Module International Regions and Municipalities

Ratings on sub-sovereign entities outside Germany

Overview

The module International Regions and Municipalities has been designed to evaluate the solvency of sub-sovereign entities outside Germany. A differentiated modeling approach reflects the structural differences between regional and municipal governments.

The rating algorithm is based on a scorecard approach where quantitative and qualitative factors are combined using appropriate weightings. In particular, it takes into account the credit standing of the corresponding sovereign. This results in a rating grade that corresponds to the one-year probability of default (PD).

The module International Regions and Municipalities has been included in the annual validation cycle since 2005 and has been approved for the IRB Approach in Germany since early 2007.

Scope

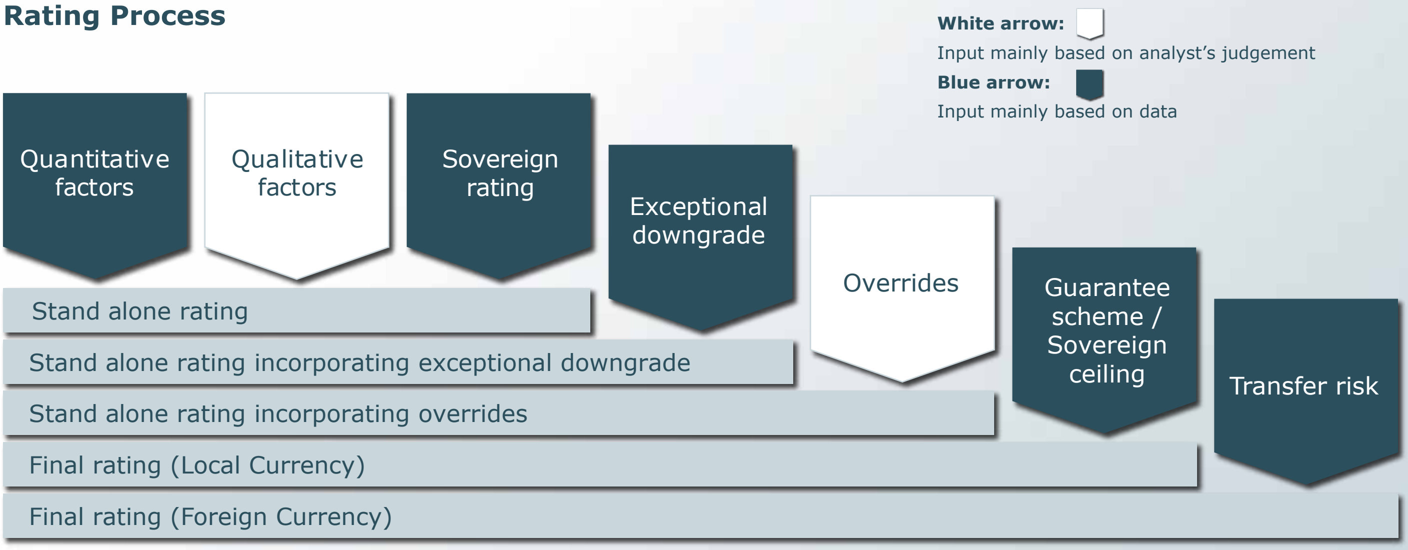
The scope of the module *International Regions and Municipalities* covers sub-sovereign entities outside Germany. Such entities are defined as administrative units below the sovereign level that have governmental responsibilities and are entitled to the proceeds from non-earmarked taxes, duties and levies.

The module may also be used for assessing special-purpose districts, such as school districts in the USA, if they are mainly funded by transfer payments from sub-sovereign entities enjoying the above tax privileges or if they cover a substantial part of their budget by levying their own non-earmarked taxes.

Limitations

The module is not applicable for evaluating public sector companies/government-related enterprises (GREs), i.e. companies that are majority-owned by a government and have a public interest mission. Such companies can be rated using the Corporates module.

Rating Process



Quantitative and Qualitative Factors, Sovereign Rating

The quantitative factors are determined based on budget and structural ratios. In addition, analysts are required to perform systematic and standardized evaluations of a number of qualitative factors. The sovereign rating (local currency) also enters into the calculation as it reflects the substantial influence of the political, legal and economic environment on a sub-sovereign entity`s creditworthiness.

Exceptional Downgrade and Overrides

If certain budget ratios reach critical values, an automatic downgrade on the stand alone rating applies. If, at the previous stages, exceptional risk-relevant circumstances have not been sufficiently taken into account, a further adjustment of the rating may be necessary. For this purpose the system provides an override option.

Guarantee Scheme, Sovereign Ceiling and Transfer Risk

A guarantee scheme is considered to apply if the sovereign or a superior entity are effectively required by law or contract to prevent the borrower from defaulting. Given the substantial influence of the sovereign, the final rating (local currency) may be capped due to a moderated sovereign ceiling. In addition, the transfer risk, i.e. the risk of currency transfer restrictions, is taken into account. This risk must be considered when the financing currency is different from the borrower`s home currency.

RSU
Rating Service Unit GmbH & Co. KG
Karlstraße 35
80333 Munich
Germany

Tel +49.89.442340-0
Fax +49.89.442340-999

marketing@rsu-rating.de
www.rsu-rating.com