Fitch Ratings

Structured Finance

Credit Products/Hong Kong
Presale Report

Artemus Strategic Asian Credit Fund Limited II

Investment-Grade Synthetic CDO

Expected Ratings*

Class	Amount (USDm)	Scheduled Maturity	Expected Rating	CE (%)	Size (%)
A	[10.0]	June 2010	AAA	7.50	[1.00]
B	[10.0]	June 2010	AA	6.10	[1.00]
C	[8.0]	June 2010	A	5.30	[0.80]
D	[10.0]	June 2010	BBB	4.30	[1.00]

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* Expected ratings are not final ratings and are subject to final note issuance and receipt, by Fitch, of documents conforming to information already received.

■ Summary

This transaction is a funded synthetic securitisation of a portfolio of credit default swap ("CDS") obligations. Fitch Ratings has assigned expected ratings to the credit-linked notes to be issued by the Cayman-incorporated company, Artemus Strategic Asian Credit Fund II ("the issuer"), as indicated at left.

The expected protection buyer, J.P. Morgan Securities CI ("the swap counterparty") which is guaranteed by J.P. Morgan Chase Bank (rated 'A+/F1'), has bought protection on a USD1.0 billion portfolio that will be managed by HVB Asset Management Asia ("HVBAM" or "the manager"). The portfolio will initially consist of 99 reference obligations, each corresponding to 1.01% of the USD1 billion portfolio. Under the deferred cash-settlement terms of the CDS, any defaults following a credit event will cause the tranche subordination to be written down in an equivalent amount. In return, the protection seller will receive periodic premium payments from the swap counterparty.

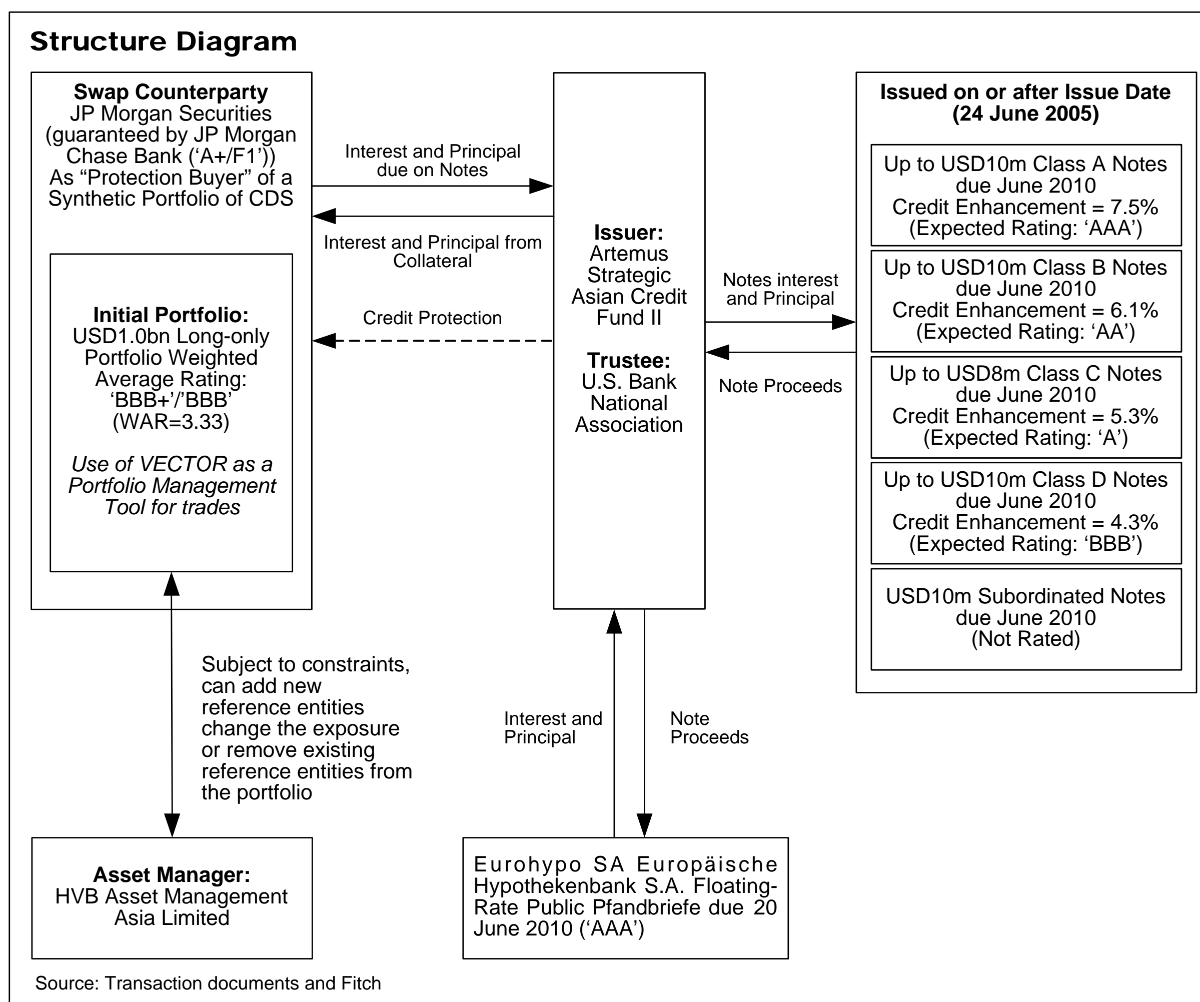
When the loss threshold (credit enhancement) is breached and the notional on the notes is written down, the collateral will not be liquidated to make any cash settlement payments.

The expected rating is based on the credit quality of the portfolio, the track record of HVBAM, the collateral, the arrangements provided under the CDS, the available credit enhancement and the sound legal and financial structure of the transaction. The expected rating addresses the likelihood of investors receiving timely payment of interest and ultimate repayment of principal by scheduled maturity in June 2010.

■ Credit Committee Highlights

- The initial protection buyer, J.P. Morgan Chase Bank, will novate the swap to J.P. Morgan Securities CI ("the swap counterparty"), whose credit support provider is J.P. Morgan Chase Bank ("the credit support provider"). In the event of the credit support provider's downgrade below 'A/F1', J.P. Morgan Securities CI may either transfer its obligations to a 'A/F1' rated institution, find a 'A/F1' rated guarantor for its obligations or post collateral for the next CDS payment date, subject to Fitch's advance rate haircuts. If the rating is downgraded below 'F2', the collateral to be posted must cover all remaining CDS payment dates.

- HVBAM may add, change or remove the credit exposure in the portfolio by entering into long or short CDS. The Fitch VECTOR Test must be satisfied before any change to the credit portfolio can take place (see *Fitch VECTOR Test*, below).



Structure

On the issue of any class of notes, Artemus II will use the proceeds to acquire the collateral securities, which are Eurohypo SA floating-rate public *Pfandbriefe*, rated 'AAA' by Fitch. At maturity, the eligible collateral will be liquidated by Artemus II and used to redeem the notes, as well as to make any accrued payments to the swap counterparty for losses that may have occurred during the life of the deal.

CDS

Artemus II initially entered into a CDS with J.P. Morgan Chase Bank, as CDS counterparty, whereby the issuer will sell protection on the underlying CDS portfolio to the swap counterparty in exchange for premium payments. This CDS will subsequently be novated to J.P. Morgan Securities CI, which is guaranteed by J.P. Morgan Chase Bank. Initially, only the subordinate note will be issued.

Credit Events

In summary, credit events under the master CDS agreements for the reference entities are:

- bankruptcy (except for Republic of South Africa, Latin America and Asia Emerging Market sovereigns);
- failure to pay at least USD1 million or equivalent;
- restructuring;
- repudiation/moratorium (applicable to Republic of South Africa, Latin American and Asia Emerging Market sovereigns);
- acceleration of obligations (applicable to Republic of South Africa and Latin American sovereigns).

The occurrence of potential credit events will cause notional amounts (balances) to be written down. However, on the resolution of such events, via confirmation that they are not credit events, the written-down notional will be restored and any withheld interest paid to noteholders.

Key Information

Deal Type: Mostly investment-grade synthetic CDO ("SCDO")

Issuer: Artemus Strategic Asian Credit Fund II (a limited-liability company incorporated under the laws of the Cayman Islands)

Swap Counterparty: Initially J.P. Morgan Chase Bank, NA ('A+/F1'), but will be novated to J.P. Morgan Securities CI, guaranteed by J.P. Morgan Chase Bank, NA, "the credit support provider"

CDO Asset Manager: HVB Asset Management Asia Limited ("HVBAM")

Custodian: J.P. Morgan Chase Bank, NA. A 'F1' counterparty trigger will apply to the custodian, below which a replacement must be sought.

Trustee: U.S. Bank National Association

Type of Assets: Long global CDS

Interest Payment Dates: 20 March, 20 June, 20 September and 20 December in each year. The first interest payment date will be 20 December 2005

Collateral: Eurohypo SA Luxembourg Europäische Hypothekenbank S.A. Floating-Rate Public *Pfandbriefe* due 20 June 2010, rated 'AAA' by Fitch

Issue Date: 24 June 2005. However, notes up to the maximum amount stated on the front page may be issued subsequently.

Scheduled Maturity: 20 June 2010

Note Denomination: USD500,000

Ratings Distribution

Rating	(%)
AAA	3.03
AA+	2.02
AA	1.01
AA-	3.03
A+	3.03
A	8.08
A-	21.21
BBB+	33.33
BBB	14.14
BBB-	4.04
BB+	5.05
BB	1.01
Not Rated	1.01

Source: Fitch

These potential credit events are discussed below.

- A potential failure to pay occurs when publicly available information confirms a reference entity's failure to pay on or before the credit observation end date, without regard to any grace period. If no grace period can be ascertained from the terms of the CDS, it will be assumed to be 30 days.

  A potential failure to pay becomes an actual failure to pay if it persists after the end of the grace period, according to public information; otherwise it will not be a credit event.

- A potential repudiation/moratorium occurs when publicly available information confirms, on or before the credit observation end date, that an authorised officer of a reference entity or a governmental authority: (a) disaffirms, disclaims, repudiates or rejects, in whole or in part, or challenges the validity of one or more obligations in an aggregate amount of no less than USD10m; or (b) declares or imposes a moratorium, standstill, roll-over or deferral, whether *de facto* or *de jure*, with respect to one or more obligation in an aggregate amount of no less than USD10m.

  On the later of 60 days after the occurrence of the potential repudiation/moratorium or the first payment date under any such bond after the date of the potential repudiation/moratorium, the potential credit event will become an actual repudiation/moratorium on the failure to pay any amount.

Valuation Process

Following a credit event, the calculation agent will choose a valuation date between the credit event date and 72 days thereafter. However, if market disruption occurs, this period can be extended to 125 days after the credit event.

The following section describes this valuation process.

0 to 3 Days after the Valuation Date

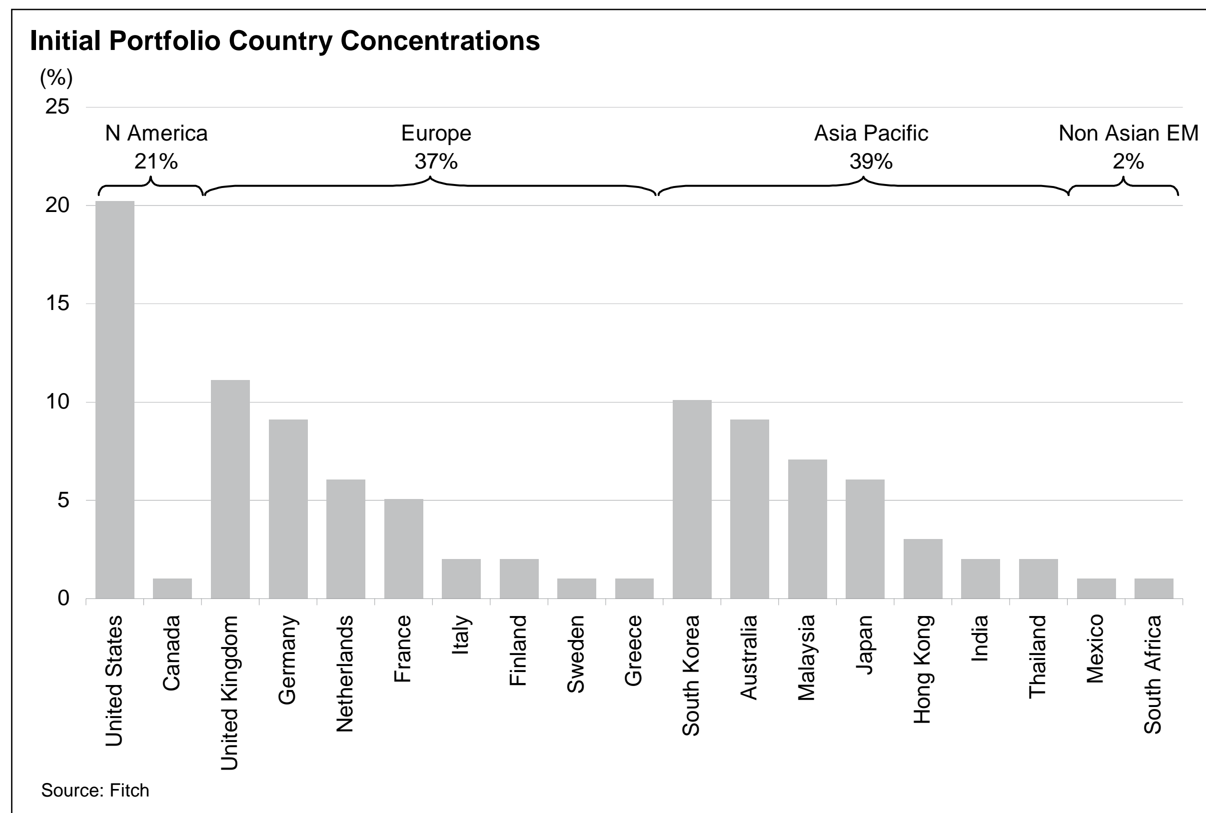
Five bids will be sought (including the calculation agent), and the highest bid used if two full quotes are obtained.

Four to 15 Days after the Valuation Date

Five bids will be sought (including the calculation agent) and the highest bid used if two full quotes are obtained; if only partial quotes are available, the weighted average quotation will be used.

On Day 15 after the Valuation Date

Any full quotes or a weighted average quotation will be used. If, in aggregate, partial bids are insufficient to cover the notional of the defaulted credit, any



amounts of the defaulted notional where no bid was obtained are assumed to be zero.

■ Reference Pool

The default risk being transferred in this transaction is on a diversified but Asian-focused pool of CDS reference obligations. The three largest country concentrations are: US (20%), United Kingdom (11%) and South Korea (10%). However, only 6% of the credits are from countries with a sovereign rating below 'A-(A minus)': 2% each from India and Thailand, and 1% each from Mexico and South Africa.

There is a strong concentration of credits in the banking and finance sector (21%), although these are relatively evenly drawn from India, Australia, Japan, Malaysia, South Korea, while the largest exposures are to the US (6%), the UK (3%) and South Korea (3%).

Some 84% of the referenced CDS are based on the senior unsecured obligations of the underlying obligors, while the remainder are based on their subordinate debt.

Initial Portfolio Industry Concentrations

Fitch Rating	(%)
Banking & Finance	21.2
Broadcasting/Media/Cable	8.1
Telecommunications	8.1
Automobiles	5.1
Chemicals	5.1
Energy	5.1
Metals & Mining	5.1
Utilities	5.1
Aerospace & Defence	4.0
Computers & Electronics	4.0
Industrial/Manufacturing	4.0
Sovereign	4.0
Food, Beverage & Tobacco	3.0
Lodging & Restaurants	3.0
Building & Materials	2.0
Consumer Products	2.0
Paper & Forest Products	2.0
Retail (General)	2.0
Supermarkets & Drugstores	2.0
Transportation	2.0
Business Services	1.0
Gaming, Leisure & Entertainment	1.0
Packaging & Containers	1.0

Source: Fitch

■ Portfolio Management and Trading Constraints

HVBAM may enter into a long or a short CDS position to alter, add or remove credit positions to and from the portfolio as long as the Fitch VECTOR

Test is satisfied. HVBAM also has the option to seek alternative counterparties when substituting credits.

The trading constraints are:

- a maximum of 20 changes to the reference portfolio. For these purposes, a change to the reference portfolio means: (a) a short CDS; (b) a short CDS and one or more long CDS to remove an existing reference entity from and to add one or more entities to the reference portfolio; or (c) a long CDS;
- the credit position of any entity in the reference portfolio following the portfolio change cannot exceed 2.5%;
- no portfolio change may occur with regard to any reference entity that has experienced a credit event, a potential failure to pay or a potential repudiation/moratorium;
- the cumulative loss, including reference entities that have not undergone the valuation process, cannot exceed 1%.

Fitch VECTOR Test

Each time a new reference entity is added to the portfolio, the Fitch Default VECTOR Model ("VECTOR") is run, comparing available credit enhancement with the credit enhancement sought. The Fitch Test is satisfied if, following the replenishment, the difference between the two credit enhancements remains positive or equal to zero or (if the difference is already negative) does not increase further.

Trading Gains and Losses

The manager can elect to pay the swap counterparty for any net trading loss (PM payment amount) outside the structure, to prevent any adjustments to the credit enhancement.

Collateral Manager

HVBAM was incorporated in Singapore in April 2002 and is wholly owned by HVB Asia, a 100%-subsidiary of Bayerische Hypo- und Vereinsbank ("HVB AG", rated 'A-(A minus)/F2').

HVBAM focuses on managing well-diversified Asian-centric portfolios with a view of holding to maturity. Its credit selection and trading decisions are based on relative value and good-quality assets.

The team currently manages the Maximilian Capital Corporation Asset-backed Commercial Paper programme, which was established in December 2000 and is rated 'F1' by Fitch. It also manages the Artemus Strategic Asian Credit Fund, which closed in March 2003. In February 2004, Fitch upgraded three tranches of the Artemus Strategic Asian Credit Fund to 'AAA' from 'AA', to 'AA-(AA minus)' from 'A' and to 'BBB+' from 'BBB'.

Credit Analysis

When determining credit enhancement levels, Fitch used Version 2.2 of VECTOR to calculate potential portfolio defaults and loss distributions. VECTOR uses the "look-through" approach, as discussed below, to model the effect of default correlations between reference entities within the CDO.

VECTOR is a multi-period Monte Carlo simulation model that simulates correlated asset values for each obligor and each period.

In each simulation run, a standard normal random number is drawn for each obligor in the portfolio, representing the change in the obligor's asset values over the holding period or the time to default.

An obligor defaults if its simulated value falls below its default threshold – the threshold being inferred from the default probability derived from its rating and the Fitch CDO Default Matrix.

In assigning its rating levels, Fitch calculates the Rating Loss Rate ("RLR") for the portfolio.

The RLR is the expected portfolio loss for a particular credit portfolio in the respective rating scenario. It is derived from the Rating Default Rate ("RDR"), which is the percentage of the initial portfolio that is assumed to default in the respective rating scenario; this is determined on the basis of the portfolio default distribution, applying the percentile corresponding to the rating scenario and term.

The portfolio loss is calculated using Fitch's recovery rate assumptions for each asset, taking into account the asset's jurisdiction, its ranking in the capital structure of the issuer and the rating stress level. The RLR is gross of any structural mitigants, such as excess spread. In the absence of structural support, static credit enhancement has to cover the RLR for the respective rating.

For a more detailed description of Fitch's CDO rating criteria, see "*Global Rating Criteria for Collateralised Debt Obligations*", dated 13 September 2004, or "*Considerations for Funded Portfolio Credit Derivatives (Synthetic CDOs)*", dated 8 June 2005, both of which are available at www.fitchratings.com

Fitch assigned its expected rating levels based on the ratings of the obligors in the portfolio.

Default and recovery assumptions for the portfolio were determined according to the individual asset ratings, asset classes and a five-year term.

The portfolio's RLR under the various rating scenarios was calculated and Fitch found that the credit enhancement provided for the notes was sufficient to cover the projected portfolio loss for the expected ratings.

Traditionally, SCDOs have consisted of long risk positions. A loss arising from a credit event in the reference portfolio reduces the remaining credit enhancement and may, ultimately, cause a loss on the rated notes. Where the reference portfolio includes short positions, remaining credit enhancement may be supplemented by the occurrence of credit events within the short component of the reference portfolio. This was analysed using VECTOR 2.2 and applying prevailing criteria.

The high concentration of credits from the same emerging market nations exposes the portfolio to an additional dimension of transferability and convertibility risks. This was analysed using Fitch's prevailing criteria. In this instance, state-owned policy banks and government entities will be assumed to have a 100% correlation with the sovereign.

Early Termination of the Transaction

The transaction may terminate early owing to an early termination of the swaps or in the event of a default under the terms and conditions of the notes. Following a default by the swap counterparty, the issuer will use all reasonable efforts to seek a replacement swap counterparty within 30 days, after which the swap agreement will terminate.

The main events of default are:

- failure by the issuer to pay any sum due in respect of the notes or the portfolio management fee for more than five business days;
- failure by the issuer to perform or comply with its obligations under a transaction document where the failure is unremediable or is not remedied within 30 days;
- a bankruptcy event affecting either the credit support provider of the swap counterparty or the issuer;
- default of the charged asset;
- a counterparty default, as defined in the swap agreement, persists for 30 days and no agreement is entered into with another approved swap counterparty rated 'A' or 'F1'.

The swap termination events are:

- failure by either party to pay or deliver any amounts due under the swap agreements for three days;
- failure by either party to comply with its obligations;
- bankruptcy, dissolution, insolvency, assignment, liquidation proceedings, resolution for winding-up, appointment of an administrator, enforcement by a secured creditor or the like, in respect of either party;
- failure by the credit support provider of the swap counterparty to comply with or fulfil the terms of any credit support document;
- a merger when the successor entity does not assume the obligations of the credit support provider of the swap counterparty;
- tax regime changes;
- illegality.

At final maturity and following an event of default where the defaulting party is not the swap counterparty, any proceeds from the mark-to-market termination of the swap and the sale of the collateral (after deducting taxes, costs associated with the disposal and Trustee expenses) will be applied towards paying the defaulted reference entities and the relevant accrued interest and outstanding principal on the notes.

If the defaulting party is the swap counterparty and no replacement swap is entered into, the swap counterparty will pay the issuer the termination payment (without set-off). Moreover, any payments due to the swap counterparty under the above priority of payments, other than those triggered by reference entity losses, will be subordinated to payments of interest and principal on the Class A, Class B, Class C and Class D notes. However, if the defaulting party is not the swap counterparty, the mark to market payable to the swap counterparty will rank senior to the notes.

■ Performance Analytics

Fitch will monitor the transaction on a regular basis and as warranted by events. Its structured finance Performance Analytics team ensures that the assigned ratings remain, in the agency's view, an appropriate reflection of the issued notes' credit risk.

Details of the transaction's performance are available to subscribers at www.fitchresearch.com. Further information on this service is available at www.fitchratings.com.

Please contact the Fitch analysts listed on the front page of this report if you have any queries about the initial analysis of the transaction or its ongoing performance.

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