

Special Comment

Moody's Global Banking

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Moody's Assesses Bank Hybrid Securities in the Context of the Credit Crisis

I. Summary

Moody's ratings on bank hybrid securities generally reflect the assumption that if the government extends financial support to a struggling bank to avoid a bank failure, that support may also be extended for the benefit of hybrid security investors as well as other bank creditors. During the early stages of the current crisis, however, some governments extended support to banks' senior debt and depositors, but allowed their hybrid investors to suffer losses. In contrast, as the crisis intensified, the breadth of government support generally widened to the point where hybrids benefited from government support in most regions.

The actions of regulators earlier in the crisis, when hybrids absorbed losses, argue for a revision to our bank hybrid notching practices to reflect less systemic support than originally anticipated. However, our analysis is complicated by the subsequent actions taken by regulators, which have resulted in indirect support for hybrid securities. Rather than to overreact and make changes when there are conflicting signals from regulators, our approach is to do further research and engage market participants in a discussion on the topic. Our goal is to ensure that Moody's bank hybrid notching practices accurately capture hybrid risk and endure as the market returns to more normal conditions.

To this end, Moody's plans to discuss with regulators their long-term intentions regarding potential support for hybrid and other bank debt securities. In addition, we will engage investors, issuers, and other market participants in a dialog to get their views. Upon the conclusion of these discussions, we intend to publish a Request for Comment, which will detail potential changes to our hybrid rating methodology that are likely to vary across countries, depending on the level of systemic support, if any. In this Special Comment, we summarize the reasons for considering the changes to our hybrid rating methodology and detail some of the modifications under consideration.

We invite market participants to provide feedback by sending comments to cpc@moodys.com or by contacting anyone listed on the Analyst Contact List.



Moody's Investors Service

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II. Background

A reassessment of our notching practices was prompted by the observed performance of a number of bank hybrid securities in various banking systems since the beginning of the current credit crisis in 2007. In certain cases, hybrid securities have absorbed significant losses as the credit crisis has unfolded. Consequently, there is evidence that hybrid securities, particularly non-cumulative preferred securities and certain types of subordinated debt, do not share in the systemic support provided to more senior creditors and depositors at a time of financial distress. The behavior of some regulators has also changed in that they have allowed certain types of hybrids to absorb losses, some of which pose a greater risk of loss to investors than others.

These observations provided evidence to support a change in the starting point for notching bank hybrid ratings and widening the notching to capture a hybrid's riskiness based on its structural characteristics. To date, the reference, or "anchor" rating used as the starting point for the rating of hybrid securities has been the bank's senior unsecured rating (Bank Debt Rating or BDR), which sometimes benefits from systemic support among other potential forms of external support. With the developing experience of hybrids earlier in the crisis, the Baseline Credit Assessment (BCA) rating, which captures the intrinsic strength of the bank absent systemic support, is arguably the more appropriate starting point from which to rate hybrids. By doing this, bank hybrid rating would not incorporate systemic support unless there is a clear argument for doing so¹.

However, with the rapidly evolving and deepening severity of the credit crisis, regulators are altering their policy responses by providing extraordinary levels of support to restore confidence in the banking system. This support, which has taken various forms including preferred stock investments by governments in banks, has benefited hybrid securities as well as more senior debt and depositors. Regulators' objective to restore confidence in the markets has eclipsed the market discipline of allowing hybrids to take losses as they were designed to do.

The pivotal moment in the shift of regulatory behavior during the crisis almost certainly was the failure of Lehman Brothers and the ensuing evaporation of market confidence and intensified sensitivity of investors to counterparty risk. As a result, regulators are less inclined to discriminate in the forms of support that they provide. Until this event, support was provided for various classes of senior creditors, with losses being imposed on other creditors — most notably holders of hybrids. The resolutions of Roskilde Bank, Northern Rock, and Fannie Mae and Freddie Mac are all illustrative of this approach. Following Lehman, however, support mechanisms have evolved to be supportive across the capital structure. Probably the clearest illustration was the recent support structure put in place on behalf of Citigroup, which involved an incremental non-dilutive injection of capital and loss containment for the bank's most problematic assets.

These developments have created a fluid situation in which it is difficult to make a final determination on the level of systemic support that will prevail for hybrids once the current market crisis has passed. Our expectation is that regulators will work to restore their balanced objectives where the loss absorbing quality of hybrid capital is restored, which argues for a modification to Moody's hybrid ratings methodology.

In the next several pages, we discuss in broad terms the potential revisions we had envisioned prior to the intervention by governments globally. There will be no immediate change to our notching practices; a change in methodology will await greater clarity of regulatory policies as the crisis unfolds. To help us determine whether today's level of government support will be part of the landscape in the future or transitional in nature, we will conduct a country-by-country analysis, contacting regulators to determine their intentions related to long-term support of bank hybrids. We will also engage other market participants in the dialog. Following this reassessment, which will likely extend through the first quarter of 2009, we will consider the alternatives described herein and intend to release a Request for Comment outlining more specific details of any proposal.

¹ It is worth noting that hybrid ratings may benefit from some degree of parental and/or cooperative support, independent of systemic support. This is explained in more detail on page 3.

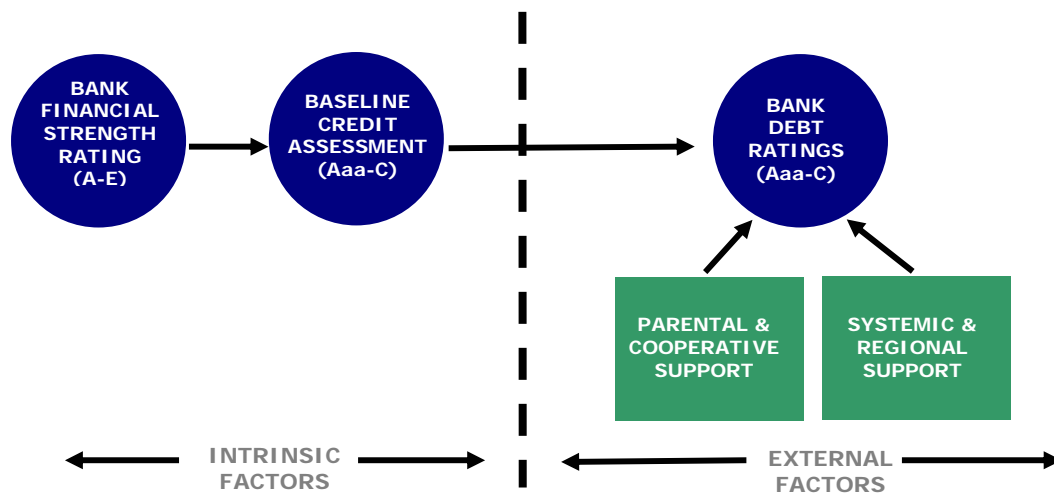
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III. Starting Point: Moody's Bank Rating Methodology

The best starting point for the discussion is a short review explaining how bank ratings, of which external support is a factor, are determined based on Moody's bank rating methodology. This is an important consideration in understanding Moody's bank hybrid notching.

Bank Rating Methodology

The schematic below summarizes the broad analytical concepts underpinning the bank rating process by highlighting the relationship between the Bank Financial Strength Rating (BFSR) and the Baseline Credit Assessment (BCA).



In analyzing the creditworthiness of banks, Moody's separates the intrinsic risk factors from external risk factors. The starting point for bank ratings is the assessment of a bank's intrinsic financial strength as captured by the BFSR, which measures the risk that a bank will require external support. While the BFSR and government intervention may be closely correlated, the BFSR is meant to signal the distance to a problem based on the bank's intrinsic financial strength. It is measured on a scale from A to E, with A for the strongest banks and E for the weakest. The BFSR is then translated into a BCA, ranging from Aaa to C.

The BFSR and BCA rating forms the basis for the BDR, which further incorporates both external support and risk elements. Anticipated external support may lift debt ratings while sovereign-related risk may cap them. External support could come from four different sources:

1. Support from a parent (operating company or family group);
2. Support from a cooperative or mutualist group;
3. Support from a regional or local government; and
4. Systemic (i.e. national government and/or central bank) support.

Unless capped by the local or foreign currency debt ceiling, the BDR can be derived by adding total external support to the BCA rating.

Current Bank Hybrid Notching Guidelines

Under Moody's current bank hybrid notching guidelines summarized in Appendix A, the starting point in the analysis is the BDR, which incorporates systemic support. Until now, our assumption was that at a time of financial distress, the systemic support extended to senior creditors would, at least to some extent, also be extended to hybrid investors. It is this assumption that has been challenged by more recent contradictory evidence.

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In the earlier months of the crisis, bank regulators, which have classified specific types of hybrids as regulatory capital, demonstrated that they expect hybrids to absorb losses. While preferred securities are the most likely to provide a cushion for more senior creditors, many regulators expanded their definition of loss absorbing capital to include certain forms of subordinated debt.

The chart below includes a number of examples where hybrid investors have taken losses while senior creditors and depositors have come out whole. The hybrids issued by the Icelandic banks and Washington Mutual have also taken losses, but were excluded from the list because their entire capital structures were subject to losses.

Bank Hybrids That Have Suffered Losses

Company	Jurisdiction	Summary	Number of Notches from the BDR to Preferred Security Ratings
Bradford & Bingley	UK	Following the transfer of Bradford & Bingley's retail deposits and branch network to Abbey National plc, its subordinated debt and preferred shares were excluded from the government support provided to senior debt and bank depositors. The assets remaining to satisfy these junior obligations will be very limited after payments are made to all other secured and unsecured creditors.	1/02/07: -2 9/16/08: -5
Fannie Mae / Freddie Mac	US	As a result of being put into conservatorship, non-cumulative preferred dividends will be forgone for several years.	7/15/08: -4 8/07/08: -19
IKB	Germany	The bank announced that it would miss coupons on its Tier 1 and Upper Tier 2 capital for several consecutive years. In addition, the dated Genussscheine (Profit Participation Certificates) and the Stille Beteiligungen (Silent Participations) issued by IKB AG and IKB International were written down to approximately 50% of their par values.	1/02/07: -3 4/01/08: -9
Northern Rock	UK	The bank's GBP400 million non-cumulative preference shares were excluded from the umbrella of UK government protection provided to senior and some of its subordinated creditors.	1/02/07: -3 2/20/08: -11
Roskilde	Denmark	A "good bank/bad bank" structure was used to help address Roskilde's severe financial distress following substantial losses on its loan book. Both preferred securities and junior subordinated debt will reside in the "bad bank" and will only receive cash payments from the "good bank" if there is a significant turnaround in its financial condition.	6/29/07: -2 8/25/08: -10

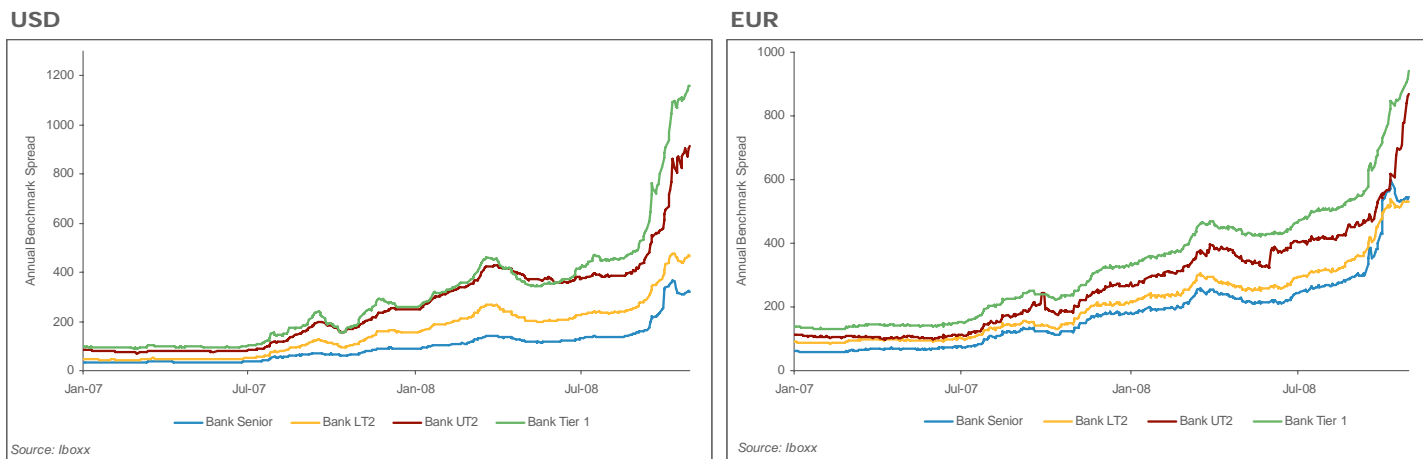
In addition to the increasing incidents whereby hybrids have not been supported in a restructuring, these securities have experienced greater transition risk than originally assumed. As such, the probability of a hybrid loss is greater than the probability of a bank default.

The current crisis has contributed to the sensitivity of these ratings. In a more normal environment, banks with deteriorating financial performance are able to continue operating and maintain access to the capital markets for an extended period of time. However, in the current environment, a bank that faces, or is perceived to face, capital or liquidity constraints is at risk of being driven to failure very rapidly as market confidence evaporates and extreme operating pressure occurs. The end result has typically been a severe shock leading to a government-initiated restructuring rather than a gradual deterioration in performance. This creates heightened risk to all classes of creditors, but exposure to losses and loss severity is greatest for holders of preferred and other deeply subordinated hybrid securities.

Notwithstanding the extraordinary support provided to banking systems generally, the market has already recognized the increased risk of hybrids. The charts on the next page compare benchmark spreads for bank hybrids broken down by the type of regulatory treatment (Tier 1, Upper Tier 2, and Lower Tier 2) relative to bank senior debt, both in the US Dollar Market and in the Euro Market.

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Hybrid Benchmark Spreads Relative to Senior Debt Spreads



In the absence of government support, Moody's believes that the increased risks to investors should be captured in all bank hybrid ratings². Consequently, the alternative notching guidelines under consideration provide a range of potential notching outcomes depending on the risk characteristics of a hybrid's features and the financial strength of the issuing bank. If some form of these guidelines was adopted, wider notching combined with systemic support no longer being assumed in certain countries, could potentially result in lower hybrid ratings for a number of banks, regardless of the level of the BFSR.

IV. Alternative Approaches for Bank Hybrid Notching

Any potential changes to Moody's bank hybrid notching would involve the anchor rating (opting to start at the BDR or BCA, as warranted) and the possibility to widen notching based on hybrid type as the BFSR drops. Both pieces are explained in depth below.

Anchor Rating

To factor in the possibility that certain types of hybrids may not receive government support at a time of financial distress, Moody's is considering using the BCA, which excludes systemic support and recognizes only the intrinsic strength of the bank, as the starting point for determining a hybrid rating. If appropriate, some benefit for parental and/or cooperative support may be given. Through such a change, the rating would be more aligned with the intrinsic financial strength of the bank itself, with less or no benefit from systemic support.

Hybrid Type	Anchor Rating	
	Existing Guidelines	Possible Changes
Plain Vanilla Subordinated Debt	BDR	Most likely none
Junior Subordinated Debt	BDR	BDR or BCA
Preferred Securities	BDR	BDR or BCA

For all hybrids except "plain vanilla" subordinated debt³, we would allow for the possibility of notching from either the BDR or the BCA, depending on the strength of country-wide systemic support, if any. For "plain vanilla" subordinated debt, which is typically treated as Lower Tier 2 regulatory capital, the starting point for notching would generally continue to be the BDR as the failure to pay interest on time is an event of default,

² It is worth noting that our bank hybrid ratings do not capture extension risk, which is the risk that a hybrid will not be called at the call date. This risk has increased in the current market crisis, which limits refinancing at a reasonable cost to banks.

³ "Plain vanilla" subordinated debt is defined as dated subordinated debt without any coupon non-payment features.

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typically allowing investors to pursue legal actions, including forcing bankruptcy or insolvency proceedings. As a result, relative to junior subordinated debt, which has the contractual ability to skip coupon payments, holders of subordinated debt are in a stronger position in terms of their ability to influence the solvency and/or liquidation of an issuer, and they often benefit from a restructuring, which typically supports depositors and senior debt.

Factoring in a Hybrid's Relative Risk Characteristics

In addition to potentially changing the anchor rating, however defined, in certain jurisdictions, Moody's is also considering revising its notching guidelines to more accurately reflect the relative risk of hybrids to investors based on the structural characteristics of these instruments. For example, while coupon non-payment over an extended period of time, particularly for non-cumulative hybrids, may result in increased loss for investors, principal impairment poses a greater risk of loss⁴. Further, a bank that defers payments for several consecutive years is increasingly likely to be taken over, bailed out, or put into liquidation. Differences such as these should be captured in the notching of the instruments:

- *Subordination level*
- *Principal write-down, and the hierarchy of how principal can be written down and written up*
- *Cumulative vs. non-cumulative coupon non-payment, which may or may not be tied to a trigger breach*

Under this approach, the notching from the anchor rating would be based on the relative risk to investors, ranging from the least risky, with the lowest possibility of a loss, to the most risky, with the highest possibility of a loss. The notching would widen as the risk increases. The four broad categories of hybrid structures are:

- **"Plain Vanilla" Subordinated Debt**

This form of Lower Tier 2 capital has no coupon non-payment features and, in a restructuring, is generally expected to be supported. As a result, the BDR would remain the anchor, and we would notch primarily to reflect subordination risk resulting from a lower recovery rate in liquidation.

- **Cumulative or ACSM-settled⁵ Junior Subordinated Debt**

For all other types of junior subordinated debt viewed as Tier 1 or Upper Tier 2 regulatory capital, which are either cumulative or allow for the possibility of an Alternative Coupon Settlement Mechanism (ACSM), the rating may be notched below the BCA. In doing this, Moody's is considering guidelines which would increase the number of notches for banks with lower BFSRs, reflecting greater expected loss. These hybrids allow for the recovery of missed coupon payments and may or may not receive systemic support in a restructuring outside liquidation.

- **Genussscheine**

Genussscheine are dated junior subordinated debt that usually absorb losses in proportion to any other loss absorbing capital (i.e., equity and silent participations). While Genussscheine are cumulative and also allow for a principal write-up, this form of Upper Tier 2 capital is susceptible to increased losses at a time of financial distress. Compared to other Junior Subordinated Debt, the greater possibility of a principal write-down at a time of financial distress results in incremental risk. Again, Moody's would expect to reflect this greater risk through additional notching relative to Junior Subordinated Debt and notching would similarly expand for weaker banks, as reflected in the BFSR.

⁴ Generally speaking, the loss potential associated with principal impairment is much higher than for coupon non-payment. Annual coupon payments are relatively small compared to the principal amount and, depending on the relative amount of hybrids in the capital structure, will not conserve a significant amount of cash, if suspended. Consequently, coupons are likely to be paid until a bank is close to a restructuring, unless specific triggers lead to coupon non-payment at an earlier point in time.

⁵ Hybrids with an Alternative Coupon Settlement Mechanism (ACSM) feature require the issuer to subsequently settle any accumulated coupons through the issuance of common stock or certain types of preferred securities. As such, they are cumulative in nature.

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■ Preferred Securities

Preferred securities, which are typically non-cumulative and may have an explicit principal write-down feature, are considered to be Tier 1 capital by regulators. As a result, even without an explicit write-down feature, they have the lowest priority of claim and are increasingly expected to absorb losses. To reflect their greater risk, the notching would be lower than Junior Subordinated Debt and, again, the notching would expand for banks with lower BFSRs.

Assessing the Impact of Triggers

Except for "plain vanilla" subordinated debt, all other hybrid types have coupon non-payment mechanisms, which allow a bank to skip a coupon payment without creating an event of default. A hybrid may have optional or mandatory deferral language, which is usually tied to the breach of pre-specified triggers. The triggers could be defined as the availability of distributable profits, minimum regulatory capital requirements, solvency ratios, or simply regulatory intervention. In evaluating the probability of a coupon non-payment, Moody's will closely assess the strength of a trigger. For instance, we consider a net loss trigger to be relatively tighter than a balance sheet loss trigger⁶, which could potentially be avoided by making reserve adjustments.

Any revisions to our hybrid notching practices would factor in the likelihood that a hybrid will skip coupon payments. We do not expect a bank to opt for coupon non-payment and risk loss of market access unless it is in severe financial distress. However, a trigger could be breached before the point at which optional deferral happens. After considering the probability of a trigger breach, the next step in determining the appropriate notching would be an assessment of whether the hybrid is non-cumulative, ACSM-settled, or cumulative. To the extent that a non-cumulative hybrid has tight triggers, we may consider additional notching because this combination has the greatest potential for loss.

Summary of the Alternatives

To summarize, the alternative bank hybrid notching proposals under consideration are:

1. *Leave the existing guidelines in place, if we believe that the current level of systemic support will continue and is not transitional in nature;*
2. *Other than for "plain vanilla" subordinated debt, change the anchor rating from the BDR to the BCA rating and widen notching; or*
3. *Keep the BDR as the anchor rating and widen notching.*

Our existing guidelines are summarized in Appendix A as already noted. A framework for the latter two alternatives is explained in Appendix B with generic examples illustrating the impact of the most severe change, where the anchor rating shifts to the BCA rating and we allow for the possibility of wider notching, in Appendix C.

V. Next Steps

The alternative hybrid notching guidelines presented in this report provide the market with guidance as to our evolving thinking related to rating bank hybrid securities. While we believe that there is justification for revising our notching practices, our analysis is complicated by the different actions taken by the regulators during the current financial crisis. As it continues, there is increased systemic support throughout the capital structure for most banks that are issuers of hybrid securities, which benefits the outstanding hybrids indirectly. We do not expect that this will remain the enduring condition, but believe that further research is necessary before making a final determination. Once we have considered comments received from market participants and developed a long-term view of countrywide systemic support following our review in the first quarter of 2009,

⁶ In contrast to a net loss trigger, which is income-based, a balance sheet loss trigger includes retained earnings, reserves, and the latest fiscal year's earnings. We consider a balance sheet loss trigger to be a weaker one because a bank will likely experience several years of losses and substantial capital depletion before there is a balance sheet loss. However, if a bank has experienced several years of net losses, the probability of a balance sheet loss trigger breach increases.

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we intend to publish a Request for Comment, which details a more specific proposal. In the meantime, we will adjust hybrid ratings as warranted by bank-specific circumstances in the normal course of business.

As a further note, following completion of any changes to Moody's bank hybrid ratings methodology, we will review our basket assignment practices described in Moody's Hybrid Tool Kit⁷, which classifies hybrids in terms of their relative debt and equity characteristics. This may result in greater equity credit than previously assigned for deeply subordinated, non-cumulative instruments with certain types of mandatory coupon non-payment triggers, and/or principal write-down features. Conversely, the absence of these features could potentially result in the reduction of equity credit. The end result of this review will be to better align our basket assignment practices with our bank hybrid notching practices.

Moody's Related Research

Rating Methodologies

- Guidelines for Rating Bank Junior Securities, April 2007 (102726)
- Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology, March 2007 (102639)
- Moody's Tool Kit: A Framework for Assessing Hybrid Securities, December 1999 (49802)
- Refinements to Moody's Tool Kit: Evolutionary, not Revolutionary!, February 2005 (91696)
- Refinements to Moody's Tool Kit: An Addendum for Banks and Insurers, January 2006 (96740)

Rating Actions

- Moody's downgrades Northern Rock's senior debt and deposit ratings to A2, preference shares downgraded to C, February 2008
- Moody's downgrades IKB to Baa3/E from A3/E+, April 2008
- Moody's downgrades Roskilde Bank's BFSR to E, subordinated debt and preferred stock downgraded to C, August 2008
- Moody's cuts Fannie Mae's and Freddie Mac's preferred stock ratings; affirms Aaa senior debt, August 2008
- Moody's announces rating actions on Bradford and Bingley, September 2008

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.

⁷ Please refer to "Moody's Tool Kit: A Framework for Assessing Hybrid Securities", dated December 1999; "Refinements to Moody's Tool Kit: Evolutionary, not Revolutionary!", dated February 2005; and "Refinements to Moody's Tool Kit: An Addendum for Banks and Insurers", dated January 2006.

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Appendix A

Summary of Existing Guidelines

(Anchor Rating is the BDR unless otherwise indicated)

Moody's Existing Bank Hybrid Notching Guidelines

	Hybrid Subordination	Typical Regulatory Treatment	Most Common Characteristics				Number of Notches below BDR*		
			Coupon Non-Payment	Principal Write-Down	BFSR / BCA				
					A / B / C (Aaa - Baa2)	D (Baa3 - Ba3)	E (B1 - Caa3)		
1	"Plain Vanilla" Subordinated Debt	Lower Tier 2	None	None	R - 1	R - 1	R - 1		
2	Junior Subordinated Debt	Upper Tier 2 or Tier 1	Optional, Cumulative or cash-cumulative (ACSM) settlement	None	R - 1	R - 1	R - 2		
3	Genussscheine	Upper Tier 2	Optional/Mandatory, Cumulative	Explicit language with possibility that principal write-down can be reversed	R - 1	R - 2	Closer to BCA		
4	Preferred Securities	Tier 1	Optional/Mandatory, Non-cumulative	With or without explicit principal write-down language.	R - 2	R - 3	Closer to BCA		

* Shown in table as R for anchor rating.

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Appendix B

Moody's Bank Hybrid Notching Guidelines under Consideration

(Anchor Rating is the BFSR/BCA Rating unless otherwise indicated)

Relative to our existing hybrid notching guidelines, those under consideration allow for the possibility of notching from the BCA rating, unless there is evidence to the contrary that systemic support will be provided. However, uplift may be given for parental and/or cooperative support, if appropriate. In addition, there is the possibility of notching wider within a range to capture the hybrid's riskiness as well as transition risk, where the probability of a hybrid loss is greater than the probability of a bank default. In terms of possible alternatives, our options include:

1. Leave the existing guidelines in place, if we believe that the current level of systemic support will continue and is not transitional in nature;
2. Other than for "plain vanilla" subordinated debt, change the anchor rating from the BDR to the BCA rating and widen notching; or
3. Keep the BDR as the anchor rating and widen notching.

The outcome of our country-by-country analysis to determine the degree of systemic support for hybrid securities at a time of financial distress as well as our dialog with market participants will drive our decision on any changes to bank hybrid notching practices.

Moody's Bank Hybrid Notching Guidelines under Consideration

Hybrid Subordination	Typical Regulatory Treatment	Coupon Non-Payment	Principal Write-Down	Number of Notches below Anchor Rating		
				A / B / C	C - / D	E
Most Common Characteristics				BFSR / BCA + Parental and/or Cooperative Support*		
				(Aaa - A3)	(Baa1 - Ba3)	(B1 - Caa3)
1 "Plain Vanilla" Subordinated Debt	Lower Tier 2	None	None	BDR - 1**	BDR - 1**	BDR - 1**
2 Junior Subordinated Debt	Upper Tier 2 or Tier 1	Optional, Cumulative or cash-cumulative (ACSM) settlement	None	R - 1	R - 1 or -2***	R - 1 to -3***
3 Genussscheine	Upper Tier 2	Optional/Mandatory, Cumulative	Explicit language with possibility that principal write-down can be reversed	R - 2	R - 2 or -3***	R - 2 to -4***
4 Preferred Securities	Tier 1	Optional/Mandatory, Non-cumulative	With or without explicit principal write-down language.	R - 2 to -3***	R - 3 to -4***	R - 3 to -5***

* Shown in table as R for anchor rating.

** If there is strong evidence that "Plain Vanilla" Subordinated Debt will not be supported, the rating will be linked to the BCA (+/-).

***The positioning of a hybrid rating within the range depends on the strength of the trigger, if any, the type of coupon non-payment mechanism, and the probability of a restructuring.

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Appendix C

Examples

As described earlier, one of our alternatives under consideration changes the starting point for bank hybrid ratings to the stand-alone creditworthiness of an entity, which is expressed through the BFSR and BCA rating, plus any uplift given for parental and cooperative support, if appropriate. The starting point could be significantly lower than under the existing guidelines where hybrids are notched down from the BDR.

The examples below, which use the same securities described in Appendix B, assume the impact of the most severe change where the starting point is the BCA rating and there is the possibility of wider notching. Each is designed to give the reader a sense of the rating implications for hybrids, given varying levels of parental and cooperative support and after taking into consideration the hybrid type. "Plain vanilla" subordinated debt is not included in the chart because the ratings will not likely be impacted by any changes since it is notched from the BDR. However, if there is evidence that systemic support does not extend to "plain vanilla" subordinated debt, we would use a lower starting point.

	Bank 1	Bank 2	Bank 3	Bank 4	Bank 5	Bank 6	Bank 7	Bank 8
BFSR	B-	B-	C-	C-	D	D	E+	E+
BCA	A1	A1	Baa1	Baa1	Ba2	Ba2	B2	B2
Parental & Cooperative Support	0	+1	0	2	0	+1	0	+5
Regional & Systemic Support	0	+2	+2	+2	+2	+5	+5	0
Total Support	0	+3	+2	+4	+2	+6	+5	+5
BDR	A1	Aa1	A2	Aa3	Baa3	A2	Baa3	Baa3
Old Starting Point for Hybrid Notching	A1	Aa1	A2	Aa3	Baa3	A2	Baa3	Baa3
<i>New Starting Point for Hybrid Notching</i>	<i>A1</i>	<i>Aa3</i>	<i>Baa1</i>	<i>A2</i>	<i>Ba2</i>	<i>Ba1</i>	<i>B2</i>	<i>Baa3</i>
Junior Subordinated Debt								
Old Rating	A2	Aa2	A3	A1	Ba1	A3	Ba1	Ba1
<i>New Rating</i>	<i>A2</i>	<i>A1</i>	<i>Baa2/Baa3</i>	<i>A3/Baa1</i>	<i>Ba3/B1</i>	<i>Ba2/Ba3</i>	<i>B3-Caa2</i>	<i>Ba1-Ba3</i>
Potential Downgrade	-	2	2-3	2-3	2-3	5-6	5-7	0-2
Genussscheine								
Old Rating	A2	Aa2	A3	A1	Ba2	Baa1	Ba3*	Ba2*
<i>New Rating</i>	<i>A3</i>	<i>A2</i>	<i>Baa3/Ba1</i>	<i>Baa1/Baa2</i>	<i>B1/B2</i>	<i>Ba3/B1</i>	<i>Caa1-Caa3</i>	<i>Ba2-B1</i>
Potential Downgrade	1	3	3-4	3-4	2-3	5-6	4-6	0-2
Preferred Securities								
Old Rating	A3	Aa3	Baa1	A2	Ba3	Baa2	B1*	Ba3*
<i>New Rating</i>	<i>A3/Baa1</i>	<i>A2/A3</i>	<i>Ba1/Ba2</i>	<i>Baa2/Baa3</i>	<i>B2/B3</i>	<i>B1/B2</i>	<i>Caa2-Ca</i>	<i>Ba3-B2</i>
Potential Downgrade	0-1	2-3	3-4	3-4	2-3	5-6	4-6	0-2

*Assumed rating. For E-rated banks, the current methodology suggests a rating closer to the BFSR.

Each pair of banks above has the same financial strength with varying levels of external support, which results in different hybrid notching outcomes, given the same type of hybrid security. For example, Bank 2 receives external support while Bank 1 does not. Consequently, when systemic support is removed, Bank 2 faces more severe notching downgrades for all hybrid types.

Both Bank 3 and 4 receive the same 2-notch uplift for systemic support. When systemic support is removed, Bank 4 continues to benefit from parental/cooperative support. As a result, the starting point for notching Bank 4's hybrids is higher than the one for Bank 3, although the notching differential remains the same because the same amount of systemic support was removed from the ratings of both banks.

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In comparison, Banks 5 and 6 are financially weaker than Banks 1 to 4. Relative to Bank 5, Bank 6 benefits from higher levels of external support generally. When systemic support is removed, Bank 6 continues to benefit from parental/cooperative support and has a higher starting point for notching bank hybrids than Bank 5. Nonetheless, the potential rating downgrades for Bank 6 are relatively more severe than for Bank 5 because a greater level of systemic support was removed.

Both Bank 7 and Bank 8 are the financially weakest of all the pairs of banks and both have high levels of external support. However, Bank 7 receives the benefit of a 5-notch uplift for systemic support while Bank 8 receives a 5-notch uplift for parental/cooperative support. As a result, when systemic support is removed from Bank 7, its potential downgrades will be significantly more severe than for Bank 8, which continues to benefit from parental/cooperative support.

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