

# RatingsDirect®

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## Banco del Estado de Chile

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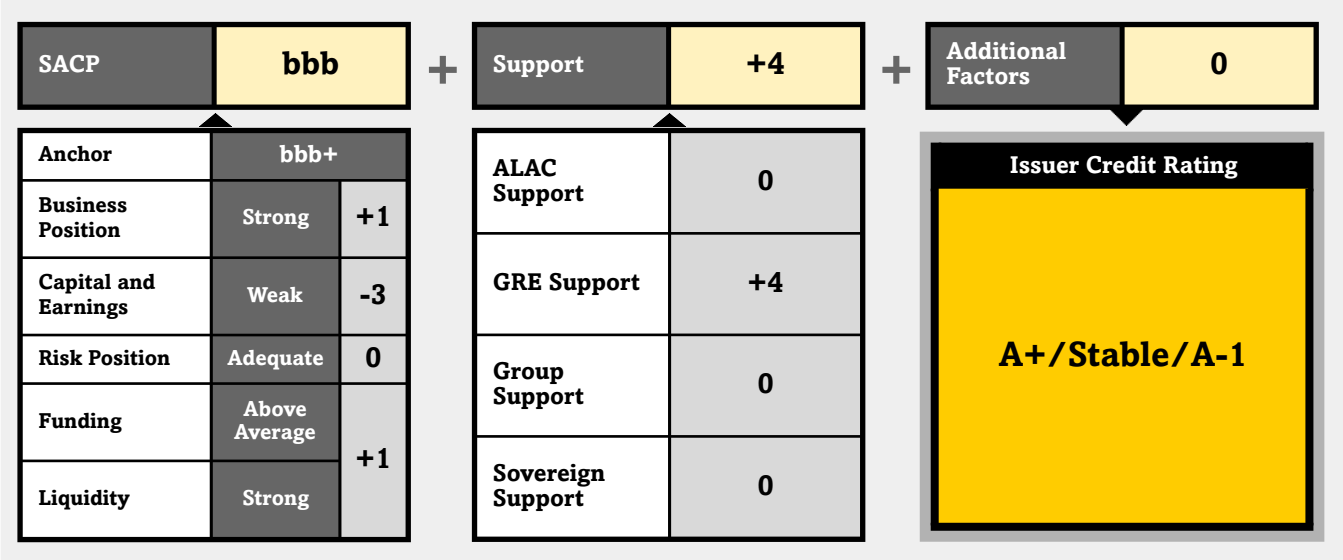
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# Banco del Estado de Chile



## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>Extremely high likelihood of extraordinary support from the Chilean government;</li> <li>Strong business position as the third-largest and the only public bank in Chile; and</li> <li>Above-average and diversified funding, given its access to a large and stable deposit base.</li> </ul>	<ul style="list-style-type: none"> <li>Weak capitalization metrics, but we expect capitalization to increase as part of the Chilean government's initiatives to tackle social unrest in the country and in light of the implementation of the new banking law;</li> <li>Expected worsening in asset quality metrics because of its countercyclical role and mandate to support small and medium enterprises (SMEs); and</li> <li>Although improving, weaker-than-average profitability (including the effect of a higher tax burden compared to peers).</li> </ul>

**Outlook: Stable**

The stable outlook on Banco del Estado de Chile (Banco Estado) for the next 24 months reflects that on the sovereign, and our expectation that the bank will maintain its strong market position and public policy role. Given that we expect an extremely high likelihood of government support, our ratings on Banco Estado will move in tandem with those on the sovereign, as long as the bank maintains its stand-alone credit profile (SACP) at 'bb-' or above (the SACP is currently 'bbb').

**Downside scenario**

We could lower the ratings on the bank in the next 24 months if we downgrade the sovereign.

**Upside scenario**

We could raise the ratings on Banco Estado in the next 24 months if we take a similar action on the sovereign.

**Rationale**

The ratings on Banco Estado reflect its sound business position as the country's only state-owned bank, and its business scale and stability stemming from its status as the country's third-largest bank in terms of total loans and the largest in terms of deposits. The weak capital and earnings profile is a credit shortcoming for the bank, although forecast to improve in the upcoming quarters. In our capital assessment, we use our risk-adjusted capital (RAC) ratio, which incorporates the effect of the deduction of deferred tax assets from the bank's capital. We consider Banco Estado to have an adequate risk profile with plain vanilla operations focused on lending, and asset quality metrics and a business mix that fit with its public bank role and mandate of expanding banking services to the lower- and middle-income slices of the population. We consider Banco Estado to have an above-average funding profile thanks to a high share of stable deposits and strong liquidity.

The credit quality of the bank also incorporates our view that there's an extremely high likelihood that Chile (foreign currency: A+/Stable/A-1; local currency: AA-/Stable/A-1+) would provide extraordinary and timely support to the bank in the event of financial distress. Because of this support, the long-term issuer credit rating on the bank is four notches higher than its SACP, which is currently 'bbb'. Refer to the Support section for further details.

In December 2019, Chile's Ministry of Finance announced a set of countercyclical measures to respond to social needs, protect employment, and foster economic recovery. This included the capitalization of \$500 million in Banco Estado to support SMEs, ensure the continuity of the payment chain of companies, and fund investments. In the individual segment, the bank would further facilitate the access to housing to middle income segments and beneficiaries of housing subsidies, and strengthen the granting of loans to ease the burden and facilitate recovery of companies and families after social unrest. We expect this to result in Banco Estado's higher-than-industry-average growth in its loan portfolio, as well as potentially higher delinquency levels, provisions, and losses that would be absorbed by increased capital from the mentioned capital injection from the government and the capitalization of part of results.

### Anchor: 'bbb+' for banks operating in Chile

Our bank criteria use our Banking Industry Country Risk Assessment's (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Chile, where Banco Estado mainly operates, is 'bbb+', the strongest anchor in Latin America.

Chile's resilient economy reflects many years of sound and consistent economic policies, with a strong fiscal performance, low inflation, and a healthy financial system. However, the country's GDP per capita is still lower than those of more developed BICRA peer countries; about \$16,000 in 2018. Recent massive public demonstrations in Chile are likely to have a negative and transitory short-term impact on both GDP growth and public finances. In addition, growth would be influenced by global volatility related to the trade war between the U.S. and China that could affect copper prices. In the next few months, the economic slowdown and the impact of unrest would result in a higher demand for working capital credit lines to normalize operations, potential increase in refinancing of loans, and deterioration in asset quality metrics. However, in the next few years, the higher social spending and other government initiatives--such as the rollback of transportation rate hikes, more generous pension payments, and lifting of minimum wages--should improve the population's purchasing power and ease its financial burden.

In terms of industry risk, we believe Chile has a comprehensive regulatory framework and ample supervisory coverage. In January 2019, Chile enacted the new banking law that aims to align with Basel III principles, gradually implement the principles in the next few years, and increase levels of required capital. In order to further strengthen the financial regulator's governance and autonomy, the Comisión para el Mercado Financiero, a new regulatory body (created in 2017), took over the supervision of the banking and insurance sectors. We currently don't believe the new law will affect the likelihood of government support to banks, but we'll monitor potential changes in the resolution framework. The banking sector has generated adequate profitability for the past five years, and the absence of significant market distortions results in healthy competitive dynamics. We also believe Chile's financial system has an adequate funding mix consisting of deposits, domestically issued debt, and external debt (banks and capital markets). However, institutional deposits have historically played a significant role, especially for mid-size and smaller banks.

**Table 1**

Banco del Estado de Chile Key Figures					
	--Year-ended Dec. 31--				
(Mil. CLP)	2019*	2018	2017	2016	2015
Adjusted assets	41,330,093	40,023,221	37,722,252	34,651,509	32,415,778
Customer loans (gross)	25,065,604	23,934,547	22,531,470	20,745,293	19,071,559
Adjusted common equity	869,896	848,373	821,322	879,259	955,272
Operating revenues	1,199,384	1,457,492	1,278,285	1,243,492	1,116,889
Noninterest expenses	624,818	805,178	771,697	718,482	663,202
Core earnings	217,374	243,583	176,622	205,254	168,894

\*Data as of Sept. 30. CLP--Chilean peso.

### Business position: Only state-owned bank in Chile, with a sound market presence in segments relevant for the government

We assess Banco Estado as having a strong business profile given its position as the only state-owned bank. We also incorporate its position as the country's third-largest bank in terms of total loans and the largest in terms of deposits,

with market shares of about 14.2% and 20.1%, respectively, as of the end of September 2019. Its scale of operations and broad customer base give Banco Estado significant business stability, making operations less vulnerable to adverse operating conditions than the industry risk score indicates.

Banco Estado follows the government's guidelines for facilitating access to banking products, including transactional accounts, for the low-income population. To comply with the guidelines, Banco Estado has a large presence in the country, with 519 branches and ServiEstado (service centers), 28,700 remote service centers (Caja Vecina), and 2,432 ATMs as of September 2019. Additionally, as of the same date, about 11.8 million customers use the bank's CuentaRut card, a debit card that cardholders can use for money transfers or for retail purchases. As a result, Banco Estado controls 62% of the domestic debit card market, a significant achievement in offering banking services to Chile's wider population.

Retail banking represents about half of the bank's loan portfolio, consisting of mortgages, consumer loans, and credit cards. Commercial banking represents the other half and includes middle-market companies--the bank gained market share in this segment from 2014-2017 but it slightly declined in 2018 and part of 2019 as the economy recovered. However, we expect the bank to execute anticyclical measures as mandated by the government after the social unrest that began in Chile this October, supported by a capital injection of \$500 million and capitalization of results (refer to the Rationale section).

In addition, the bank will continue facilitating credit access for the low-income population and financial inclusion through its remote service centers, digitalization of the CuentasRut debit card, and its continued presence in remote areas. We also believe the bank will further expand loans to middle-market companies, with higher coverage than private banks, and think it will help foster a savings culture in the country. The bank plans to further focus on gains in efficiency by improving cross selling (especially to the emerging segments), margins, and funding mix and costs (with more participation in demand deposits).

**Table 2**

Banco del Estado de Chile Business Position					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Loan market share in country of domicile	14.2	14.5	15.3	14.7	14.2
Deposit market share in country of domicile	20.13	20.97	21.99	20.28	20.09
Total revenues from business line (currency in millions)	1,199,384	1,457,492	1,278,285	1,243,492	1,116,889
Commercial banking/total revenues from business line	18.53	19.98	21.97	22.83	21.07
Retail banking/total revenues from business line	60.87	69.87	67.38	62.31	59.08
Commercial & retail banking/total revenues from business line	79.40	89.85	89.35	85.14	80.16
Other revenues/total revenues from business line	20.60	10.15	10.65	14.86	19.84
Return on average common equity	12.13	10.71	8.25	10.48	9.02

\*Data as of Sept. 30.

### Capital and earnings: Capitalization metrics improving in different stages

The bank's capitalization levels are one of its credit weaknesses. This is because our calculation of its capitalization metrics (RAC, according to our methodology that's aligned with Basel III principles) incorporates the impact of high

deferred tax assets. This is due to the bank's high tax burden (as a government-owned entity, it pays 40% in addition to the regular tax rate that other banks pay) and because it can't discount the loan-loss provisions of the tax payment until the loan is written off, amid its high share of mortgages that have low charge-offs.

Over the next few quarters, we expect capital metrics to somewhat improve because of the recently approved \$500 million capital injection. This capitalization would allow Banco Estado to finance the growth of its loan portfolio and to absorb associated credit losses related to assisting segments affected by social unrest.

Therefore, our projected RAC ratio before diversification is now about 4% for the next 18 months. This forecast incorporates:

- Slower GDP growth in Chile in 2019-2020, returning to average levels;
- Loan portfolio growth of 5% in 2019 and 8%-9% in 2020 (on a nominal basis) taking into account the bank's countercyclical role in the economy;
- Margins at about 2.9%-3.0%, influenced by higher expected inflation compared to 2018. This is in light of Chilean banks' net exposure to indexed currency assets (in Unidades de Fomento [UF]), boosting revenues in a context of higher inflation rates;
- Weaker asset quality metrics given the increased access to banking in segments that were affected by social unrest and increased unemployment;
- Dividend payout of 100% in 2019 and returning to 50% in 2020; and
- Damage to branches and ATMs to be mainly covered by insurance.

Banco Estado's quality of capital suffers from the high share of deferred tax assets (DTA) that account for 57% of total adjusted common equity as of September 2019. In November 2019, the Comisión del Mercado Financiero (CMF) published a consultation on calculating regulatory capital, in which it suggested to the Ministry of Finance to guarantee DTAs related to the higher tax burden. This could have positively affect capitalization metrics once approved, but we don't yet incorporate it into our projections.

On the other hand, earnings--although modest partly due to the high tax burden--have been steady amid adequate diversification. Net interest income represented 68% of earnings on average over the last three fiscal years, followed by fee income (20%) and market-sensitive income and other income (12%). We expect profitability to continue improving, but to be influenced by the bank's focus on increasing its presence in the small company and low-income segments.

**Table 3**

Banco del Estado de Chile Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Tier 1 capital ratio	6.64	6.78	6.99	7.03	7.30
S&P Global Ratings' RAC ratio before diversification	N/A	3.21	N/A	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	2.66	N/A	N/A	N/A
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00	100.00
Net interest income/operating revenues	68.43	68.20	69.34	67.10	68.15

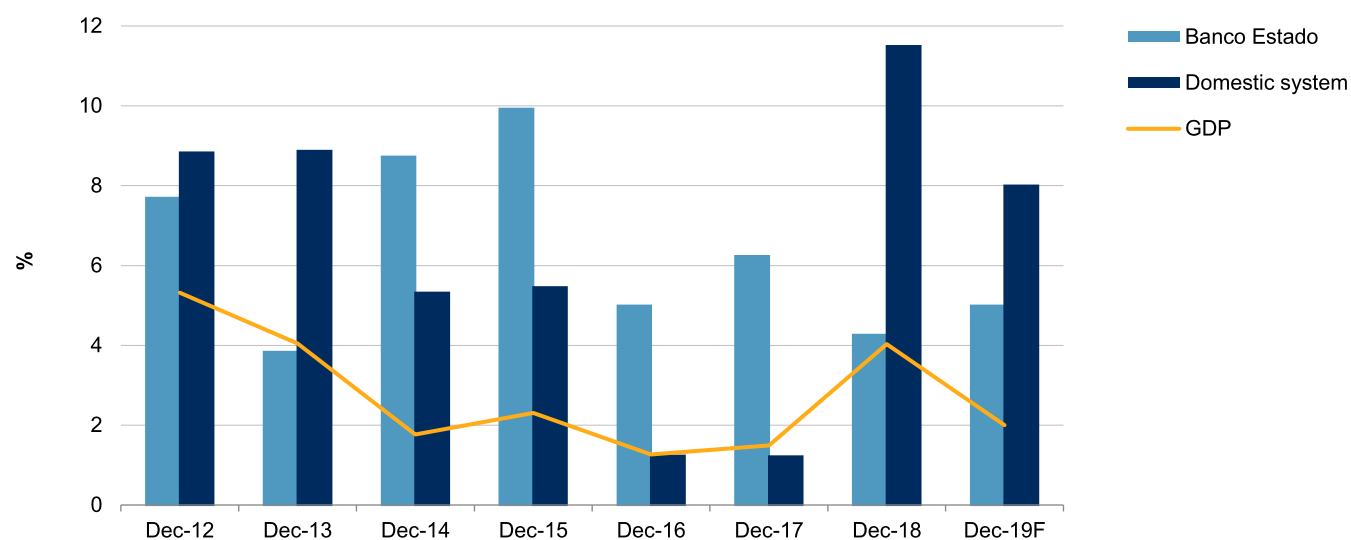
**Table 3**

Banco del Estado de Chile Capital And Earnings (cont.)					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Fee income/operating revenues	20.66	20.99	20.36	19.12	17.70
Market-sensitive income/operating revenues	10.03	9.34	9.43	12.69	12.86
Noninterest expenses/operating revenues	52.09	55.24	60.37	57.78	59.38
Preprovision operating income/average assets	1.88	1.67	1.39	1.56	1.50
Core earnings/average managed assets	0.71	0.62	0.49	0.61	0.56

\*Data as of Sept. 30. N/A--Not applicable.

**Chart 1****Real Credit Growth Versus GDP**

Domestic system excludes Banco Estado



F--Forecast. Source: S&P Global Ratings.

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### Risk position: Focus on lending, with portfolio diversified by economic sector, business segment, and single-name exposure

We consider Banco Estado to have a satisfactory risk profile thanks to its focus on plain vanilla lending operations, and its diversified loan portfolio among economic sectors, business segments, and single-name exposures.

The bank's asset quality has been weaker than the industry average given that it's exposed to the low-income residential mortgage segment. The bank shifted its focus to the middle-income segment for its mortgages, resulting in a lower amount of mortgages guaranteed by the government. The government guaranteed about 23.5% of the bank's mortgages at the end of September 2019, generally stable from 2015 but down from 36% at the end of December

2012. As of September 2019, nonperforming loans (90-day NPLs) were about 3.5% of Banco Estado's total loans, compared with the industry average of about 2.0%. We expect asset quality metrics to worsen due to the increased exposure to SMEs and individuals as part of the government initiatives to support segments affected by the recent social unrest.

Banco Estado also has one of the highest levels of additional provisions among its domestic peers; higher than the regulatory requirement. If we add these provisions to the required provisions, the coverage for NPLs is about 141% as of September 2019.

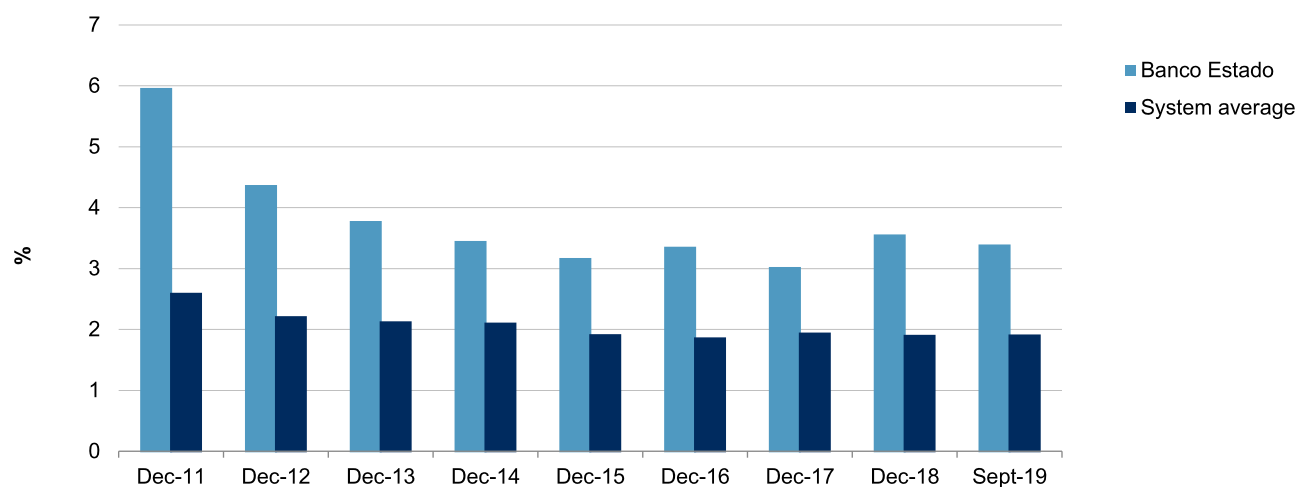
**Table 4**

<b>Banco del Estado de Chile Risk Position</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2019*</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Growth in customer loans	6.30	6.23	8.61	8.78	14.79
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	21.03	N/A	N/A	N/A
Total managed assets/adjusted common equity (x)	47.69	47.41	46.13	39.56	34.07
New loan loss provisions/average customer loans	0.99	1.00	0.86	1.05	0.82
Net charge-offs/average customer loans	0.70	0.72	0.58	0.42	0.34
Gross nonperforming assets/customer loans + other real estate owned	3.50	3.65	3.10	3.44	3.09
Loan loss reserves/gross nonperforming assets	85.68	79.57	97.92	87.75	90.44

\*Data as of Sept. 30. N/A--Not applicable.

**Chart 2****NPLs Evolution**

Banco Estado Versus Banking System



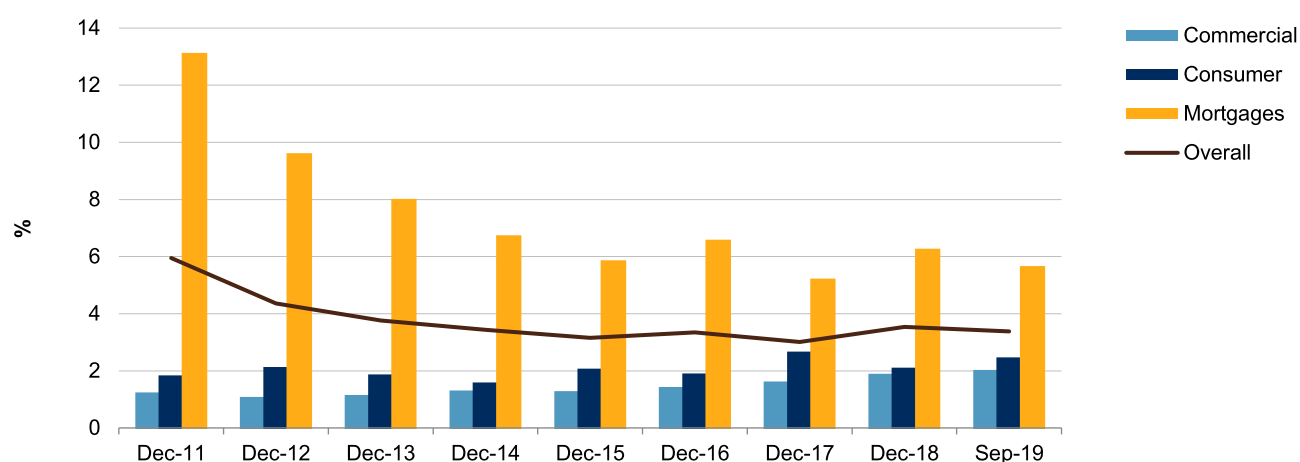
Source: SBIF (Superintendencia de Bancos e Instituciones Financieras).

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Chart 3

## NPLs Evolution By Lending Segment



Source: SBIF (Superintendencia de Bancos e Instituciones Financieras).

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### Funding and liquidity: Above-average funding structure and strong liquidity compared to peers

We view Banco Estado's funding as above average. The bank's nationwide distribution network and strong market position result in the largest deposit base in Chile: a competitive advantage given this funding's stability and its lower cost than other funding sources. As of September 2019, Banco Estado had 20.1% of the system's total deposits, and customer deposits represented about 72% of the bank's funding base. As of the same date, Banco Estado's stable funding ratio was 116%, and has averaged 119% for the past three years. Additionally, the bank sources about 15% of total liabilities from the government either as payment of government employee salaries or as payment to government service providers. The other main funding sources are bonds (senior and subordinated) and bank loans, which account for about 27% of the funding base. Repos make up the remaining 1%. Banco Estado has access to the domestic and international capital markets and to deposits through its branch based in New York, and has access to the central bank's funding if needed.

Banco Estado enjoys high levels of liquidity, as seen in its large portfolio of liquid assets, which include mainly cash and securities from domestic banks and the central bank. The bank's broad liquid assets to short-term wholesale funding ratio is high, almost 3.6x at the end of this September, compared with the average of 3.5x for the past three years, an average that's better than that of the Chilean banking system. The bank has manageable debt maturities in the upcoming quarters.

Table 5

Banco del Estado de Chile Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Core deposits/funding base	71.51	73.28	75.83	74.38	75.48
Customer loans (net)/customer deposits	92.68	87.08	83.92	86.30	83.19

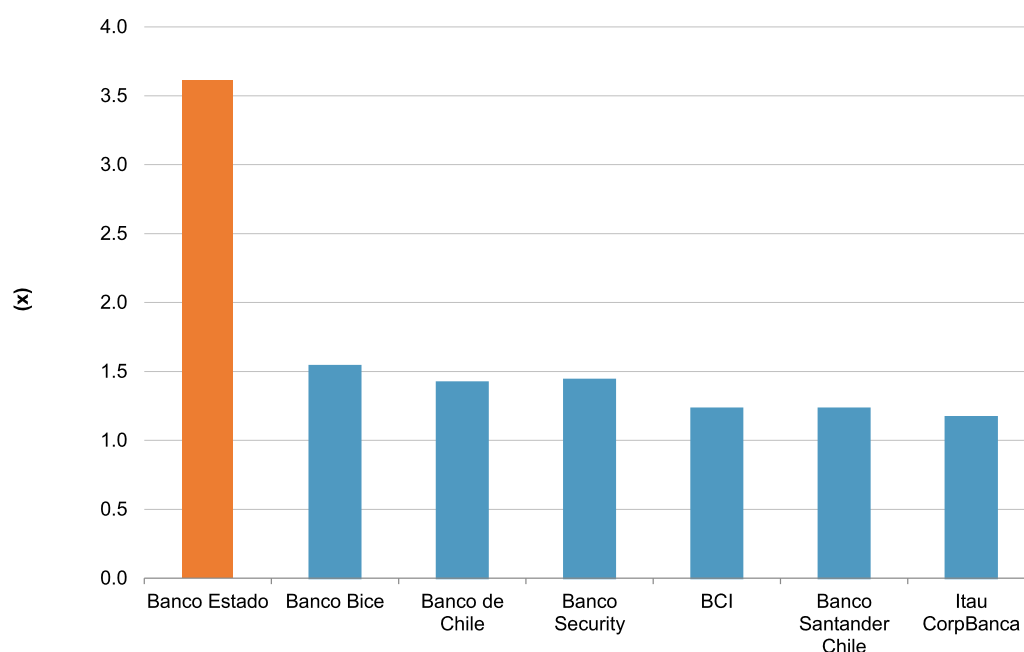
**Table 5**

<b>Banco del Estado de Chile Funding And Liquidity (cont.)</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2019*</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Long-term funding ratio	93.31	92.67	92.76	91.33	94.05
Stable funding ratio	115.96	119.79	121.79	116.85	122.21
Short-term wholesale funding/funding base	6.98	7.64	7.55	9.07	6.22
Broad liquid assets/short-term wholesale funding (x)	3.61	3.58	3.80	3.04	4.50
Net broad liquid assets/short-term customer deposits	25.59	27.22	32.56	32.92	38.91
Short-term wholesale funding/total wholesale funding	24.51	28.58	31.23	35.39	25.37
Narrow liquid assets/3-month wholesale funding (x)	8.12	5.11	8.30	4.97	7.63

\*Data as of Sept. 30.

**Chart 4****Broad Liquid Assets To Short-Term Wholesale Funding**

As of September 2019



Source: S&P Global Ratings.

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**Support:**

The credit quality of the bank also incorporates our view that there's an extremely high likelihood that Chile would provide extraordinary and timely support to the bank in the event of financial distress.

According to our criteria for government-related entities (GREs), we base our view of this support on our assessment

of Banco Estado's very important role as a vehicle in promoting the low-income population's use of banking products and access to home ownership. We also account for the bank's integral link with the Chilean government, which fully owns the bank. Banco Estado and the government are integrally linked in terms of management, strategic, and financial monitoring; coordination of debt issuance; and the bank's public policy role. Because of these factors, we believe that there's an extremely high likelihood of support from Chile.

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
<b>3</b>	a-	a-	bbb+	<b>bbb+</b>	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

### Ratings Detail (As Of December 17, 2019)\*

#### Banco del Estado de Chile

Issuer Credit Rating

A+/Stable/A-1

## Ratings Detail (As Of December 17, 2019)\*(cont.)

Senior Unsecured		A+
<b>Issuer Credit Ratings History</b>		
14-Jul-2017	<i>Foreign Currency</i>	A+/Stable/A-1
27-Jan-2017		AA-/Negative/A-1+
27-Dec-2012		AA-/Stable/A-1+
14-Jul-2017	<i>Local Currency</i>	A+/Stable/A-1
27-Jan-2017		AA-/Negative/A-1+
06-Aug-2015		AA-/Stable/A-1+
<b>Sovereign Rating</b>		
Chile		
	<i>Foreign Currency</i>	A+/Stable/A-1
	<i>Local Currency</i>	AA-/Stable/A-1+
<b>Related Entities</b>		
<b>Banco del Estado de Chile Sucursal New York</b>		
Issuer Credit Rating		A+/Stable/A-1
Short-Term Debt		A-1

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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