

BlueOrchard[®]

Microfinance Investment Managers

BlueOrchard Loans for Development – 2007 (BOLD 2)

INVESTORS' UPDATE as of October 2009

Dear Investor:

In this newsletter, we provide an overview of the performance of BOLD 2 and its 20 participating microfinance institutions (MFIs) for the 12 months ending June 2009, with focus on the change in the past 6 months.¹ As you will see in the various sections of the report, the global financial crisis is having an impact on the institutions in the BOLD 2 portfolio, though such impacts vary significantly from country to country and region to region. Generally the MFIs continue to perform well in spite of the very challenging global environment, however several warrant close monitoring, particularly in Nicaragua and Russia.

In addition to reporting on the performance of the MFIs in the BOLD 2 portfolio, we wish to make investors aware that Standard and Poor's (S&P) has placed the BOLD 2 Class A (rated "AA") and Class B (rated "BBB") on negative credit watch. This means there is a possibility that the bonds will be downgraded in the near term, though a downgrade is not guaranteed. S&P's action is the result of an extensive review of its collateralized debt obligation criteria and is not related to any development in the BOLD 2 financing. BlueOrchard will remain in close contact with S&P and will keep investors informed.

Eleventh Interest Payment: September 2009

All 20 MFIs made their 1st September 2009 interest payment on schedule, and coupons were subsequently paid to note holders on 15th September 2009. BOLD 2 has made 11 interest payments to investors since the transaction's May 2007 closing. The next payment is due in December 2009.

MFI Loans	Country	Amount
1 Popayan	Colombia	10,000,000
2 EBS	Kenya	10,000,000
3 ProCredit	Georgia	10,000,000
4 AccessBank (MFBA)	Azerbaijan	8,000,000
5 Partner	Bosnia	6,500,000
6 EKI	Bosnia	6,500,000
7 Banex (Findesa)	Nicaragua	6,000,000
8 Zao Finca	Russia	6,000,000
9 Mikrofin	Bosnia	5,200,000

¹ Based on unaudited numbers, self-reported by the MFIs through June 2009.

10	Agroinvest Montenegro	Montenegro	5,200,000
11	Medellin	Colombia	5,000,000
12	Crear Arequipa	Peru	5,000,000
13	Xacbank	Mongolia	5,000,000
14	Constanta	Georgia	4,000,000
15	FDL	Nicaragua	3,000,000
16	Confianza	Peru	3,000,000
17	EDYFICAR	Peru	3,000,000
18	CredAgro	Azerbaijan	2,000,000
19	AMRET	Cambodia	2,000,000
20	Agroinvest Serbia	Serbia	1,300,000
			106,700,000

Investment Monitoring: The 20 MFIs:

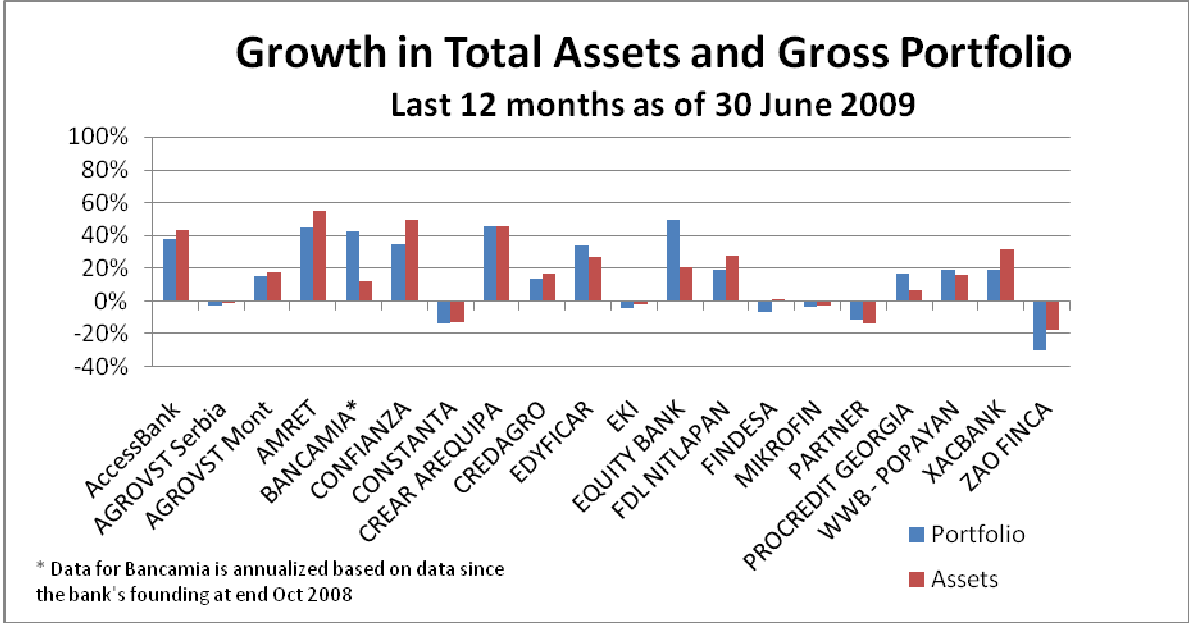
(1) Asset and Portfolio Growth:

For the 12 months ended June 2009, the total assets of MFIs in BOLD 2 MFIs grew by an average of 16% in local currency terms and reached more than USD equivalent 3.8bn by 30, June 2009. The aggregate loan portfolios of the MFIs grew to USD 2.96 billion, equal to 77% of total assets, and in line with historical levels. Almost all MFIs have experienced lower growth rates from 2007 and 2008 – when the average annual asset growth was over 70% -- due in large part to lower liquidity available to them as a result of the financial crisis and increased lending conservatism by the MFIs in light of the negative impacts of the crisis on portfolio quality. It is important to note, however, that there is wide variation across institutions and the majority (13 of the 20) experienced positive growth in portfolio for the last 12 month period.

The strongest growth was experienced by MFIs that are located in countries not overly impacted by the global financial crisis: Amret in Cambodia (55% asset growth and 45% portfolio growth), Confianza and Crear Arequipa in Peru (49% and 45% asset growth and 35% and 45% portfolio growth respectively) and AccessBank in Azerbaijan (43% asset growth and 38% portfolio growth). Importantly, the portfolio quality of all these MFIs remains solid, with PAR30 + restructured well below the average in the portfolio, indicating that these institutions are well-prepared to manage high growth rates. The MFIs operate in very different environments, however: Access Bank has experienced very strong growth since its inception in 2002 as the local economy has been booming and the microfinance sector is still less mature than in many other regions. In both Peru and Cambodia, by contrast, the microfinance market is much more developed, with strong competition, greater specialization among institutions, and an advanced regulatory framework.

Three MFIs experienced a double digit contraction in both assets and portfolio, however: Zao Finca in Russia (-30% in portfolio and -17% in assets) Constanta in Georgia (-13% in both portfolio and assets) and Partner in Bosnia (-11% in portfolio and -14% in assets). In the case of Zao Finca, the global financial crisis has hit Russia particularly hard, and as microentrepreneurs have seen their businesses suffer from the sharp decline in economic activity, they have been borrowing less. While Zao Finca has fared much better than many of its competitors management has tightened lending standards further, and the loan portfolio has declined as a result. At Constanta, assets and portfolio have been declining for several quarters, reflecting a change in market focus from solidarity to individual lending. More recently, however, assets have also declined as management deliberately reduced disbursements in order to free up cash for debt repayments. Please see more detail on Zao Finca and Constanta in Section 6 below.

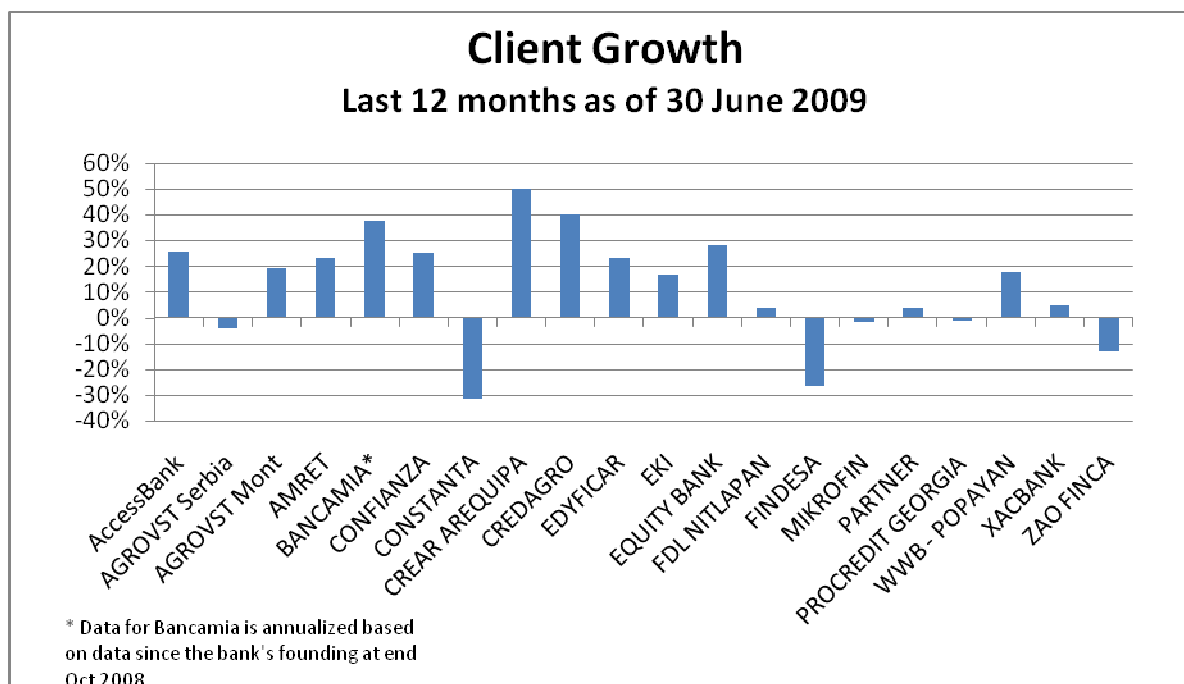
Finally, at Partner, assets have contracted in response to worsening conditions in the Bosnian microfinance market and signs of overindebtedness among clientele. For the past several years, Bosnia has seen rapid growth in its microfinance sector, and extremely high quality portfolio indicators (with PAR30 for the leading institutions usually less than 1%). In recent months, however, delinquency has increased and MFIs are taking a much more conservative stance in their lending. Thus while relative to other regions, portfolio quality remains good (PAR30 + restructured loans for Partner is at 4% of total gross loan portfolio), management tightened lending standards and reduced disbursements.



(2) Client Outreach:

As of 30 June 2009, the MFIs in BOLD 2 were providing loans to over 2.1 million clients, representing a 12% increase in the number of clients served by the MFIs over the past 12 months. Client growth was only slightly lower than portfolio growth, resulting in a relatively stable average loan size, currently at USD 1,946. The average loan size of the individual MFIs ranges from a low of approximately USD 243 at Amret in Cambodia to over USD 4,683 at ProCredit Bank Georgia.

As seen in asset and portfolio growth figures, the majority of the MFIs saw an increase in clients over the past year, though less dramatic than in recent periods. Six MFIs saw a reduction in number of clients however, with three showing double-digit declines: Constanta in Georgia (-31%), Banex in Nicaragua (-27%), and Zao Finca in Russia (-13%). The dramatic decrease at Constanta is related to a significant change in strategy at this MFI over the course of the year due to strong competition from universal banks in consumer lending. Constanta changed its methodology from group to individual lending, and was not able to retain a large portion of its previous group clients despite the creation of a new individual loan product for them. Also, as described above, disbursements were reduced in order for the MFI to meet large debt repayments in the summer. At Banex, and Zao Finca, the sharp decline in clients is attributable to the severe downturns of both the Russian and Nicaraguan economy and over-indebtedness among some of the MFI's clients. Lower loan demand, delinquencies and tighter loan underwriting have therefore resulted in a large decline in overall client numbers.

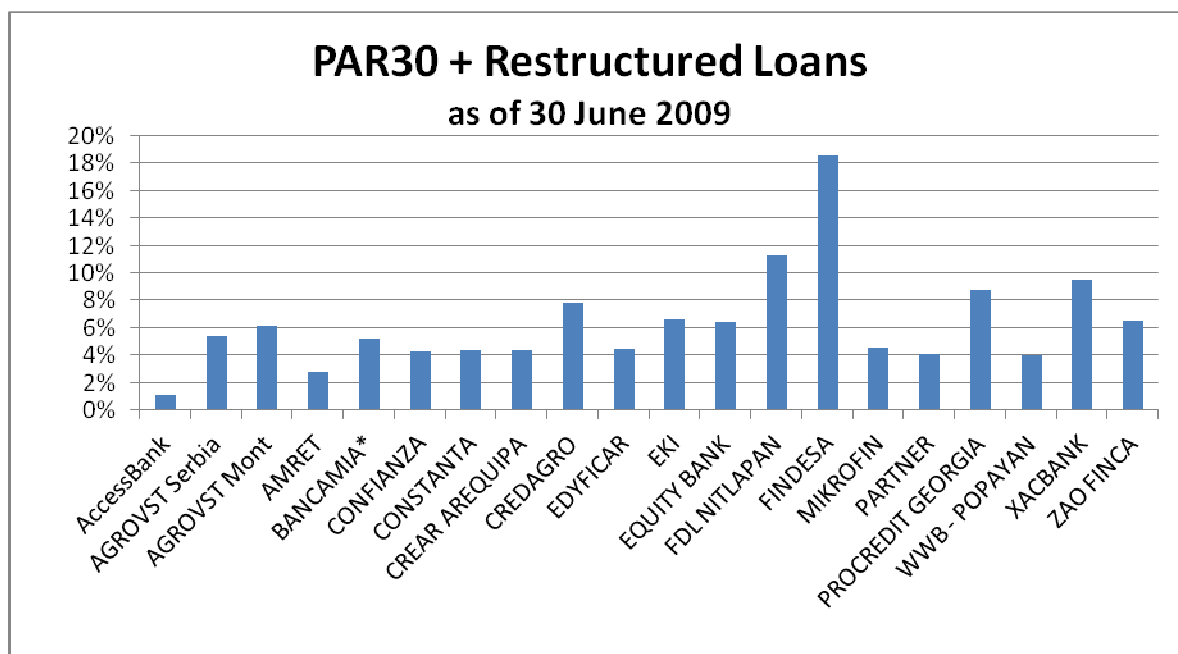


(3) Portfolio quality:

In this newsletter we continue to show a modified portfolio quality measure. This ratio is more conservative than the “PAR30” typically used in the microfinance industry. It measures “portfolio at risk” as the sum of the loans more than 30 days delinquent (PAR 30) plus the amount of restructured and refinanced loans. We feel that this measure controls for the potentially uneven treatment by MFIs of PAR30 and restructured loans.

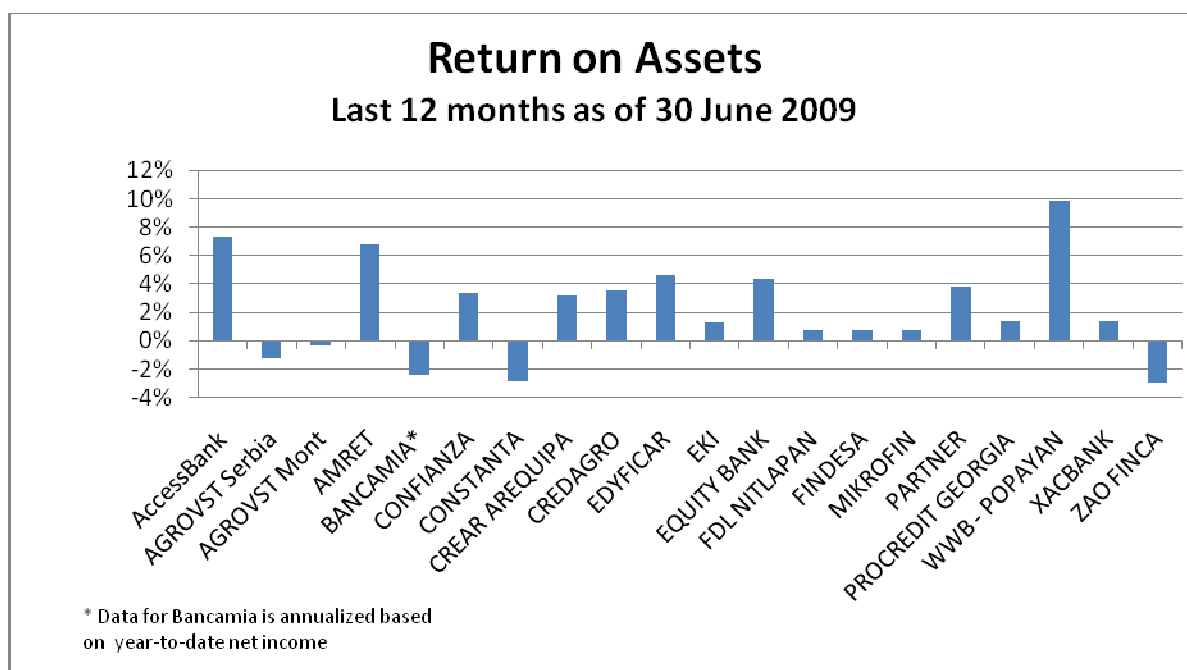
The average portfolio at risk ratio for the MFIs rose to 6.3% as of end-June 2009, more than double the level of 3% in 31 December 2008. This is due in large part to an increase in restructured loans at many MFIs, particularly those located in Nicaragua. Almost all MFIs have seen a deterioration in their portfolio quality in the past several months as the global financial crisis has hit local economies and reduced clients’ repayment capacity. The decline in quality is reflected in the fact that only one MFI (AccessBank) has risk ratios below 2% while there were nine at the time of the last newsletter. Most MFIs continue to have ratios below 5%, however, and in all regions, microfinance players are solidly outperforming mainstream banks. Actual write-offs also remain very low for MFIs in the BOLD2 portfolio, at 1% on average, only slightly higher than Dec 2008’s 0.8%.

The two Nicaraguan MFIs in the portfolio show the highest portfolio at risk: Banex with 18.6% (of which 12.2% is restructured loans) and FDL with 11.3% (of which 4.1% represents restructured loans). As reported in our last newsletter, the increase in portfolio at risk at the Nicaraguan MFIs is due to a number of country-specific factors, including an organized movement in the north of the country to restructure/ not repay debt (the “no pay” movement). We continue to monitor the situation closely and BlueOrchard is proactively joining creditor groups when appropriate. (More detail is provided on these topics in Section 5 below).



(4) Profitability:

On average, the MFIs in BOLD 2 remain profitable, and generated an average 2008 ROA of 2.2% and ROE of 11.3%. Again, there is wide variation among the MFIs in the portfolio: Five institutions show negative returns for the last twelve months, while three MFIs show ROAs above 5%.



Negative results are greatest at Constanta in Georgia (-2.9%), though the figures show an improvement since spring 2009, and Zao Finca (also -2.9%), where the portfolio has deteriorated as a result of the difficult economic climate in Russia. Losses at Zao Finca are attributable mainly to increased provisions against potential losses on the portfolio. Very strong results, on the other hand, were posted by WWB Popayan in Colombia (9.8% ROA

and 26.5% ROE), AccessBank in Azerbaijan (7.3% ROA and 43.1% ROE) and Amret in Cambodia (6.8% ROA and 34.6% ROE).

(5) Global Economic and Political Environment

The global financial crisis has eased significantly since the time of the last newsletter in March, and many developed countries, including the United States, Japan and most parts of the EU, are now thought to have emerged from recession. Stock markets globally have rallied since the spring, many currencies have rebounded from their weak levels, and credit markets have normalized to some extent. Many weaknesses still exist, however, and it is clearly too soon to say whether the recovery will be a strong, lasting one, or rather be followed by a “double dip” recession. Moreover, the impact of the crisis on developing countries continues to be felt through low remittances, low exports, and tight credit. Again, the impact of the crisis varies significantly from region to region and country to country, and we see much stronger negative effects in countries such as Russia and Nicaragua than in, for example, Peru and Azerbaijan.

The global financial crisis led some banks to reduce lending to MFIs and many investors sought to reduce risk in their portfolios. Consequently, lending to MFIs dropped in late 2008 and early 2009. Most Microfinance Investment Vehicles (MIVs) were strapped for cash as investor inflows slowed or halted and took defensive positions with regards to liquidity management. This was a serious situation for MFIs needing to refinance outstanding debt. In other cases it resulted in the curtailing of growth plans. The situation was less severe for those institutions that take deposits and in certain countries where the government and/or local banking sources continued to finance MFIs.

The situation improved by mid-2009 as many private investments planned for late 2008 materialized, providing ample liquidity to MIVs. In addition, new funds, mostly sponsored by development banks have been or are in the process of being created, many of which are not yet fully deployed. Stronger MFIs, such as those represented in the BOLD 2 portfolio, are generally able to refinance their current liabilities and finance projected growth without too much difficulty. However liquidity remains a challenge for some MFIs facing weakened portfolios as a result of the international financial crisis and of investors in the industry becoming more cautious in the financing of Tier II and Tier III institutions.

The following are brief updates of the BOLD 2 countries that have been particularly impacted by the global crisis, or which are undergoing important political and/or microfinance policy changes.

Nicaragua:

In early 2009, the “no pay” movement of borrowers in the Northern provinces seeking to restructure or not to repay their debt to MFIs continued to be active, albeit in a less forceful manner. In 2008, this movement had caused MFIs operating in the affected Northern areas to reschedule significant amounts of their loan portfolios. However, this movement is no longer supported by President Ortega who recently declared that borrowers should negotiate directly with MFIs and that a culture of defaulting on debt will not be allowed. This is a major improvement from his previous position as this movement contributed to deterioration in portfolio quality for most MFIs in Nicaragua throughout 2008. However, there are a few members of parliament that still support the “no pay” group.

In August 2009, the group restarted protests in 7 regions in the North of Nicaragua, seeking political support to approve a new law (“Ley de Moratoria”) that looks to suspend for one year all judicial actions against agricultural and livestock clients. In response, ASOBANP (banking network) and ASOMIF (microfinance network) issued a press release listing the damages

this law could bring to the financial system and economy. The networks also said they will close branches (and therefore all loan disbursements) in regions where they believe their personnel are at risk.

In 2008, real GDP growth slowed to an estimated 2.8% due to the local economy's close links to the US/Western economies through trade, remittances and budget support, its dependence on Chavez's waning generosity and the freezing of foreign aid in protest to the internal political strife. It is expected that the economy will contract by an estimated 3.1% in 2009 (it had contracted 1.1% as of April 2009). The official exchange rate continues to be adjusted daily according to a crawling peg which devaluates the Córdoba against the U.S. dollar at an annual rate of 5%.

Russia:

The economic recession seems to have troughed during the second quarter of 2009 and the risk of a systemic banking crisis has significantly diminished. However, private consumption is likely to remain weak until the last quarter of 2010, limiting recovery prospects. GDP is forecasted to contract by 8% in 2009, and then grow by only 2% to 3% per annum over the medium term. The pace of economic recovery will, however, be highly dependent on oil prices.

Increased oil prices during the second and third quarters crucially bolstered foreign investor confidence and capital inflows. Net capital outflows ended in the second quarter, bringing liquidity back to the domestic market. The rouble stabilized in a range between RUR 30.5-33/USD. Foreign exchange reserves have increased to USD 400 billion, after having dropped by USD 200 billion year-on-year. General expectations are for oil prices to remain above USD 65/bbl. Any further weakness would increase pressure on the Rouble and reduce perspectives for macroeconomic improvements.

The RUR 2.4 trillion (USD 80 billion) bank recapitalization plan announced in July has helped stabilize the sector and restore investor confidence. This plan only concerns banks with assets exceeding RUR 50 billion (USD 1.6 billion). Consolidation and merger transactions are expected among smaller regional players. Rising non-performing loans continue to be an issue. Increasing provisions will negatively impact banks' profitability beyond 2010. Banks will focus on cleaning their balance sheet before renewing domestic credit growth, thereby limiting domestic demand recovery. Domestic demand is set to fall by 16% over 2009.

The collapse in bank lending and, consequently, domestic demand has had an important impact on tax revenues. The government deficit is expected to average 8-9% of GDP in 2009 and 2010. Part of the deficit will be financed out of the two fiscal reserve funds built up on the past oil windfall. Both funds are likely to be depleted by 2012 since they will also be used to recapitalize the banking sector and the public pension system. The Russian government should move back to a net debtor in the medium term.

(6) MFI Updates

This section provides detail on MFIs that are experiencing important changes in their performance, operations, or legal structure.

Agroinvest Serbia² [\[1\]](#)

² Note that the borrower of record in BOLD 2 is in fact Agroinvest Holding, Montenegro, the sole owner of Agroinvest Serbia. The funds from BOLD 2 to this entity, however, were directed entirely to Agroinvest Serbia from the holding company and we therefore report on the operational performance of the subsidiary in Serbia.

From January to August 2009, AgroInvest Fund Serbia's portfolio decreased by 5.9% (in EUR) and the number of clients dropped by 2.6% compared to 8.6% and 1.5% respectively in 2008. The reductions in growth (Loan Portfolio, Total Assets, Active Borrowers), deterioration in portfolio quality (PAR 30 of 5.9%, WO of 1.8% but no restructured loans as of August 2009) and a low profitability levels can be largely explained by three significant factors:

- The change in the interpretation of Serbian regulations that forced AIS to put a hold on its disbursements for nearly four months in 2008 as it readjusted its operations and set up the new partnership with PBB Banka to conform to the new regulations. Operations in 2009 are still impacted by this new methodology,
- The global credit crisis, that has largely affected portfolio quality,
- The sharp depreciation of the Serbian dinar (RSD) over the first quarter 2009, that entailed important FX losses over the first semester 2009 and negatively impacted net income.

In order to mitigate the negative financial impact of the RSD depreciation, AIS's management has increased its interest rates to cover a further depreciation of the RSD and started disbursing loans indexed to EUR in March 2009.

As a consequence, since June 2009, AIS has posted positive net income (EUR 260,000 as of August). In addition, despite an increase of its PAR30, AIS maintained a risk coverage ratio of 110% as of August 2009. Operational and financial outlook for the end of 2009 looks promising and AIS's profitability should keep improving.

Banex (formerly Findesa)

Banex' portfolio quality has been severely impacted by the combination of a weak economy in Nicaragua, the presence of the "no pay" group and the levels of overindebtedness in the market. As of July 2009 PAR30 reached 6.9% (versus 3.9% in December 08 and 2.5% in December 2007) and the restructured and extended portfolio was 14.6% (6.6% in December 2008 and 0.4% in December 2007).

Around 55% of the restructured portfolio is "extended" loans, in which Banex granted borrowers a grace period (on average for 2.5 months) for principal and/or interest payments. These extensions started around April 2008 and have increased due to the "no-pay" movement, a major fire in a major market in Managua in 2008 and a decision to delay the export of meat to the US by a group of farmers due to low prices (Banex, like all MFIs in the country, has a concentration in livestock). PAR30 of these "extended" loans have fluctuated around 6% in the first semester, whereas PAR30 for the restructured portfolio as a whole has ranged between 1 and 5% (2% as of August 2009).

Banex implemented measures to improve portfolio quality including increasing efforts on recuperation and suspending loans in areas where the "no pay" group is present. It is worth noting that all loans in the livestock area (with concentration of arrears) have mortgages as guarantees. Given the significant size of restructured loans in this sector, their performance will continue to be tracked closely.

The deterioration of the portfolio has had an impact on the profitability of the MFI and as of July 2009 last 12 month ROA was 0.0% and cumulative net income year to date was negative USD1.1 million. This is mainly driven by the high levels of provisions the MFI has made. Risk coverage ratio is low, at 55.1% as of July 2009, and the Board has therefore approved a USD3 million capital injection that will be used to create more reserves. Banex expects to receive the money in fall 2009.

Constanta

Constanta reduced its portfolio by 18% during H1 2009 to free up cash to meet sizeable debt obligations during the first two quarters of the year. The bank progressively resumed lending activities in April-May 2009 after it received USD 3 million of debt financing from DWM and Symbiotics. Due to tight local regulatory requirements in terms of capital adequacy ratio and Constanța's significant share of USD portfolio (which carries a higher risk-weighting), the bank still needs to find new equity investors (Tier 1 and/or Tier 2 capital) to finance portfolio above USD 33 million; i.e. up by 15% when compared to June 09 level. Constanța is currently in talks with one potential investor. Unfortunately, expected changes in the shareholding structure, including the introduction of international shareholders, did not materialize as hoped earlier this year due to a disagreement on terms and conditions.

Portfolio quality worsened slightly with PAR 30 at 2.7%, restructured at 1.7% and write-offs of 1.3% as of June 2009. This deterioration is less severe than the industry average and is both a result of the impact of the current financial crisis on clients' incomes and repayment capacity and a consequence of having a smaller portfolio (the denominator of this calculation). Constanța reversed some loan loss provisions during H1 2009 to take into account the decline in portfolio. Loan loss provisions are expected to increase over H2 2009, however, and put some pressure on the bank's performance.

As of June 2009, year to date net income was positive at USD 356,440 (5.3% of equity) thanks to reversals of loan loss provisions and a reduction of operating expenses. Constanța's management forecasts a net income of about USD 600,000 for the full year 2009.

CredAgro

Credagro is one of the large Azeri MFIs with a loan portfolio of USD 50 million and 21 branches. It is fully owned by ACDI/VOCA. In the summer of 2008, a fraud was discovered by the CEO. Following the dismissal of the HR Manager, Internal Auditor and Chief Accountant in the summer of 2008 several Branch Managers were dismissed as well and in October the size of the fraud was quite clear to Credagro's management (around USD 1.5 million). A series of measures were taken to strengthen Credagro's structure and controls and clean the fraudulent loans. The new CFO, Internal Controller (who reports to the CEO), Deputy CEO (acting COO), IA and Internal Auditor have been hired and a Credit Department has been established (8 people). A new internal auditor shall be hired soon. The IFC is implementing technical assistance on governance and the creation of a proper Risk Management department. Credagro decided to focus on microcredit since SME loans (apart from fraudulent loans) account for a large portion of the delinquencies. One branch has stopped lending and 4 branches only disburse loans to repeat clients through a centralized credit committee at the central office until the situation is clarified.

Today, PAR30 is around USD 3.5 million (or 6.5% of the gross loan portfolio) out of which approximately USD 1.5 million is linked to fraudulent loans (3%) and the rest to weak procedures for bigger loans. PAR30 might reach 10 – 12% in the following months due to contamination of the portfolio, but management's target is to reduce it to 6% by the end of 2009.

Credagro is provisioning at 100% of PAR30 which affects its profitability and despite showing strong last 12 months figures year to date net income is slightly negative. The institution is relatively cash rich at the moment and does not need additional funding.

Edyficar

In September CARE and Banco de Crédito del Perú announced an agreement has been reached for Banco de Crédito del Perú, Peru's oldest and largest financial institution, to acquire CARE's majority stake in Financiera EDYFICAR. According to the press release, the agreement will mean no changes to EDYFICAR's business. EDYFICAR will continue as an independent entity, preserving its business model, its brand and personnel. It will continue to provide financial services to the same lower-income segment of the population of Peru.

The acquisition reflects Banco de Crédito del Perú's strategy to lead all segments of retail banking in Peru. It is also in line with its commitment to contribute to increasing access to banking services in the country. EDYFICAR and Banco de Crédito del Perú's stated that their loan portfolios are complementary, so there will be no changes either for Banco de Crédito del Perú's strategy or its loan offers for small companies. Closing of the transaction is subject to customary closing conditions, including receipt of regulatory approvals, and is expected to occur in the coming weeks.

Zao Finca

ZAO Finca was negatively impacted by the financial crisis, although to a lesser extent than other financial institutions in the country. This may be explained by the MFI's tight credit procedures and conservative policy in terms of loan restructuring. Total portfolio went down by 56% over the first eight months of 2009 to USD 19.4 million. The number of clients decreased by 21% to 9,570 clients during the same period of time. This drop reflected the weak demand nationwide as well as ZAO Finca's strong focus on credit quality. Client and portfolio are expected to stabilize during the fourth quarter of the year to reach 8,800 clients and USD 19 million in loan portfolio as at December 2009.

Non performing loan rates are lower than the industry average, with PAR 30 at 5%, reprogrammed loans at 0.7% and written off loans at 4.1% as at August 2009. Write offs are expected to be significant for the year 2009 at about USD 1 million, i.e. 5.3%, whilst PAR 30 would consequently decrease down to 3%.

ZAO Finca reported a financial loss of USD 1.1 million as at August 2009 (25% of equity) due to loan loss provisions of USD 1 million and limited financial revenues. Tier 1 capital of USD 4 million is reinforced by Finca International's subordinated debt of USD 3 million. Liquidity is high at 23% of total assets at USD 6 million. This provides a cushion for future debt repayments and contributes to maintain a long position in USD.

Looking Ahead

Despite recent improvements in the global macroeconomic outlook, we continue to expect a general slowdown in MFI growth as well as potential increases in portfolio at risk numbers due to the magnitude of the crisis and some lagging impacts on developing countries. BlueOrchard expects BOLD 2 participating MFIs to generally perform better than their peers, given that they are market leaders in their countries and aware of the challenges to come. We will continue to keep investors apprised of any material changes to the institutions in the BOLD 2 portfolio or the environments in which they operate, and remain available to answer any questions you may have.

Sincerely yours,

The BlueOrchard Team

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