

Banking System Outlook

Moody's Global Banking

August 2009

Vietnam

The outlook¹ for the Vietnamese banking system is negative. This outlook expresses Moody's expectations for the fundamental credit conditions in Vietnam's banking system over the next 12 to 18 months.

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Average Ratings and Outlook

Vietnamese Banks' Average Ratings and Outlook

Bank Financial Strength Rating (BFSR), weighted average	D-	Stable
Long-Term Foreign Currency Deposit Ratings, weighted average	B1	Negative
Country Ceiling: Foreign Currency Deposits	B1	Negative
Country Ceiling: Foreign Currency Debt	Ba2	Stable
Country Ceiling: Local Currency Deposits	Ba1	Stable
Country Ceiling: Local Currency Debt	Ba1	Stable
Long-Term Foreign Currency Government Debt	Ba3	Negative
Long-Term Local Currency Government Debt	Ba3	Negative

Ratings Universe

	Bank Deposits	Outlook	BFSR	Outlook
Asia Commercial Bank (ACB)	B1/NP	Negative	D	Stable
Bank for Investment and Development (BIDV)	B1/NP	Negative	E+	Stable
Vietnam Technological and Commercial Joint Stock Bank (TCB)	B1/NP	Negative	D-	Stable
Vietnam International Bank (VIB)	B1/NP	Negative	D-	Rating under review

¹ Outlooks for industries or sectors represent Moody's view on the likely future direction of credit conditions in that sector. They do not represent our projection of rating upgrades versus downgrades.



Vietnam

Summary Opinion

Vietnamese bank earnings are still benefiting from high credit growth; in 2008, loan growth for the sector was around 21%, while economic growth was 6%. In the first half of 2009, GDP growth was around 4%, placing Vietnam among only a handful of economies still registering rises in 2009.

High inflation – above 28% in August 2008 – prompted the government to tighten monetary policy and to cap loan growth at 30% for 2008. The government plans to ensure that annual inflation stays below 10% (4% in June 2009) as inflationary pressures are re-emerging, while loan growth has been capped at 25% to 27% for 2009 (17% for the 6 months to June 2009).

Despite the challenging economic environment, growth is likely to result from ongoing economic reforms and foreign direct investment inflows. Moody's expects Vietnam to register real GDP growth of 4.5% in 2009 and 5.0% in 2010, bucking the worldwide trend of contraction and differentiating itself from most of its neighbors.

The government's US\$8 billion stimulus package – to spur growth – seems to have been well received. The package includes subsidizing bank loans since February 2009 (as part of the stimulus measures, the government helps offset 4% off interest rates on loans which enterprises obtain from commercial banks), a cut in taxes for small- and medium-sized enterprises (SMEs) by 30%, and a value-added tax cut to 5% from 10%.

The goal is to promote investment packages, increase the banking sector's capitalization, and improve competitiveness.

Most local banks reported reasonable profits for 2008, despite encountering various stumbling blocks. These included a volatile interest rate environment where the base rate rose from 8.25% to 14% in the first half of 2008, before dropping to 7% in 2009. Ordinary loans carry an interest rate of no higher than 10.5% a year, with the imposition of a cap by the State Bank of Vietnam (SBV) on lending rates at 1.5 times the base rate.

As accounting disclosure is poor, assessing the banks' true credit fundamentals is difficult. However, they are moving towards International Financial Reporting Standards (IFRS) reporting. And while governance is also poor, the legal system weak and slow, and land rights inadequate, the government and regulators are trying to develop a sound legislative framework for banking.

The system is highly concentrated at the top, but fragmented at the bottom. The biggest four state-owned commercial banks (SOCBs) control 60% of all assets, including the partially privatized Bank for Foreign Trade of Vietnam (Vietcombank) and the Vietnam Bank for Industry and Trade (Vietinbank). At present, Vietnam has 38 partly privatized and joint-stock banks, four state-owned banks, one bank for social policies, one for development, two wholly foreign-owned banks, five joint-venture banks, and about 33 foreign bank offices.

Historically, state-owned banks have dominated and the levels of government ownership are still high, although the government is "equitizing" and slowly privatizing the banks. This process, coupled with foreign investments in domestic banks, will improve credit fundamentals. The number of overseas institutions wanting stakes in local banks is also growing, with a foreign bank able to hold up to a 20% stake.

Vietnamese banks are principally corporate lenders, and consumer banking remains underdeveloped, with only 17% of the population holding bank accounts. Overall, the low market penetration provides potential for expansion into the SME and consumer banking sectors as income levels rise.

The average D- BFSR of Moody's-rated Vietnamese banks – except for one – has a stable outlook. This outlook is supported by favorable prospects for the banking sector, improving risk management controls, strengthening credit fundamentals, and skills transfers from foreign strategic investors. However, rapid credit growth poses challenges for the banks' risk management, asset quality, and capitalization.

While overall asset quality has improved over the past two years – during which time SOCBs cleaned up non-performing loans (NPLs) and made provisions in line with IFRS – asset quality has deteriorated in the context of the global credit crisis, rapid domestic loan growth, and the untested nature of current risk management tools.

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Bad debt in the banking system reached 3.5% of loans by end-2008, up from 2% a year earlier. Bad loans under IFRS are significantly higher than the NPL ratios currently reported under Vietnamese Accounting Standards (VAS). The ratios under IFRS can be up to three times more than those under VAS. In addition, it is important to note that the continued clean-up of legacy NPLs at SOCBs is masking the size of NPL growth in the system.

Banks' risk profiles have shown some improvement, coupled with developments in corporate governance, but are still plagued by single-name concentrations.

Vietnamese banks generally display low capital relative to international standards. Therefore, many of the SOCBs to be equitized will require capital injections from the government and strategic investors to support quick balance sheet growth. By end-2010, banks will be required to have registered capital of at least VND3 trillion, a requirement which may force consolidation in the banking sector.

At present, all four rated banks in Vietnam have B1 foreign currency deposit ratings that are constrained by the country ceiling. If the ceiling was lifted, the four constrained deposit ratings would be upgraded. On June 4, 2008, the outlook for the banks' foreign currency deposit ratings was revised to negative from positive, following a similar revision of the outlook for Vietnam's B1 deposit ceiling.

Positive and Negative Rating Drivers

Positive Rating Trends

- Strengthening of system progressing through privatization of SOCBs and introduction of international standards and regulatory reforms
- Enhancements made to risk management and economic solvency
- On-going recapitalization and restructuring of SOCBs, reductions in borrower concentrations, and improvements to technical expertise, corporate governance, and managerial resources
- Big improvements in the operating and regulatory environment and legal infrastructure to allow more predictable and prompt foreclosures
- Improved financial fundamentals, particularly in terms of risk-adjusted earnings; income diversification and stronger capital for absorbing unexpected loss; tapping profitable and stable fee income businesses; and expanding lending to higher yielding SME and consumer banking sectors
- Continued resolution and disposal of both legacy and new NPLs; tighter credit controls to prevent new NPLs; increased loan loss reserve coverage

Negative Rating Trends

- Challenges of dampening high credit growth in the face of harsh competition
- Lack of skilled management and solid risk management practices to support growth
- Banks' intrinsic financial strength remains threatened by the protracted global economic crisis, such that asset quality and economic solvency are compromised
- Widening trade deficit and tightening monetary policy, making access to funding/liquidity a major concern
- Consolidation in the banking sector has been slow
- Presence of high credit risk concentrations in some sectors heighten banks' risk profiles, making losses and write-down requirements more unpredictable

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Rating Changes

On August 3, 2009, Moody's downgraded the issuer and deposit ratings of four Vietnamese banks. The banks were ACB, BIDV, TCB and VIB. The rating actions partially conclude the review initiated on May 27, 2009, when Moody's placed the issuer and deposit ratings of four banks in Vietnam on review for possible downgrade.

In addition, the BFSR of VIB remains on review for possible downgrade.

Separately, in the same review process, Moody's also examined its assumption of banks' systemic support probabilities in relation to their corresponding market shares in the banking system. As a result, TCB's systemic support probability has been changed to "high" from "very high", and VIB's systemic support probability has been changed to "moderate" from "high". This is in line with Moody's Joint-Default methodology for determining probability of systemic support in rating these banks.

Refer to "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology" (March 2007) for details.

Moody's previously used the local currency deposit ceiling (LCDC) as the main input for its assessment of the ability of a national government to support its banks. Although anchoring the probability of support at the LCDC is appropriate in many circumstances – regarding the provision of liquidity to a selected number of institutions over a short period of time – this might overestimate the capacity of a central bank to support financial institutions in the event of a banking crisis becoming both truly systemic and protracted.

This approach is outlined in the Special Comment, entitled, "Financial Crisis More Closely Aligns Bank Credit Risk and Government Ratings in Non-Aaa Countries", which was published in May 2009.

In the report, Moody's points out that the appropriate reference rating for the capacity of a national government to provide support to banks in a prolonged and widespread crisis would be aligned with or constrained by the government's own debt rating. However, Moody's also believes that this rating could be adjusted, usually positively, to reflect the non-fiscally dependent measures that many central banks and governments can deploy to support banks.

Consistent with the analytical criteria specified in that report and in light of Vietnam's current situation and prospects, Moody's concluded that the systemic support input for Vietnamese bank ratings be changed to Ba2 from Ba1, the former being one notch above Vietnam's local currency government debt rating of Ba3.

This change has led to the downgrade of the local currency deposit and issuer ratings of ACB, BIDV and TCB to Ba2 from Ba1. In addition, VIB's local currency deposit and issuer ratings, as well as its foreign currency long-term issuer rating have been downgraded to Ba3 from Ba2.

Separately, the BFSR of VIB remains on review for possible downgrade. The review of VIB's D- BFSR will focus on the likely deterioration of the Vietnamese operating environment and its potential impact on the bank's financial fundamentals and its overall creditworthiness. Although currently its profitability and capital levels seem adequate, Moody's believes that these factors are likely to prove less resilient to stressed conditions than those of its D- rated peers.

Moody's cautions that the following factors may translate into a significant deterioration of the bank's capital adequacy and earnings generation over the course of 2009: (i) deteriorating macroeconomic environment in Vietnam, which is expected to lead to higher default rates among borrowers; (ii) ongoing global crisis, which continues to weigh negatively on export markets, unemployment levels and property prices; and (iii) reduced profitability due to elevated credit costs, a lower interest rate environment, and weaker loan growth.

In determining VIB's BFSR, Moody's will also assess its capital level after incorporating expected losses in its risk assets using scenario analysis. This approach is consistent with Moody's special comment, entitled "Calibrating Bank Ratings in the Context of the Global Financial Crisis," February 2009.

At present, the outlook for the credit ratings of Vietnamese banks is stable, except for VIB.

All four rated banks have a B1 foreign currency deposit rating, or are at the country ceiling for foreign currency deposits. In the coming 12 months, if the country ceiling is downgraded, the banks' deposit and debt ratings may likewise be downgraded.

Vietnam

Moody's assesses Vietnam as a medium-support country. Vietnamese banking assets equal 120% of GDP. In the past, the central bank has supported state-owned and larger joint-stock banks, but has allowed small weak cooperative deposit takers to fail. If country support is assessed to have fallen, bank deposit ratings would be affected.

In the medium term, downward pressure on some BFSRs may be prompted by: (i) material deterioration in asset quality; (ii) weakening in banks' financial performances, as a result of generally poor risk management practices or the mismanagement of currency, interest rate and/or liquidity risks; and (iii) more volatile macroeconomic and operating conditions.

On the other hand, upside potential for the BFSRs could stem from: (i) significant reductions in borrower and industry concentrations; (ii) successful diversification into the SME and retail segments, provided healthy financial performances are consistently maintained; and/or (iii) mergers with stronger banks or strategic partners.

Key Issues

Slowing economy weighs down bank financials

In the face of the current global downturn and looming recession, the macroeconomic environment in Vietnam has deteriorated and is likely to weigh on banks' financial fundamentals. The effects of the global economic slowdown and tightening credit conditions are negatively affecting Vietnam's economic growth and operating environment.

The full impact of the global economic crisis and stresses in the operating environment are starting to become evident in the Vietnamese banking sector, due to a time lag of around 9-12 months before the impact of global trends can be absorbed.

Exposure to the export trading and manufacturing sectors will negatively affect the asset quality of Vietnamese banks. A weakening economy will also feed through into the consumer segment and weigh on asset quality and increasing unemployment. In addition, corporate borrowers will increasingly start to experience payment problems.

The priority for the country is to stabilize the economy and improve market sentiment. Like the rest of Asia, Vietnam is not immune from being affected by global economic conditions, but there is cause for cautious optimism. We expect the Vietnamese economy to gradually slow from the high levels seen in the past decade, mainly due to weaker external demand, but also as growth in domestic consumption and investments is expected to moderate. But if the country is able to maintain political stability and implement further reforms, it will be in a good position to ride out this global recession.

Finally, the economic slowdown is not expected to be as dramatic as in some other Asian countries, and the country is still expected to report positive GDP growth rates in 2009; we do not expect this scenario to exert significant pressure on bank ratings in Vietnam. However, a sharper or a protracted slowdown could result in some downward pressure on ratings as asset quality and profitability are likely to be affected.

Increasing pressure on asset quality

We anticipate that the rapid credit expansion of recent years could gradually reveal increased asset quality problems when banks' loan books start to season in the context of more challenging economic conditions. This deterioration has already been reflected in banks' asset quality. Under VAS, the share of overdue loans in total loans increased to 3.5% at end-2008 from 2% at end-2007.

We expect this trend to continue, as corporate and retail borrowers' ability to service their loans will be reduced. We, however, note that the level of problem loans varies considerably from bank to bank.

We expect more rapid deterioration in asset quality indicators in view of (i) the weakening operating environment resulting in growing unemployment; (ii) tighter lending conditions affecting business sector liquidity; and (iii) high single-borrower concentration likely to intensify the volatility of asset quality indicators.

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Although an abrupt deterioration is not anticipated, the presence of high credit-risk concentrations in some sectors – such as export trading and manufacturing – will heighten the risk profiles of individual banks. We already observe a heightened volume of restructured loans in these industries.

Key System Performance Measures/Rating Drivers

Franchise

Vietnamese banking system remains dominated by SOCBs

At end-2008, banking sector assets equalled 120% of GDP. The system is highly concentrated at the top, but fragmented at the bottom. The largest four SOCBs – including partially privatized Vietcombank and Vietinbank – control 60% of all assets.

In general, Vietnamese banks are principally corporate lenders, and consumer banking remains underdeveloped with only 17% of the population holding bank accounts. Overall, low market penetration provides potential for expansion into the SME and consumer banking sectors. The banks follow a straightforward business model with deposit-taking and lending as main products.

We expect aggregate assets growth to slow, reflecting tightened credit and funding conditions. The government-controlled banks are likely to expand their market shares in the system as they play increasing policy roles to stimulate the economy during the economic slowdown.

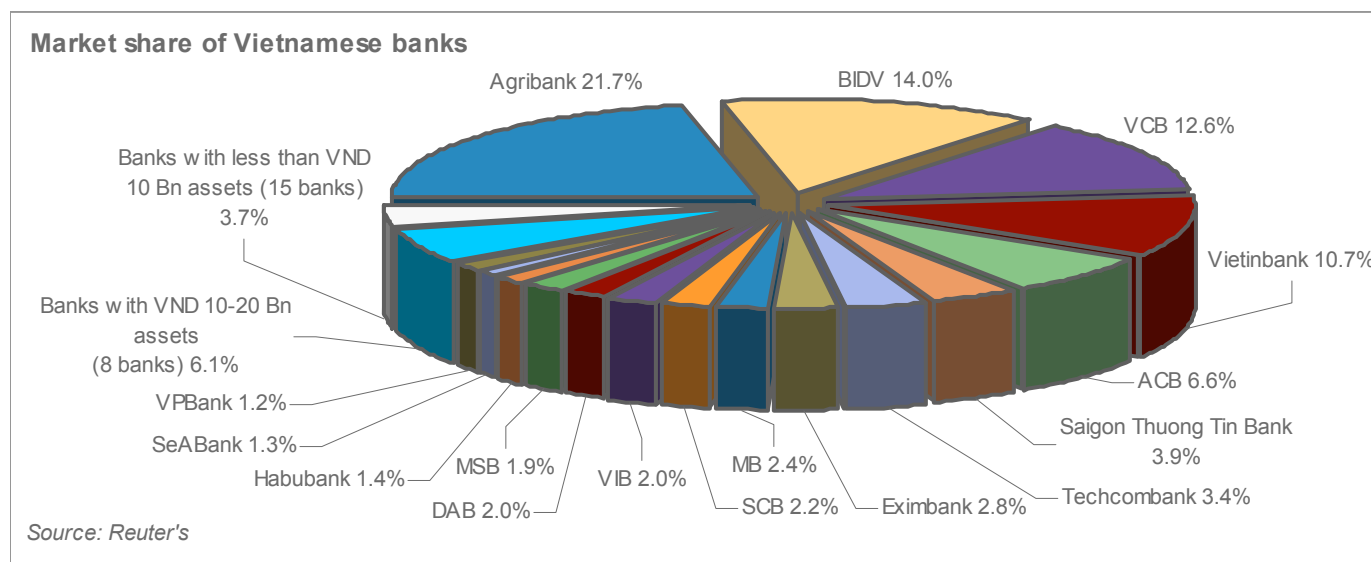
Competition is geographically concentrated within Vietnam's small and concentrated market

Competition in the market has been to some extent driven by the limited geographic diversification of the banks, which focuses primarily on the domestic market. The operations of the domestic banks are highly concentrated in the Vietnamese market which is vulnerable to the cyclicalities of a few economic sectors.

Hence the operating environment limits the franchise dynamics of local banks while introducing an element of industry and concentration risk to their loan portfolios. Moreover, the small size of the local institutions precludes them from significant expansion outside their domicile.

The Vietnamese banks' operations remain concentrated in urban areas – namely Hanoi and Ho Chi Minh City. Rural communities have little exposure to banking services. This situation offers a large market to tap in the longer term.

Exhibit 1



Vietnam

Government ownership in major banks may fall in medium term

Historically, state-owned banks have dominated and the levels of government ownership are still very high, although the government is "equitizing" and slowly privatizing the banks. This process, coupled with foreign investments in domestic banks, will improve credit fundamentals. The number of overseas institutions wanting stakes in local banks is also growing.

The government still fully owns BIDV, Vietnam Bank for Agriculture and Rural Development (Agribank), Mekong Housing Bank, Vietnam Development Bank and Vietnam Bank for Social Policies – the latter two being policy banks. Post-equitisation, it also holds 91% in Vietcombank and 89% in Vietinbank.

Given the strong interest of foreign investors, as well as the government's willingness to sell its stakes in a number of state-owned entities, the foreign presence in the Vietnamese financial sector will rise. In the medium term, if prices are right, investors are likely to buy the government's shareholdings in the relevant banks. Possible upcoming deals involve the equitisation of BIDV and Mekong Housing Bank.

Strategic tie-ups with global players – aimed at strengthening franchises and market positions – have been common, as illustrated by the table below.

Exhibit 2**Foreign strategic stakes in Vietnamese Banks**

ACB	15% Standard Chartered Bank
TCB	20% HSBC
Phuong Nam Bank (Southern Bank)	15% United Overseas Bank
Export Import Bank (Eximbank)	15% Sumitomo Mitsui Financial Group
An Binh Bank (ABBank)	15% Malayan Banking Berhad;
Dong Nam A Bank (SeABank)	15% Societe Generale Bank;
Saigon Thuong Tin Bank (Sacombank)	10% Australia and New Zealand Banking Corporation
Phuong Dong Bank (Orimcombank)	10% BNP Paribas
Hanoi Building Bank (Habubank)	10% Deutsche Bank
Bank for Private Enterprises (VP Bank)	15% Oversea-Chinese Banking Corporation

At present, domestic banks must have registered capital of VND1 trillion to be qualified to sell shares to foreign banks. By end-2010, banks will be required to have registered capital of at least VND3 trillion.

Vietnam caps total foreign ownership in a domestic bank at 30% with a 15% for a strategic investor. A foreign bank can own 10% and a non-bank investor that is not a strategic investor can own 5%. A foreign strategic investor could own 20% subject to government approval.

A total of 35 foreign banks command a combined 14% share of market lending. There are 6 joint-venture banks, 10 financial leasing ventures, 13 financial leasing firms, 998 people's credit funds and 50 representative offices of foreign banks also operating in Vietnam. About 17% of the 86 million population had bank accounts in 2008, up from 10% in 2007.

Such tie-ups aim to leverage the resulting synergies and each party's respective expertise, creating a stronger healthier entity. Foreign bank investments have contributed to the banks' franchise development through improved risk management, better quality of service and greater product innovation. Additionally, such investments have strengthened the sector by improving corporate governance and transparency.

In the next 5-10 years, a further shake-up of the sector is inevitable. Fewer and larger banks will help stabilize the financial system, as long as the mergers result in well-managed and profitable entities.

Such developments would occur against the backdrop of stricter regulatory requirements from the SBV, growing competition, and the strengthening role of the banking sector. The higher minimum capital requirement by 2010 could just be one of several factors pushing consolidation.

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Earnings mainly from corporates, but focus remains on SME and retail sectors

As lending to corporates carries low, albeit somewhat increasing, margins, banks are focusing on the SME and retail segments, in which they can (i) exploit their local knowledge; (ii) offer more flexible and complex services with high margins; and (iii) use the full potential of their client and branch networks.

The share of banks' income generated from retail and SME lending is increasing by 5-10%. The Vietnamese banking market is highly competitive and most banks aim to build market shares in both the SME and fast-growing retail segments. The current government stimulus programs further boost these shifts.

These strategic shifts, if properly implemented, will help (i) lower earnings volatility and provide wider interest margins; (ii) reduce concentration risk; and (iii) lower provisioning burdens. But these benefits could take time to materialize. Like other markets, some losses may be incurred in the interim as banks gain experience in calibrating lending models and scorecards.

The focus on consumer and SME lending could intensify competition and further pressure smaller players. If loan standards are relaxed, while market share and growth are pursued, this could increase the risk of deteriorating asset quality and rising credit costs. Moreover, languishing consumer confidence, due to economic and political instability, could negatively affect the retail lending sector, especially the credit card business.

In our view, the bigger banks have defensible franchises, which do not face a real threat from competitive pressures. On the other hand, the franchise dynamics of the smaller banks face greater challenges. Without a significant niche, these banks will be continuously tested by the more competitive environment and difficult funding conditions.

Risk Positioning

Corporate governance structure improving, but shortcomings evident

The risk management frameworks of Vietnamese banks are improving. As banking in the country evolves, banks will need to enhance their risk management functions, particularly in the area of credit risk in order to ensure that credit expansion is properly captured and controlled in a volatile local economy.

Given the still rudimentary nature of banking products, risk management lacks the sophistication of more developed banking systems, reflecting also the simple nature of banking operations within Vietnam's nascent financial sector. At the same time, the country's outdated technical infrastructure and the weak IT of many banks compound operating risk concerns. But Moody's understands that the larger banks have started to upgrade their IT and technical infrastructures, with core systems already in place for some.

Although customer information has improved it remains inadequate, particularly in relation to customers with very new banking relationships (a still large portion of the population remains non-banking). Additionally, the small size of most Vietnamese banks means they tend to exhibit large single-party and (to a somewhat lesser extent) industry concentrations.

In general, banks are still developing their risk governance structures before safely moving beyond existing customer bases. The objective is to ensure that their risk management systems meet international standards.

High credit concentration levels weigh on risk-positioning assessment

A number of Vietnamese banks report high concentrations – relative to similarly-rated peers – in both single-name borrowers and industry. This level of concentration raises concerns with regard to the vulnerability of their loan portfolios to the defaults of certain large borrowers or to cyclical movements in certain industries.

Moody's uses two measures to calculate credit concentrations. The first captures the size of a bank's top 20 group exposures, and the second captures exposure to an underlying industry sector. Although the sizeable concentrations evident in Vietnamese bank loan portfolios – in relation to Tier 1 capital – are within prudential limits, they elevate the risks relative to specific groups of customers and weigh on the banks' positioning assessments. We will continue monitoring trends in this area.

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Material credit risk (and concentration) also arises from banks' extensive portfolios of government securities, which, given the Vietnamese government's low credit rating, are certainly not risk free. Within the context of links between industry and banking in the country, there are also some concerns about potentially related-party lending.

Banks' exposure to market risk is low to moderate

Vietnamese banks have limited market risk appetite largely because of the narrow nature of the stock and debt markets in the country. Market risk appetite aims at capturing the sensitivity of both the trading and non-trading books and to major changes in key financial variables, such as interest rates, foreign exchange, equity prices and credit spreads.

Since stress tests or economic capital allocated to market risk – which capture potential losses in both trading and non-trading books to major market movements – are not publicly available, Moody's has estimated the related losses and expressed them as a percentage of Tier 1 capital. The sum of Moody's-rated banks' exposures to interest rate risks, foreign exchange risks and equity risks is currently low to moderate, but we continue to monitor the trends moving forward.

More robust risk management and control systems required

Corporate governance remains underdeveloped by international standards. Most banks in the country have no independent members on their supervisory boards and risk management committees. The presence of independent directors on their boards is important as it boosts independent oversight of insiders, thereby reducing risk profiles.

Vietnamese banks demonstrated a material increase in their risk profiles, which was evidenced by an aggressive lending and borrowing strategy in recent years. Notably, deteriorating asset quality and increasing refinancing and liquidity risks of some banks reflect their weak risk positioning, specifically with regard to their risk management systems, controls and corporate governance culture. The control environment is weak as most banks have had issues relating to qualified audits, governance or control in the previous five years.

Separately, liquidity management is fair and characterized by stable core funding, and modest monitoring of liquidity positions on a daily and long-term basis.

Transparency needs enhancement

Financial transparency is still moderate. Financial statements are prepared under VAS and audited by globally recognized accounting firms. In addition to reporting according to local standards some banks also produce IFRS financial statements. In the area of global comparability, significant efforts need to be made to align financial statements with international standards, such as IFRS, or US GAAP.

Some banks release operational and financial reports annually with key information on asset quality, capital positioning, earnings, and business analysis. Nevertheless, more detailed public disclosure of risks undertaken by banks would further improve transparency, while yearly updates are usually prepared only according to local standards and lack sufficient analysis.

As accounting disclosure is poor, assessing the banks' true credit fundamentals is difficult. And while governance is poor, the legal system weak and slow, and land rights inadequate, the government and regulators are trying to develop a sound legislative framework for banking.

To sum up, Vietnam's constantly evolving regulatory environment, combined with its gradually improving IT infrastructure and risk management frameworks, is enhancing the outlook for the banking sector. Increasing participation of international banks in Vietnam's banking sector is gradually alleviating some shortcomings – refining corporate governance and risk management, as well as internal controls – although there is much room for further improvement.

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Profitability***Profitability expected to weaken with concerns on rising NPLs***

Vietnamese banks have been demonstrating decent profitability, supported by rapid growth in earning assets in recent years and healthy interest margins.

The banks' profitability have been on a volatile trend in the past 18 months with core income benefiting from the high lending environment and interest rate hikes in 1H2008. Most local banks reported reasonable profits for 2008, despite encountering various stumbling blocks. These included a volatile interest rate environment where the base rate rose from 8.25% to 14% in the first half of 2008, before dropping to 7% in 2009. Ordinary loans carry an interest rate of no higher than 10.5% a year, with the imposition of a cap by the SBV on lending interest rates at 1.5 times the base rate.

SOCBs appear to be less profitable than their joint-stock bank counterparts with a higher spread recorded by the latter. Concurrently, fierce competition and lower interest rates are placing pressure on bank margins.

Overall profitability of Vietnamese banks is expected to weaken in 2009 as the challenging operating environment is likely to adversely affect banks' financial results.

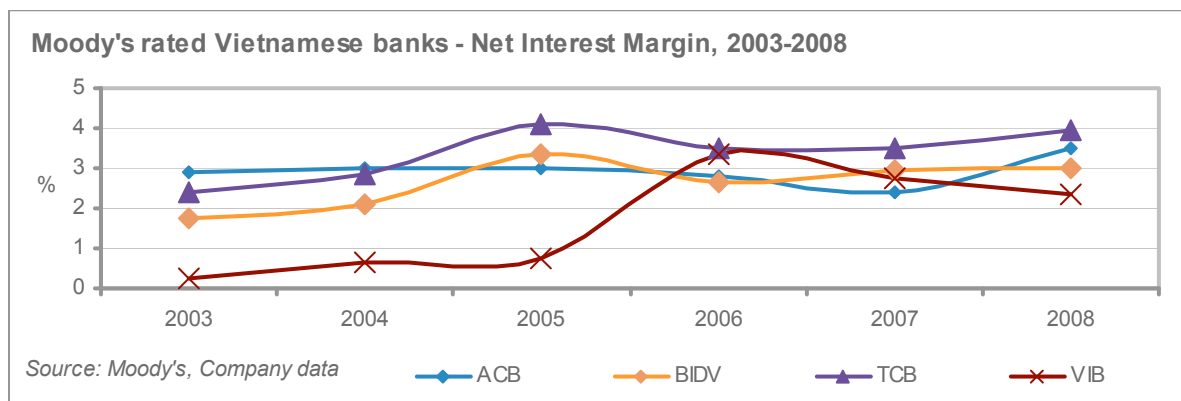
A number of factors are expected to put more pressure on the bottom-line profits of Vietnamese banks, including: (i) increasing loan loss provisioning charges, driven by an expected deterioration in asset quality; and (ii) lower rates of credit growth due to lower demand, and tighter lending and liquidity conditions.

The key constituent of Vietnamese bank profitability is interest income. Net interest income is the major contributor to operating income – ranging from 53% to 84% of the total. But this share is expected to decrease. Given the global recession and adverse market conditions, it is increasingly important for banks to improve their fee-generating capabilities in order to protect future earnings against declining interest income and possible further future losses in their books.

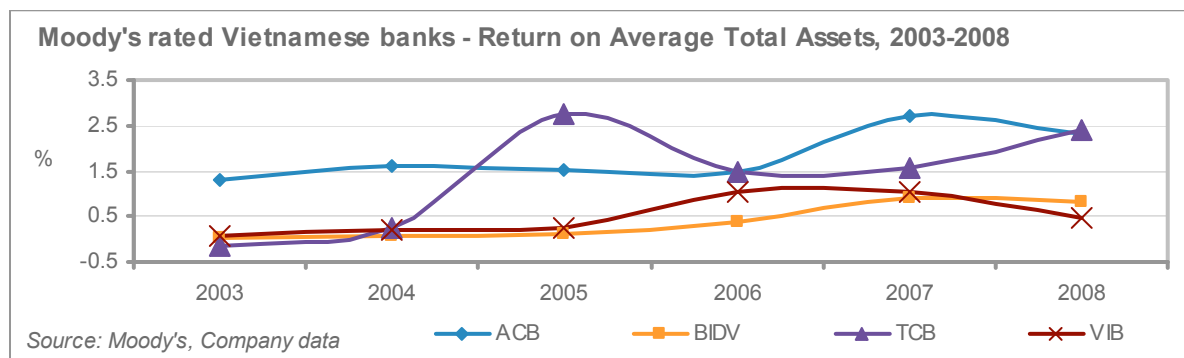
In summary, Vietnamese banks generate profitability levels that support their ratings. However, on a global basis, their profitability metrics can be quite high with joint-stock banks registering pre-provision profits (PPP) as a percentage of average risk weighted assets (RWA) as high as 8% and net income as a percentage of average RWA as high as 5%. SOCBs, on the other hand, tend to record lower profitability metrics – such as 2.5% and 1%, respectively, in the case of BIDV.

Moody's expects Vietnamese banks' PPP to remain relatively stable going forward, with slightly lower margins on the one hand, and reduced expansion costs on the other. However, bottom-line profitability is likely to decrease due to increases in loan loss provisions.

Given that there is significant variation in the performance of individual banks, weaker ones with smaller capital cushions could face increasing pressure, potentially leading to consolidation in Vietnam's banking sector.

Exhibit 3: NIM/ROA of Moody's-rated banks

Vietnam



Liquidity

Liquidity remains adequate, but is tightening

The Vietnamese banking sector's limited reaction to the credit crisis has been to some extent a result of its ample liquidity. The sector as a whole can still fund loan book growth from its deposit base. However, its loan-to-deposit ratio (LDR) is creeping up. According to SBV, credit growth in June 2009 has been 17% since end-2008, higher than deposit growth of 16%. At end-2008, Moody's-rated system's LDR ranged from 54% to 100%, reflecting the considerable variations which exist among individual banks. We note that the joint-stock banks generally display better liquidity profiles than the SOCBs.

In the past months, SBV has taken preventative measures to ease pressure on liquidity in order to maintain stability of its financial system and mitigate negative impact from the global economic and liquidity crisis. The central bank has gradually cut base interest rates to 7% from 14% since 1H 2008 and reduced reserve requirements for bank liabilities.

As liquidity and refinancing risks have become main priorities of the local regulator, the overall aim of these measures was to support liquidity and stability in the financial system, protect depositors, mitigate increasing refinancing risk, and ensure that the banking system has the funds necessary to refinance foreign borrowings and maintain lending to the economy.

The potential for banks to attract domestic funding is high. However, this is still hindered by the population's historical (albeit decreasing) lack of confidence in the banking system and the cash-based nature of the economy, whereby a significant percentage of the population maintains its savings outside the banking system. In addition, the recent surges in both the property and stock markets – on the back of a low interest rate environment and investors seeking higher yields that safeguard against inflation – contribute to the increased competition for retail deposits among banks.

Nevertheless, customer deposits remain the primary source of funding – forming 70 to 75% of total funding sources – an important rating driver for Vietnamese banks. Most of the banks' short-term deposits are reasonably sticky and typically roll over on the banks' books – under normal operating conditions – assuring them of a relatively cheap and stable source of funding.

Active deposit mobilisation strategies by joint-stock banks as well as the ability to offer more attractive deposit rates partly explain differences in deposit growth in the system. To strengthen their funding base and boost liquidity, banks will continue to play leapfrog with one another in devising new products to lure customers.

We note that banks are constantly seeking alternative avenues to fund their growth, including borrowing funds from international organizations and issuing debt securities. Such funding resources are typically more expensive and more volatile than customer deposits as they can be disrupted in periods of market distress. Provided these resources are matched to finance assets with similar maturities and do not lead to an erosion of a bank's deposit franchise or to notable interest margin pressure, we do not expect any negative rating implications from such borrowing activities. The overall system's reliance on market funding is low, although increasing.

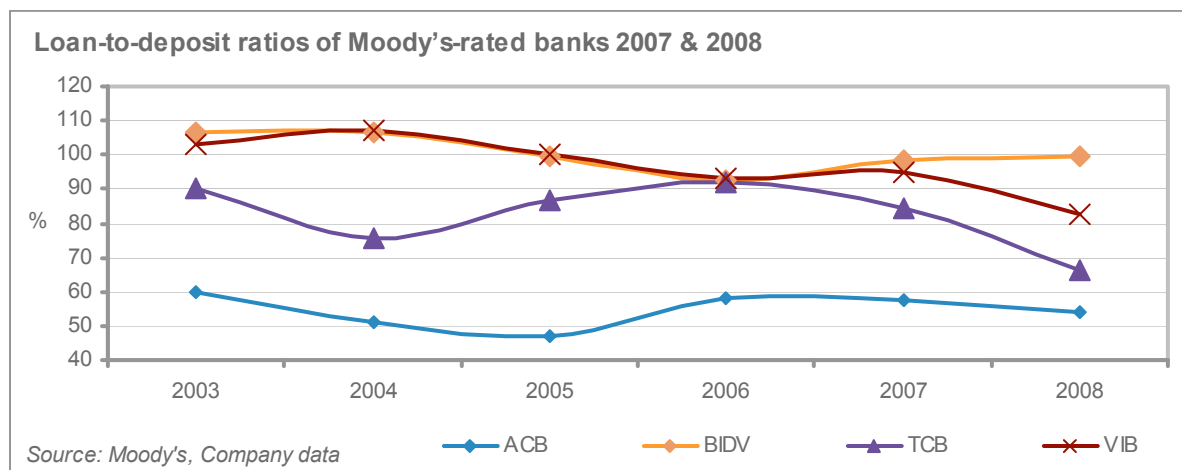
Vietnam

As Vietnamese banks have little exposure to international debt markets, the sector is not particularly vulnerable to global liquidity crunches. But a prolonged period of international financial distress would affect the general inflow of funds and thereby overall liquidity. Foreign currency deposits constitute around 20% of all deposits in the system. Separately, the sub-prime crisis has had a limited impact on Vietnamese banks.

Vietnam has a deposit insurance scheme in place. The current scheme covers only local currency deposits of up to VND50 million (approximately US\$3,000) per account. This current limit covers around 90% of depositors. Generally, credible deposit insurance contributes to financial stability by reducing the likelihood of depositor runs. However, given the historically low confidence in the banking system in Vietnam and lessons learned from the current global liquidity crisis, deposit insurance cannot ensure stability even in advanced economies and a deposit run would be difficult to manage under a stress scenario.

All in all, Vietnamese banks' strong deposit franchises are a core competency supporting their financial profiles and ratings. Potential growth is expected to be limited by the consumers' declining capacity to save. With the increased competition for deposits and a more cautious approach to lending, we expect a slow down in liquidity tightening. In addition, a mitigating factor with regard to liquidity is the banking sector's limited reliance on wholesale funding.

Exhibit 4



Efficiency

Expansion strategies pressure efficiency ratios

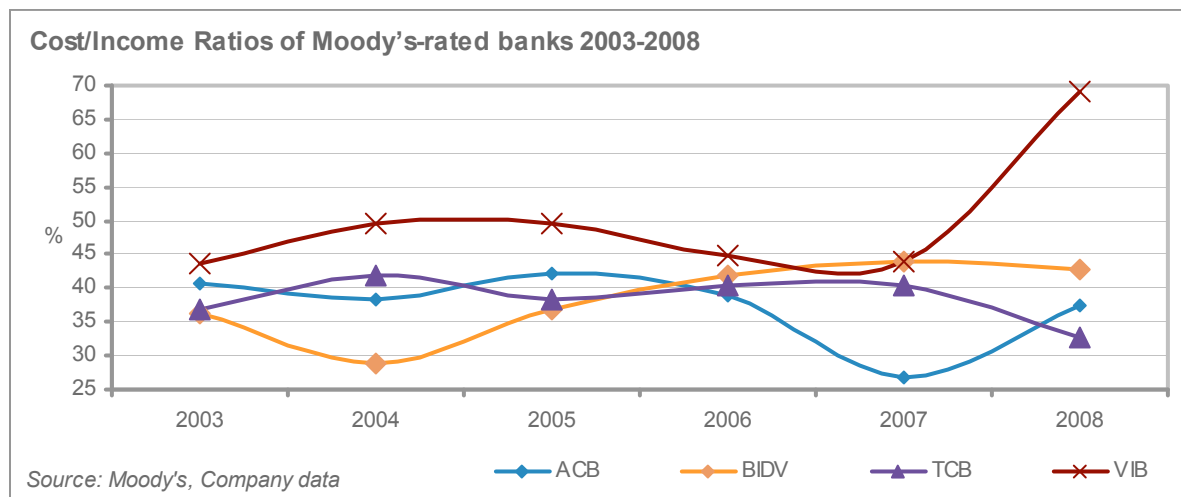
The efficiency of rated banks varies – ranging from 33% to 69% – depending on factors such as ownership structure, business model and strategy, as well as the evolution of operating expenses. For example, joint-stock banks in Vietnam operate with higher levels of automation and a smaller number of higher-paid personnel. Their efficiency ratios have been deteriorating on the back of ongoing infrastructural developments, growing personnel costs, and other administrative expenses related to the expansion of the banks' network and evolving retail business. Vietnam has about 4,000 bank branches, 2,200 of them run by Agribank.

Personnel expenses have been on the rise as, given the scarcity of banking professionals, banks have had to increase salaries to prevent employees from defecting to the competition (particularly following the arrival of better-paying foreign banks).

In addition, over half of Vietnam's 86 million population is under 35 years old resulting in a young and productive workforce. But there is a shortage of staff at this time, especially in the managerial sectors and at professional levels in white-collar businesses. Returning overseas Vietnamese – who command more pay – have made an impact by contributing the skill sets that they have learned from their exposure and experience abroad.

Vietnam

Many banks will face additional expenses if they choose to make necessary updates to their IT infrastructure and expand their networks. If revenues should decline – albeit only modestly – banks will try to respond by streamlining their branch networks in order to operate more efficiently. Banks will likely adopt more conservative and prudent business strategies, which is likely to be accompanied by cost-cutting measures.

Exhibit 5**Capitalisation****Capitalisation is inadequate and needs further strengthening**

The Vietnamese banking sector remains undercapitalized. The banks generally display low capital relative to international standards. Therefore, many of the SOCBs to be equitized will require capital injections from the government and/or strategic investors to support quick balance sheet growth.

Under statutory capital adequacy guidelines and in line with Basel I standards, Vietnamese banks are required to maintain a minimum CAR of 8%. By end-2010, banks will also be required to have registered capital of at least VND3 trillion.

Moody's has noted a wide disparity in capital ratios among SOCBs and joint-stock banks – ranging from 7% to 14% – with SOCBs' CARs at the lower end of the scale. In general, given a stressed environment, we believe that banks operating in emerging market economies require more capital than would be the case for those in developed countries.

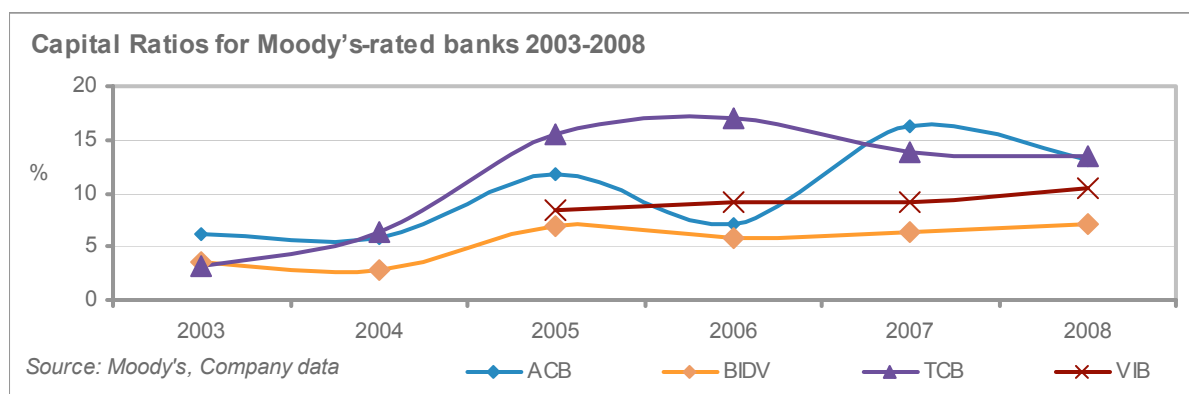
Moody's has some concerns regarding future capitalisation of joint-stock banks, whereby shareholders' ability to provide timely capital is difficult to estimate. Although aggregate capitalisation levels currently appear adequate, the capacity of Vietnamese banks to grow and expand market share in a dynamically growing banking environment largely depends on their capacity to raise capital funds.

More weakly capitalised banks will both find it harder to maintain their market shares and may face solvency pressures in the event that narrowing interest margins and rising NPLs start eroding their capital levels.

Economic conditions will be of primary importance, since a strong economy is vital to limiting losses, supporting collateral values and increasing earnings. At the same time, the time needed will vary, depending on each bank's levels of bad assets, loan loss reserves and earnings.

Although we expect banks' asset quality to deteriorate, the extent of such potential losses and their impact on the capital remains uncertain given the current global financial distress and expectations for deteriorating domestic operating conditions. We believe the more weakly capitalised banks need to further strengthen their capital positions in order to absorb any unexpected future losses. This is particularly important as the sector's economic capitalisation is weakened by the systemically low provisioning levels and heightened concerns about rising NPLs and high concentration levels in the system.

Vietnam

Exhibit 6**Asset Quality****Rapid credit growth pressures asset quality**

After a period of strong growth, the seasoning of the loan portfolio and weakening of the operating environment might result in deterioration of asset quality indicators. Since 2001, aggregate banking sector credit in Vietnam grew at more than 20% per annum, peaking at 50% in 2007. Credit growth remained buoyant in the first six months of 2009, rising by 17% from end-2008; banks have been ordered to restrict overall credit growth to between 25% and 27% in 2009.

A longer track record could prove to be a good test of the robustness of the system's credit portfolios, as well as the effectiveness of the credit approval practices used by Vietnamese banks. We see risks, especially in the growing portfolio of SME lending and the growing debt burden of households. However, if economic conditions do not weaken significantly, the deterioration in asset quality is not expected to be dramatic.

While overall asset quality has improved over the past two years – as SOCBs cleaned up NPLs and made provisions in line with IFRS – asset quality has deteriorated in the context of the global credit crisis, rapid domestic loan growth, and the untested nature of current risk management tools. Reductions in NPLs remain slow, largely because of the legal process for asset foreclosures.

Under VAS, bad debt in the banking system reached 3.5% of loans by end-2008, up from 2% a year earlier. Bad loans under IFRS are significantly higher than the NPL ratios currently reported under VAS. The ratios under IFRS can be up to three times more than those under VAS.

Higher NPLs will naturally result in elevated credit costs for banks. We note that asset quality differs from bank to bank, and is to a considerable extent defined by the composition and relative weight of the loan categories for each bank's portfolio.

As can be seen from Exhibit 7, asset quality of joint-stock banks generally appears better than that of the state-owned banks like BIDV. In addition, it is important to note that the continued clean-up of legacy NPLs at SOCBs is masking the size of NPL growth in the system.

Despite the fact that Vietnam appears thus far to have been largely shielded from the effects of the global financial crisis, it could yet suffer from a second-round impact due to the economy's external vulnerabilities. This is because the country is exposed to a potential slowdown in the economies of its main trading partners.

Another source of concern is the banks' relatively high single-party exposure concentration. In the context of the weakening economic environment, it is Moody's opinion that Vietnamese banks are facing increasing challenges due to their high single-borrower concentrations, which, along with the high lending growth and resulting unseasoned loan portfolios, are likely to have a negative impact on banks' asset quality.

Vietnam

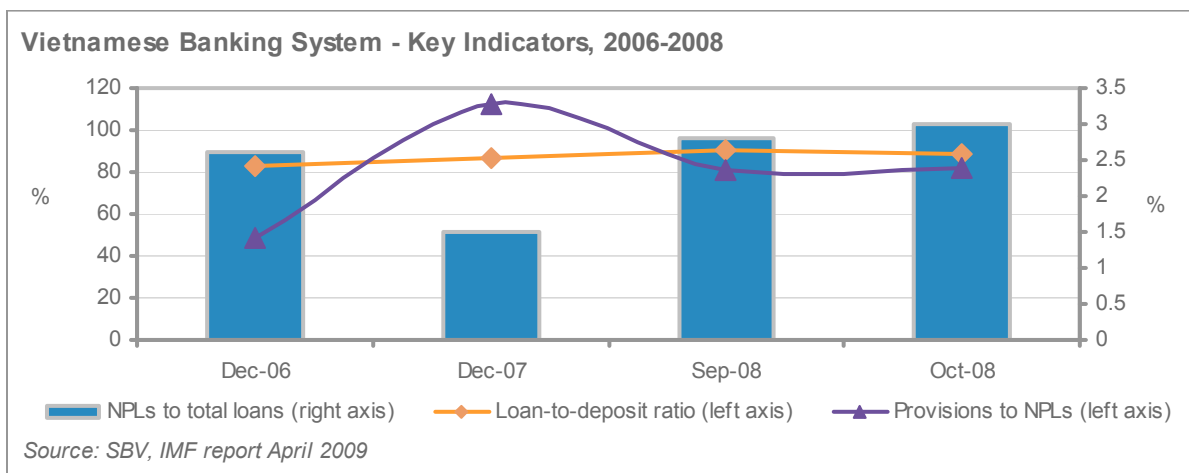
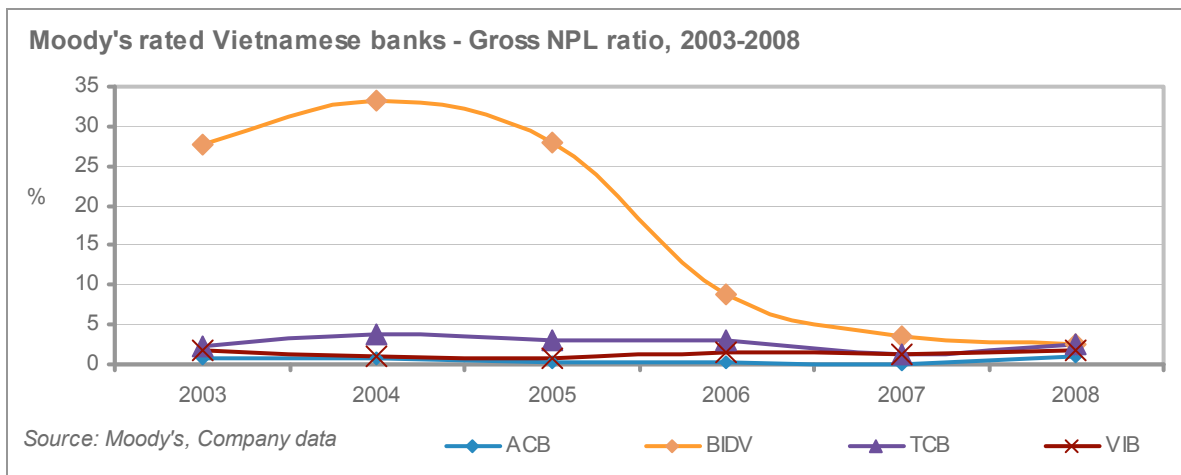
On a brighter note, we view positively the growing share of retail loans in the total portfolio especially as it is driven by secured lending. We believe that, as long as banks are prudent in offering household loans, this should enhance their franchises and boost customer confidence in the banking system. The loan-to-value (LTV) ratio has been increasing but still hovers around 60%-70%. This development was driven by stiff competition on the market; however, there has been some tightening in lending conditions. We regard high-LTV lending as inherently more risky and would view a continuing rise in the proportion of these loans as a negative development.

Moody's believes that the system's asset quality will deteriorate further as lower economic growth – typically with a time lag – brings weaker income growth and investments and increased unemployment. The repayment capacity of private households and companies will come under pressure with the liquidity constraints and the generally tightened credit criteria. In addition, banks' exposure to sectors of the economy that are heavily affected by the economic slowdown is likely to lead to declines in asset quality.

Under Moody's base-case stress scenario, NPL ratios under IFRS could reach 20% for SOCBs and 10% for joint-stock banks; though this is still half of the levels seen during the Asian financial crisis.

The challenge for Vietnamese banks will be to maintain good asset quality against a backdrop of changing economic conditions and potential second-round effects from the global economic downturn; deteriorating economic conditions in the country's trade partners could adversely affect domestic economic growth and lead to asset quality problems. We will monitor the performance of banks' loans portfolios and may take action in the future, if need be.

Exhibit 7



Vietnam

Deposit Rating Drivers

Local currency deposit ratings

Moody's assesses Vietnam as a medium-support country. This guideline considers: (i) the history of support for banks; and (ii) the strength, size and the fragmentation of the Vietnamese banking system.

SBV may, under certain conditions, decide to provide systemic support to certain banks in distress. This view takes into consideration regulatory practice within the Vietnamese banking sector and the history of its development. Moody's would also take into account the extent of the required support and the relative financial strength of the government of Vietnam when evaluating the probability and scale of potential systemic support in each particular case. In particular, we believe that SBV may provide assistance to financially distressed banks, extending emergency loans and advances for the purpose of providing liquidity.

Vietnamese banking assets equal 120% of GDP. In the past, the central bank has supported state-owned and larger joint-stock banks, but has allowed small weak cooperative deposit takers to fail. If country support is assessed to have fallen, bank deposit ratings would be affected.

The system is highly concentrated at the top, but fragmented at the bottom. The biggest four SOCBs – including the partially-privatized Vietcombank and the Vietinbank – control 60% of all assets. At present, Vietnam has 38 partly privatized and joint-stock banks, four state-owned banks, one bank for social policies, one for development, two wholly foreign-owned banks, five joint-venture banks, and about 33 foreign bank offices. All four Moody's-rated deposit-taking institutions have received uplifts for their local currency deposit ratings because of their higher degree of systemic support received.

Foreign currency deposit ratings

At present, all four rated banks have a B1 foreign currency deposit rating, or are at the country ceiling for foreign currency deposits. In the coming 12 months, if the country ceiling is downgraded, banks' deposit and debt ratings may likewise be downgraded.

Vietnam

Moody's Related Research**Credit Opinions:**

- Vietnam, 16 July 2009
- ACB, 3 August 2009
- BIDV, 3 August 2009
- TCB, 3 August 2009
- VIB, 3 August 2009

Country Statistics:

- Vietnam, 24 May 2009

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.

Vietnam

Appendix

Appendix I: BFSR/Baseline Credit Assessment Mapping

BFSR	Baseline Credit Assessment (BCA)
A	Aaa
A-	Aa1
B+	Aa2
B	Aa3
B-	A1
C+	A2
C	A3
C-	Baa1
C-	Baa2
D+	Baa3
D+	Ba1
D	Ba2
D-	Ba3
E+	B1
E+	B2
E+	B3
E	Caa1
E	Caa2
E	Caa3

Vietnam

Appendix II: Sovereign Credit Opinion

Credit Strengths

Support factors for Vietnam include:

- High level of official foreign exchange reserves
- Rapid GDP growth in the past decade
- External orientation and trade dynamism
- Substantial financial support from official creditors

Credit Challenges

Credit challenges for Vietnam include:

- Sustainability of the current account deficit
- Monetary and financial system stability
- Containment of government deficits and debt
- Structural and governance weaknesses
- Timely reporting of key statistics

Rating Rationale

Vietnam's Ba3 government bond ratings reflect a relatively low degree of economic and institutional strength, although long-term growth prospects are moderately favorable. Despite rapid growth in recent years, the scale and diversity of Vietnam's economy is still relatively modest and the per capita income level low compared with all countries rated by Moody's. Vietnam has a low susceptibility to political and economic event risks.

Trade liberalization and gradual economic reform have improved economic efficiency and are laying the foundation for long-term economic strength. Vietnam's bilateral trade agreements and WTO accession have boosted exports and FDI inflows. Vietnam's ratio of current account receipts to external debt is very favorably placed among peers. Current account deficits have been financed by FDI until recently, tempering debt accumulation. A sizable cushion of foreign exchange reserves has reduced vulnerability to external shocks.

The government's financial strength is modest and depends largely on financing from the multilateral development banks and foreign governments. Fiscal deficits have been sizable, taking into account "off-budget" investment expenditure, but are sustainable as long as economic growth is maintained and inflation contained. Past disagreement over the IMF's safeguard policy concerning external auditing of central bank accounts has not jeopardized World Bank and ADB support, but would make access to IMF facilities difficult.

Although the macroeconomic and financial data from the government and State Bank have improved, deficiencies persist which hinder assessment of Vietnam's credit fundamentals.

Rating Outlook

The change in the outlook to negative from positive in June 2008 was prompted by the emergence of inflation and economic imbalances which were greater than anticipated. The main concerns were the sharp rise in inflation, the large current account deficit and the stability of the banking system. We are concerned that the current account deficit may exceed available external financing, in particular from stable, long-term capital inflows such as FDI, thus putting downward pressure on official foreign exchange holdings.

The rating will also be affected by the ability of the authorities to manage the country's vulnerability to the global financial market crisis and avoid a deep and sustained deterioration in relative credit metrics.

Vietnam

What Could Change the Rating – Up

Concerns about policy capabilities would need to be allayed, meaning reining in inflation, reducing fiscal deficits, ensuring stability in the banking system and containing the current account deficit.

What Could Change the Rating – Down

Persistently high inflation and a large current account deficit that significantly reduces official foreign exchange reserves, banking system instability, and/or an erosion in the investment environment would have negative rating implications.

Recent Developments

Headline CPI inflation has rapidly moderated in recent months to 3.9% year-over-year in June from a peak of 28.3% in August 2008, but inflationary pressures are re-emerging.

Real GDP growth bounced back in the second quarter of 2009 after a very weak first quarter, but annual growth will likely remain below potential, estimated at around 7 percent by the World Bank. The downturn in economic growth prompted the National Assembly to approve a larger budget deficit of 8% of GDP for 2009.

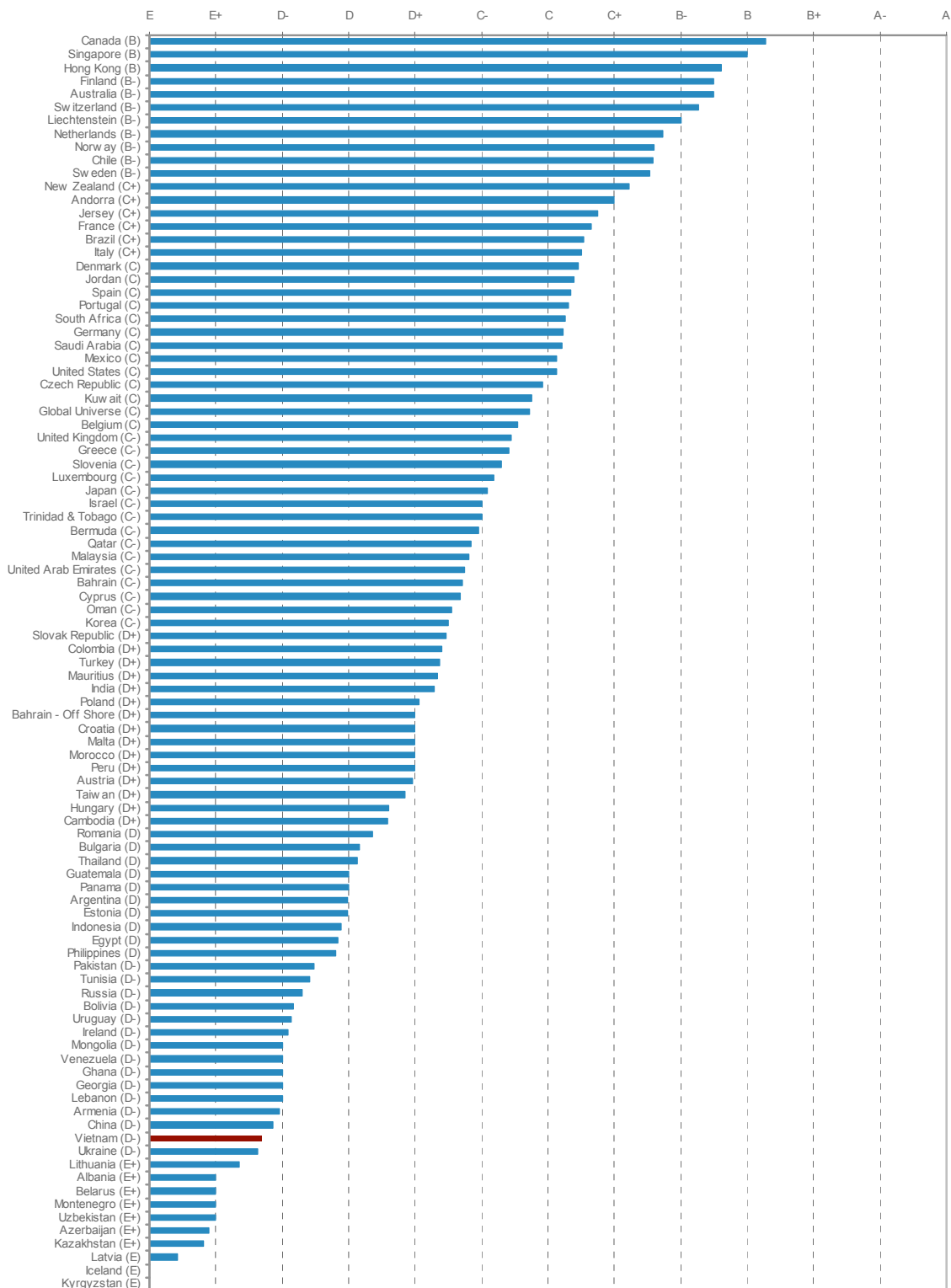
A sharp weakening in exports in the second quarter offset growth of 7% in the first quarter. The steeper decline in imports, however, suggests that the current account deficit will not be as large in 2009 as in 2008, yet some pressure will likely persist on the overall BOP position from a weak capital account and on official foreign exchange reserves.

Vietnam

Appendix III

Average* Bank Financial Strength Ratings by Country

As of August 2009

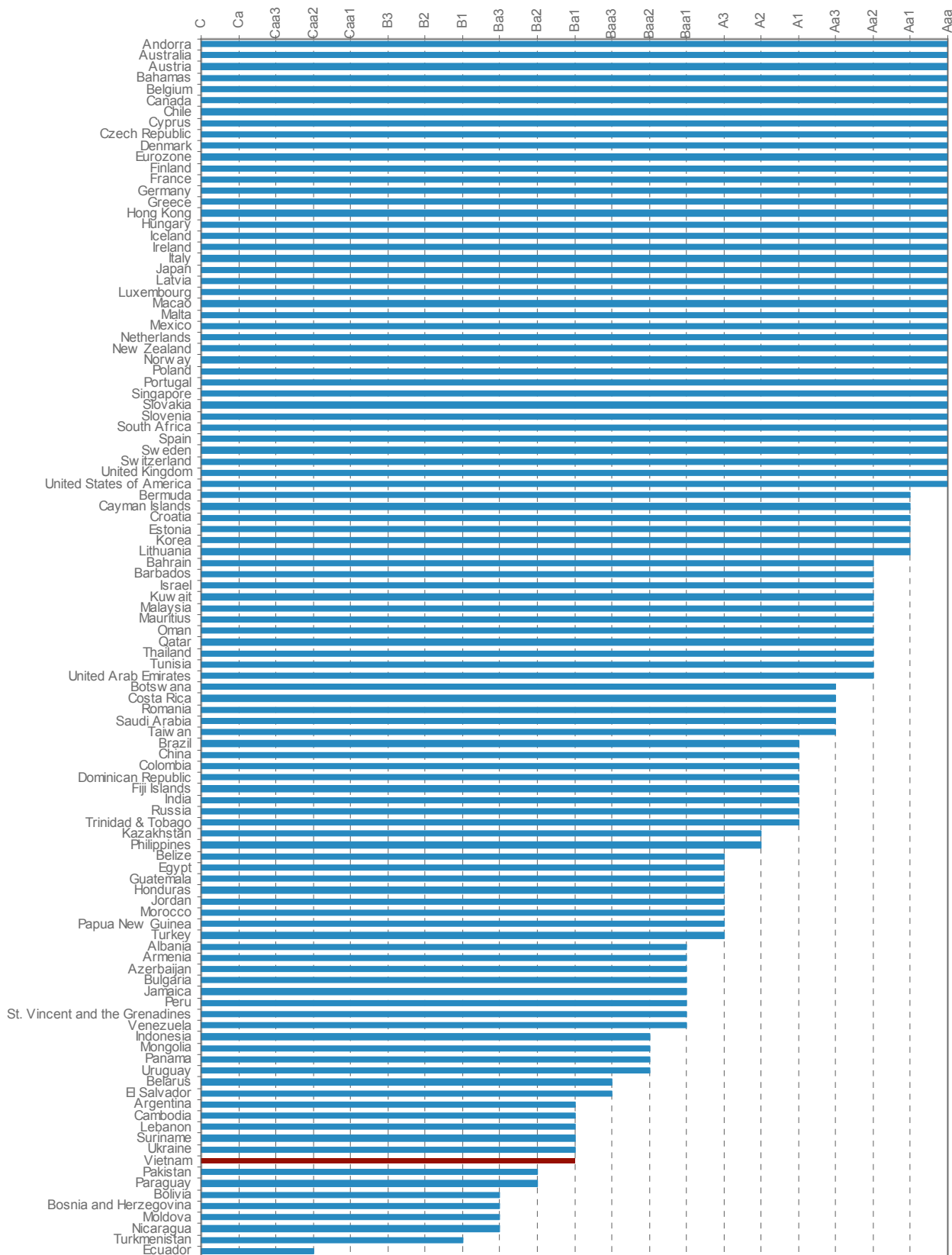


* Weighted by Assets

Vietnam

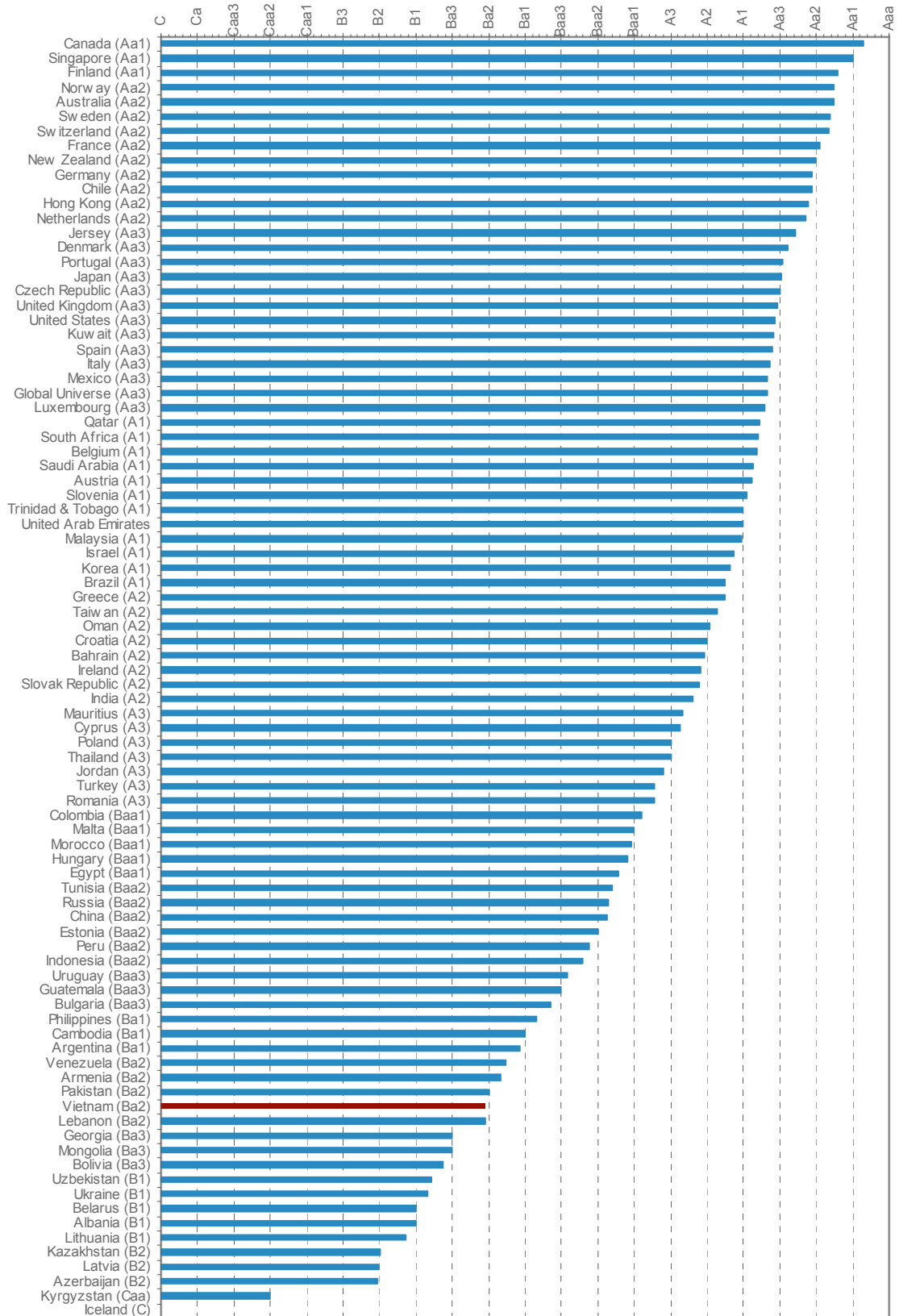
Country Ceilings for Long-Term Bank Deposits (Domestic Currency)

As of August 2009



Vietnam

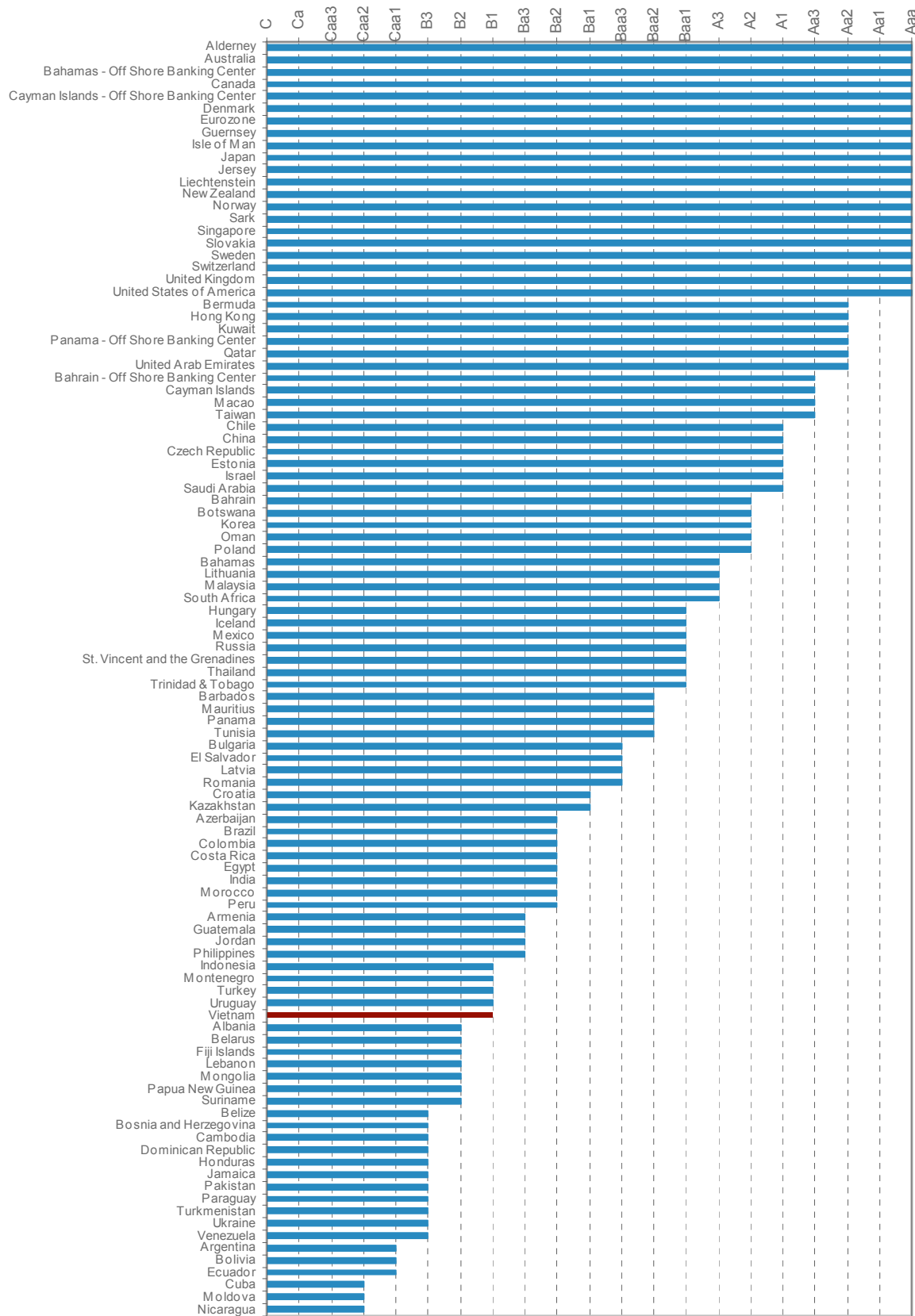
Average* Long-Term Bank Deposits by Country (Domestic Currency)
As of August 2009



*Weighted by Assets

Vietnam

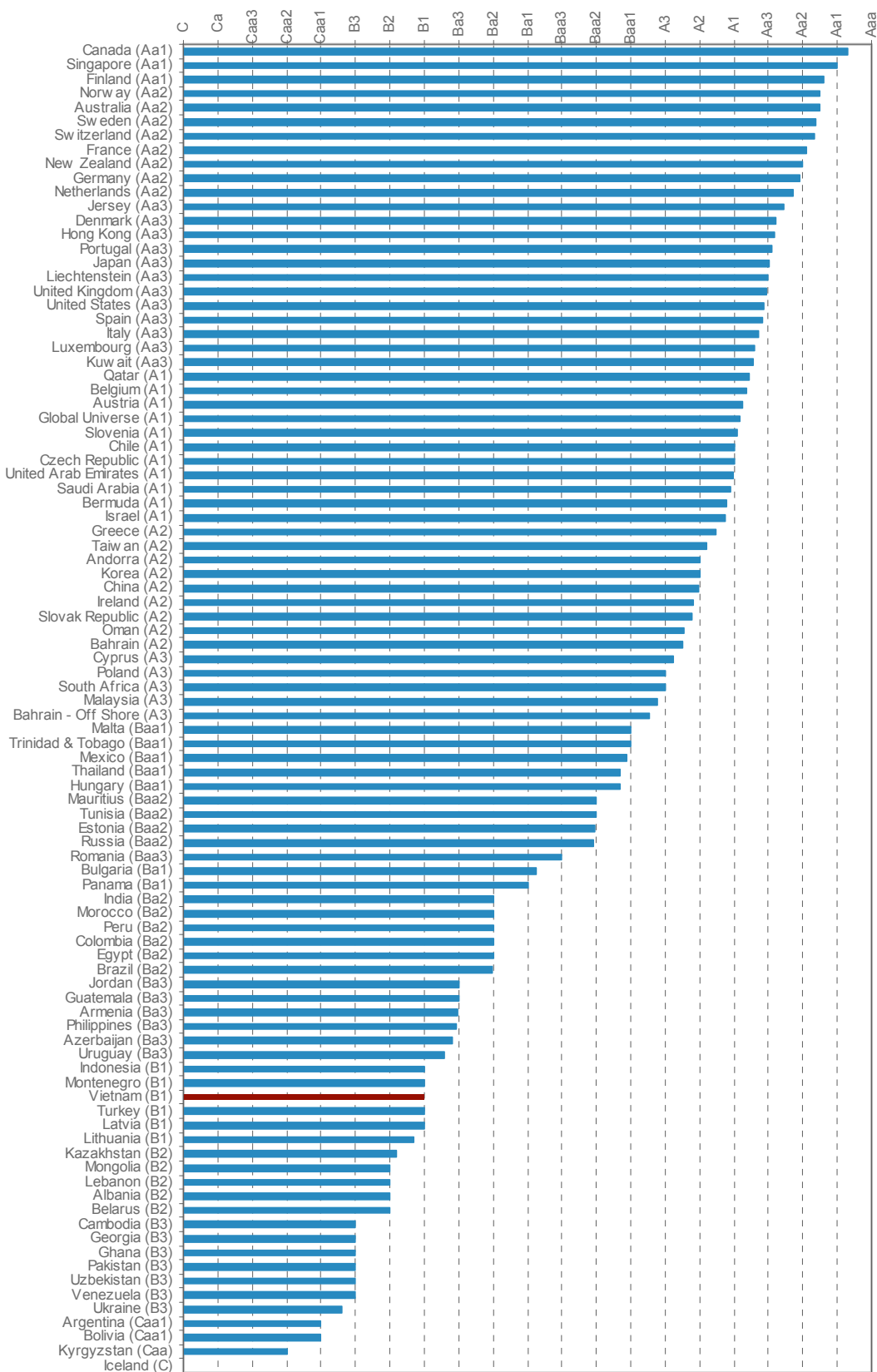
Country Ceilings for Long-Term Bank Deposits (Foreign Currency)
As of August 2009



Vietnam

Average* Long-Term Bank Deposits by Country (Foreign Currency)

As of August 2009



*Weighted by Assets

Vietnam

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