

Credit Market Research

U.S. Corporate Bond Market: A Review of Second-Quarter 2007 Rating and Issuance Activity

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Exhibits Index

Quarterly Rating Trends	4
Rating Activity by Broad Market Sector	5
Investment Grade Rating Trends	5
Rating Activity by Rating Category	6
Rating Activity by Industry	6
New Issuance by Broad Market Sector	7
Quarterly New Issuance	7
New Issuance by Industry	8
New Issuance by Asset Class	8
Fixed Vs Floating New Issuance	9
Industrial New Issuance by Tenor	9
Median Fixed Coupon by Rating	9
Treasury Yield Curve	10
Bond Yields by Rating Category	10
Bond Spreads by Rating Category	10
O/S Volume by Rating Mix	11
Investment Grade Mix by Industry	12
O/S Volume by Vintage	12
Maturity Schedule by Rating	13
Maturity Schedule by Industry	13

■ Summary

The par value of U.S. corporate bonds affected by upgrades totaled \$34.6 billion in the second quarter, or 1.0% of market volume, while downgrades (including defaults) affected \$23.8 billion in bonds (0.7% of market volume). Rating changes were concentrated mostly at the speculative grade level. Investment grade issues, in contrast, experienced relatively little activity. Speculative grade upgrades totaled \$20.3 billion (3.3% of sector volume) while downgrades totaled \$14.1 billion (2.3% of sector volume). Investment grade rating activity in total, considering both upgrades and downgrades, affected less than 1% of investment grade volume.

■ Second-Quarter 2007 Highlights

- Overall, upgrades affected 0.5% of investment grade volume in the second quarter and downgrades just 0.3%, for a downgrade to upgrade ratio of 0.7 to 1.0. At the speculative grade level, the impact of positive and negative rating changes was 3.3% and 2.3%, respectively, for a similar downgrade to upgrade ratio of 0.7 to 1.0.
- Upgrades topped downgrades across all rating categories in the second quarter, albeit by a small margin and on generally low volumes. The 'BB' rating pool saw the most activity for the quarter with \$11.4 billion in upgrades and \$8.1 billion in downgrades. The low level of defaults continued to contribute to limited rating deterioration at the 'CCC'-'C' level with \$1.8 billion in U.S. bonds defaulting during the quarter.
- Second-quarter upgrades were concentrated in the following sectors: banking and finance (\$8.6 billion, 0.6% of sector volume); telecommunication (\$6.9 billion, 4.0% of sector volume); transportation (\$3.7 billion, 4.1% of sector volume); and food, beverage and tobacco (\$2.9 billion, 3.6% of sector volume). Adjusting for each sector's size, upgrades were most pronounced in leisure and entertainment (6.7% of sector volume, \$0.6 billion); transportation (4.1%); and telecommunication (4.0%). In total, 19 industry sectors experienced some rating gains in the quarter.
- Topping second-quarter downgrades: broadcasting and media (\$4.0 billion, 4.2% of sector volume); energy (\$3.1 billion, 1.8% of sector volume); telecommunication (\$3.1 billion, 1.8% of sector volume); and automotive (\$1.9 billion, 3.0% of sector volume). Again, adjusting for sector size, downgrades had the biggest

August 3, 2007

Parameters of the Fitch Ratings U.S. Corporate Bond Index

- Based on outstanding U.S. dollar-denominated, nonconvertible bonds issued by companies domiciled in the United States.
- Includes rated-only public bonds and private placements with 144A registration rights.
- Includes issues with a minimum of \$25 million and medium-term notes with maturity dates of one year or greater.
- Excludes all defaulted issues
- For the purpose of this study, Fitch used composite ratings.
- All rating movements equal the upgrade or downgrade of any issue from one whole rating category to another.

Source: Bloomberg and Fitch Ratings.

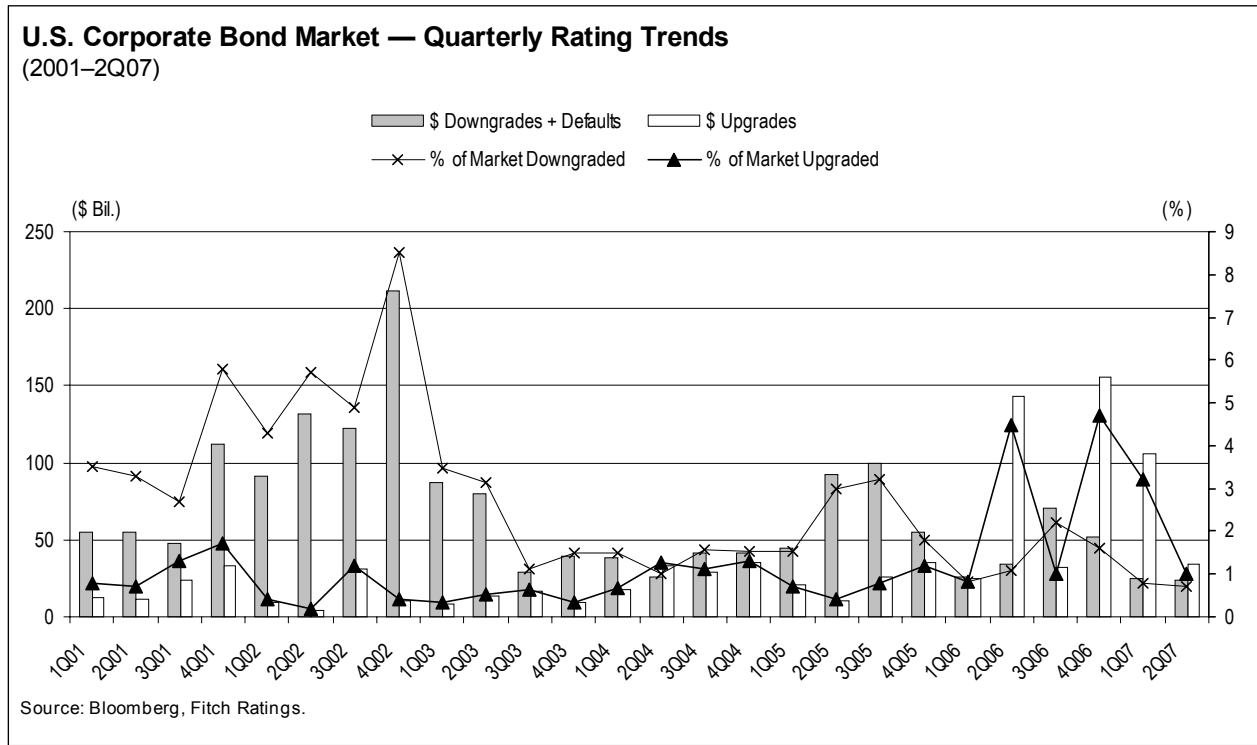
impact on leisure and entertainment (19.6% on \$1.8 billion); textiles and furniture (5.9% on \$0.6 billion); broadcasting and media (4.2%); and building and materials (3.8% on \$1.6 billion). In total, 20 sectors experienced some downgrades in the fourth quarter, a notch higher than the 19 sectors experiencing upgrades, although as noted above on a dollar basis, upgrades exceeded downgrades.

- New issuance totaled \$256 billion in the second quarter of 2007, up 11% quarter-over-quarter and 19% year-over-year (relative to 2006's second-quarter issuance activity). The second quarter's strong results were mostly due to a very meaningful pick-up in issuance among industrials. Industrial new issuance totaled \$112.9 billion, compared with \$83.8 billion in the first quarter and \$71.2 billion in the second quarter of 2006. Issuance gains were registered across the rating spectrum with both investment grade and non-investment grade industrials participating.
- In contrast, financial issuance (consisting predominantly of investment grade bonds) was essentially flat both quarter-over-quarter and year-over-year. Of note, the industrial issuance tally of \$112.9 billion noted above was the highest quarterly volume in more than three years.

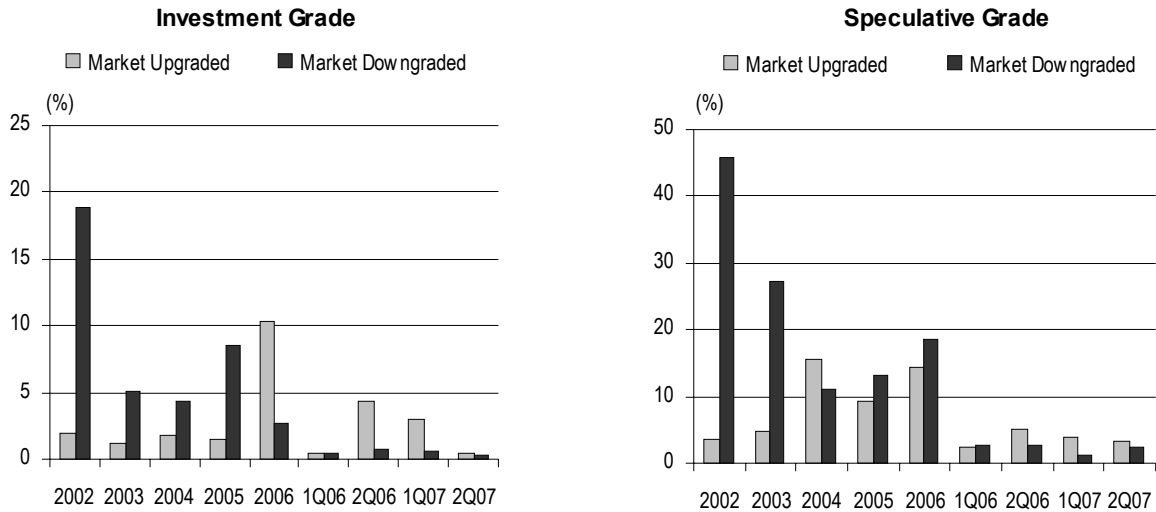
- Accompanying the increase in speculative grade bond issuance in the second quarter was another strong quarter for leveraged loan issuance. According to Bloomberg data, leveraged loan issue volume ended the quarter at \$273.6 billion, up dramatically compared with 2006's second-quarter tally of \$184.4 billion and also up \$56.7 billion quarter-over-quarter. Leveraged loan issuance continued to readily top high yield bond issuance by a wide margin. In fact recent Fitch research suggests that the balance sheets of heavily indebted firms are becoming more loan heavy as a consequence of the shift in issuance from the bond to the loan market. Long term, this may affect both default and recovery rates. For more on this please see the Fitch report, "Speculative Grade Balance Sheets Becoming More Loan Heavy — Recovery Prospects at Risk," dated May 7, 2007, and available at www.fitchratings.com.
- Year-over-year, 17 of the 23 industrial sectors tracked by Fitch saw an uptick in issuance in the second quarter. These included utilities (\$17.2 billion in second-quarter 2007 versus \$8.1 billion in second-quarter 2006); computers and electronics (\$9.1 billion in 2007 versus \$2.0 billion in 2006); supermarkets and drug stores (\$7.0 billion in 2007 versus \$0.0 billion in 2006); and energy (\$15.6 billion in 2007 versus \$8.8 billion in 2006). Noteworthy industries experiencing a year-over-year decline in issuance included: telecommunication, broadcasting and media, and building and materials.
- Flat financial new issuance and the acceleration in industrial issuance resulted in a mix of floating to fixed paper of 43% to 57% in the second quarter, compared with a 50%-50% mix in the first quarter. Nonetheless, the quarter saw the strongest activity in floating rate issuance among industrials, totaling 18% of industrial volume, the highest tally in several years.
- Industrial companies continued to favor long-term bond sales in the second quarter with more than 66% of new issuance carrying maturities of 10 years or more, up from 60% in the second quarter of 2006 but down slightly from the first quarter. Maturities on the short end (less than five years) contracted to just 0.9% in the second quarter compared with 1.0% in the first quarter and 3.3% in the second quarter of 2006.

- Median coupons, while still low by historical standards, moved higher across nearly all rating categories in the second quarter. The largest quarter-over-quarter increase was in the highly-speculative ‘CCC’-‘C’ rating category, which saw median coupons move up to 10% from 9.375% in the first quarter of 2007. The 10%, however, was in line with levels recorded in 2006.
- As of June 30, 2007, the U.S. Corporate Bond Market totaled \$3.7 trillion in outstanding par value, split 82% investment grade and 18% speculative grade. The market’s rating mix at quarter-end consisted of the following: ‘AAA’ (8.2%), ‘AA’ (25.5%), ‘A’ (27.5%), ‘BBB’ (21.0%) , ‘BB’ (6.9%), ‘B’ (7.4%), and ‘CCC’-‘C’ (3.6%).
- The 82% versus 18% investment grade to speculative grade split is mostly due to the inclusion of the highly rated financial sectors. When examining the market’s rating mix across just the pool of industrial bonds, the share of bonds rated speculative grade is substantially higher at 31%. This share has gradually increased from its pre-recession mark of just 26%.
- The par value of bonds maturing for the remaining six months of 2007 totals \$194.9 billion compared with \$186.0 billion scheduled to mature over the same period one year ago. The bulk (95%) of this volume (\$186.0 billion) consists of investment grade bonds, with the remaining volume (\$8.9 billion) residing at the speculative grade level.
- Approximately 1.3%, 3.4% and 6.1% of speculative grade volume is scheduled to mature in 2007 (6 months), 2008 and 2009, respectively. Of this, totaling \$71.6 billion, 7.3% is currently rated ‘CCC’-‘C’. On the surface, this may appear moderate, however strong issuance volumes in the leveraged loan market suggest that many high yield borrowers have shifted a substantial portion of their funding requirements to the leveraged loan market. As a result, refinancing risk may be more of a concern on maturing loans rather than bonds and any disruptions in the loan market could put significant upward pressure on default rates. A report recently published by Fitch addressed this issue. Please refer to, “Loan Issuance Boom Shifts Refinancing Risk Strongly to Loan Market,” dated July 26, 2007.
- Among industrial issuers, \$157.1 billion in bonds is scheduled to mature over the next 18 months. Utilities clearly lead with \$32.8 billion in bonds coming due (or 11.5% of utility volume outstanding), followed by telecommunication (\$13.2 billion, 7.5%), retail (\$10.5 billion, 11.8%) and energy (\$10.4 billion, 5.5%). Looking at financial bond maturities, \$577.5 billion is scheduled to mature by 2008; a large portion of this volume is rated ‘A’ and above.
- According to Fitch’s U.S. High Yield Default Index, the trailing 12-month default rate still remains below 1% at 0.6% through the first half of 2007, down from the 0.8% rate recorded at year-end 2006.

■ **Appendix**

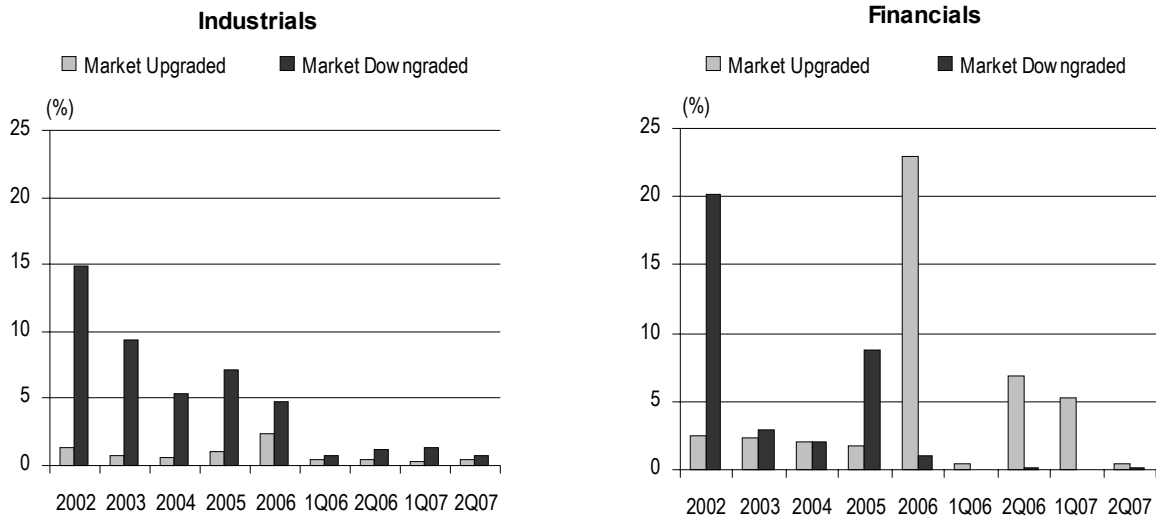


U.S. Corporate Bond Market — Rating Activity by Broad Market Sector
(2002–2Q07)



Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Investment Grade Rating Trends
(2002–2Q07)



Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Upgrade-Downgrade Activity by Rating Category

(Second-Quarter 2007)

Rating Bucket	Upgrade		Downgrade	
	Volume (\$ Bil.)	Upgrade %	Volume (\$ Bil.)	Downgrade %
'AAA'	0.0	0.0	0.0	0.0
'AA'	0.6	0.1	0.4	0.0
'A'	7.7	0.8	4.4	0.5
'BBB'	6.0	0.8	4.9	0.7
'BB'	11.4	4.6	8.1	3.3
'B'	5.0	2.0	4.2	1.6
'CCC'-'C'	3.8	3.5	1.8	1.6
Total	34.6	1.0	23.8	0.7
Investment Grade	14.3	0.5	9.7	0.3
Speculative Grade	20.3	3.3	14.1	2.3

Source: Bloomberg, Fitch Ratings.

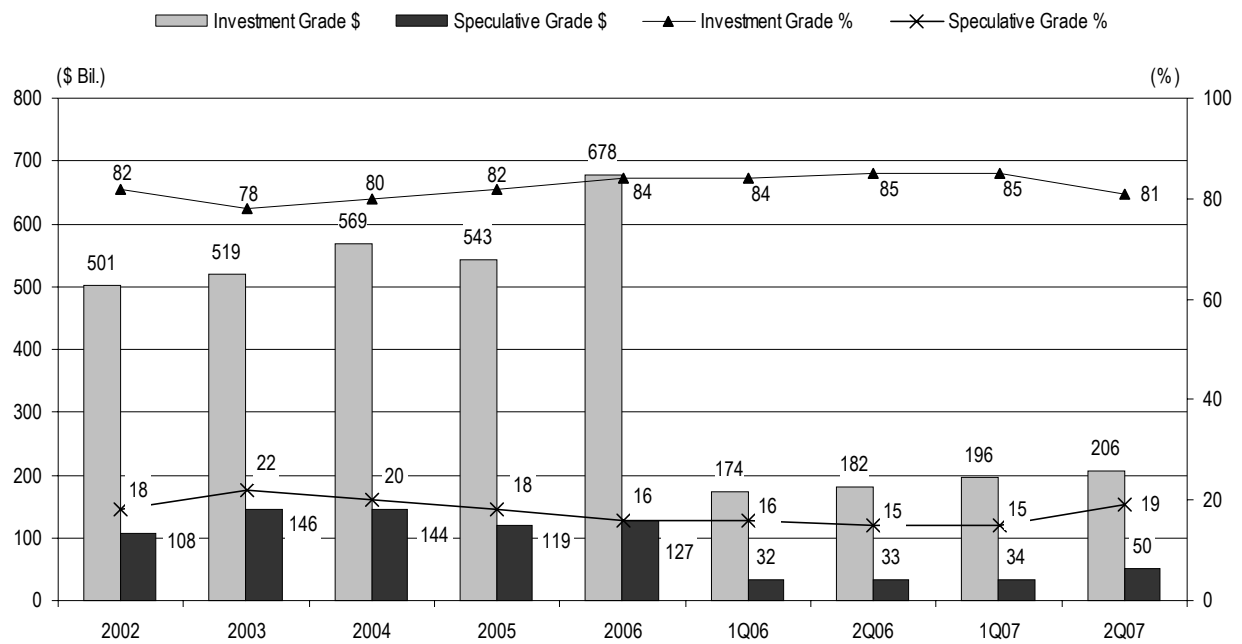
U.S. Corporate Bond Market — Upgrade-Downgrade Activity by Industry

(Second-Quarter 2007)

Fitch Industry	Upgrade		Downgrade	
	Volume (\$ Bil.)	Upgrade %	Volume (\$ Bil.)	Downgrade %
Automotive	0.7	1.0	1.9	3.0
Banking and Finance	8.6	0.6	0.7	0.0
Broadcasting and Media	0.0	0.0	4.0	4.2
Building and Materials	0.4	0.8	1.6	3.8
Cable	0.0	0.0	0.0	0.0
Chemical	0.1	0.3	0.3	0.8
Computers and Electronics	0.8	1.2	0.4	0.6
Consumer Products	0.0	0.0	0.2	0.5
Energy	2.5	1.4	3.1	1.8
Food, Beverage and Tobacco	2.9	3.6	1.3	1.5
Gaming, Lodging and Restaurants	1.7	3.7	0.3	0.6
Healthcare and Pharmaceutical	0.0	0.0	1.2	1.1
Industrial/Manufacturing	0.3	0.6	0.0	0.1
Insurance	0.1	0.1	0.3	0.2
Leisure and Entertainment	0.6	6.7	1.8	19.6
Metals and Mining	1.1	3.6	0.8	2.6
Miscellaneous	0.4	0.7	0.4	0.7
Paper and Forest Products	0.0	0.0	0.0	0.0
Real Estate	0.4	0.4	0.0	0.0
Retail	2.0	2.3	0.9	1.1
Supermarkets and Drug Stores	0.0	0.0	0.0	0.0
Telecommunication	6.9	4.0	3.1	1.8
Textiles and Furniture	0.4	3.8	0.6	5.9
Transportation	3.7	4.1	0.3	0.3
Utilities	1.2	0.5	0.7	0.2
Total	34.6	1.0	23.8	0.7
Industrials	25.9	1.5	22.9	1.3
Financials	8.7	0.5	1.0	0.1

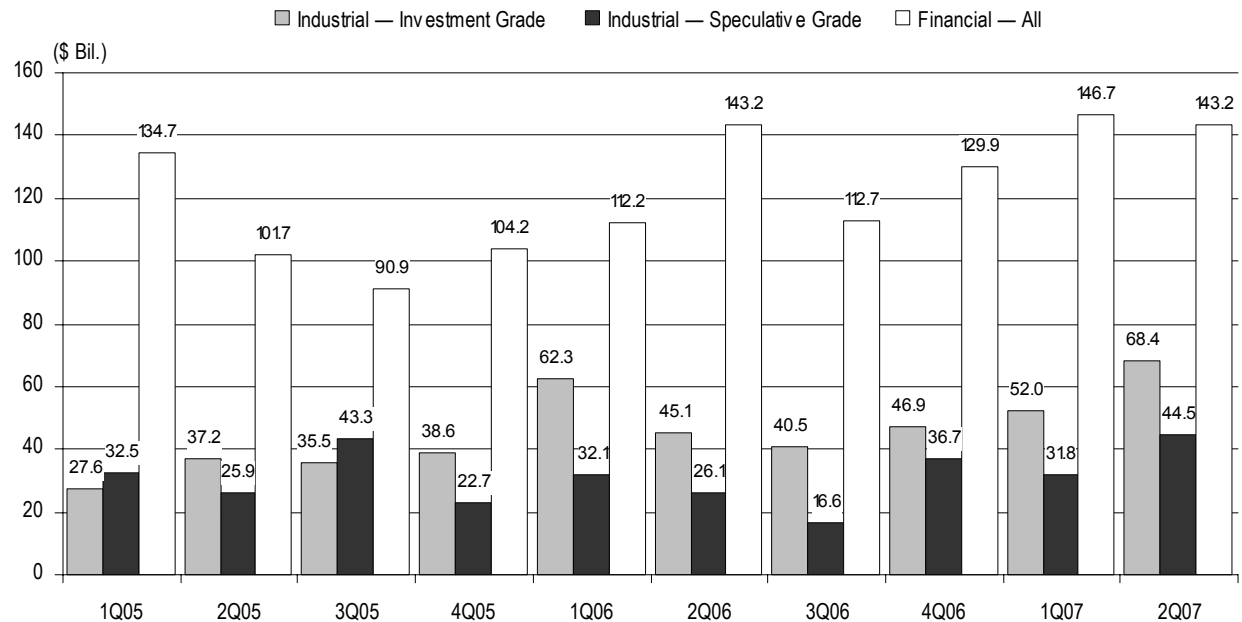
Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — New Issuance by Broad Market Sector



Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Quarterly Industrial Versus Financial New Issuance



Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — New Issuance by Industry

Fitch Industry	2Q06		2Q07	
	New Issuance Volume (\$Bil.)	% of Sector	New Issuance Volume (\$Bil.)	% of Sector
Banking and Finance	132.0	92.1	126.8	88.6
Insurance	11.3	7.9	16.3	11.4
Total — Financial Sector	143.2	100.0	143.2	100.0
Automotive	0.3	0.4	0.2	0.2
Broadcasting and Media	7.3	10.2	1.9	1.6
Building and Materials	3.2	4.4	1.7	1.5
Cable	0.0	0.0	5.0	4.4
Chemical	0.8	1.1	0.9	0.8
Computers and Electronics	2.0	2.8	9.1	8.0
Consumer Products	1.6	2.2	2.7	2.4
Energy	8.8	12.3	15.6	13.8
Food, Beverage and Tobacco	3.3	4.7	4.1	3.6
Gaming, Lodging and Restaurants	2.5	3.5	3.2	2.8
Healthcare and Pharmaceutical	10.6	14.9	14.3	12.7
Industrial/Manufacturing	0.6	0.9	1.2	1.0
Leisure and Entertainment	0.3	0.5	0.1	0.1
Metals and Mining	1.5	2.1	2.7	2.4
Miscellaneous	2.8	4.0	4.1	3.7
Paper and Forest Products	0.4	0.5	0.8	0.7
Real Estate	2.5	3.4	6.5	5.7
Retail	2.0	2.8	5.3	4.7
Supermarkets and Drug Stores	0.0	0.0	7.0	6.2
Telecommunication	10.0	14.0	4.6	4.1
Textiles and Furniture	0.2	0.3	0.0	0.0
Transportation	2.5	3.5	4.8	4.3
Utilities	8.1	11.3	17.2	15.2
Total — Industrial Sector	71.3	100.0	112.9	100.0
Total — All Industries	214.5		256.1	

Source: Bloomberg, Fitch Ratings.

Yearly New Issuance Analysis by Asset Class

(\$ Bil.)

Market	2002	2003	2004	2005	2006	1Q06	2Q06	1Q07	2Q07
U.S. Corporate Bond Market — All Issuance	608.8	664.8	713.7	662.2	804.3	206.7	214.5	230.5	256.1
U.S. Corporate Bond Market — Investment Grade	500.8	518.8	569.2	543.1	677.6	174.3	181.9	196.3	206.4
U.S. Corporate Bond Market — Speculative Grade	108.0	146.0	144.5	119.1	126.7	32.4	32.7	34.2	49.7
U.S. Syndicated Loan Market — Syndicated Loans	880.5	817.6	1,290.6	1,464.4	1,729.7	374.6	545.3	455.7	604.9
U.S. Syndicated Loan Market — Leveraged Loans	211.4	260.8	459.5	534.0	681.1	125.0	184.4	216.9	273.6

Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Fixed Versus Floating Rate New Issuance

Distribution

(% of New Issuance)

Coupon Type	2002	2003	2004	2005	2006	1Q06	2Q06	1Q07	2Q07
Total Market									
Floating	24	28	42	42	48	42	52	50	43
Fixed/Other	76	72	58	58	52	58	48	50	57
Investment Grade Market									
Floating	29	36	51	50	54	49	59	57	51
Fixed/Other	71	64	49	50	46	51	41	43	49
Speculative Grade Market									
Floating	0	2	7	8	11	5	17	9	13
Fixed/Other	100	98	93	92	89	95	83	91	87
Industrials									
Floating	3	4	10	9	12	10	12	14	18
Fixed/Other	97	96	90	91	88	90	88	86	82
Financials									
Floating	46	51	62	62	69	69	72	70	63
Fixed/Other	54	49	38	38	31	31	28	30	37

Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Industrial New Issuance Distribution by Tenor

(% of New Issuance)

Range (Years)	2002	2003	2004	2005	2006	1Q06	2Q06	1Q07	2Q07
<5	30.7	33.7	7.2	5.3	12.3	2.9	3.3	1.0	0.9
5 to <10	28.7	28.6	40.9	35.8	28.6	28.1	38.0	28.2	32.8
10 to <15	31.7	29.7	42.6	43.4	40.7	52.5	40.6	45.4	40.0
>=15	8.9	8.1	9.3	15.5	18.3	16.5	18.0	25.4	26.3

Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — New Issuance Median Fixed Coupon by

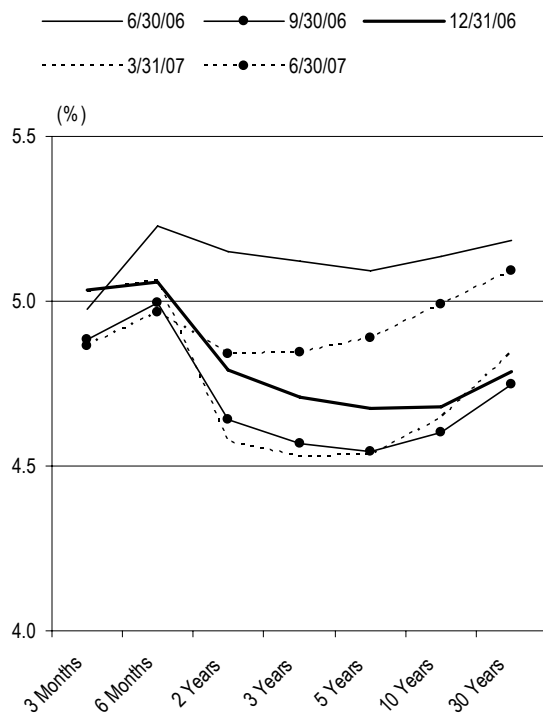
Rating Category

(% of New Issuance)

Rating Category	2002	2003	2004	2005	2006	1Q06	2Q06	1Q07	2Q07
'AAA'	4.33	4.13	4.50	4.85	5.40	5.20	5.38	5.35	5.40
'AA'	4.85	4.42	4.95	5.00	5.40	5.20	5.43	5.42	5.65
'A'	5.50	4.50	5.00	5.00	5.75	5.35	6.08	5.63	5.95
'BBB'	6.00	5.13	5.10	5.25	6.05	5.78	6.25	5.88	6.25
'BB'	8.38	7.00	6.38	6.38	7.13	6.75	7.34	7.00	7.02
'B'	9.63	9.00	8.25	7.80	8.63	8.13	8.25	8.25	7.78
'CCC'-'C'	11.56	10.19	9.69	10.00	10.31	9.25	10.25	9.38	10.00

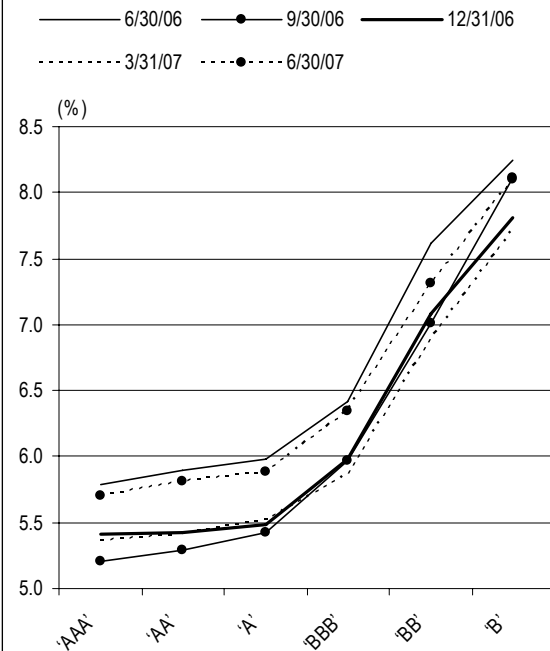
Source: Bloomberg, Fitch Ratings.

Historical Treasury Yield Curve



Source: Bloomberg, Fitch Ratings.

Historical 10-Year U.S. Corporate Bond Yields by Rating Category (Industrials)



Source: Bloomberg, Fitch Ratings.

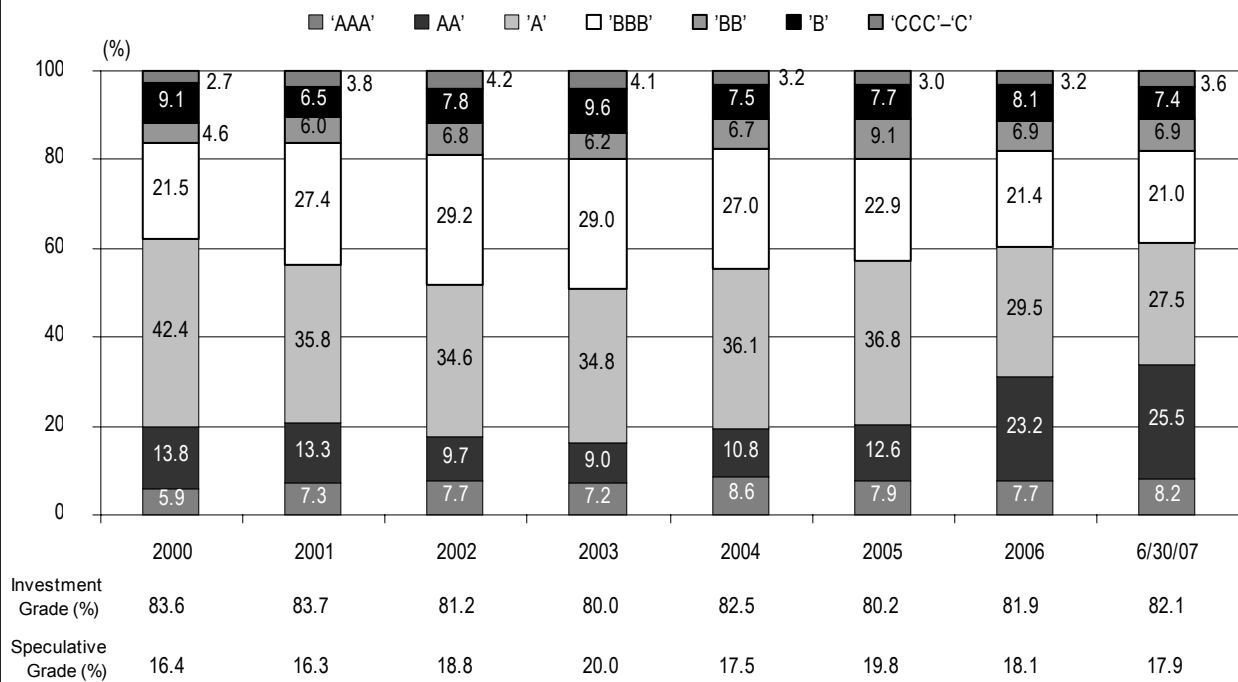
U.S. Corporate Bonds Spreads (Industrials)

(Basis Points)

Rating-Term	12/31/05	3/31/06	6/30/06	9/30/06	12/31/06	3/31/07	6/30/07
'AAA'							
Five-Year	42	37	41	48	62	51	56
Ten-Year	58	61	58	51	66	71	55
'AA'							
Five-Year	44	49	57	50	65	55	64
Ten-Year	59	65	70	60	68	75	65
'A'							
Five-Year	55	61	65	64	70	71	77
Ten-Year	72	76	78	74	73	87	73
'BBB'							
Five-Year	89	91	97	104	97	104	112
Ten-Year	116	118	121	127	123	120	118
'BB'							
Five-Year	196	169	192	180	187	172	184
Ten-Year	246	218	241	232	234	222	216
'B'							
Five-Year	316	232	260	299	259	259	249
Ten-Year	344	262	304	342	307	305	294

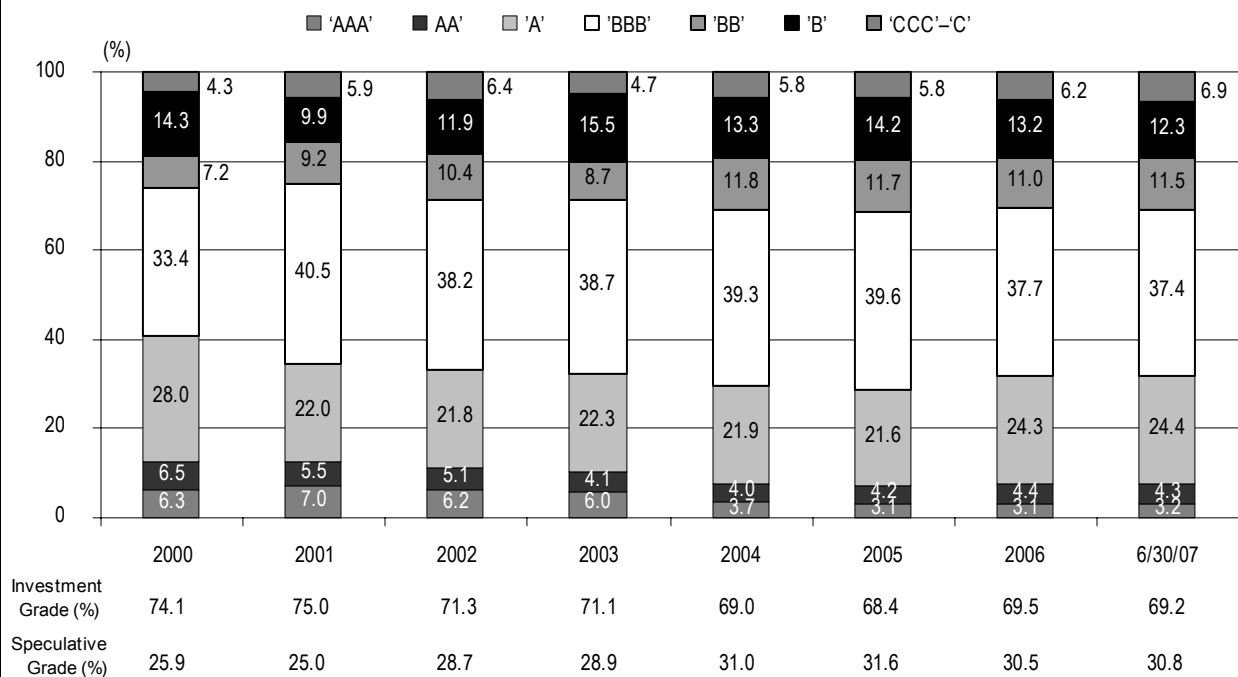
Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Outstanding Volume By Rating Category — All Sectors



Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Outstanding Volume By Rating Category — Industrials Only



Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Investment Grade Concentration by Industry

(% of Industry Rated 'BBB-' or Higher)

June 30, 2006

100-90	89-80	79-70	69-60	59-50	< 50
Insurance	Real Estate	Retail	Industrial/Mfg	Computers and Electronics	Automotive
Banking and Finance	Transportation	Consumer Products	Building and Materials	Chemical	Metals and Mining
	Utilities	Telecommunication	Energy	Paper and Forest Products	Textiles and Furniture
	Food, Beverage and Tobacco	Health Care and Pharmaceutical		Supermarkets and Drug Stores	Gaming, Lodging and Restaurants
		Broadcasting and Media		Cable	Leisure and Entertainment

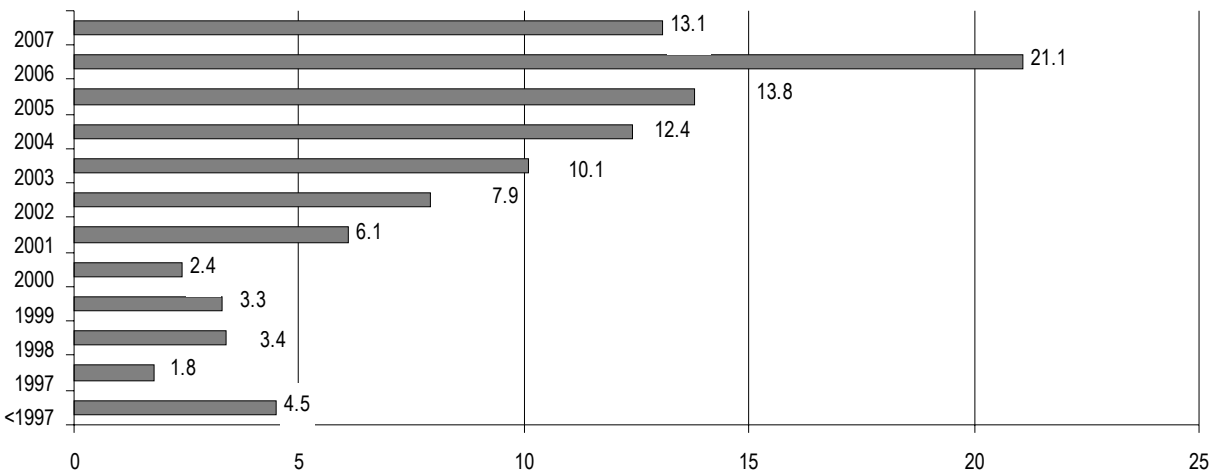
June 30, 2007

Insurance	Utilities	Retail	Health Care and Pharmaceutical	Cable	Automotive
Banking and Finance	Real Estate	Consumer Products	Computers and Electronics	Chemical	Paper and Forest Products
	Transportation		Energy		Textiles and Furniture
	Food, Beverage and Tobacco		Industrial/Mfg		Metals and Mining
	Telecommunication		Building and Materials		Gaming, Lodging and Restaurants
			Supermarkets and Drug Stores		Leisure and Entertainment
			Broadcasting and Media		

Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Outstanding Volume by Vintage

(% of Volume Outstanding)



Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Maturity Schedule by Rating Category

(\$ Bil., As of June 30, 2007)

Rating	Six Months 2006		Six Months 2007		2008		2009	
	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)
'AAA'	21.3	8.5	33.1	11.0	79.3	26.2	40.0	13.2
'AA'	46.6	8.6	76.3	8.1	232.6	24.7	163.0	17.3
'A'	77.3	6.5	53.5	5.3	152.0	15.0	121.2	12.0
'BBB'	28.2	3.7	23.1	3.0	53.2	6.9	53.0	6.8
'BB'	9.3	3.3	6.0	2.4	12.6	5.0	19.4	7.6
'B'	2.4	1.0	2.8	1.0	8.5	3.1	17.1	6.2
'CCC'-'C'	0.9	1.1	0.1	0.1	1.5	1.1	3.7	2.8
All Ratings	186.0	5.5	194.9	5.3	539.7	14.6	417.5	11.3
Investment Grade	173.4	6.3	186.0	6.1	517.1	17.1	377.2	12.4
Speculative Grade	12.7	2.0	8.9	1.3	22.5	3.4	40.2	6.1

Source: Bloomberg, Fitch Ratings.

U.S. Corporate Bond Market — Maturity Schedule by Industry

(\$ Bil., As of June 30, 2007)

Industrial Sectors	Six Months 2007		2008	%	2009	%
	2007	%				
Automotive	1.5	2.4	7.4	11.8	8.0	12.7
Broadcasting and Media	1.3	1.3	4.9	5.0	9.2	9.3
Building and Materials	1.0	2.2	2.6	5.9	2.0	4.4
Cable	1.0	1.5	3.4	5.2	4.0	6.1
Chemical	1.8	4.6	2.4	6.0	4.3	10.7
Computers and Electronics	2.2	2.8	7.2	9.2	8.4	10.7
Consumer Products	2.0	5.3	3.0	7.9	4.5	11.9
Energy	3.9	2.1	6.5	3.4	12.8	6.7
Food, Beverage and Tobacco	1.5	1.8	8.2	9.6	5.9	6.9
Gaming, Lodging and Restaurants	1.1	2.2	2.3	4.8	2.7	5.8
Healthcare and Pharmaceutical	1.3	1.0	5.6	4.3	5.5	4.3
Industrial/Manufacturing	0.8	1.7	3.4	6.8	3.9	7.7
Leisure and Entertainment	0.0	0.0	0.1	0.6	0.8	8.4
Metals and Mining	0.7	2.0	0.1	0.4	1.2	3.7
Miscellaneous	1.2	1.9	3.0	4.9	2.6	4.2
Paper and Forest Products	0.2	0.4	1.4	3.7	2.3	6.2
Real Estate	3.5	3.8	3.5	3.7	7.8	8.3
Retail	4.1	4.6	6.4	7.2	7.7	8.7
Supermarkets and Drug Stores	1.3	3.7	1.7	4.8	2.7	7.5
Telecommunication	2.8	1.6	10.4	5.9	10.0	5.7
Textiles and Furniture	0.0	0.2	0.1	1.0	0.4	3.9
Transportation	3.0	3.1	4.5	4.7	6.1	6.4
Utilities	9.3	3.3	23.5	8.2	16.2	5.7
Total	45.5	2.5	111.6	6.0	128.7	6.9
Financial Sectors						
Banking and Finance	138.8	8.4	396.3	23.9	272.8	16.5
Insurance	10.6	5.8	31.9	17.6	15.9	8.8
Total	149.3	8.1	428.1	23.3	288.7	15.7

Source: Bloomberg, Fitch Ratings.

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