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The (A)iceberg beneath tech debt: Recognized calm, rising spreads below the waterline

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In Summary

- **Equity captures the upside of the AI build-out, while credit absorbs the loss if it fails – yet creditors are compensated with under 1% p.a. on 5-year bonds and around 2% on 10-year.** The asymmetry has grown as total long-term debt at the eight dominant US tech companies rose by 86% in the 12 months to mid-2026. If AI investment pays off, equity holders benefit; if it does not, the added debt, increasingly compounded by off-balance-sheet commitments, leaves creditors exposed to a skewed distribution of outcomes that current spread levels may not reflect. This paper tests whether spreads price that skewed risk using three structural credit models – Merton, and KMV-inspired, and CreditGrades – with financial-filing and equity data for eight mega-caps.
- **On recognized debt, the market's calm is justified but we see the first drifts.** Our modelling agrees with market pricing and ratings on most names. As of mid-2026, recognized leverage across the panel is low, at 0.2% to 6.8%, implying credit risk broadly consistent with Aaa–A ratings. Three of the eight screen weaker than their formal rating due to high leverage (Meta) or equity volatility (Oracle, SpaceX).
- **The real risk lurks below the waterline: off-balance-sheet debt lifts the debt burden by nearly 150% on average, and pulls the model-implied credit quality down 1-2 notches.** The deterioration surfaces as quality migration before it surfaces in price, because distance-to-default is too far for spreads to react. The market has noted the direction, but not yet the size: CDS spreads more than doubled over the past year, while the average model-implied credit spread rose six-fold once off-balance-sheet debt is included. Off-balance-sheet debt keeps growing as new commitments are signed, and AI profit potential, even realized, offers little spread-tightening against it.
- **Ranked against the broad corporate credit universe, the panel is bifurcated:** model-implied credit quality spans from the 97th percentile (strongest) to the 2nd (weakest), with the average sitting near the 62nd — barely better than a median credit. In effect, the rank bought by rising market capitalizations and compressed volatility is being spent on debt growth, both recognized and hidden. The two legs are not symmetric – debt is contractual and accumulates on schedule, while equity relies on the future.
- **A severe market repricing – equity down 10%, volatility up 10pp, debt up 50% – would cost the panel two standard deviations of distance-to-default, translating into ~20bps of model spread.** Debt sensitivity is actually lower: recognizing leases – equivalent to 150% of debt – moves spreads by only ~10bps, with wide dispersion across names. Mid-2022 is the natural stress test: the same balance sheets, carrying far less debt, still showed vulnerability – volatility and time horizon matter more than rates or equity levels.
- **As tech allocation in credit portfolios grows, spreads do not fully compensate for skewed risk.** Default risk is still remote, but spread risk will increasingly surface. The liability leg is contractual and arrives on schedule, while the equity leg can reverse in a quarter. Tech's curve steepness already prices the long horizon as the key risk, and that may extend to the front-end. Tech has avoided the iceberg so far, but the navigation is getting trickier, and the metric to watch is spread vs. quality ranking within the corporate market, including by financial commitments and equity volatility.

From the broad market to the (A)Iceberg

What is the right price for carrying the tail risk of the AI build-out? We put that question to structural credit models that price default risk from the equity market and the balance sheet, rather than from credit markets themselves. By definition, equity keeps the upside if the AI build-out works, credit mainly absorbs the loss if it does not. The mega-cap technology complex already dominates the equity indices and is now ballooning in credit to finance that build-out. And investment-grade spreads offer only modest compensation of ~80bps, even after the tech-led widening of 2026.

The starting point is Merton (1974), and behind the mathematics sits a simple idea: a company owns assets and owes debt. If the assets are worth more than the debt when the bill comes due, shareholders keep the difference; if they are not, creditors take what is left. Owning the shares is therefore a bet on the assets clearing the debt – and that means the equity market is already saying something about default risk. Two things drive the answer: how much cushion sits between what a company is worth and what it owes, and how fast that cushion can move, which is what equity volatility measures. A thick cushion that barely moves is safe. A thin one that swings around is not. The model implicitly assumes the consensus AI narrative embedded in equity, with equity volatility taken as a proxy for the market's uncertainty. This approach may not fully appreciate the income from current AI-investment. But credit investors will barely benefit from it, and instead need to focus on downside against slim spread.

Merton's limitation is that it is too well-behaved at the top end. Give it a company with 2% leverage and it reports a default risk of essentially zero – hard to argue and work with. A KMV-inspired approach¹ – our own implementation of the published structural framework, not the proprietary Moody's Analytics KMV model – keeps that logic and fixes the last step: instead of reading default risk off a bell curve, it reads it off what has actually happened in the past to companies with similar cushions. It also assumes a that firm has to cover its short-term debt plus part of its long-term debt, rather than everything all at once. The output arrives in a language credit investors already use – an implied rating. That matters here, because when Merton has flattened to zero, the rating still moves. CreditGrades, a variant that allows for uncertainty about exactly where the default point sits, is run alongside as a sanity check.

We run both models on key technology companies – Microsoft, Apple, Alphabet, Amazon, Meta, Nvidia, and Oracle. SpaceX was also added in recent analysis, completing the eight-name panel we refer to throughout. The analysis covers five timestamps from mid-2022 – the onset of the AI theme – to mid-2026, using the market capitalization, equity volatility and risk-free rate prevailing at each date. Each name is priced under two debt barriers: reported balance-sheet financial debt only, versus balance-sheet debt plus off-balance sheet commitments – together, the (A)Iceberg.

On the recognized balance sheet, default risk pricing is a volatility story

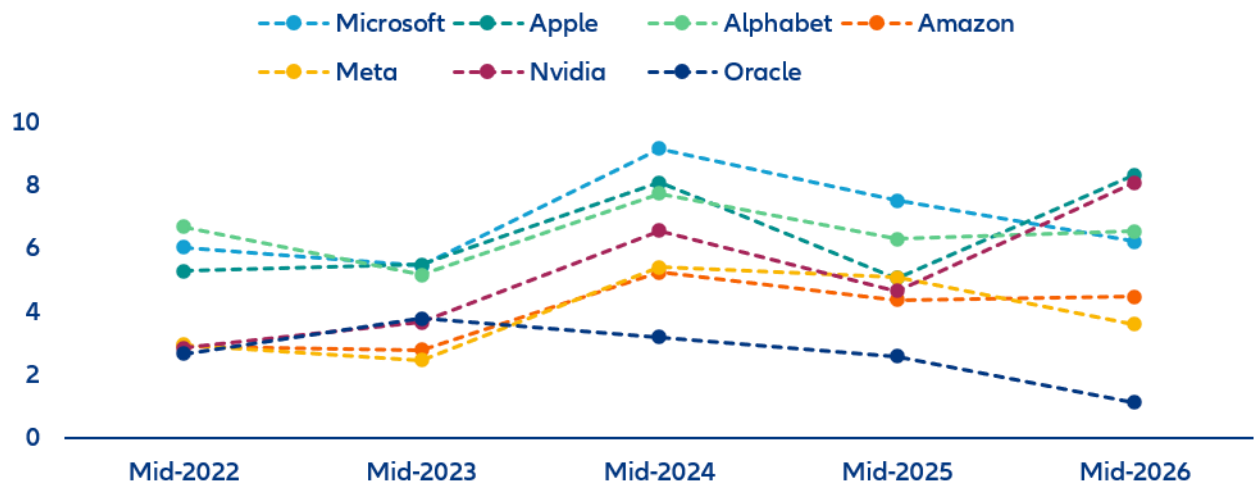
Five years of distance-to-default read as a volatility cycle, not a leverage cycle. Distance-to-default was weakest in mid-2022, when the inflation-and-policy shock had left market capitalizations 40–70% below today's levels and pushed single-name volatility into the 41–57% range. As the 2024 economic rally rebuilt equity cushions, it subsequently dipped in 2025, and split in 2026 (Figure 1). Meanwhile, balance sheets remained more static and the debt barrier quite stable from 2022 to 2025. Heavy issuance of new debt started only in late 2025. Oracle's path is the only one that can be explained through leverage: its distance-to-default has ground down substantially (from 2.4 to 0.8 standard deviations), as debt grew into an equity cushion that halved over 2026. Generally, below 1 standard deviation is naturally the danger zone (CCC-rating and below) while above 3 enters investment grade and 7 in AAA-space.

¹ Moody's KMV (Kealhofer, McQuown, Vasicek) operationalises the Merton model by mapping distance-to-default to default frequencies estimated from a proprietary default database, rather than through the Gaussian mapping, which understates default risk in practice. See Crosbie and Bohn (2003), Modeling Default Risk, Moody's KMV.

The 2026 differentiation is itself informative: model default risk improved sharply at Apple and Nvidia, while it deteriorated at Microsoft, Meta and Oracle, whose distance-to-default fell by 23–31%. Applying equity volatility has already divided the panel into the names it believes are winning the build-out and the names paying for it, with Oracle as the outlier – a point that debt markets also noted.

Figure 1: Distance to default, mid-2022 to mid-2026 – a volatility cycle for six names, a leverage story for one

Model-implied distance to default, standard deviations of asset value



Sources: Bloomberg, Allianz Research. Merton distance-to-default (standard deviations, 5-year horizon), recognized-debt barrier; higher is safer.

Mid-2026 shows the recognized numbers justifying the market's calm (Table 1), while SpaceX is repeating the volatility story. Recognized leverage – all short-term debt, plus 75% of long-term debt, against market-implied asset value – sits between 0.2% (Nvidia) and 6.8% (Amazon) for the six mega-caps; only Oracle, at roughly 25%, carries leverage that a structural model can even see. SpaceX makes the volatility point in its purest form: at just 1.3% leverage, its distance-to-default is short at 0.9. The model reads B against current ratings at Baa1, purely because equity volatility near 113% makes even a small barrier reachable.

Merton and CreditGrades spreads accordingly collapse for the AA/AAA quality names – nearly zero implied spread against market CDS of 31–71bps. Those numbers are not a data problem, they follow from what each side measures. Default risk at these balance sheets is so remote that the models' risk-neutral normal tail rounds it to zero, while the market spread is largely everything a default model does not price: liquidity, risk premium and the technicals of supply and demand. Model and market spread levels therefore cannot be compared directly – the information sits in the rankings and the changes.

The KMV-inspired overlay – an empirical mapping from distance-to-default to observed default frequencies, is used precisely to restore that information: Aaa-equivalent for Microsoft, Apple, Alphabet and Nvidia, A for Amazon, Baa for Meta and B for Oracle and SpaceX (Table 1). Set against the rating agencies, the mapping lands close for most of the panel: on five of eight companies, the model echoes both the agencies' and the market's calm. The outlier is Meta -Baa in the model against Aa3 at Moody's, roughly three notches below the agencies, because the model assumes 39% equity volatility and ignores the profit potential which is uncertain. Oracle's gap (B against Baa2), runs the same direction and the high leverage weighs on the result. However, the model better justifies market CDS price rather than the agencies: at 71bps Meta trades the widest of the six mega-caps excluding Oracle – wider than higher-rated Alphabet (Aa2, 55bps) and even BBB benchmark (60bps). The mismatch between market pricing and model implied default risk reflects the debt beyond the current balance sheet, namely announced future issuance and off-balance sheet debt, as well as future profit expectations.

Table 1: The recognized balance sheet in mid-2026 and model-implied rating

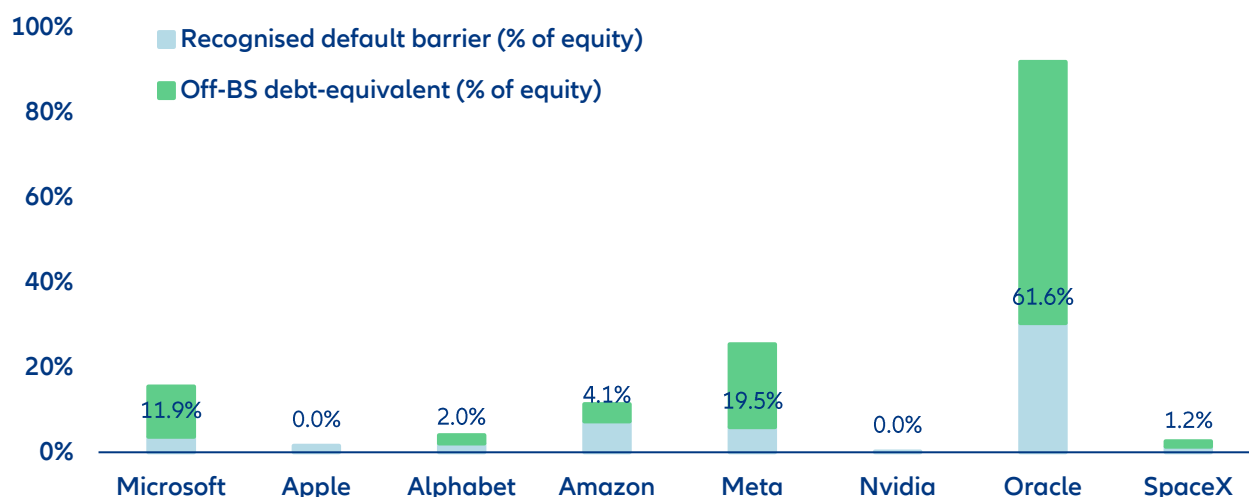
Company	Equity vol (1y, %)	Debt Barrier (USDbn)	Leverage	Distance to default	Model impl. rating	CDS impl. rating	Market 5y CDS at mid-2026 (bps)
Microsoft	27	101	3.6%	5.6	Aaa	Aa3	42
Apple	24	67	1.5%	7.9	Aaa	Aa2	31
Alphabet	30	90	2.0%	6.0	Aaa	A1	55
Amazon	31	186	6.8%	4.1	A	A1	55
Meta	39	85	5.7%	3.3	Baa	A3	71
Nvidia	36	10	0.2%	7.6	Aaa	A1	48
Oracle	63	128	24.9%	0.8	B	Baa3	171
SpaceX	113*	30	1.3%	0.9	B	Baa2	138

Sources: Bloomberg, Allianz Research. Barrier = ST debt + 0.75×LT debt; leverage = barrier / market-implied asset value; distance to default from the Merton solve at a 5-year horizon; model-implied rating from our own empirical default-frequency mapping. *Equity vol of Space X is annualized 10-days vol as there is no 1y trading history yet.

The (A)Iceberg: USD1.1trn of obligations the default barrier cannot see

The largest claims on future cash flow in this complex are hidden from the balance sheet. Data-center capacity contracted today but delivered in 2027–2031 stays disclosed-only until the lease commences: take-or-pay cloud, compute and power purchase agreements behave like debt services, but book as executory contracts; residual-value guarantees and vendor-financing structures sit further out still. According to Bloomberg Intelligence, Alphabet, Meta, Oracle, Microsoft, and Amazon collectively hold off-balance sheet commitments nearing \$2.6 trillion as of August 2026. That number is up from \$573 billion a year prior, driven primarily by AI infrastructure build-outs – including uncommenced data-center leases and long-term supply agreements.²

Figure 2: The iceberg in one chart – recognized barrier versus off-balance-sheet debt-equivalents, % of market equity, mid-2026

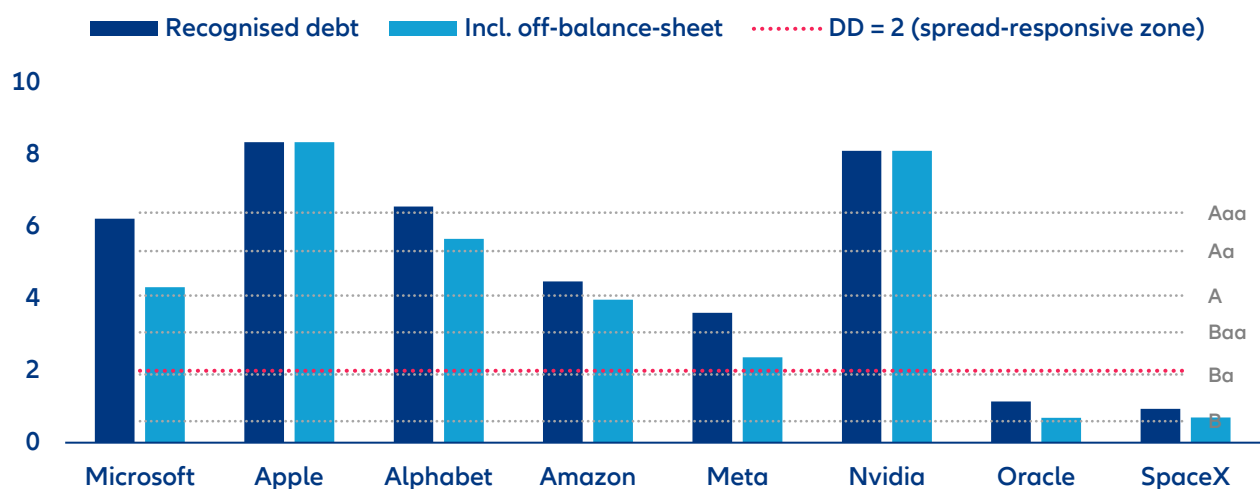


Sources: company filings (commitments notes), Bloomberg, Moody's, Allianz Research. Off-balance-sheet debt-equivalents are judgement-based estimates of not-yet-commenced leases; undiscounted, mid-2026 only.

² [Bloomberg Intelligence](#) Mandeep Singh, 08/13/26

The hidden debt moves model-implied credit quality by one to two notches while leaving most model spreads visually less changed. This is because the distance to default is still too far to reflect in model pricing. Adding the commitments lifts leverage to 16% and 25% respectively and multiplies Microsoft's and Meta's debt burden more than four times and (Figure 2). Therefore, as shown in Figure 3, distance-to-default would be cut by 1.9 and 1.2 standard deviations – equivalent to a 1-2 notch downgrade. Yet the model-implied spread response is close to nil everywhere except the two names whose cushions were thin to begin with: Meta moves from 0.2bps to 7.4bps (CreditGrades: 0.1 to 10.2bps) and Oracle from 192bps to 326bps (CreditGrades: 230 to 467bps). The model also translates the same compression into ratings language, full recognition of the off-balance sheet items moves model-implied quality by one to two notches overall (Microsoft Aaa to A, Alphabet Aaa to Aa, Meta Baa to Ba). Our measure of the stack is deliberately narrow: only uncommenced leases, the one component disclosed in the commitments notes and clearly definable as a debt-equivalent. Layering in the take-or-pay supply agreements, purchase obligations and guarantees would deepen every one of these migrations.

Figure 3: Distance to default, mid-2026 – recognized debt versus including the off-balance-sheet stack
Dotted line as model implied rating band floor

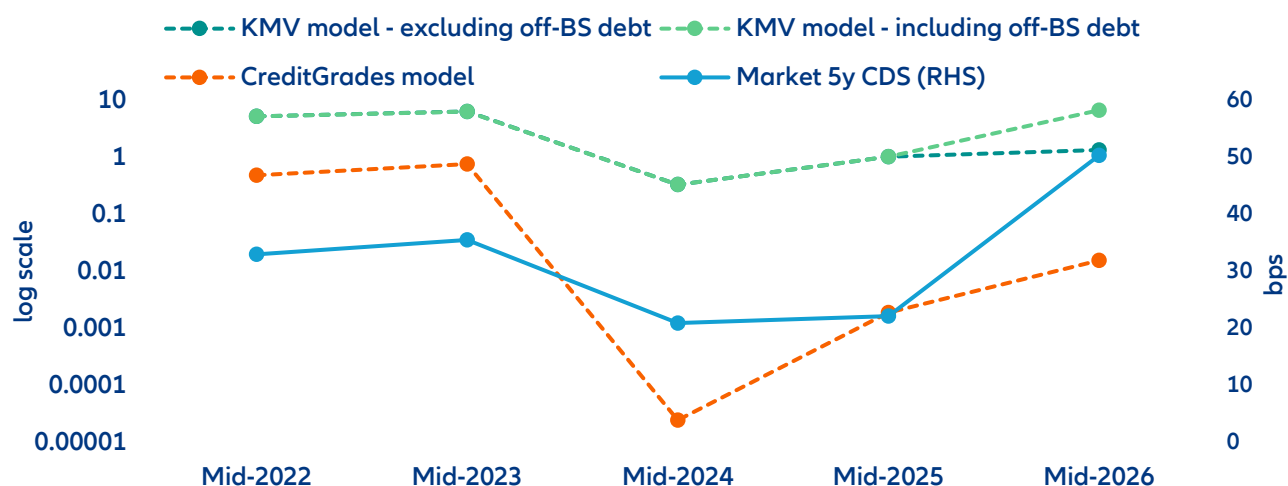


Sources: Bloomberg, company filings, Allianz Research. Below roughly $DD = 2$, structural model spreads become responsive; above it, barriers can multiply without spreads reacting.

The market is not blind to this – but it is not fully pricing it either. The 2026 widening is itself partial recognition: the two names carrying the largest commitment stacks relative to their recognized debt, Meta and Oracle, are also the two widest spreads in the group. Spreads have moved by tens of basis points year-to-date while, the inclusion of off-balance sheet items implies one to two notches of quality migration – a repricing consistent with part, not all, of the off-balance sheet stack. And the stack is not static: commitment schedules are still being signed, recognized debt is growing alongside them and every lease that commences converts a disclosed obligation into a recognized barrier.

Current spreads price part of the off-balance sheet stack, but pricing all of it would imply further widening, and the gap is still growing. Mid-2026 is the first time in the AI era that model and market widen together, and the models widen furthest where the hidden debt is counted. Model spread levels price expected default loss only, and sit far below traded spreads which reflect liquidity and other non-fundamentals drivers. Consequently, Figure 4 should be read for direction rather than level. From mid-2022 to mid-2025, model and market tightened together; into mid-2026 both widen. Once we exclude Space-X, due to its lack of history, and Oracle, due to its wider spread, the average market 5-year CDS of the remaining names more than doubled over the last year, from 22bps to roughly 50bps. The model average rises about 30% on recognized debt alone, and roughly six-fold once the off-balance-sheet stack is counted. This supports our argument that the market's widening only partially reflects inclusive deterioration. Given the continuing financing needs and dynamic nature of the commitments, we don't expect the widening pressure to fade away any time soon.

Figure 4: Model versus market, excluding Oracle, bps, log scale



Sources: Bloomberg, Allianz Research. Market line = average 5-year CDS; before 2026 only Microsoft, Apple and Amazon carried liquid quotes, and Alphabet, Meta and Nvidia enter the average in 2026. Model spreads capture expected default loss only and sit below market by construction – compare trends and the wedge, not levels.

Ranked against the broad issuer universe, the panel has bifurcated, stretching the whole range from 97th to 2nd percentile

Ranked against the broad issuer universe, rather than against each other, the panel has moved from clustered to bifurcated – and once the commitment stack is counted, four years of apparent improvement net out to almost nothing. On recognized debt, the average placement of the seven names rises from the 61st percentile in mid-2022 to the 73rd percentile in mid-2026, showing an improvement among the Investment Grade universe. Add the off-balance-sheet stack at full weight, however, and the average falls back to the 62nd (Table 2).

Table 2: Ranked against the broad issuer universe, the panel has bifurcated – percentile of model-implied distance-to-default, mid-2022 versus mid-2026

Company	Percentile mid-2022	Percentile mid-2026 ex off-BS	Direction on recognized debt	Percentile mid-2026 incl. off-BS	Net change (pp)	Direction incl. off-BS
Microsoft	95.0	94.1	Broadly stable	70.3	-24.7	Deteriorated
Apple	88.5	97.6	Improved	97.6	+9.1	Improved
Alphabet	96.3	95.4	Broadly stable	90.1	-6.2	Deteriorated
Amazon	39.0	73.8	Improved	62.0	+23.0	Improved
Meta	39.6	54.1	Improved	20.7	-19.0	Deteriorated
Nvidia	37.5	97.1	Improved	97.1	+59.7	Improved
Oracle	34.4	3.5	Deteriorated	1.8	-32.6	Deteriorated
Average	61.5	73.7	Improved	62.8	+1.3	Broadly stable

Sources: Bloomberg, company filings, Allianz Research. Percentile = placement of the model-implied physical distance-to-default in the broad issuer cross-section (323 issuers at mid-2022, 455 at mid-2026). Note: the comparator universes are built from recognized borrowings only, so the inclusive columns place an off-balance-sheet-adjusted distance-to-default into an unadjusted peer distribution – a conservative lower bound rather than a like-for-like rank. Direction reads the percentile change: improved or deteriorated for moves beyond ± 5 pp, broadly stable within it.

Although the aggregate level seems flat, the idiosyncratic movement is significant and the off-balance sheet debt amount is decisive. Three names improve on net, with or without the off balance sheet burden: Nvidia, Apple and Amazon all favorably ride favorable equity market effects with modest change in leverage. Nvidia gains most, from the 37th to the 97th percentile, and Apple rises from the 88th to the 98th. Neither carries a readily measurable commitment liability (Nvidia's buyer support via equity contributions obviously add circularity elsewhere and

financing support may rise in the future). Amazon keeps a net gain of 23pp despite handing back 12pp once its USD106bn of commitments are counted. Microsoft, Alphabet and Meta deteriorate only once the off-balance-sheet liability is counted, as their market-cap gains and volatility increases are not enough to offset liabilities growing several-fold. Microsoft is the clearest illustration: its placement is broadly stable over four years (95th to 94th) considering balance sheet debt, but if off-balance sheet liability is added, model-implied credit would deteriorate by one notch from Aa to A, as does the percentile rank. Meta runs the mechanism at higher intensity: +14 percentile-point change on recognized debt, -33 percentile-point from the stack, a huge net -19 percentile-points for eventual placement in the bottom quartile of the universe at the 20th percentile. Oracle is the only name dragged by everything at once – a fallen market capitalization, equity volatility, growing recognized debt and a stack equivalent to 60% of its equity – sliding from the 34th percentile to the 2nd at the bottom. All of above is not precise for each company but meant to offer insight into the dynamics for the overall technology panel and big-tech sector.

If benign markets turn: mid-2022 is the stress test built into the sample

Table 3 shows that horizon and equity volatility dominate the model results. Altogether, a stress scenario would cost the panel some two standard deviations of distance-to-default – equivalent to one to two rating letters or around 20bps of spread widening. Horizon matters the most (± 1 year is worth 0.42–0.58 standard deviations), because the model measures cumulative default risk within the horizon. The high horizon sensitivity also helps explain why the AI-related bonds curve is steeper, i.e. long-dated AI bonds are traded at a higher premium compared to the market curve. Among the market-facing parameters equity volatility dominates – 1pp moves distance-to-default by 0.20 standard deviations on average, against 0.11–0.13 for a 10% move in market capitalization or in debt. Implicitly, the model assumes that the equity markets efficiently price both the market consensus on the AI-outlook and the volatility surrounding it. The volatility channel is non-linear where it counts: the same shock produces larger spread reaction for names with currently lower volatility (e.g. Apple and Nvidia), and less spreads reaction for names already has high equity volatility (e.g. Oracle). Rates stress is less of a concern, as a 1pp move in rates only impacts distance-to-default by 0.07 standard deviations – a reasonable result while debt remains modest and off-balance sheet commitments lack rate sensitivity. A simultaneous stress scenario – equity down 10%, volatility up 10pp, plus debt up 50% (keeping the high issuance pace) – costs the panel two standard deviations of distance-to-default on average, which implies spread widening of around 20bps. Recognizing all the uncommenced leases pushed distance-to-default another 0.71 standard deviations shorter or around 10bps. Risk is firmly skewed to the downside in credit.

Debt and equity conditions are not two separate risks here – both enter distance-to-default, one raising the barrier and the other the cushion. Today they pull in opposite directions. Debt has grown hard on both sides of the disclosure line, yet distance-to-default has held for most of the big tech companies, because the equity leg moved the other way: market capitalizations are 40–70% above mid-2022 and volatility for all of them except Oracle sits at 24–39%, compared with the 41–57% of 2022. The equity market has also already taken sides: Apple and Nvidia re-rated through 2026, while Microsoft, Meta and Oracle de-rated, so the cushion is thinning precisely where the commitments are largest. For now spreads are held tight by the price-insensitive demand we described in July. But the offset is one-directional: commitments migrate to the financial statements on schedule regardless, so a turn in the volatility regime would raise the vulnerability and thin the cushion at the same time. In a market with less tailwind from demand that repricing tends to arrive quickly.

Table 3: Sensitivity and stress test – model-implied distance-to-default change by scenarios (based on Mid-2026, excluding off-Balance sheet debt)

Scenario	Average change (standard deviation)
Equity vol +1pp	-0.20
Equity vol -1pp	0.21
Equity price +10%	0.11
Equity price -10%	-0.13
Debt level +10%	-0.11
Debt level -10%	0.13
Risk-free +1pp	0.06
Risk-free -1pp	-0.06
Horizon T +1y	-0.42
Horizon T -1y	0.58
Stress scenario (price -10%, vol +10pp, debt +50%)	-2.00
Off-BS debt included	-0.71

Sources: Bloomberg, company filings, Allianz Research. Cells show the change in model-implied physical distance-to-default (standard deviations) from the mid-2026 baseline, one parameter at a time except in the combined-stress row.

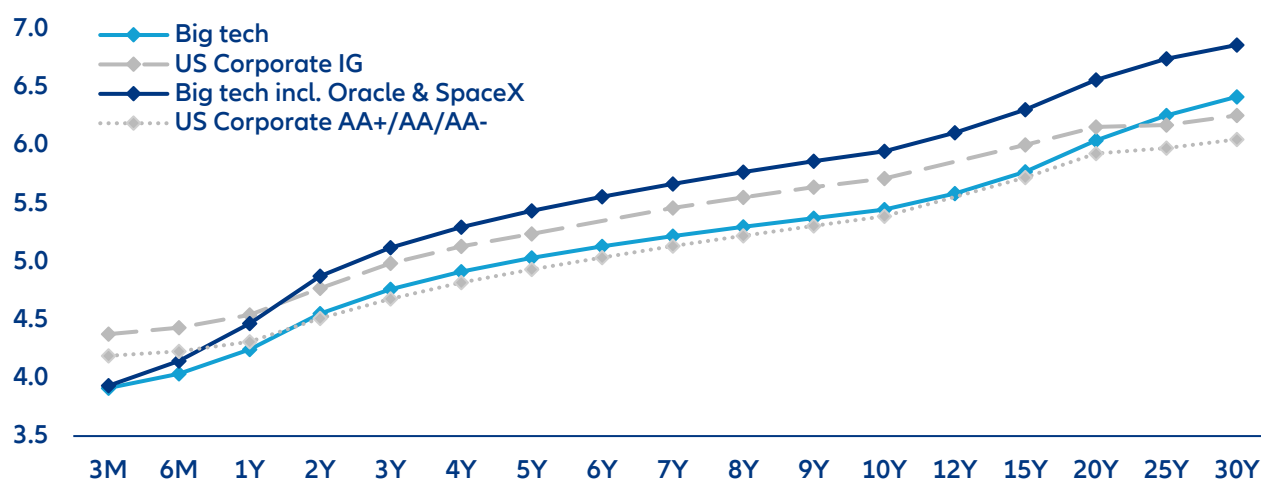
What this means for credit investors

First and foremost, based on today's balance sheets at the big-tech companies we examined, imminent default risk is remote for most of the panel. The finding is the dispersion and the direction. Their improvement in ranking compared with the broader market since 2022 came from the equity side – higher market capitalizations and lower volatility – and sits with the names that carry no commitment burden. Every name with large off-balance sheet liability deteriorates once that is counted. And the newly liquid CDS market has begun siding with the model approach, e.g. Meta CDS tends to reflect part of the off-balance sheet commitments. Default risk is still remote, but spread risk will increasingly surface.

Second, the metric to monitor is debt migration. The disclosed commitments commence and will move to financial statements between now and roughly 2031. The liability leg is contractual and arrives on schedule, while the equity leg reflects a market expectation that can reverse in a quarter, given uncertain monetization, or a technology jump to more efficient chips. The models say this will show up first as quality migration – e.g. one to two notches at Microsoft, Alphabet and Meta on full recognition, and if not matched by additional revenue – while spreads stay pinned until cushions are far thinner. The market pricing reflects the direction, but not yet the size: the 2026 widening covers part of the off-balance sheet liability, and the unpriced portion grows as new commitments are signed.

Third, after recognition of off-balance sheet liabilities, the main risk that remains is horizon and volatility, as Table 3 sizes it. A severe market repricing costs the panel two standard deviations of distance-to-default, or roughly 20bps of model spread. Recognizing the leases adds another 10bps on average. The two channels compound, because the commitments migrate on to the balance sheet on schedule, into whatever volatility regime prevails. The offset holding the rankings up is volatile: the equity leg can reverse in a quarter; the debt leg cannot. Horizon sensitivity concentrates the exposure in long-dated paper, consistent with the steeper curves on AI-linked issuance. In a repricing, the names with only a thin-cushion move by multiples, the rest by market beta. Oracle's CDS, already the sector's risk proxy, is where the move would be read first. Tech's curve steepness already prices the long horizon as the key risk, and that may extend to the front-end.

Figure 5: Big tech curves vs IG and AA benchmarks – higher premium at long-end



Sources: Bloomberg, Allianz Research

Tech has avoided the iceberg so far, but the navigation is getting trickier. The metric to watch is spread versus quality ranking within the corporate market, measured to include financial commitments and equity volatility. In recent years, the search for yield and tech's low initial weight in credit portfolios provided a tailwind that may turn into a headwind. With technology accounting for an ever-larger share of credit, integrating this into position sizing and maintaining the flexibility to adjust course if the (A)Iceberg appears will be key.

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