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New Results From European Leveraged Loan Study Show Slight Acceleration In Default Rate

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Standard & Poor's Ratings Services has completed its latest "European Leveraged Loan Default And Recovery Study." This is the fourth annual study, with analysis up to the end of 2007. With an increase in the number of data providers, the size of the portfolio of transactions is contributing to an increasingly robust report. However, with the backdrop of the liquidity crunch and in particular the banking crisis, we emphasize that the analysis in the report is historical in nature and reflects defaults and recoveries from a much more benign credit environment. Future recoveries may be lower.

Highlights of the report's findings include the following:

- The annual default rate in 2007 shows some acceleration to nearly 2.0% from 1.3% in 2006.
- The seven-year cumulative default rate for transactions in the aggregate leveraged loan portfolio was approximately 15%, which is slightly below the seven-year cumulative default rate for publicly rated 'BB-' corporate debt.
- Recoveries of defaults in the aggregate portfolio were very strong and follow a skewed distribution typical of recoveries, with more than half recovering more than 90%.

Up until 2004 there was little, if any, empirical default and recovery data for European leveraged loans or data distinguishing between the recoveries of differently structured loan transactions. Since then, we have worked with 17 leading banks and investors active in leveraged finance in Europe to pool default and recovery data from their loan portfolios. Pooling data from individual lenders into an aggregate portfolio provides participating institutions with a much wider data set than they would otherwise have had based on their own individual loan portfolios. Our aim is to provide an independent, objective analysis of the historical risk performance of European leveraged loans and to quantify potential future performance.

The consortium whose data we pool and analyze comprises Alcentra Ltd., Alliance & Leicester Commercial Bank PLC, Babson Capital, Bank of Scotland PLC, BayernLB, Calyon, DZ Bank AG, Fortis Bank (Nederland) N.V., GE Commercial Finance, Harbourmaster Capital Management Ltd., HSH Nordbank, KBC Bank NV, M&G Investment Management Ltd., Natixis, Royal Bank of Scotland, Société Générale, and WestLB AG.

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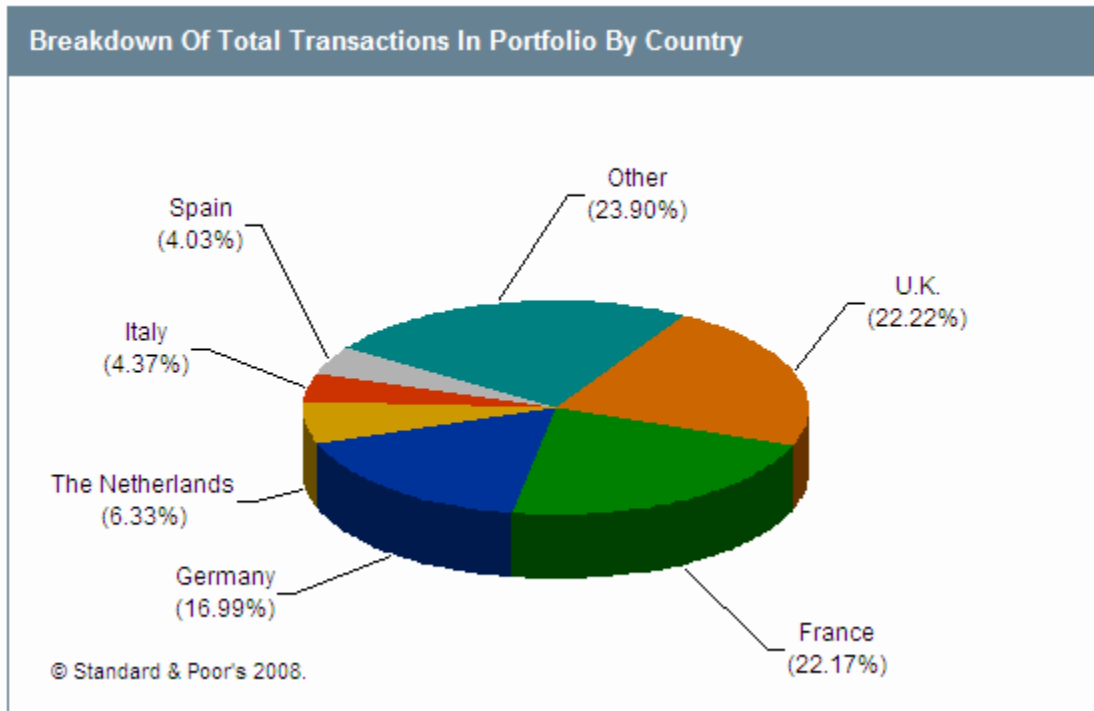
Scope of the study

The 2007 portfolio comprises European leveraged loan data originated or acquired in the 10-year period from Jan. 1, 1998 to Dec. 31, 2007. We observed defaults in the period from 2000-2007 and used the Basel II definition of default to determine defaulted transactions. Notably, this definition includes restructured leveraged loans and distressed sales of the loans.

The 2007 aggregate portfolio doubled in size to approximately 2,084 transactions (involving more than 13,573 related leveraged loan tranches). Of these, 82 transactions defaulted and reached resolution. While adding a significant number of new observations, the vast majority of conclusions and trends remain consistent with the ones we have reported previously.

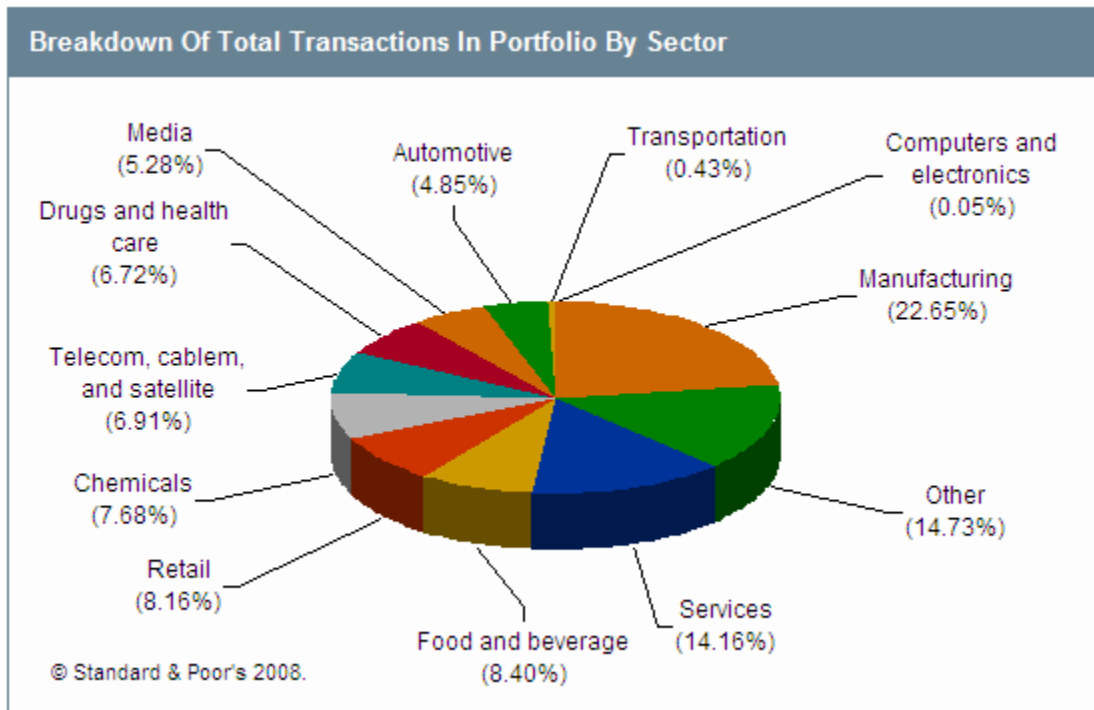
In terms of jurisdiction, the U.K., Germany, and France account for more than 60% of the portfolio and most of the defaulted transactions (see chart 1). Nevertheless, there is an observable increase in transactions originated in the smaller European markets.

Chart 1



The sectors we analyzed included media and telecommunications, chemicals, manufacturing, services and leasing, food and beverage, and conglomerates (see chart 2). An analysis of default rates by sector shows volatility across all of them.

Chart 2



The report lists recovery by type of resolution, broken down into liquidation, restructuring, and instrument sale. Finally, we performed a correlation analysis between the credit environment, as measured by the default rate, and leveraged loan recoveries. Results from such an analysis help to quantify differences between recoveries in downturn periods and those in more benign credit periods.

Future data and reporting

We produce the "European Leveraged Loan Default and Recovery Study" annually for participating banks and investors. The next report for the bank group is scheduled to be published in mid-2009 and will include leveraged loan portfolio data up to Dec. 31, 2008.

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