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First-Ever Sovereign Ratings Assigned to Belarus

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CIS Securitisation Market Experiences Increasing Activity Despite Slowing Issuance

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Rating RMBS Transactions in Emerging Markets

In recent years Moody's has rated a range of Residential Mortgage-Backed Securities transactions in new markets in Europe, making use of the same RMBS methodology that it applies to all markets in the region. This combines the use of Moody's Individual Loans Analysis (MILAN) model for collateral analysis with a cash flow model such as Moody's Analyser of Residential Cash Flows (MARCO) or ABSROM. full story – **page 7** »

Moody's Investors Service

Sub-Prime Turmoil Impacts CIS Banks



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The financial turmoil caused by the problems in the US sub-prime mortgage market has spread to the emerging markets, raising fears of a liquidity or even credit crunch. In this context, financial institutions in the developing world, although not directly exposed to the troubled US credit markets, have been affected alongside their Western peers.

For two years, many emerging economies enjoyed the favour of global investors, benefiting from the excess liquidity in the world market. However, a sudden drying-up of liquidity and a reassessment of the risks associated with emerging market lending could make it difficult for borrowers based in the Commonwealth of Independent States (CIS) to raise new debt or to roll over existing foreign loans.

In Moody's opinion, the overall liquidity situation of the Russian banking system is relatively strong and refinancing risk for Russian banks is fairly modest. The Moody's-rated Russian banks are due to repay approximately US$16.7 billion of the total debt to foreign banks by the end of 2007, US$9.4 billion of which relates to bilateral loans and includes short-term self-liquidating trade finance. These repayments, although large, appear manageable, since Russian banks have accumulated enough liquidity – US$125 billion of liquid assets as at 30 June 2007 – to support these repayments.

There are no immediate threats for the Ukrainian banking system, given that debt maturities of Ukrainian banks are structured such that there are no significant repayments falling due by the end of 2007 or in 2008 – reducing the immediate threat of the current liquidity crisis.

Kazakhstan is undoubtedly the country in the CIS region most vulnerable to the impact of the liquidity crisis on the world market. According to Moody's estimates, the current total of Kazakh banks' international borrowing is around US$40 billion, accounting for over a half of their total non-equity funding.

Moody's is of the view that – given the importance of the banking system for the country's economy and political stability – Kazakh banks are likely to receive support from the Kazakh financial authorities and/or from banks' shareholders in a stress situation. However, a prolonged tightening could have significant implications for Kazakh banks through negative effects on macroeconomic development. The lack of access to international markets looks set to slow Kazakh banks' operations and might put pressure on the margins and growth rates of Kazakh banks in the longer term.

Lack of access to international markets should slow Kazakh banks' operations

For a copy of the Special Comment entitled "CIS Banking: Impact of the Global Liquidity Crunch", please contact Moody's client services desk on +44 20 7772-5454 or by email to clientservices@moodys.com.



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Credit Market Disruption Has Limited Impact on European Corporates

The credit turmoil in US sub-prime mortgage markets has not affected corporate debt issuers uniformly around the world. Although European companies are not immune from sub-prime contagion, corporate discipline and sound liquidity management are helping to bolster their defences.

Moody's believes the summer 2007 crisis is very different from the last credit downturn in 2001-2003 and is less threatening for corporates. Firstly, the credit cycle remains sound, with positive economic growth throughout Europe. This is sustaining the operating performance of companies and should bolster market confidence. Secondly, this crisis is not currently focused on corporate issuers, even though they are feeling the impact from time to time. Thirdly, the previous crisis was characterised by a large sector concentration of refinancing risk following the significant inflation of asset values. Finally, the refinancing of large M&A transactions is generally not dependent upon asset sales, in contrast to what happened with telecoms in the early years of this decade.

Liquidity issues tend to be more company-specific than sector-specific: a company's ability to sustain ample liquidity and its vulnerability to liquidity disruptions depend largely on its financial standing and management's degree of preparedness. However, we have identified three areas of potential vulnerability:

- Commercial paper remains one of the most confidence-sensitive markets and, in troubled times, the markets can evaporate or become much more selective; hence, the importance of issuer contingency plans.
- Companies that use asset-backed programmes to support their continued operations may also be vulnerable. While such companies should continue to be able to secure funding, the cost of access may increase, at least in the short term.
- With regard to developing markets, a number of issuers – in Russia, Central Europe, the Middle East and, to some extent, South Africa – have typically less structured liquidity management, and are often dependent upon their local banks to provide them with liquidity. A small number of issuers in Russia, in particular, have significant refinancings to finalise within the next year, the success of which will depend on their ability to access the capital markets. Despite these potential challenges, Moody's is reasonably confident that these issuers will be able to carry through their funding as their operations are in decent shape.

More generally, the repricing of risk that has already occurred – at least partially – may be costly or even fatal for a few overextended issuers. Nonetheless, the main risk of the current liquidity situation is the toll that it may take on economic growth, which could have a knock-on effect on credit quality if it was to endure.

For a copy of the report entitled "Market Turmoil Takes Uneven Toll", please contact Moody's client services desk on +44 20 7772-5454 or by email to clientservices@moodys.com.

Corporate discipline and sound liquidity management are helping to bolster European companies' defences



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Business Development Overview: Rating Surge Continues

» After a strong start, the growth in credit ratings has continued apace in the CIS markets in 2007, with a healthy number of new ratings issued in the past few months.

Indeed, Moody's published 138 global scale ratings (GSRs) and 112 national scale ratings (NSRs) as of 1 October 2007, representing increases of 11 and 10, respectively, compared with 1 June. Broken down by franchise, Corporates accounted for 47 GSRs and 27 NSRs; Financial Institutions for 80 GSRs and 73 NSRs; and Regional and Local Governments for 9 GSRs and 11 NSRs.

Moody's total market coverage in Russia, Ukraine and Kazakhstan is now about 63%. In Russia alone, Moody's has published ratings on 80 financial institutions.

Broken down by geography, Moody's rated approximately 140 entities in Russia, 40 in Ukraine and 30 in Kazakhstan as of 1 October 2007.



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Moody's and IFC Publish Russian "Glossary of Mortgage Finance and Securitisation Terms"

Moody's and the International Finance Corporation (IFC) are pleased to announce the release of the jointly developed Russian-language "Glossary of Mortgage Finance and Securitisation Terms". As far as the developers are aware, it is the first glossary of Russian terminology for this segment of the market.

The project was launched in April 2007 and is based on years of experience accumulated by Moody's and IFC in the global securitisation markets, as well as in-depth analysis and research by Moody's and IFC of the housing market and the secondary mortgage market in Russia.

"The continuing growth of securitisation in Russia and the CIS highlighted the need for the creation, optimisation and standardisation of industry-specific terminology. The new glossary, containing over 800 terms, is designed to provide a common vocabulary for the rapidly developing structured finance industry in the region," said Igor Zelezetskii, Analyst in Moody's Global CDO and Credit Derivatives team and the main contributor to the glossary for Moody's.

"The glossary will be a tremendously valuable tool for market participants in Russia and the CIS. Not only does it set a standard for industry terminology in the region, but it also serves to educate new entrants to the market who are still learning about securitisation and mortgage lending," said Daniel Mumzhiu, AVP – Analyst in Moody's Structured Finance Group's Business Development team.

For more information on the Glossary, please contact Moody's client services desk on +44 20 7772 5454 or by email to clientservices@moodys.com.



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First-Ever Sovereign Ratings Assigned to Belarus

Moody's has assigned the first-ever sovereign ratings to the Republic of Belarus, taking into account factors including the country's recent economic successes and the likelihood that rapidly increasing energy prices will lead to the substantial restructuring of enterprises.

The following ratings were assigned, all with stable outlook:

- Ba2 foreign currency country ceiling
- B1 issuer ratings for foreign and local currency government debt obligations
- B2 foreign currency bank deposit ceiling
- Baa3 local currency country ceiling
- Baa3 local currency bank deposit ceiling
- Not Prime short-term government bond ratings
- Not Prime short-term country ceilings for foreign currency bonds and deposits
- Not Prime short-term country ceiling for local currency deposits

Macroeconomic Successes

The ratings reflect both the recent macroeconomic successes of Belarus and the likelihood that rapidly increasing energy prices will require a substantial restructuring of enterprises and may lead to a deterioration of some macroeconomic indicators. While the Belarusian 'model' for promoting strong economic growth with relatively little social inequality has performed very well over the past five years, the degree to which existing institutions and mechanisms can cope with a qualitatively new economic environment is uncertain.

Foreign currency borrowing will probably grow significantly in the coming period

Substantial terms-of-trade gains from cheap Russian energy inputs have been redistributed through budgetary and non-budgetary channels such as economy-wide mandated wage increases and subsidised energy inputs to state-owned enterprises. A negotiated increase in the price of gas energy inputs from US$54 in 2006 to world price levels in 2010 would seem to present a challenge to this approach.

Substantial Subsidies

Belarus has some world-class enterprises that are currently channelling substantial investment into fixed assets to deal with the challenge of higher energy prices through productivity gains. Nevertheless, the current account performance might prove vulnerable, and foreign currency revenues might not grow at the desired rate. The government will likely attempt to meet this new economic environment with a series of fiscal measures, including selective privatisation and an attempt to wean enterprises off budgetary subsidies.

It seems quite probable that foreign currency borrowing by both government and state-owned enterprises will grow significantly in the coming period. However, the starting point for this likely growth of public-sector external debt is very low; even worst-case stress scenarios do not result in a very heavy debt service burden in the medium term.

For more details on Moody's rating actions for Belarus, please contact Moody's client services desk on +44 20 7772 5454 or by email to clientservices@moodys.com.



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CIS Securitisation Market Experiences Increasing Activity Despite Slowing Issuance

While market turbulence caused by the problems in the US sub-prime mortgage market has led to a slowdown in the public issuance of structured bonds in the CIS, there continues to be plenty of activity in preparation for future deals that are expected to close when the markets return to normal. Most recently, a bond issue totalling $750 million, backed by diversified payment rights from Kazakhstan, closed in October. This was the only public issuance of structured bonds from the CIS since the global liquidity crisis began in August, although there is potential for a couple more deals to close in the region by year-end.

Furthermore, not only is the pipeline of structured deals continuing to build in Russia, but several new asset classes are set to enter the pipeline as well. Indeed, several Russian issuers have plans to issue bonds in the first quarter of 2008. The tremendous growth in consumer and mortgage lending in the CIS as well as an ongoing need from banks for funding continue to be the key drivers for securitisation. Many of the transactions that were planned to close this year have been postponed until 2008 or have been diverted to warehouse facilities. A number of warehouse facilities are going to be rated in the fourth quarter, including several different asset classes.

Beyond Russia, activity is also expected to rebound once market conditions return to normal, with plans for asset securitisations in Ukraine and Kazakhstan expected to go ahead. One possible impediment is the potential downgrade of banks in the region, which could have a negative effect on future issuance. Many structures used for securitisation in the region include rating triggers related to the originator of the assets. A breach of such triggers may in some cases lead to events such as servicing transfers and early amortisation. Moody's continues to closely monitor the performance of the CIS banking system in light of the impact of the global liquidity crunch on emerging markets, focusing particularly on largely wholesale foreign-funded institutions.

The mortgages underlying RMBS in the CIS are still of relatively high quality

While the focus in the US has been on the credit quality of sub-prime loans, the mortgages underlying residential mortgage-backed securities (RMBS) in the CIS are still of relatively high quality. In fact, at this stage, the liquidity and credit crisis does not appear to have had an impact on the quality of the assets underlying CIS structured transactions.

For Moody's latest research on securitisation in the CIS, please contact Moody's client services desk on +44 20 7772 5454 or by email to clientservices@moodys.com.

Rating RMBS Transactions in Emerging Markets



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In recent years Moody's has rated a range of Residential Mortgage-Backed Securities (RMBS) transactions in new markets in the EMEA region. The first securitisation from Latvia was rated in 2004 and a Tunisian deal, the first in North Africa, was rated in 2006. Three Russian offshore transactions also came to market in 2006 as well as the first domestic Russian RMBS transaction. Four further Russian deals have followed so far in 2007, as have one Ukrainian and one Kazakh deal. Given ongoing legal framework improvements and a favourable socio-economic environment, we expect to see a growing number of RMBS deals in these and other new markets.

When rating transactions in these new markets, Moody's makes use of the same RMBS methodology that it applies to all EMEA markets. This combines the use of Moody's Individual Loans Analysis (MILAN) model for collateral analysis with a cash flow model such as Moody's Analyser of Residential Cash Flows (MARCO) or ABSROM.

The MILAN model is a scoring tool (adapted to each local market) used to determine the credit quality of a loan portfolio based on loan, borrower, property and pool characteristics. Its output is the MILAN Credit Enhancement, which represents Moody's estimation of the loss the portfolio will suffer in a severe recession scenario throughout its life. The MILAN Credit Enhancement and the mean loss of the pool are taken as inputs into the MARCO model to construct a loss distribution of the mortgage portfolio backing the notes.

In dealing with countries with local currency bond ceilings below Aaa, Moody's adjusts some of its modelling assumptions that were originally calibrated to countries with Aaa local currency ceilings. Indeed, for such countries, the approach puts greater emphasis on the guidance provided by country analysts – to more closely reflect the loss distribution in the emerging markets, where there could be an increased risk of a country-wide event, which would result in significant losses for the pool.

In addition, each of the markets requires specific parameters and inputs, reflecting, for example, potential changes in house prices, regional concentration, and the length and costs of foreclosure procedures. The developing nature of emerging markets results in various risks associated with collateral that are not commonly found in developed markets. One of the main risks Moody's has encountered is lack of historical data with regard to collateral performance which affects virtually all types of performance data.

One of the main risks Moody's has encountered is lack of historical data

However, there are a number of other risks and factors that Moody's takes into consideration when rating RMBS transactions in emerging markets and these are discussed in detail in a new rating methodology.

For a copy of "Moody's Approach to Rating RMBS in Emerging Securitisation Markets – EMEA", please contact our client services desk on +44 20 7772-5454 or by email to clientservices@moodys.com.



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Russian True-Sale Transactions: Challenges and Mitigating Factors

» Russia has witnessed sharp growth in structured finance activity since Moody's rated the first securitisation of Russian assets structured as a true sale in July 2005. Following a 17-fold increase in 2006, Moody's expects issuance volume in Russia to continue to grow, albeit at a slower rate, in the near future as economic growth is maintained and securitisation becomes a strategic financing tool for banks and corporates. As of the publication of this newsletter, Russian structured bond issuance for 2007 to date amounted to approximately $1.9 billion.

Moody's recently published an overview of the major challenges facing a typical Russian securitisation transaction structured as a true sale using an offshore SPV. Moody's believes the challenges may be broadly broken down into legal considerations and structural and asset considerations.

The key legal concern relates to the enforceability of the "true sale" mechanism employed in most Russian securitisation transactions. Although most legal opinions state that "true sale" would work under general Russian law provisions, they are subject to broad qualifications over enforceability. Nonetheless, Moody's believes the overall likelihood of the true sale being successfully challenged during the life of the transaction, thereby resulting in a severe loss to the structure, is reasonably low.

Therefore, whilst Moody's believes the ratings of notes issued under a securitisation are linked to the ratings of the Originator/Seller, a securitisation may still achieve ratings that are noticeably above the Originator's ratings at closing. In particular, the concerns highlighted in the report do not preclude Moody's from assigning investment-grade ratings to notes issued by low-rated Originators, provided Moody's believes the transaction has structural and/or legal mitigants to address such concerns. The ratings assigned would be capped by either Russia's Local Currency Guideline (currently A1) or the Foreign Currency Country Ceiling (currently A2), as applicable. However, given the linkage to the ratings of the Originator, the ratings assigned to notes originated by low-rated Originators in most cases would likely be below the Foreign Currency Country Ceiling.

Commingling also remains a concern in Russia as Moody's understands that credit loss may arise to the extent that, even after notification, the obligors continue to pay into the collections account of the defaulting Originator. In relation to set-off, Moody's understands that legal constraints under Russian law on the ability of the obligor to exercise rights of set-off following notification and/or insolvency of the Originator suggest that the risk of set-off to a securitisation may be limited.

Structural and asset considerations that Moody's typically observes include: (i) issues arising from a portfolio that is denominated in, or pegged to, a foreign currency (possibly leading to increased default frequency or loss arising from a possible redenomination event); (ii) challenges to the quantitative analyses arising from insufficient historical data; and (iii) challenges in applying typical structural features because of concerns over the underlying banking infrastructure.

For a copy of the report entitled "Key Legal and Structural Rating Issues in Russian Securitisation Transactions", please contact our client services desk on +44 20 7772-5454 or by email to clientservices@moodys.com.

The legal concerns in Russia do not preclude Moody's from assigning investment-grade ratings to securitisation notes issued by low-rated Originators



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Company Profile: Ukrainian Steel Producer Zaporizhstal

Located in the Zaporizhya region in eastern Ukraine, VAT Zaporizhstal is the country's fourth-largest integrated steel producer with an annual production capacity of 4.4 million tonnes. It has a single mill that specialises in the production of hot-rolled and cold-rolled sheets and coils, which accounted for 90% of total revenue in 2006.

The majority of the company's sales are to Turkey, the CIS and the EU. In 2006, it reported sales of UAH8.018 billion (approx. US$1.6 billion) and EBITDA of UAH1,283 billion (approx. US$254 million). Zaporizhstal is controlled by two main shareholders: Zaporizhye Group (44.98%) and Midland Group (44.75%), with 10.27% free-floating shares.

Zaporizhstal's B3 corporate family rating reflects a number of positive factors. Firstly, it enjoys an established position in the Ukrainian steel market, in particular with respect to higher value-added flat steel products. In addition, its current debt level is low and it has a good track record of cash flow generation, as well as a low fixed cost base and an ability to compete on a global scale. Its geographic proximity to its raw materials and major steel consuming markets is also a key strength. Moody's also views favourably the continued focus on cost reduction, as reflected in a number of forthcoming investments aimed at improving the product mix and efficiency.

VAT Zaporizhstal is Ukraine's fourth-largest integrated steel producer

The ratings are also constrained by a number of challenges, including its relatively modest size, its exposure to the highly cyclical steel industry and to end-consumer industries, such as the railway cars and machine building, construction and tubular goods sectors. In addition, the significant share of exports and the company's reliance on trading entities owned by the same shareholders as its own for such exports also present challenges, as do its exposure to protectionist barriers in the export markets and the limited level of shareholder transparency and risk of significant cash outflows to shareholders. The evolving and unpredictable nature of the Ukrainian business, fiscal and legal environment additionally poses some potential risks.

However, the rating also continues to reflect the company's stable but below-industry-average operational and financial results that it reported in 2006 and H1 2007, underpinned by continued benign market conditions for Ukrainian steel producers.

Going forward, Moody's expects ongoing capex investments to enable the company to better control costs and further develop higher value-added products. However, such a programme would require substantial investments to be financed mostly by debt, which would in turn result in a significant increase in leverage, which may – at least initially – more than offset the potential benefits.

European Steel Industry Outlook

In Moody's view, the European steel industry is enjoying a very positive business environment, which has continued for the past three to four years. The outlook for the industry going into 2008 is largely stable and for certain companies slightly positive. The industry is set to continue consolidating, although there is a threat of a further increase in input prices. There is also a medium-term risk of overcapacity stemming mainly from hefty capacity increases in China.

For a copy of the report entitled "European Steel Industry Outlook" or for information on the ratings of VAT Zaporizhstal, please contact Moody's client services desk on +44 20 7772 5454 or by email to clientservices@moodys.com.

Russian Banking System Enjoys Positive Rating Pressure



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A number of factors – the currently favourable macroeconomic environment, ongoing institutional reforms in the banking sector, increasingly diversified activities and improving financial fundamentals – are exerting positive pressure on Russian banks' ratings over the near to medium term. However, ratings remain constrained by banks' generally opaque ownership structures, significant corporate governance issues, relatively high levels of credit risk concentration and low economic capitalisation.

Russia's banking system is benefiting significantly from a robust macroeconomic environment and is growing rapidly

Russia's banking system is benefiting significantly from a robust macroeconomic environment and is growing rapidly. However, banking penetration remains relatively low, with scope for considerable expansion in both corporate and retail lending. Recent institutional reforms such as the introduction of a Deposit Insurance System and legislative measures facilitating mortgage lending will play a key role. In addition, consolidation is likely to speed up in coming years, with foreign investors showing interest in entering the market.

Despite a steady increase in foreign borrowing, Russian banks' dependence on the global wholesale market is limited and does not pose a significant risk to the banking system or its major players. The impact of the global liquidity crisis is likely to be limited to a slowdown in credit growth and depressed earnings (see also article on page 2).

In recent years the Central Bank of Russia has achieved some positive results in implementing international best practices, most visibly in areas such as transparency of ownership and capital adequacy regulation. However, banking supervision remains more focused on banks' formal compliance with prudential ratios than on the economic substance of their operations.

Although growing international activity is contributing to some progress in corporate governance and risk management systems are improving slowly, credit risk management often remains rudimentary. Thus, loan portfolios continue to be highly concentrated, while related-party lending remains an area of concern.

The banking system's overall asset quality remains satisfactory, although the true level of problem loans may be somewhat understated given the insufficient level of disclosure in financial reporting. Loan portfolio quality would likely decline if the macroeconomic situation were to worsen, while rapid growth in delinquencies on current consumer loans could become a systemic problem in the medium term.

Profitability indicators remain relatively high, but are under pressure from shrinking margins and rising costs related to aggressive development of the retail business. Meanwhile, substantial investments in regional networks, high demand for qualified staff and the need to modernise infrastructure make material improvements in efficiency indicators unlikely in the near term.

Finally, the rapid growth and current shareholders' inability to make new contributions are weighing on banks' capital adequacy, although stronger players may well resolve this issue through IPOs or placements of marketable subordinated debt.

For a copy of the report entitled "Banking System Outlook: Russia", please contact Moody's client services desk on +44 20 7772-5454 or by email to clientservices@moodys.com.

New Appointments



Michel Madelain »
Executive Vice President,
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Michel Madelain has been appointed as Executive Vice President of Moody's Investors Service. Michel assumes responsibility for Global Fundamental Ratings, which includes corporate finance, financial institutions, public finance and infrastructure. Previously, Michel Madelain was Senior Managing Director with responsibility for global banking. Prior to that, he was responsible for Moody's corporate ratings in Europe, Middle East and Africa and held several Managing Director positions in the U.S. and the U.K. fundamental rating groups. Michel Madelain holds a master's degree in management from Northwestern University and is qualified as a Chartered Accountant in France. Before joining Moody's in 1994, Michel Madelain was a Partner of Ernst & Young, Auditing Practice.



Michael West »
Group Managing Director

Michael West has been appointed as Group Managing Director in Moody's European Corporate Finance Group (CFG). Michael is now responsible for the company's corporate ratings business in Europe, Middle East and Africa, where Moody's currently rates approximately 650 corporate families across the entire ratings scale. Michael joined Moody's London office in 1998 as a Corporate Finance Analyst. After an assignment in the Speculative Grade team in New York, he held various responsibilities at the London office and was promoted to Team Managing Director in 2003 in Frankfurt. In this role, Michael spearheaded the development of CFG in Germany and Eastern Europe before returning to London in 2005. Prior to joining Moody's, he worked for Bank of America and HSBC in London. Michael is a graduate in politics and economics from Loughborough University.



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Andrey Artyukhin is the lead analyst for a number of Russian and Kazakhstani banks. Prior to joining Moody's Moscow office in September 2005, he worked as a consultant at PricewaterhouseCoopers, with previous experience as an adviser on strategy to the President at Locko-bank, a senior expert at the World Bank's Financial Institutions Development Project in Russia and as a bank analyst at Mezhcombank. Andrey holds a master's degree in world economic and political geography from Moscow State University and a Ph.D. in International Economic Relations.



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