Publication date: 15-Dec-2003
Reprinted from RatingsDirect

New Issue: Nexus Bonds Ltd. - Portfolio Linked Floating Rate Notes

A$70 Million Portfolio Credit-Linked Notes

Credit Analyst: Paul Lalor, Melbourne (61) 3-9631-2065

Ratings Detail

Profile

New Rating

BBB

Closing date:Dec. 16, 2003

Transaction Summary

Issue date: Dec. 16, 2003.
Final maturity date: Six years from the issue date, subject to the early repayment and late repayment provisions of the notes.
Structure type: Portfolio credit-linked notes.
Reference portfolio: A replenishable portfolio of senior secured or unsecured debt obligations of at least 70 companies that have been originated by the Deutsche Bank Group. As of Dec. 12, 2003, each company in the portfolio has a Standard & Poor's rating, or an equivalent credit rating by Deutsche Bank AG, of 'BBB-' or higher.
Credit enhancement: Investors are not exposed to the first A$67.0 million of portfolio losses (the "protection amount") under the portfolio agreement with Deutsche Bank AG. This equates to 3.35% of the A$2.0 billion reference portfolio.
Authorized investments: Deposit account with Deutsche Bank AG.
Supporting ratings: Deutsche Bank AG (AA-/Stable/A-1+) as counterparty for portfolio agreement, and deposit account provider; and National Australia Bank Ltd. (AA/Stable/A-1+) as series bank account provider.

Rationale

The 'BBB' rating assigned to the notes indicates that Nexus has an adequate capacity to pay interest due on the initial face value of the notes on each quarterly payment date, and repay principal in full to investors no later than the final maturity date of the notes.

The notes are debt securities whose payment of interest and principal is linked to the credit risk performance of the companies in the A$2.0 billion reference portfolio (subject to the A$67.0 million protection amount) for a term of six years. The credit risk is limited to where a company is subject to insolvency or defaults on its obligations (referred to as a "company event" under the prospectus and in this report).

It is important to note that Nexus has exposure to, but does not own, the reference portfolio debt obligations. The assets of Nexus in respect to the notes are limited to the A$70 million note proceeds that have been deposited with Deutsche Bank AG (Deutsche Bank), interest on that deposit, and the premium that will be paid to Nexus by Deutsche Bank under the portfolio agreement.

What Does the 'BBB' Rating on the Notes Reflect?

The rating on the notes reflects Standard & Poor's assessment of:

- The credit risk of the reference portfolio (and specifically, it addresses the probability that losses in the reference portfolio will exceed the A$67.0 million protection amount); and
- The credit risk of Deutsche Bank, which has entered into the portfolio agreement with Nexus and which is the deposit account provider and payer of the series fees and expenses.

As long as the rating on the notes is outstanding, the rating will be the lower of the rating assigned to Deutsche Bank and Standard & Poor's assessment of the credit quality of the reference portfolio after taking into account the sufficiency of the remaining protection amount.

Reference Portfolio

Criteria for Inclusion in Initial Reference Portfolio

Subject to the first loss protection amount, investors are exposed to the credit performance of the senior secured and unsecured borrowed money obligations (senior debt) of companies in the reference portfolio.

The reference companies represent the obligors of specifically selected senior debt obligations originated by the Deutsche Bank Group (obligations include corporate loans, syndicated loans, revolving credit facilities, letters of credit, and guarantees). Because all companies in the reference portfolio have entered into senior secured and unsecured debt arrangements with Deutsche Bank, all company debt has been rated by the bank's internal rating system. Standard & Poor's, in conducting its rating analysis of the notes, has mapped Deutsche Bank's internal credit rating scale to its own corporate issuer credit ratings. Based on this mapping, Standard & Poor's uses the equivalent Deutsche Bank internal credit rating for any company not rated by it in its rating analyses. All companies in the reference portfolio, at the time of inclusion, have either a Standard & Poor's rating of 'BBB-' or higher, or a Deutsche Bank rating with an equivalent Standard & Poor's rating ("Standard & Poor's equivalent rating") of 'BBB-' or higher. At least 40% of the companies are directly rated by Standard & Poor's. Criteria applying to the initial reference portfolio are shown in table 1.

Table 1 – Initial Reference Portfolio Criteria	
Portfolio size (bils. A$)	2.0
Min. no. of companies	70
Max. remaining weighted avg. maturity of portfolio (yrs.)	3.0
Min. % of portfolio with a public rating by Standard & Poor's	40.0
Min. Standard & Poor's or Standard & Poor's equivalent rating (for initial portfolio)	'BBB-'
Min. Standard & Poor's sovereign long-term foreign currency rating	'A-'
Max. % of portfolio balance to each of following:	
With Standard & Poor's sovereign long-term foreign currency rating below 'AA-'	6.0
Individual countries with Standard & Poor's sovereign long-term foreign currency rating below 'AA-'	3.0
Each reference obligor (with Standard & Poor's equivalent rating of 'BBB' or higher)	1.65
Each reference obligor (with Standard & Poor's equivalent rating of 'BBB-')	1.5
Largest industry group*	12.0
Second-largest industry group	12.0
Third-largest Standard & Poor's industry group	10.0
Each of all other Standard & Poor's industry groups	8.0
Americas (including Bermuda)	45.0
Europe	65.0
Australia and New Zealand	20.0
Asia	6.0
*Industry classifications are based on Standard & Poor's industry groups for CDO ratings.	

As at Dec. 12, 2003, the initial reference portfolio of A$2.0 billion comprised 117 different reference companies with relative weights up to a maximum of 1.5%. The companies, while not identified by name in this report or the prospectus because of banking confidentiality and privacy conditions, are diversified by Standard & Poor's industry group (see table 2) and by geography (see table 3). The distribution of Standard & Poor's ratings and equivalent ratings in the initial reference portfolio is shown in table 4.

Table 2 – Initial Portfolio Distribution by Standard & Poor's Industry Group		
Industry name	**Value exposure (%)**	**Cumulative exposure (%)**
Financial intermediaries	10.3	10.3
Business equipment and services	7.9	18.2
Food products	6.9	25.1
Utilities	6.4	31.5
Chemical/plastics	6.3	37.8
Industrial equipment	6.2	44.0
Automotive	5.5	49.6
Building and development	5.1	54.7
Retailers (except food and drug)	4.8	59.5
Insurance	4.5	64.0
Electronics/electric	3.8	67.8
Air transport	2.8	70.6
Forest products	2.7	73.4
Nonferrous metals/minerals	2.6	76.0
Drugs	2.6	78.6
Publishing	2.4	80.9
Equipment leasing	2.3	83.2
Other	1.5	84.7
Aerospace and defense	1.5	86.2
Beverage and tobacco	1.5	87.7
Food/drug retailers	1.5	89.2
Food service	1.5	90.7
Health care	1.5	92.2
Leisure goods/activities/movies	1.5	93.7
Steel	1.5	95.2
Oil and gas	1.2	96.5
Brokers/dealers/investment houses	1.1	97.5
Clothing/textiles	1.0	98.6
Rail industries	0.8	99.3
Surface transport	0.7	100.0
Total	100	

Table 3 – Initial Portfolio Distribution by Country		
Country	**Value exposure (%)**	**Cumulative exposure (%)**
United States	25.0	25.0
Great Britain	20.0	45.0
Germany	11.0	56.0
France	7.0	63.0
Australia	6.6	69.6
Netherlands	5.8	75.5
Switzerland	5.6	81.1
Canada	3.7	84.7
Denmark	3.0	87.7
Norway	2.5	90.2
Sweden	2.5	92.7
Spain	2.0	94.7
Finland	1.5	96.2
Belgium	1.4	97.6
New Zealand	1.3	98.9
Ireland	0.8	99.7
Luxembourg	0.3	100.0
Total	100.0	

Table 4 – Initial Portfolio Distribution by Ratings		
Standard & Poor's equivalent rating	**Value exposure (%)**	**Cumulative exposure (%)**
AAA	0.0	0.0
AA+	1.1	1.1
AA	1.5	2.6
AA-	1.5	4.1
A+	3.0	7.1
A	9.9	17.0
A-	3.0	20.0
BBB+	15.2	35.2
BBB	41.7	76.9
BBB-	23.1	100.0
Total	100.0	

Replenishment

Deutsche Bank will be able to replenish the repaid or prepaid reference obligations only to the extent that they do not lead to a deterioration in the overall credit quality of the portfolio, as measured by Standard & Poor's trading model. That is, the replacement can be made only if the credit rating on the reference portfolio following the replacement (calculated in accordance with Standard & Poor's trading model) is 'BBB' or higher; or if the rating on the reference portfolio is lower than 'BBB', it must not be lower than it was immediately before the replacement.

In addition, a replacement must not cause a breach of the initial reference portfolio criteria (see table 1); or if the reference portfolio is already in breach of the criteria, the replacement must not worsen the extent of non-compliance. Deutsche Bank does not have the right to remove reference obligations from the reference portfolio. Additionally, there is no obligation upon Deutsche Bank to remove reference obligations that no longer comply with the initial reference portfolio criteria.

Credit Evaluation

The primary credit risk to investors is linked to the reference portfolio, which is a function of the probability of company events arising in respect of senior debt of the companies in the reference portfolio and the recovery value of that senior debt. The credit evaluation therefore involves:

- Determining the probability of company events arising in the reference portfolio using Standard & Poor's CDO Evaluator (see explanation below);
- Determining the recovery value of the senior debt of the companies in the reference portfolio; and
- Determining the required protection amount, taking into account the probability of experience of company events, the recovery value, and the notional amount of the reference portfolio.

Determining Probability of Default

Standard & Poor's has estimated the probability of company events arising in respect of senior debt of the companies within the reference portfolio by comparing the rating on each company and maturity term of each obligation in the portfolio with a set of default probability assumptions based on Standard & Poor's report, 'Ratings Performance 2002: Default, Transition, Recovery, and Spreads' (see Related Research). The proprietary tool that Standard & Poor's uses to undertake this analysis is called CDO Evaluator. For this portfolio, Standard & Poor's estimated stressed default rate is 4.19% at the 'BBB' rating level. The stressed default rate is then adjusted by applying recovery value assumptions to derive the net default rate and the required protection amount, as described below.

Note, the 'Ratings Performance 2002: Default, Transition, Recovery, and Spreads' report contains data on the performance of all Standard & Poor's ratings on companies over time, including the default experience of companies at each rating category, and rating changes on companies over time for each rating category. Investors should note, however, that the reference portfolio is a very small subset of the total universe of ratings Standard & Poor's assigns to companies around the world. The reference portfolio may not perform in the same way as the total ratings portfolio in Standard & Poor's corporate default study.

Recovery Value
Recovery value assumptions used by Standard & Poor's depend on a combination of factors, including market liquidity/recovery data, bankruptcy laws, ranking of obligations, type of obligations, valuation method, and valuation date. Standard & Poor's also takes into account the sale and work-out processes used by Deutsche Bank in determining recovery rates following company events.

Standard & Poor's has assumed an average recovery value for this initial reference portfolio of 36.58%. This implies an estimated average loss of 63.42% for each company event. This initial weighted average recovery value of 36.58% can change due to replenishment and subsequent changing of the pool distribution.

Standard & Poor's Required Protection Amount
The reference portfolio is much larger than the face value of the notes to be issued. This risk is addressed in Standard & Poor's rating in that the protection amount required to achieve the 'BBB' rating on the notes has been calculated on the size of the reference portfolio and not on the issue amount of the notes.

Once the reference portfolio's stressed default rate and recovery value are determined, it is then possible to calculate the net loss that the reference portfolio may suffer in a stressed environment commensurate with the credit rating sought. The estimated net loss rate, and therefore the required protection amount, is calculated as follows:

Estimated net loss rate = Stressed default rate x (100% - recovery value)

= 4.19% x (100% - 36.58%)

= 4.19% x 63.42%

= 2.66%

Required protection Amount = Notional amount of reference portfolio x Estimated Net Loss Rate

= A$2.0 billion x 2.66%

= A$53.2 million

Based on the general approach above, the protection amounts for the initial reference portfolio that are required to achieve different rating levels on the notes have been calculated by Standard & Poor's, and are shown in table 5.

Table 5 – Standard & Poor's Required Protection Amounts at Different Rating Levels

Rating on notes	Minimum required protection amount (% of reference portfolio)	Minimum required protection amount (mils. $A)*
AAA	4.57	91.4
AA+	4.29	85.8
AA	3.65	73.0
AA-	3.49	69.8
A+	3.33	66.6
A	3.22	64.4
A-	3.06	61.2
BBB+	2.78	55.6
BBB	2.66	53.2
BBB-	2.25	45.0
BB+	1.71	34.2
BB	1.53	30.6
BB-	1.43	28.6

*Based on A$2.0 billion reference portfolio.

It is a condition of the rating on the notes that the protection amount must be available to absorb losses on the reference portfolio before any losses can be allocated to investors. At the issue date, the actual protection amount to be provided under the portfolio agreement with Deutsche Bank was A$67.0 million, which is A$13.8 million (0.69% of the reference portfolio) more than the minimum protection amount required by Standard & Poor's to support the 'BBB' rating on the notes. Setting a protection amount in excess of the minimum required level is a feature of the notes that provides for enhanced stability of the 'BBB' rating on the notes over time. The excess protection amount serves to buffer the rating on the notes against any loss amounts that may arise from company events in the reference portfolio.

Rating Surveillance

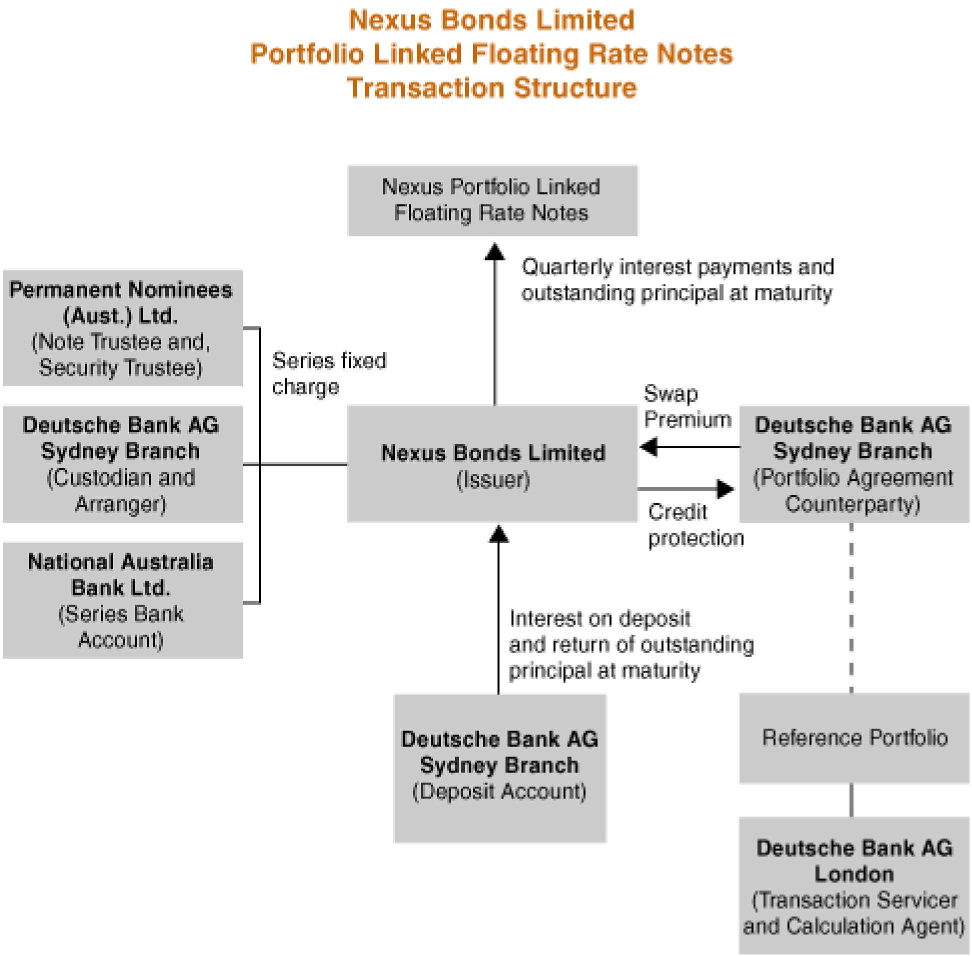
A number of events can lead to the rating on the notes being revised after the initial rating date. These include:

- Changes to the credit ratings on the companies in the reference portfolio;
- If there are company events in the reference portfolio, and any resulting losses impact the protection amount such that the remaining protection amount is lower than that required on the reference portfolio for a 'BBB' rating level on the notes at that time; and
- Changes to the credit rating on Deutsche Bank.

As long as the notes remain outstanding, the remaining actual protection amount needs to exceed Standard & Poor's estimation of the required protection amount at a given rating level to maintain that rating on the notes. Standard & Poor's will recalculate the required protection amount on a regular basis, as the term to maturity shortens, as ratings in the reference portfolio change, and if companies in the reference portfolio suffer a company event and loss amounts in relation to those companies are calculated and applied to reducing the protection amount. If the actual remaining protection amount is less than Standard & Poor's estimation of the required protection amount, the rating on the notes will be lowered. Equally, it is possible that if the actual remaining protection amount is greater than Standard & Poor's estimation of the required protection amount, the rating on the notes may be raised.

Structural Review

Transaction Structure
The following chart illustrates the transaction structure.



How Will Nexus Pay Interest and Repay Principal to Investors?
In return for Nexus, and hence investors, taking the exposure to the credit risk on the senior debt of the companies in the reference portfolio, Nexus will receive a quarterly premium under the portfolio agreement.

On the day that the notes were issued, Nexus invested the note issuance proceeds in a deposit account held with Deutsche Bank. Nexus will earn sufficient income from the interest paid by Deutsche Bank on the deposit account, and the premium paid by Deutsche Bank under the portfolio agreement, to pay quarterly interest due on the notes, and the other fees and expenses in full and on time.

If there are company events in the reference portfolio and the cumulative losses from these exceed the sum of the protection amount and the note issue amount (in aggregate A$137.0 million), then the notes will be subject to early redemption with investors receiving no return of principal (see Early Redemption of Notes). Where cumulative losses exceed the A$67.0 million protection amount but are less than A$137.0 million, the face value of the notes will be reduced at maturity to the extent of those excess losses, and investors will receive an accordingly reduced principal return at maturity. The probability of this occurring is consistent with the 'BBB' rating assigned to the notes.

As long as the cumulative losses on the reference portfolio do not exceed A$137.0 million (equal to 6.85% of the reference portfolio), investors will continue to receive interest on the full face value of the notes until maturity. This feature of interest entitlement on the notes ensures that investors will continue to receive quarterly interest on the full face value of the notes until maturity, if cumulative losses on the reference portfolio exceed the 'BBB' rated protection amount provided under the portfolio agreement (subject to maximum losses of A$137.0 million).

In essence, the payment of interest on the notes until maturity is supported by a protection amount of just under A$137.0 million, or 6.85% of the reference portfolio amount, which is more than the A$53.2 million (2.66% of the reference portfolio amount) required by Standard & Poor's to achieve the 'BBB' rating on the notes. If cumulative losses do exceed this maximum amount, the notes will be subject to early redemption, with investors receiving only the accrued interest through to the date of redemption.

Under a separate agreement, Deutsche Bank has undertaken to pay all of Nexus' expenses, other than the interest on the notes, if Nexus has insufficient funds to pay those expenses and an event of default has not occurred.

Company Events
During the term of the notes, companies in the reference portfolio may default giving rise to a company even. A company event occurs only if a company:

- Becomes insolvent or bankrupt; or
- Fails to pay within any applicable grace period at least A$10,000 (or its equivalent) on the reference portfolio obligation originated by Deutsche Bank, or at least US$1 million (or its equivalent) on any other borrowed money obligations of the reference companies.

Following the occurrence of a company event, Deutsche Bank has up to 60 business days to deliver a notice of advice to Nexus. This period enables Deutsche Bank to monitor the status of the company event, such that if full payment is made by the reference company of any unpaid amounts, then all notices in relation to that company event are rescinded. Consequently, it will be deemed that no company event occurred. However, if Deutsche Bank has delivered a company event notice to Nexus and it has not been cured within the 60 business-day period, Deutsche Bank will provide a written confirmation from a firm of independent accountants to Nexus that a company event has occurred in relation to a company in the reference portfolio. Full confidentiality is maintained, such that at no stage is the company name disclosed to Nexus.

Calculation of Loss Upon a Company Event
Upon occurrence of a company event, the relevant Deutsche Bank branch servicer commences work-out procedures with the defaulting obligor in respect of the specific obligation owed to Deutsche Bank. Such work-out processes, which may include the sale of the relevant obligation, are conducted under Deutsche Bank's loan servicing standards. Subject to the 60 business-day review period for determining the final status of the company event, the recovery value of the obligation is determined as the amount recovered at the end of the work-out and sale process, calculated as a percentage of principal outstanding for the debt obligation as at the date of the company event.

Protection Amount
The actual protection amount is A$67.0 million, or 3.35% of the aggregate value of the reference portfolio. This is A$13.8 million (0.69% of the reference portfolio) more than the level required by Standard & Poor's to achieve the 'BBB' rating on the notes (see "Standard & Poor's Required Protection Amount"). The protection amount means that if there are company events in the reference portfolio and the cumulative loss calculated in respect of those company events is less than or equal to A$67.0 million, then Deutsche Bank will not be entitled to make a claim on Nexus for loss. As such, investors will not be exposed to calculated losses on the reference portfolio up to this amount. If, however, during the term of the notes there are company events and the cumulative loss in respect of those events exceeds the A$67.0 million protection amount, then Deutsche Bank is entitled to claim only those loss amounts that exceed the protection amount, up to a maximum of A$70 million, or 100% of the initial note issue amount deposited into the deposit account.

Reliance on Deutsche Bank
In addition to direct financial obligations under the deposit agreement and the portfolio agreement, Deutsche Bank entities also provide several critical supporting roles in this transaction, including those of arranger, custodian, transaction servicer, reference obligation servicers, operating agent, and calculation agent under the portfolio agreement. For example, if there is a company event in the reference portfolio, Deutsche Bank, as obligation servicer, conducts all work-out and sale arrangements by which the loss amount percentage for that entity is determined.

Early Redemption of Notes
The notes may be redeemed early if:

- Cumulative losses arising from company events on the reference portfolio exceed A$137.0 million as the aggregate of the protection amount and the note issue amount;
- There is a change in the interpretation of law or a change of law that negatively impacts Nexus' ability to meet its obligations to investors and/or Deutsche Bank; or
- There is there is an introduction of, or change to, German law or regulations such that there is a material reduction in the regulatory capital adequacy relief that Deutsche Bank gains from entering into this transaction as the counterparty to the portfolio agreement.

Where early redemption arises from the third event, investors will receive an additional amount equal to the present day value of 2.5% per annum for the period between the early redemption date and the maturity date, calculated on the note balance repayable to investors.

The likelihood of the first instance occurring, in which investors would receive no return of principal, has been fully considered by Standard & Poor's in assigning its 'BBB' rating to the notes. In the latter two instances, if the notes are repaid early, investors may receive less than the initial face value amount of their investment. The likelihood of these events occurring and the impact to investors are not addressed by Standard & Poor's rating.

Events of Default and Enforcement
Events of default are significant adverse events that may arise within this Nexus series that will or are likely to impair the ability of Nexus to continue to meet its payment obligations in full and on time. These include, inter alia, failure by Nexus to pay any money when due to investors or to Deutsche Bank under the portfolio agreement, an insolvency event in relation to this Nexus series, or any transaction document ceasing to be enforceable in accordance with its terms, or becoming illegal, invalid, or unenforceable. An example of the latter event would be a failure by either Nexus or Deutsche Bank to make any required payment when due under the portfolio agreement, leading to its termination.

Following an event of default, the charge over the secured assets of the series becomes enforceable and the security trustee will convene a meeting of the secured creditors to determine the enforcement action. The secured creditors include the investors, the note and security trustee, and Deutsche Bank as counterparty to the portfolio agreement. The security trustee will not take such actions unless it reasonably believes that it is necessary to do so to protect the interests of the secured creditors.

An event of default in one series of notes issued by Nexus does not become an event of default in any other Nexus series of notes. Furthermore, secured creditors in any one series do not have recourse to the assets of any other series in enforcing their rights against Nexus.

Ranking of Creditors After An Event of Default
Following an event of default and enforcement, the portfolio agreement is terminated. Deutsche Bank may first recover amounts due in relation to any company events that arose before swap termination and which resulted in (as yet unpaid) loss amounts.

Termination of the portfolio agreement may also lead to early termination payments, or break costs, payable by Nexus to Deutsche Bank. These break costs are based on market shifts in credit spreads and foreign currency rates on the debt obligations in the reference portfolio over time, and may be substantial. Deutsche Bank ranks in priority to investors for its post-enforcement claims, including break costs (if any), except where enforcement has arisen solely because of Deutsche Bank's insolvency or default on its payment obligations in this transaction. In the latter case, Deutsche Bank will rank pari passu with investors for its payment claims.

Standard & Poor's rating assigned to the notes is based on the expected probability that the calculated losses on the reference portfolio will not exceed the required protection amount, and on the probability implicit in Deutsche Bank's 'AA-' long-term rating that it will not default in its obligations in this transaction. However, should either of these events occur, the rating does not address the ultimate return to investors.

Late Repayment of Notes
The maturity date on the notes is six years from the issue date, but can be extended by up to one year if company events arise in the reference portfolio and the sale or work-out processes in relation to such company events have not been completed prior to the scheduled maturity date. If this occurs, the maturity date is extended because the process to calculate losses following a company event is not immediate. In such circumstances, there may be a partial return of principal to investors on the scheduled maturity date, but full repayment (subject to final cumulative losses not exceeding the protection amount) is deferred. Standard & Poor's 'BBB' rating on the notes addresses the likelihood of payment of interest on the initial amount invested on each payment date and full repayment of principal no later than seven years from the initial issue date.

Related Research

- Ratings Performance 2002: Default, Transition, Recovery, and Spreads, published Feb. 25, 2003.

This article is available on RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. It can also be found on Standard & Poor's Web site at www.standardandpoors.com.au Under Related Products & Services select Risk Solutions. Scroll down and select Research from Risk Solutions. Then scroll down and select 'Standard & Poor's 2002 Annual Corporate Default Study and Related Articles'.

What is a Credit Rating?
A Standard & Poor's credit rating is a current assessment of an issuer's ability to make full and timely payments on its financial obligations. An 'BBB' rating means that an issuer has an adequate capacity to meet financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to weakened capacity of the obligor, compared to higher rated obligors, to meet its financial commitments on these obligations.

Long-term ratings range from Standard & Poor's highest category 'AAA', to the lowest, 'D'.

Ratings in the 'AAA', 'AA', 'A', and 'BBB' categories are regarded as investment grade.

Ratings in the 'BB', 'B', 'CCC', 'CC', and 'C' categories are regarded as having significant speculative characteristics.

A rating of 'D' denotes a payment default on financial commitments.

For More Information About Standard & Poor's Ratings

- Corporate Credit Ratings - A Guide, published July 26, 2001.

This article is available on Standard & Poor's Web site at www.standardandpoors.com.au.

Published by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. Executive offices: 1221 Avenue of the Americas, New York, NY 10020. Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280.