What is Generator Income Notes (“the Notes”) invested in?

The Notes invest in collateralised debt obligations (CDOs) that reference the corporate debt of 143 companies (as at 31 August 2008). The structure of the Notes is in two parts—the ‘Income Portfolio’ and the ‘Principal Portfolio’. These two separately managed reference portfolios are divided into “tranches” which are portions of the portfolios distinguished by the amount of income they receive and the order in which they bear losses from the entire portfolio.

Recent event affecting income of the Notes – default of Lehman Brothers Holding Inc (“Lehman”)

On 15 September 2008, Lehman went into Chapter 11 bankruptcy protection in the US. As per the Prospectus this was a “Credit Event” for the purpose of the Notes. For a further explanation refer to page 14 of the Prospectus. However, in summary, a Credit Event may occur if a Reference Company held in either or both of the ‘Income Portfolio’ or the ‘Principal Portfolio’ becomes insolvent or bankrupt.

What percentage of the Notes were invested in Lehman?

The weighting of the Notes investment in Lehman was 1.5% of the ‘Principal Portfolio’ and 2% of the ‘Income Portfolio’ as at 31 August 2008.

Estimated impact on ‘Principal Portfolio’

Using the expected recovery rate of 8.625%, the net effect to the current higher risk debt in the Portfolio would be as follows:

\[
1.50\% \times (1-0.08625) = 1.37\%
\]

Prior to the event, the subordination in the Principal Portfolio was 10.08%. The estimated Total Protection would therefore be: 10.08% - 1.37% = 8.7%.

With the holdings remaining, it would take approximately six Lehman-sized defaults or approximately 19 average sized-defaults based on the average holding in the portfolio to affect principal repayment. It is important to be aware that Lehman’s weighting was higher than the current average investment, which is around 0.6%. These defaults would have to occur prior to maturity in October 2011 to affect the capital.

Credit rating of ‘Principal Portfolio’

The current level of subordination required to maintain a Standard & Poor’s rating of AAA on Investment Principal only is 7.37% (estimated 31 August 2008). However, the amount of this subordination may change in the future.

Estimated impact on ‘Income Portfolio’

Within the structure of the Notes the ‘Income Buffer’ (which is an amount which bears losses before the income investment is affected on the occurrence of a Credit Event or Trading Reduction) was initially 0.15% of the value of the ‘Income Portfolio’ and has been reduced to zero through the impact of the previous Delphi investment default.

The actual impact on income will be determined by the weight of Lehman in the portfolio, adjusted for any recovery. The outcome can be modelled as follows:

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<table>
<thead>
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<tbody>
<tr>
<td>A</td>
<td>Lehman weight of investment in ‘Income Portfolio’</td>
</tr>
<tr>
<td>B</td>
<td>Expected funds recovery % rate</td>
</tr>
<tr>
<td>C</td>
<td>Lehman weight of investment in portfolio after recovery (A x B)</td>
</tr>
<tr>
<td>D</td>
<td>Tranche thickness</td>
</tr>
<tr>
<td>E</td>
<td>Proportionate reduction in Notes income (C / D)</td>
</tr>
<tr>
<td>F</td>
<td>Bank Bill Swap rate plus 2% (7 Oct 2008)</td>
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<tr>
<td>G</td>
<td>Adjusted annual rate of income from Notes (F x (1-E))</td>
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</table>
What is the prospect of further reductions in income?

AXA Investment Managers, Paris S.A. (AXA IM) is employed to actively manage the ‘Income Portfolio’ with a view to minimising defaults. However, it is unlikely AXA IM will be able to avoid further defaults in the current economic environment. Therefore there remains a higher risk of further reductions in the income rate, potentially to zero, for at least the next 12 months.

In summary

The Notes are an investment in a credit product. That means that in times of credit market stress, performance is likely to be adversely affected. Importantly, the direct impact is primarily on the Income and not on Principal. However, there was a significant reduction in the subordination in the Principal portfolio. The risk profile on repayment of Principal is relatively low.

It is important to keep the Lehman event in perspective and remember that over the course of a seven year investment some defaults are inevitable. That is why the Principal Portfolio has a substantial buffer in place.

The total number of credit defaults experienced to date is not unexpected or out of line with historic averages. Although defaults can be expected to be higher than usual over the next one to two years, this follows on from a period of low defaults over the first three years of the Notes.