Delivering a Smarter Investment Strategy: How UPS Created a Unique Tool for Analyzing Counterparty Risk

Jimmie Irby, Credit and Risk Administration, J.P. Morgan Global Liquidity

Jennifer Powers, United Parcel Services
Agenda

• Overview of the UPS Short Term Investment Policy
• How does UPS evaluate counterparties?
• How does a money fund evaluate counterparties
• Q&A
Structure of Cash Organization

HQ: Atlanta, GA
Regional: London
Regional: Singapore
Regional: Miami
Counterparty Evaluation starts with the UPS Short Term Investment Policy

### Primary Investment Objectives

The primary investment objectives of each portfolio, in order of importance, should be:

<table>
<thead>
<tr>
<th>Objective</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Preservation of Principal</strong></td>
<td>• Safety of principal is the foremost objective of the investment program. Investments will be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio</td>
</tr>
<tr>
<td><strong>Yield</strong></td>
<td>• The investment portfolio shall be managed with the objective of attaining a competitive and consistent rate of return, based on the benchmark criteria and investment constraints outlined in this policy</td>
</tr>
<tr>
<td><strong>Liquidity</strong></td>
<td>• The investment portfolio shall remain sufficiently liquid to meet all operating requirements that may be reasonably anticipated. This will be accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands</td>
</tr>
<tr>
<td><strong>Portfolio Diversification</strong></td>
<td>• The Company’s investment portfolio will be adequately diversified as to quality, maturity and issuers. Market conditions and relative value will determine portfolio composition</td>
</tr>
</tbody>
</table>
Key Facts about the UPS Short Term Investment Policy

- The majority of the portfolio is self-directed by an experienced team of traders based in the Atlanta Headquarters
- Cash is global, with all decisions made at the HQ and regional teams implementing designated strategy
- There are two core investment portfolios that must adhere to the counterparty limits stated in the investment policy
- The weighted average maturity (WAM) of the combined portfolios cannot exceed one year
- The Company maintains its investment values on a current basis; all portfolio assets are revalued at current market prices
- At least quarterly, the UPS Corporate Treasury Investment Committee will review a status report of the portfolio, which must contain, but is not limited to the following:
  - Breakdown of securities held in each portfolio, including maturity date and current yield
  - Performance relative to benchmark
  - Portfolio credit quality
  - Investment allocation by type and maturity
  - Out-of-compliance and/or downgraded positions
# UPS CORPORATE TREASURY
## Permitted Investment Guidelines

<table>
<thead>
<tr>
<th>Permitted Investment Type</th>
<th>Counterparty Bank Rating</th>
<th>Investment Type as % of Portfolio</th>
<th>Purchase Commitment as % of Investment Portfolio</th>
<th>Maximum % of Security's Outstanding Amount</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Systemically Important Bank Owned and Non-Bank Owned Money Market Funds</td>
<td>A-/A-/A3 or better</td>
<td>100%</td>
<td>N/A</td>
<td>10%</td>
<td>UPS may own no more than 10% of the fund portfolio. ALL MONEY MARKET FUNDS MUST BE AAA RATED</td>
</tr>
<tr>
<td>Non-Systemically Important Bank Owned and Non-Bank Owned Money Market Funds</td>
<td>N/A</td>
<td>40%</td>
<td>N/A</td>
<td>5%</td>
<td>UPS may own no more than 5% of the fund portfolio ALL MONEY MARKET FUNDS MUST BE AAA RATED</td>
</tr>
<tr>
<td>Repurchase Agreements</td>
<td>AA-/AA-/Aa3 or better</td>
<td>100%</td>
<td>N/A</td>
<td>N/A</td>
<td>Maximum Investment 8% of Total Investment Portfolio Collateral types and margin % based on Appendix ‘B’</td>
</tr>
<tr>
<td>Repurchase Agreements</td>
<td>A-/A-/A3 or better</td>
<td>100%</td>
<td>N/A</td>
<td>N/A</td>
<td>Maximum Investment 6% of Total Investment Portfolio Collateral types and margin % based on Appendix ‘B’</td>
</tr>
<tr>
<td>Direct Obligations of the U.S. Government (Including Treasury bills &amp; notes)</td>
<td>N/A</td>
<td>100%</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Supranational &amp; Sovereign Debt Obligations</td>
<td>N/A</td>
<td>50%</td>
<td>5%</td>
<td>10%</td>
<td>A-/A-/A3 or better: Maximum exposure to a single country is $500MM Below A-/A-/A3: Maximum exposure to a single country is $300MM.</td>
</tr>
<tr>
<td>Government Agencies (Fully Guaranteed)</td>
<td>N/A</td>
<td>100%</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Government Agencies (Implicit Guarantee)</td>
<td>N/A</td>
<td>50%</td>
<td>5%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Certificates of Deposit, Time Deposits, EuroDollar Deposits &amp; Banker’s Acceptances (Issued by Banks or their Foreign Branches)</td>
<td>A-/A-/A3 or better</td>
<td>50%</td>
<td>5%</td>
<td>N/A</td>
<td>Counterparty Bank Minimum Asset Size: $5B</td>
</tr>
</tbody>
</table>
# UPS CORPORATE TREASURY
## Permitted Investment Guidelines

<table>
<thead>
<tr>
<th>Permitted Investment Type</th>
<th>Counterparty Bank Rating</th>
<th>Investment Type as % of Portfolio</th>
<th>Purchase Commitment as % of Investment Portfolio</th>
<th>Maximum % of Security’s Outstanding Amount</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Certificates of Deposit, Time Deposits, EuroDollar Deposits &amp; Banker’s Acceptances (Issued by Foreign Banks)</td>
<td>A+/A-/A3 or better</td>
<td>30%</td>
<td>5%</td>
<td>N/A</td>
<td>Counterparty Bank Minimum Asset Size: $40B</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>N/A</td>
<td>40%</td>
<td>5%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Taxable Commercial Paper</td>
<td>N/A</td>
<td>40%</td>
<td>5%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Tax-Exempt Commercial Paper</td>
<td>N/A</td>
<td>50%</td>
<td>5%</td>
<td>10%</td>
<td>Tax-exempt purchases within 2% safe harbor guideline</td>
</tr>
<tr>
<td>Taxable &amp; Tax-Exempt Municipal Bonds</td>
<td>N/A</td>
<td>50%</td>
<td>5%</td>
<td>10%</td>
<td>Tax-exempt purchases within 2% safe harbor guideline</td>
</tr>
<tr>
<td>Tax-Exempt Securities</td>
<td>N/A</td>
<td>50%</td>
<td>5%</td>
<td>10%</td>
<td>Tax-exempt purchases within 2% safe harbor guideline</td>
</tr>
<tr>
<td>Called Securities</td>
<td>N/A</td>
<td>25%</td>
<td>5%</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>VRDN’s, VRDO’s, Option Tender Bonds</td>
<td>N/A</td>
<td>25%</td>
<td>5%</td>
<td>5%</td>
<td>Prior Approval Only</td>
</tr>
<tr>
<td>Preferred Stock, Common Stock, Equity Related Instruments</td>
<td>N/A</td>
<td>75%</td>
<td>75%</td>
<td>N/A</td>
<td>Prior Approval Only</td>
</tr>
<tr>
<td>Securitizations (Including MBS, CMBS, &amp; Credit Cards)</td>
<td>N/A</td>
<td>25%</td>
<td>5%</td>
<td>5%</td>
<td>Prior Approval Only</td>
</tr>
<tr>
<td>Money Market Preferred Stock &amp; Auction Rate Securities</td>
<td>N/A</td>
<td>40%</td>
<td>5%</td>
<td>5%</td>
<td>Prior Approval Only</td>
</tr>
</tbody>
</table>
Evaluating Counterparties—What does UPS look at when selecting securities

- Short term and long term ratings
- Systematically vs. Non-Systematically important banks
- 5 year Credit Default Swap (CDS) rates
- Standard deviation vs. historical norms for CDS rates
- Annual revenue minimums for counterparties
- Ratings on money funds
- Bank owned vs non-bank owned money funds
Evaluating Counterparties– How does UPS deliver?

- UPS Traders utilize a Bloomberg terminal to update an excel spreadsheet on a daily basis

- 5 year CDS rates for relationship banks are entered into the spreadsheet and established formulas are used to determine the portfolio allocation

- Standard deviation “triggers” are set so that if the CDS rates go above certain levels, UPS will reduce exposure
Credit Risk Management Process– Tool in order to assist decision making in a consistent manner globally

<table>
<thead>
<tr>
<th>Date</th>
<th>BANK 1</th>
<th>BANK 2</th>
<th>BANK 3</th>
<th>BANK 4</th>
<th>BANK 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>8/1/2013</td>
<td>111.734</td>
<td>116.203</td>
<td>117.812</td>
<td>105.66</td>
<td>163.807</td>
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<tr>
<td>8/2/2013</td>
<td>112.725</td>
<td>117.036</td>
<td>116.715</td>
<td>106.337</td>
<td>164.188</td>
</tr>
<tr>
<td>8/5/2013</td>
<td>111.237</td>
<td>117.054</td>
<td>117.597</td>
<td>105.292</td>
<td>163.98</td>
</tr>
<tr>
<td>8/6/2013</td>
<td>110.907</td>
<td>117.701</td>
<td>116.898</td>
<td>104.251</td>
<td>162.45</td>
</tr>
<tr>
<td>8/7/2013</td>
<td>112.305</td>
<td>119.349</td>
<td>120.209</td>
<td>105.406</td>
<td>163.255</td>
</tr>
<tr>
<td>8/8/2013</td>
<td>111.577</td>
<td>117.898</td>
<td>117.082</td>
<td>103.421</td>
<td>152.709</td>
</tr>
<tr>
<td>8/9/2013</td>
<td>111.067</td>
<td>117.747</td>
<td>116.492</td>
<td>103.413</td>
<td>151.094</td>
</tr>
<tr>
<td>8/12/2013</td>
<td>110.575</td>
<td>117.986</td>
<td>115.946</td>
<td>104.238</td>
<td>151.383</td>
</tr>
<tr>
<td>8/13/2013</td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>8/14/2013</td>
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<tr>
<td>8/15/2013</td>
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<tr>
<td>8/16/2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>8/19/2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8/20/2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

30-day Mean (Change formula to current)
- Mean since 09/15/2008 (Change formula to current)

Standard Deviation Calculation
- Mean since 09/15/2008 (Change formula to current)

Standard Deviation Formula (Change formula to current)

Automatically Calculates
- $1 \sigma$
- $2 \sigma$
- $3 \sigma$
A Snapshot of the UPS Portfolio

UPS Corporate Treasury Portfolio Summary—As of: August 13, 2013

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>Total Amount</th>
<th>Investment Type as % of Portfolio</th>
<th>Portfolio Limits</th>
<th>UPICO</th>
<th>% to Portfolio</th>
<th>GTP</th>
<th>% to Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Called Bonds</td>
<td>$0.00</td>
<td>0.00%</td>
<td>N/A</td>
<td>–</td>
<td>0.00%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Certificates of Deposit, Time Deposits, etc. (Foreign Banks)</td>
<td>$697,581,298.29</td>
<td>16.18%</td>
<td>30%</td>
<td>$214,000,000.00</td>
<td>4.96%</td>
<td>$483,581,298.29</td>
<td>11.21%</td>
</tr>
<tr>
<td>Certificates of Deposit, Time Deposits, etc. (U.S. Banks)</td>
<td>$100,000,000.00</td>
<td>2.32%</td>
<td>50%</td>
<td>$100,000,000.00</td>
<td>2.32%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>$328,544,925.16</td>
<td>7.62%</td>
<td>40%</td>
<td>$328,544,925.16</td>
<td>7.62%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Direct Obligations of the U.S. Government</td>
<td>$0.00</td>
<td>0.00%</td>
<td>100%</td>
<td>–</td>
<td>0.00%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>MMP &amp; Auction Rate Securities</td>
<td>$0.00</td>
<td>0.00%</td>
<td>40%</td>
<td>–</td>
<td>0.00%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Money Market Funds (Bank Owned/Guarantied)</td>
<td>$470,239,378.23</td>
<td>10.90%</td>
<td>100%</td>
<td>$256,940,633.85</td>
<td>5.96%</td>
<td>$213,298,744.38</td>
<td>4.95%</td>
</tr>
<tr>
<td>Money Market Funds (Non-Bank Owned/Guarantied)</td>
<td>$60,923,322.70</td>
<td>1.41%</td>
<td>40%</td>
<td>$60,923,322.70</td>
<td>1.41%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Municipal Bonds</td>
<td>$10,587,990.00</td>
<td>0.25%</td>
<td>50%</td>
<td>$10,587,990.00</td>
<td>0.25%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Preferred/ Common Stock &amp; Equity Related</td>
<td>$0.00</td>
<td>0.00%</td>
<td>75%</td>
<td>–</td>
<td>0.00%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Repurchase Agreements</td>
<td>$1,479,988,066.29</td>
<td>34.32%</td>
<td>100%</td>
<td>$250,000,000.00</td>
<td>5.80%</td>
<td>$1,229,988,066.29</td>
<td>28.52%</td>
</tr>
<tr>
<td>Securitizations</td>
<td>$0.00</td>
<td>0.00%</td>
<td>25%</td>
<td>–</td>
<td>0.00%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Supranational &amp; Sovereign Debt</td>
<td>$493,795,307.93</td>
<td>11.45%</td>
<td>100%</td>
<td>$493,795,307.93</td>
<td>11.45%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Tax-Exempt CP</td>
<td>$57,090,000.00</td>
<td>1.32%</td>
<td>50%</td>
<td>$57,090,000.00</td>
<td>1.32%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Tax-Exempt Securities</td>
<td>$0.00</td>
<td>0.00%</td>
<td>50%</td>
<td>–</td>
<td>0.00%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Taxable CP</td>
<td>$613,626,245.71</td>
<td>14.23%</td>
<td>40%</td>
<td>$405,930,055.20</td>
<td>9.41%</td>
<td>$207,696,190.51</td>
<td>4.82%</td>
</tr>
<tr>
<td>U.S. Government Agencies (Fully Guarantied)</td>
<td>$0.00</td>
<td>0.00%</td>
<td>100%</td>
<td>–</td>
<td>0.00%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>U.S. Government Agencies (Implicit Guaranty)</td>
<td>$0.00</td>
<td>0.00%</td>
<td>50%</td>
<td>–</td>
<td>0.00%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>VRDNs, VRDOs, Option Tender Bonds</td>
<td>$0.00</td>
<td>0.00%</td>
<td>25%</td>
<td>–</td>
<td>0.00%</td>
<td>–</td>
<td>0.00%</td>
</tr>
<tr>
<td>Total</td>
<td>$4,312,376,554.31</td>
<td>100.00%</td>
<td>$2,177,812,234.84</td>
<td>50.50%</td>
<td>$2,134,564,319.47</td>
<td>49.50%</td>
<td></td>
</tr>
</tbody>
</table>
How do money market funds assess counterparties?

• Key objective: limit credit and headline risk
  – Redemptions occur at 1 unit/share
  – Uniform, defensive standards curb event risk

• Credit factors

• Important money fund sectors
  – Sovereigns and agencies
  – Banks and bank funding vehicles

• Structural and security considerations

• Continuous, collaborative review process
J.P. Morgan internal credit ratings

All issuers are assigned internal short-term ratings using a long-term rating scale, which reflects better risk delineation.

Internal ratings establish ceilings for firm limits, account concentrations, and maturity restrictions.

- Higher concentrations and longer dated issues require solid, stable ratings quality.
- Greater diversity and shorter maturities are mandated for lower-rated or deteriorating credits.
- Actively monitor purchase limits as appropriate.

Issues and issuers must be approved by an analyst prior to purchase.

Moody’s Rating Scale

<table>
<thead>
<tr>
<th>JPM Internal Ratings</th>
<th>Global Cash</th>
<th>Managed Reserves</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tenors (days)</td>
<td>Account [Conc]</td>
<td>Tenors (days)</td>
</tr>
<tr>
<td>Aaa</td>
<td>AAA</td>
<td>397 5.0%</td>
</tr>
<tr>
<td>Aa1</td>
<td>AA+</td>
<td>397 5.0%</td>
</tr>
<tr>
<td>Aa2</td>
<td>AA</td>
<td>397 5.0%</td>
</tr>
<tr>
<td>Aa3</td>
<td>AA-</td>
<td>370 4.5%</td>
</tr>
<tr>
<td>A1</td>
<td>A+</td>
<td>275 3.0%</td>
</tr>
<tr>
<td>A2</td>
<td>A</td>
<td>190 2.0%</td>
</tr>
<tr>
<td>A3</td>
<td>A-</td>
<td>35 0.5%</td>
</tr>
<tr>
<td>Baa1</td>
<td>BBB+</td>
<td>NA NA</td>
</tr>
<tr>
<td>Baa2</td>
<td>BBB</td>
<td>NA NA</td>
</tr>
<tr>
<td>Baa3</td>
<td>BBB-</td>
<td>NA NA</td>
</tr>
<tr>
<td>Ba1</td>
<td>BB+</td>
<td>NA NA</td>
</tr>
</tbody>
</table>

* 1100d for non-bank issuers only

Shown for illustrative purposes only.
J.P. Morgan internal credit ratings

Commercial paper outstandings ($ billions)

Source: Federal Reserve Bank (not seasonally adjusted). * Represents peak in commercial paper.

Adding certificates of deposit, time deposits and repurchase agreements into the mix, finance likely comprises 95 – 98% of the cash market

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Credit sector specialization

The financial sector encompasses all issuers deriving substantial revenue from financial assets (positive spread carry)

- Finance companies underwrite assets — or the risks associated with those assets — with shorter dated funding from wholesale and retail sources
Assessing sovereign risk

| Political structure | Stability of political institutions  
|                     | Transparency of elections and economic policy  
|                     | Public security  

| Economic growth prospects | Economic diversity  
|                          | Labor flexibility  
|                          | Credit availability to facilitate economic growth  
|                          | Effective financial sector  
|                          | Employment and prosperity levels  

| Debt burden | General government debt level  
|            | Share of revenue devoted to interest payments  
|            | Depth and breadth of local capital markets  
|            | External liquidity/external debt burden  

| Fiscal & monetary control | Revenue, expenditure and surplus/deficit trends  
|                          | Ability and effectiveness in raising revenue  
|                          | Fiscal policy to manage debt  

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## Primary credit factors

<table>
<thead>
<tr>
<th>Primary credit factors</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital</td>
<td>Should be inversely proportionate to earnings volatility (low earnings volatility requires less capital, high earnings volatility requires more capital)</td>
</tr>
<tr>
<td>Asset quality</td>
<td>Assess underlying credit quality and inherent liquidity of underlying assets</td>
</tr>
<tr>
<td>Management</td>
<td>Should demonstrate integrity</td>
</tr>
<tr>
<td>Earnings</td>
<td>Review for consistency and quality over different time periods</td>
</tr>
<tr>
<td>Liquidity</td>
<td>Match funding, back-up credit lines or stable retail funding base</td>
</tr>
<tr>
<td>Industry and operating trends</td>
<td>Reviews operating trends, cash flows, industry or product dominance and relative performance, compared with a peer group</td>
</tr>
<tr>
<td>Alternative repayment options</td>
<td>Check that underlying collateral securing an investment can be sold in the event of default</td>
</tr>
</tbody>
</table>
Comparing structure and security

Company Structure, Ratings & Issuance

ABC & Co. (A/A2) CP and MTNs

ABC Markets (A+/A1) Repo and PNs

ABC Bank NA (A+/Aa3) CDs/TDs/BNs

XYZ Funding (A-1/P-1) ABCP

Priority

Bank

Broker

HoldCo

Security

Repo

ABCP

Deposits, BNs, PNs, CP and MTNs

AFP® Annual Conference
Micro process continually monitors security selection

- Active management of interest rate duration (WAM limited to 60 days)
- Constant evaluation of spread duration — credit WAM carefully controlled and monitored
- Ongoing dialogue and review of sponsor/administrators, dealers and rating agencies
BofA Merrill Lynch 1-3 Year Corporate Index (C1A0)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Issuers</th>
<th>Outstandings</th>
<th>Largest*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automotive</td>
<td>13</td>
<td>36</td>
<td>9</td>
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<tr>
<td>Basic Industry</td>
<td>34</td>
<td>35</td>
<td>12</td>
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<tr>
<td>Capital Goods</td>
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<tr>
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<td>Media</td>
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<td>Services</td>
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<tr>
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<td>9</td>
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<tr>
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<td>9</td>
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<tr>
<td>Utility</td>
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<td>33</td>
<td>12</td>
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<tr>
<td>Grand Total</td>
<td>378</td>
<td>442</td>
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</table>

* Issuers with outstandings greater than or equal to $1 billion

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<th>BBB2</th>
<th>BBB3</th>
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<td>21</td>
<td>184</td>
</tr>
</tbody>
</table>
Credit sector specialization

- Dedicated personnel — career path
- More than 20 analysts — over 15 years average experience

As of April 30, 2009.
Financial sector – bank analysis

Rating Assessment Factors (scaled 1 to 5; 1 is best)

<table>
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<tr>
<th>Weight</th>
<th>Inputs</th>
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<tr>
<td>Franchise</td>
<td>35% Assets, customer deposits, Market shares</td>
</tr>
<tr>
<td>Liquidity</td>
<td>15% Wholesale funding and funding gaps</td>
</tr>
<tr>
<td>Profitability</td>
<td>10% Preprovision operating profit (PPOP)</td>
</tr>
<tr>
<td>Capital adequacy</td>
<td>10% Tangible common and Tier 1</td>
</tr>
<tr>
<td>Asset quality</td>
<td>10% Non-performing assets, AOCI, reserves</td>
</tr>
<tr>
<td>Stress test</td>
<td>20% Embedded losses, AOCI, 2 yr PPOP, reserves</td>
</tr>
</tbody>
</table>

- Franchises are valued based on size and core deposits. Market shares in profitable lines also contribute to a higher rating.
- Current financial measures—like capital, asset quality, earnings and liquidity—account for nearly half an issuer’s rating.
- The stress test is a prospective measure designed to reduce exposures to deteriorating credits.
- Additional factors include potential sovereign support, and that sovereigns’ ability and willingness to pay when an issuer is distressed.
Structural issues

HoldCo versus OpCo

- The HoldCo acts as parent for its various OpCos, as well as a consolidating entity for reporting purposes.
  - HoldCo will issue debt and push proceeds to OpCos
  - US, UK and Japan often use HoldCo structures
- OpCos control operating assets and cash flows generated by those assets
  - Banks and broker/dealers
  - Utilities
- Depending on conditions, jurisdictional regulators may limit an OpCo’s ability to upstream earnings to its HoldCo

Holding Company

Operating Company

Regulatory Considerations
Security issues

Unsecured debts

Bank deposits

Secured debts

Secured versus Unsecured debt

- Most investment grade debt is issued on a senior, unsecured basis
  - US Bank HoldCos issue CP and MTNs
  - Bank OpCos issue deposits and bank notes
- Although unsecured, deposits may garner special protections from regulators
- Collateral considerations
  - Repurchase Agreements
  - Structured funding vehicles (ABCP)
  - First mortgage bonds (utilities)
Comparing structure and security

ABC & Co. (A/A2)
CP and MTNs

ABC & Co. (holdco) owns ABC Markets (broker) and ABC Bank NA (both opcos)

CP and MTNs are senior unsecured obligations of the holdco

Deposits are senior unsecured obligations of the bank

Repo has an effective put from the broker; should the broker fail the collateral may be seized and sold

XYZ Funding is an SPE with assets, capital (ABC Bank LOC) and liquidity support (also ABC Bank)

ABCP is heavily supported by the bank; should the bank fail the SPE’s underlying assets offer a secondary source of repayment
Credit Research Summary

**Extensive**
- Team breadth: Sector specialization
- Depth: Experienced analysts follow issuers’ entire debt spectrum; complete comprehension of capital structure and liquidity
- Market access: JPMorgan Global Liquidity analysts’ control nearly $500 billion in world-wide corporate credit

**Defensive**
- Guidelines limit downside risk
- Money market funds: No transitions to Tier 2
- Managed Reserves accounts: No Junk

**Collaborative**
- Portfolio managers identify meaningful issuance
- Once identified, analysts delineate credit quality and set hard limits
- Sales groups deliver clients’ perceptions
- Continuous feedback between these three teams ensures constant refining
Disclosure

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