this country to return to accrual status in the short term. AfDB's 2004 operating income is still expected to be strong, due in part to other favorable factors, such as additional income from arrears clearance for the Congo and reduction of provisioning, that would more than offset the loss of income from the Ivory Coast. In 2003, the Bank's operating income amounted to US\$ 265 million and was also boosted by US\$31.2 million due to a write back in provisions resulting in large part from an overall reduction in outstanding loans that in turn was primarily attributable to prepayments of certain sovereign-guaranteed loans.

Prepayments of loans by borrowers amounting to about US\$ 699 million in 2003, and further prepayments amounting to about US\$ 805 million in 2004, reflected the worldwide low interest rate environment. The pace of prepayment is moderating, however, as the pool of loans likely to be prepaid diminishes and worldwide interest rates start to rise.

### **MOODY'S VIEWS THE BANK AS CAPABLE OF WITHSTANDING THE IMPACT OF SOCIO-POLITICAL AND MACROECONOMIC CONDITIONS IN REGIONAL MEMBER COUNTRIES**

The level of the Bank's arrears and non-accrual loans may fluctuate due to the socio-political and macroeconomic developments in the regional member countries. However, we believe that the structure and the financial condition of AfDB's are sufficiently robust to withstand such changes, without impairing its ability to meet its commitments to its bondholders in a timely manner. For example, in our view, the Bank would be able to withstand the impact of its two

largest borrowing countries, Tunisia and Morocco, falling into non-accrual status.

The Bank is exploring various ways in which it could enhance its impact on development in Africa through the strategic use of its net income. One option would be to develop schemes aimed at assisting post-conflict countries in decreasing their arrears, as was achieved in the case of the DRC. Another possibility is to reduce lending charges, while a third option would be to increase the grant part associated to loans.

## **Prudent Liquidity Policy and Funding**

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The Bank maintains prudent liquidity policy. The AfDB has been fine-tuning its liquidity policy in recent years. Further refinements that have been implemented have been broadly in line with those of other multilateral institutions and have reflected the recent evolution of the Bank's asset liability management practices, the new IT infrastructure and the new accounting standards. With the refinements, the Bank's liquidity policy stipulates a prudential and an operational level of liquidity. The prudential minimum liquidity level is computed every quarter based on the AfDB's one-year probable cash flow requirements as the sum of four components: the following year's net loan disbursement and debt service requirements, plus the loans' equivalent value of signed guarantees, and undisbursed equity investments. This sets the minimum liquidity level. The operating liquidity level on the other hand, is the sum of the prudential minimum liquidity level plus 50 per cent of the stock of undisbursed loans. In 2003, liquid assets represented 72.6% of outstanding borrowing.

The two major elements of the AfDB's current liquidity policy are:

- "Held to maturity" investments with remaining maturities greater than one year are excluded from liquid assets.
- The shortened time horizon and quarterly revision of the prudential minimum level of liquidity have alleviated concerns relating to refinancing risks.

For 2003, the Bank borrowed around US\$3 billion through private placements and public bond issues in various currencies. As of 31 December 2003, the borrowing portfolio after swaps amounted to US\$8.6 billion. The AfDB has been able to diversify its investor base by better addressing the needs of investors and to lower its funding costs to levels comparable with other multilateral financial institutions.

## **Related Research**

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### **Special Comments:**

[Moody's Sovereign Ratings: A Ratings Guide, March 1999 \(43788\)](#)

[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 Methodology:**

[Revised Country Ceiling Policy, June 2001 \(67679\)](#)

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

## **Related Websites**

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### **European Investment Bank**

[www.afdb.org](http://www.afdb.org)

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# African Development Bank

## KEY FINANCIAL STATEMENT STATISTICS (US\$ MILS.)

### Balance Sheet Summary

	1995	1996	1997	1998	1999	2000	2001	2002	2003
<b>Assets</b>									
Liquid Assets	14,546	13,451	12,484	13,267	13,134	11,939	11,796	11,837	15,635
Gross Loans	2,400	2,076	1,784	2,010	1,722	2,424	2,720	2,803	6,245
Gross Equity Investments	10,225	9,899	9,256	9,520	9,309	8,554	8,126	8,113	8,340
Net Loans	205	198	189	199	235	233	224	247	271
Other	10,054	9,493	8,830	9,026	8,778	8,005	7,505	7,445	7,643
<b>Liabilities</b>									
Borrowings	10,629	9,432	8,471	8,935	8,695	7,484	7,112	6,457	9,634
Other	9,198	8,409	7,385	7,582	7,168	7,015	6,549	6,057	8,587
Capital and Reserves	1,432	1,024	1,086	1,353	1,527	470	563	400	1,047
Paid-in Capital	3,917	4,018	4,013	4,332	4,439	4,455	4,685	5,380	6,001
Cumulative Exchange and Currency Adjustments	2,799	2,737	2,587	2,697	2,666	2,602	2,611	2,889	3,222
Reserves	-756	-736	-664	-744	-744	-713	-727	-811	-887
Net Income	1,421	1,473	1,514	1,730	1,814	1,856	1,903	2,302	2,768
Loan and Equity Loss Provisions	76	124	136	142	156	143	253	307	174
	376	420	440	508	547	567	645	693	724

### Capital Structure Summary

<b>Total Subscribed Capital</b>	23,412	22,835	21,529	22,375	22,976	26,772	27,008	29,243	32,043
<b>Less Total Callable Capital (CC)</b>	20,564	20,043	18,885	19,610	20,264	24,144	24,375	26,341	28,802
(CC of Aa/AA Countries)	5,887	6,142	5,763	6,014	7,083	6,731	9,061	9,802	10,713
(CC of Investment Grade Countries)	7,193	7,212	6,696	6,951	8,067	7,667	11,647	12,599	13,836
+/- Net Overdue or Prepaid Subscriptions	-49	-55	-57	-69	-46	-25	-23	-13	-18
<b>Equals Paid-in Capital</b>	2,799	2,737	2,587	2,697	2,666	2,602	2,611	2,889	3,222
Less Non Negotiable Instruments Rcvd Not Yet Due	306	228	155	119	103	79	79	79	62
Plus/minus Cum. Exchange Adjust. on Subscription	-433	-443	-386	-444	-442	-165	-163	-193	-216
Less Paid-in Capital in Non-convertible Currency	168	162	152	162	158	150	145	157	171
Plus reserves and Net Income	1,559	1,714	1,812	2,079	2,215	2,018	2,236	2,684	2,995
<b>Equals Usable Equity</b>	3,443	3,628	3,705	4,050	4,178	4,226	4,461	5,145	5,768

### Loan Portfolio Summary

Approved Loans	19,007	17,751	16,796	18,269	18,684	17,837	17,794	20,269	23,211
Less Undisbursed Balance	5,554	3,730	2,714	2,959	3,076	2,470	2,288	2,283	2,678
<b>Equals Disbursed Loans</b>	13,453	14,022	14,082	15,311	15,608	15,368	15,506	17,986	20,532
Less Repayments	3,228	4,122	4,826	5,790	6,299	6,815	7,381	9,873	12,193
<b>Equals Loans Outstanding</b>	10,225	9,899	9,256	9,520	9,309	8,553	8,126	8,113	8,340

### Income Statement

<b>Gross Income</b>	907	900	841	731	727	704	717	666	636
Income on Loans	734	780	734	619	630	574	555	556	480
Income on Investments	142	92	83	94	82	119	152	101	148
Other	31	28	24	18	15	11	9	9	8
<b>Gross Expenses</b>	803	749	680	578	558	549	559	410	371
Interest and Financial Expenses	652	619	584	491	472	452	439	352	326
Provisioning for Loan and Equity Investment Losses	86	78	54	45	40	52	75	5	-29
Administrative Expenses	58	45	38	37	41	40	38	44	67
Other	6	7	5	5	5	5	7	9	7
<b>Net Income</b>	105	150	161	152	169	155	158	257	265

## African Development Bank

1995 1996 1997 1998 1999 2000 2001 2002 2003

### KEY FINANCIAL RATIOS

#### Performance Statistics (%)

Return on Total Assets	0.7	1.1	1.3	1.2	1.3	1.2	1.4	1.9
Return on Earning Assets	0.8	1.2	1.4	1.4	1.5	1.4	1.5	2.0
Return on Equity [1]	2.7	3.8	4.1	3.7	3.9	3.5	3.5	4.5
Interest on Loans/Loans Outstanding	6.8	7.6	7.7	6.7	6.7	6.5	6.6	5.7
Interest Coverage Ratio (x)	1.2	1.2	1.3	1.3	1.4	1.3	1.4	1.8
Loans in Non-accrual as % of Paid-in Capital	50.6	36.6	33.7	49.9	50.5	81.1	61.9	54.8

#### Capital Adequacy Ratios (%)

Usable Equity as % Risk Assets	38.6	42.4	46.6	49.9	53.6	60.0	68.0	90.6
Usable Equity + CC of Aaa/Aa Members as % Total Loans Outstanding	91.2	98.7	102.3	105.7	121.0	128.1	166.4	197.6
Usable Equity + CC of Aaa/Aa Members as % Risk Assets	104.7	114.2	119.2	123.9	144.4	155.5	206.2	259.0
Usable Equity + CC of IG Members/Risk Assets	119.4	126.7	130.9	135.5	157.0	168.7	245.7	308.0

#### Liquidity Ratios (%)

Liquid Assets (incl. Special Reserve)/Total Assets	16.5	15.4	14.3	15.2	13.1	20.3	23.1	39.9
Liquid Assets (incl. Special Reserve)/Total Borrowings	26.1	24.7	24.2	26.5	24.0	34.6	41.5	72.7
Liquid Assets (excl. Special Reserve)/Undisbursed Loans	37.0	46.1	52.6	54.8	43.2	82.7	102.4	233.1

#### Coverage of Debt Service (%)

Liquid Assets as % CMLTD plus Interest Paid	184.4	99.4	179.5	123.7	162.6	190.3	116.0	424.7
Liquid Assets + Net Income + Interest Paid as % CMLTD + Interest Paid	241.4	135.9	253.0	164.8	223.3	237.0	141.5	464.9
Liquid Assets + Net Income + Interest Paid as % Interest Paid	491.4	462.8	439.3	525.2	499.6	682.2	755.2	2094.9

#### Maturity Distribution of Outstanding Borrowings (% of Total)

CMLTD	7.2	17.5	5.7	14.7	8.2	11.8	29.1	13.3
One Year	17.6	5.7	13.9	6.6	8.8	24.4	5.3	7.4
Two to Four	24.8	27.8	35.7	32.5	36.0	12.8	11.4	11.6
More than Four Years	50.4	49.0	44.7	46.2	49.9	50.9	54.2	69.2

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