

European Structured Finance
New Issue

Harbourmaster CLO 2 Limited

Arbitrage CDO – Ireland

Ratings

| Class | Amount (EUR million) | Final maturity | Rating | CE |
|------------|-------------------------|-------------------|--------|--------|
| A1 | 589.25 | Dec. 2013 | AAA | 15.39% |
| A2 | 6 | Dec. 2013 | AAA | 15.39% |
| B1 | 39 | Dec. 2013 | A | 9.56% |
| B2 | 2 | Dec. 2013 | A | 9.56% |
| C1 | 9.25 | Dec. 2013 | BBB | 7.11% |
| C2 | 8 | Dec. 2013 | BBB | 7.11% |
| D | 5 | Dec. 2013 | BB | 6.40% |
| M1 | 43 | Dec. 2013 | NR | 0% |
| M2 | 2 | Dec. 2013 | NR | 0% |
| S* (Combo) | 10 | Dec. 2013 | A | |

* The Class S Combination Notes are comprised of the Class A2, B2 and M2 Notes.

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Summary

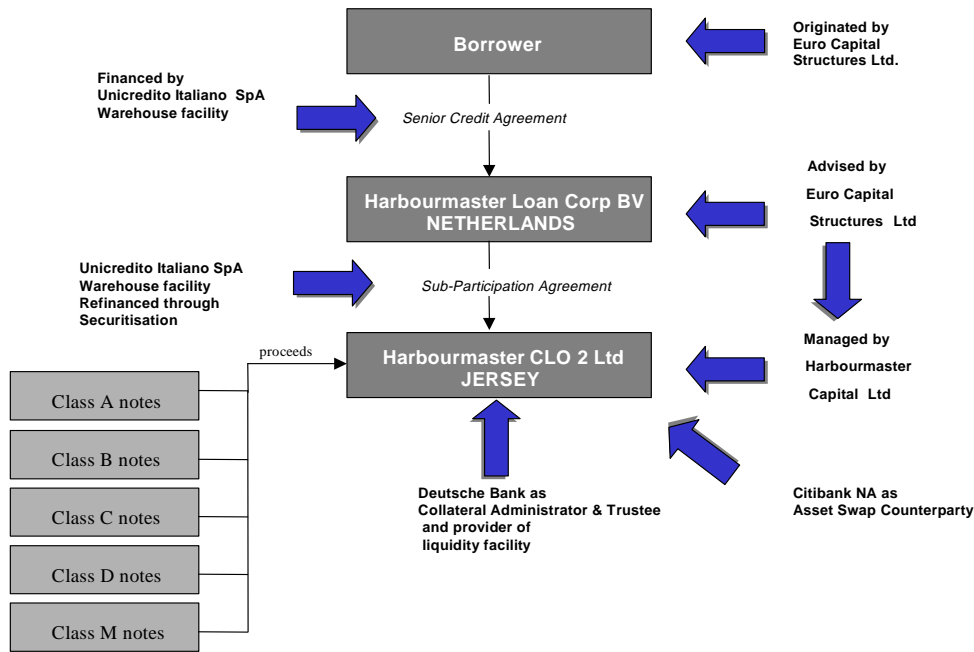
Harbourmaster CLO 2 Ltd.'s ("Harbourmaster 2" or "the issuer") liabilities are assigned ratings as indicated at left.

The issuer is a limited liability company incorporated under the laws of Jersey for the sole purpose of acquiring a EUR 700 million portfolio of sub-participations in GBP- and EUR-denominated sub-investment grade loan obligations, entering into each of the transaction documents and issuing the notes. The portfolio will be managed by Harbourmaster Capital Limited ("HCL" or "the collateral manager"), which will be advised by Euro Capital Structures ("ECS"). Harbourmaster will issue EUR 703.5 million of various classes of floating-rate notes, investing the proceeds in the portfolio either by means of:

1. sub-participations in senior secured loans acquired from Harbourmaster Loan Corporation B.V. (incorporated under the laws of the Netherlands) together with a security interest in the underlying loan in respect of which such sub-participations have been created;
2. sub-participations in senior secured loans acquired from any financial institution rated at least 'F1+'; or
3. synthetic securities linked to underlying loans and securities referred to in 1 and 2 above.

As of the closing date, the issuer had purchased approximately 69.3% of the target portfolio, and will have purchased 100% by the effective date, 15 June 2002.

The issuer's assets will serve as collateral for all the rated classes of notes. The expected ratings are based on the quality and mixture of portfolio assets, which are acquired by the collateral manager, subject to the investment guidelines outlined in the collateral management agreement. Ratings are also determined by the credit enhancement provided to the various levels of outstanding debt, which include support provided by subordinated notes and structural protection covenanted by the documents and excess spread. Investment restrictions limit the collateral manager's portfolio allocations with respect to risks to the portfolio, which include overall deterioration in the credit quality of the assets and excessive defaults on a significant portion of investments. These risks are mitigated by the portfolio guidelines, which require a minimum level of industry and country diversification, maximum obligor concentrations, a minimum weighted average loan and entity rating and average recovery rate, and the maintenance of minimum overcollateralisation and interest coverage ratios. Additionally, Fitch looks to the experience of the collateral manager's advisor, the investment manager (ECS).



All the rated notes will be secured over the assets of the issuer and have a legal final maturity by 15 December 2013. All classes of notes will make quarterly interest payments in arrears beginning 15 March 2002. The class A notes survived their respective stress scenarios with timely payment of interest throughout the transaction and full repayment of principal at maturity. In their respective stress tests, the class B, C and D notes realised ultimate payment of full and compensating interest and principal at maturity. The Class S combination notes survived their stress test with ultimate payment of principal at maturity.

Overcollateralisation and Interest Coverage Tests

Financial covenants and a cumulative loss test have been established in the collateral management agreement to maintain minimum levels of overcollateralisation and interest coverage for the various layers of rated debt (see *Financial Covenants*).

Financial Covenants (from Effective Date*) (%)

| | Overcollateralisation Test | Interest Coverage Test** |
|----------------------------|----------------------------|--------------------------|
| Class A First Priority | 111.0 | 120.0 |
| Class B Second Priority | 105.0 | 116.5 |
| Class C Third Priority | 102.0 | 114.1 |
| Class D Fourth Priority*** | 101.5/125.0 | 112.0 |

* The IC ratios are lower before the portfolio is fully ramped up.

**The IC ratio is 105% for all classes during the first payment period.

***as long as the cumulative loss test is satisfied the OC test of at least 101.5% applies.

The overcollateralisation ratios are calculated by dividing the aggregate value of the portfolio assets (sum of performing assets, recoveries on defaulted assets based on Fitch's recovery rates, and any balances outstanding) by the notes outstanding (of the respective class and the classes senior it). The interest coverage ratios are determined by dividing the total amount of interest proceeds from the portfolio assets (including balances in outstanding accounts) for a given period, minus the cost of various fees, by the sum of interest payments due on the various notes outstanding during the same period.

In the event an overcollateralisation or interest coverage test is not satisfied, the issuer must use interest proceeds, and to the extent necessary, principal proceeds according to the order of priority of payments, to redeem outstanding notes in order of priority until such tests are in compliance. For example, if the class A overcollateralisation test fails, subordinate interest payments are diverted from the class B, C and D notes to redeem the senior notes in order of priority until the overcollateralisation test is back into compliance.

Further, during the first reinvestment period, proceeds from scheduled or unscheduled principal payments under the loans which cannot be reinvested according to the portfolio guidelines shall be used to redeem the notes in accordance with the priority of payments.

■ Collateral

The rated debt securities are secured by sub-participating in a diversified portfolio of mostly sub-investment grade loans. When fully ramped up, a maximum 17% of the collateral in the initial portfolio will be GBP-denominated assets, and the remaining 83% EUR assets (currency issues are discussed below). All loans must be explicitly or privately shadow-rated by Fitch and assigned an expected recovery rate. During the ramp-up period, the unused proceeds from the notes will be paid into the unused proceeds account pending further investment in additional collateral obligations satisfying the portfolio guidelines and eligibility criteria. For mismatches in interest payment dates, a liquidity line of EUR 12 million will be provided by Deutsche Bank (rated 'F1+/AA') or other 'F1+' rated banks.

The issuer invests in sub-participations in underlying loans (or syndicated loans) either from HLC under a master sub-participation agreement or from

qualifying institutions rated at least 'F1+' The sub-participation must equate to 100% of the underlying loan in respect of which the sub-participation has been granted. Synthetic securities up to 7% of the portfolio related to specific obligors already part of the portfolio may also be acquired. The issuer is subject to certain limitations on eligible collateral based on the portfolio guidelines (*see Portfolio Guidelines below*).

Portfolio Guidelines

(% as of effective Date)

Portfolio diversification

| | |
|--|------|
| Maximum Single Obligor Concentration | 3.5 |
| Maximum concentration of obligors located in the US and Canada | 10.0 |
| Maximum synthetic securities relating to obligors currently in the portfolio | 7.0 |
| Maximum concentration of obligors in one Fitch industry | 10.0 |
| Max percentage of subparticipations from financial institutions | 50.0 |
| Max percentage of subparticipations from a single financial institution | 10.0 |
| Maximum participation with a single financial institution or synthetic security counterparty rated 'AA-/F1+' or above) | 10.0 |
| Obligation of or guaranteed by the following countries:- | |
| Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom and the U.S | |

Portfolio Profile Tests

| | |
|---|------------|
| Maximum weighted average Fitch loan rating factor | 47.0 (BB-) |
| Minimum rating of underlying loan (after closing) | B+ |
| Maximum weighted average Fitch entity rating factor | 52.2 (B) |
| Minimum rating of underlying entity | B- |
| Minimum Weighted Average Fitch Recovery Rate | 75.0 |
| Minimum Fitch Recovery Rate on any one loan | 50.0 |
| Maximum Percentage of portfolio with recovery rates below 60% | 8.0 |
| Minimum Weighted Average Margin (First Period) | 2.55 |
| Minimum Weighted Average Margin (Thereafter) | 2.35 |
| Maximum Weighted Average Loan Life (years) | 7.0 |

The portfolio guidelines are designed to limit the issuer's exposure to certain risks while allowing some flexibility in areas of the collateral manager's expertise. Every acquired loan or loan sub-participation will be assigned a Fitch credit rating which will be communicated to the collateral

manager. This loan rating is based on the entity rating and the expected recovery rate on the entity's specific senior secured obligation. The agency assigns a recovery rate to each obligation. The rating assigned to the loan can therefore be several notches above the entity rating based on the expected recoveries. Fitch will rate all loans included in the portfolio to date and post closing. The collateral manager is restricted to investments with a minimum individual recovery rate of 50% and a portfolio minimum weighted average recovery rate of 75%. Minimum loan and entity ratings are on an asset specific and weighted average basis (see portfolio guidelines above).

The transaction term can be subdivided into the three following periods:

1. Ramp-up period until effective date, 15 June 2002. During this period the portfolio investments are made according to eligibility criteria in order to fulfil the portfolio guidelines on the effective date. To ensure sufficient income from the obligations during ramp up, the weighted average minimum coupon for investments during this period is 2.55%. A liquidity facility will be provided to cover interest payment mismatches.
2. First reinvestment period until 15 December 2006. During this period proceeds from matured or prepaid loans are reinvested in eligible assets according to the portfolio guidelines. Proceeds will not be reinvested if a coverage test is breached. In this case the proceeds are used to pay timely interest and principal on the notes according to the priorities of payment. The minimum weighted average coupon for the portfolio will be maintained at 2.35% during this period.
3. Second reinvestment period until 15 December 2010. During this period reinvestments can only be made from the proceeds of unscheduled principal payments or mandatory prepayments on the loan obligations.

All the loans will amortise or redeem before the final maturity date on 15 December 2013. The transaction is non-callable during the first reinvestment period, excluding the payment date falling five years from the closing date. In the remaining seven years of the transaction, the issuer may call the transaction at the request of at least 75% of the subordinated (class M) noteholders. This would result in the principal

proceeds being applied to redeem the outstanding notes in order of priority. The subordinated noteholders may request this option be exercised on any payment date after the non-call period.

■ FX Risk

After the transaction is fully ramped up, the portfolio will comprise a maximum 17% GBP-denominated assets and 83% EUR-denominated. All of the notes issued will be denominated in EUR. To mitigate this FX risk, the issuer will enter into an asset by asset FX swap where any monies received (repayment of principal, coupon payments, recovery on defaults) that are GBP-denominated will be converted into EUR at a conversion rate determined on the closing date. There will be no reinvestment of GBP assets back into new GBP-denominated assets. Any GBP principal received, either through repayment or recoveries on defaults, must be reinvested in EUR assets (dependent on whether the monies can be reinvested or need to be paid through).

■ Interest rate and basis risk

All of the underlying collateral and notes issued will be floating rate. The notes being issued will all pay three-month EURIBOR (Euro Interbank Offered Rate) plus a spread, whereas 83% of the collateral will pay coupons based on three-month EURIBOR and the remainder will pay coupons based on three-month LIBOR (London Interbank Offered Rate). Therefore, there is no interest rate risk but there will be some basis risk. Fitch ran its standard EURIBOR and GBP LIBOR stresses in its cash flow modelling to gauge the effects of this basis risk on the transaction's ability to meet its rated interest and principal payments. For further information on the agency's rating methodology, see Research "Rating Criteria for European Arbitrage Collateralised Debt Obligations" dated June 5 2000, available on www.fitchratings.com.

■ Investment Advisor

Fitch's due diligence process included an in-depth evaluation of the investment advisor, ECS, which advises the collateral manager. This consisted of an on-site review of operations, interviews with key personnel, and a review of ECS's asset management experience and performance. This analysis of the advisor was completed in February 2001 when Fitch undertook a review prior to ECS's first CLO (collateralised loan obligation) transaction (Harbourmaster CLO 1 Ltd.). This transaction is the second European CLO for ECS. Harbourmaster CLO

1 Ltd, which closed 30 March 2001, recently completed its ramp up period several weeks ahead of schedule. Harbourmaster CLO 1 Ltd is in compliance with its eligibility criteria and portfolio profile tests at the date of the September 2001 monthly report to noteholders and is performing within Fitch's expectations.

ECS was formed in July 1999 with major equity support from Fiat and UniCredito Italiano. One of the main objectives of the firm was to manage European arbitrage CLOs. The Unicredito Italiano Group (rated 'AA-/F1+'), which is the main equity owner of ECS, is providing the warehouse facility and is investing in the class M notes of this transaction.

The ECS team numbers 14, with seven dedicated to this transaction. Senior team members have extensive experience in one or both the leveraged loan and/or securitisation markets. However, distressed debt experience within this team is relatively limited, in common with a number of other European asset managers. Fitch notes that ECS senior individuals are investing their own funds (EUR 1mm) in the equity tranche, and their remuneration structure is reliant on the performance of this transaction.

ECS proposes to be a long-term participant in the European arbitrage CDO market and expects to organise further similar transactions. Its strategy is to achieve superior returns whilst preserving capital, and to this end, it maintains a buy and hold strategy. When investing it tries to avoid certain industries that it has identified as not fitting with these objectives.

ECS's approach to assets is to complete an initial screening on a macro basis, assessing the industry, turnover, pricing and historic volatility of earnings. Once this has been completed, analysts, each focusing on specific industries, undertake an additional review to ensure assets meet an internally set credit rating score. This is followed by an in-depth credit assessment by the respective analyst and includes coverage of key areas such as financial, industry, legal and structural risks alongside the risk/return and relative value considerations. External credit assessment by Fitch is also required as part of the approval process and must be obtained prior to internal approval. All credits require unanimous investment committee approval prior to purchase.

Each asset is continually reviewed and monitored and discussed at weekly meetings, as is the performance of the overall portfolio. Much emphasis is placed on

the review process to ensure problem accounts are identified at an early stage and the risk of loss minimised.

Whilst Fitch acknowledges the short history of the asset manager, the individuals dedicated to this CLO have good credit experience. The agency believes that the portfolio manager possesses sufficient experience, systems and procedures to manage the portfolio within the parameters covenanted to by the collateral management agreement and implied by the ratings.

■ Portfolio Stress Tests

As part of the rating process, Fitch performed computer cash flow modelling that stressed a hypothetical portfolio pursuant to the issuer's investment guidelines. The models assumed the most aggressive portfolio mix permitted while maintaining a weighted average entity rating of 'B' or a Fitch Rating factor of '52.2'.

The stress scenarios applied Fitch's methodology for defaults and recovery rates for each debt rating and asset type respectively. The default rates (*see Default Rates below*) were applied to a fully ramped up portfolio. Since the maximum weighted average life of the collateral is seven years, the agency adjusted the default rates by taking 90% of the 10-year default rates.

The stress scenarios included front-loaded, back-loaded, and base case tests, which varied the timing of asset defaults. The front-loaded test stressed the

Default Rates

(%)

| Debt Rating | Default Frequency for stress test |
|-------------|-----------------------------------|
| 'AAA' | 46.98 |
| 'A' | 34.74 |
| 'BBB' | 28.62 |
| 'BB' | 25.56 |

asset portfolio over the first five years of the transaction at 33%, 25%, 16%, 13% and 13% of the aggregate defaults (realised as a percentage of the fully ramped-up collateral balance). The back-loaded stress test applied a 'B' level default rate evenly over the first nine years of the transaction and continued at a higher default rate until maturity. In the back-loaded stress test, all default percentages apply to the initial amount during the first re-investment period

(five years) and the outstanding collateral balances thereafter. Furthermore, the agency also applied its single obligor test to model the simultaneous default of the largest reference entities according to its single obligor concentration matrix.

The portfolio will have a minimum weighted average recovery rate of 75% that will need to be maintained through the life of the transaction. For the cash flow modelling, the agency assumed that the defaulted GBP investments would realise recovery rates of 70% (a 12.5% haircut below the 80% average recovery rate assigned for such assets), and a 75% recovery rate was assumed for the EUR-denominated investments. Fitch assumed recoveries are realised 30 months following defaults for the EUR assets, and 18 months after default for the GBP assets (the latter were assumed recovered in 18 months due to the requirement by the asset swap agreement that the defaulted assets must be sold within this timeframe). Because an 18 month lag for recoveries is shorter than Fitch's normal assumption of 30 months, the agency assessed a haircut (12.5%) for GBP asset recovery rates.

Recovery rates, based on Fitch's expertise, are assigned to each specific loan before it is added to the asset portfolio (see recovery grid in "*Rating Criteria for European Arbitrage Collateralised Debt Obligations*", dated 5 June 2000 and '*UK Secured Loan Recovery Study*', dated January 2000).

The models showed that the capital structure supported the Fitch default and recovery methodology. The class A notes survived their respective stress scenarios with timely payment of interest throughout the transaction and full repayment of principal at maturity. In their respective stress tests, the class B, C and D notes realised ultimate payment of full and compensating interest and principal at maturity. The Class S combination notes survived their stress test with ultimate payment of principal at maturity.

Key Information

Issuer: Harbourmaster CLO 2 Limited

Collateral Manager: Harbourmaster Capital Limited

Collateral Advisor: Euro Capital Structures Limited

Arranger and Lead Manager (sole book): Credit Suisse First Boston

Joint Lead Manager: Unicredito Banca Mobiliare S.p.A

Collateral Administrator: Deutsche Bank AG London

Asset Swap Counterparty: Citibank Bank N.A., London Branch (F1+)

Liquidity Facility Provider: Deutsche Bank AG London

Closing Date: November 2001

First Reinvestment Period: 15 December 2006

Second Reinvestment Period: 15 December 2010

■ Surveillance

Fitch will monitor the transaction on a regular basis and as warranted by events. Its structured finance surveillance 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 call the Fitch analysts mentioned on the first page of this report for any queries regarding the initial analysis or the ongoing surveillance.

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