

## Bank Hapoalim B.M.

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### Table Of Contents

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Credit Highlights

Outlook

Key Metrics

Anchor: 'bbb+' For Banks Operating In Israel

Business Position: One Of The Largest Banking Groups In Israel

Capital And Earnings: Recovered Profitability Will Sustain Capitalization

Risk Position: Concentrated Loan Book

Funding And Liquidity: Diversified Funding Base And Good Liquidity

Support: One Notch Of Uplift For Government Support

Environmental, Social, And Governance

Hybrids

Key Statistics

Related Criteria

# Bank Hapoalim B.M.

SACP	a-	+	Support	+1	+	Additional Factors	0
Anchor	bbb+		ALAC Support	0		<b>Issuer Credit Rating</b>  <b>A/Stable/A-1</b>	
Business Position	Strong	+1	GRE Support	0			
Capital and Earnings	Strong	+1	Group Support	0			
Risk Position	Moderate	-1	Sovereign Support	+1			
Funding	Average	0					
Liquidity	Adequate						

## Credit Highlights

### Overview

#### Key strengths

Market leader in Israel, with a strong presence in all key business lines.

Large capital cushion.

Large domestic customer deposit base that underpins good funding and liquidity metrics.

#### Key risks

High concentration in the real estate sector.

Limited ability to diversify or raise fees.

Regulatory attempts to limit market share.

**The Israeli economy's resilient performance supports BNHP's creditworthiness.** Our expectation of solid GDP growth of 6.5% in 2021 and 4% in 2022, after a limited contraction of 2.6% in 2020, will help Bank Hapoalim B.M.'s (BNHP's) profitability to recover after the COVID-19-related impact. Specifically, we expect strong lending expansion and growth in fee income to support revenues while economic recovery will help contain the cost of risk.

**Strong provisioning efforts in late 2019 and 2020 will help contain the impact on the bottom line.** We anticipate a moderate rise in the nonperforming loan (NPL) ratio--to about 1.3%-1.4% of total loans in 2023 from a low 1.2% as of Sept. 30, 2021. We expect credit losses to be exceptionally low in 2021, and then normalize to 20-25 basis points (bps), in line with the system average. In this context, we forecast that BNHP's risk-adjusted capital (RAC) ratio will be about 10.5%-11% in 2023, compared with 11.2% as of December 2020.

**Higher concentration will continue to constrain the ratings.** Our ratings factor in BNHP's higher-than-international peer concentration, reflecting its geographical focus on Israel, the local economy's relatively concentrated nature, and sensitivity to tail risks associated with high real estate exposure.

**Large and granular deposit base supports its funding profile.** In addition, we believe the bank's large stock of liquid assets is sufficient to comfortably cover its liquidity needs, thus reducing its reliance on short-term wholesale funding.

**Government support will continue to benefit the ratings.** We factor into our ratings our view that Israel (AA-/Stable/A-1+) would provide extraordinary support to the bank in the event of financial distress.

**Outlook: Stable**

The stable outlook on BNHP reflects our view that the bank will be able to maintain strong capitalization and grow its new lending on the back of improving economic conditions in Israel over the next 24 months. The ratings on the bank also reflect our view that the bank's business, financial, and risk profiles will remain stable over the forecast horizon. We expect the bank's RAC ratio to remain sustainably above 10% over the next two years, with asset quality metrics remaining broadly in line with the system average.

**Downside scenario**

Rating pressure could emerge if the Israeli economy, particularly the real estate sector, markedly deteriorated. Such weakening might be triggered by higher-than-expected economic stress amid the COVID-19 pandemic, abrupt readjustment of the local real estate market, or a pronounced escalation in local geopolitical turbulence.

**Upside scenario**

Although unlikely during our two-year outlook period, an upgrade could happen if BNHP materially improved its capital policy or risk profile.

**Key Metrics****Bank Hapoalim B.M. Key Ratios And Forecasts**

	--Fiscal year ended Dec. 31 --				
(%)	2019a	2020a	2021f	2022f	2023f
Growth in operating revenue	-3.4	-1.1	7.0-8.6	1.9-2.3	2.6-3.2
Growth in customer loans	3.8	3.5	10.8-13.2	3.6-4.4	3.6-4.4
Net interest income/average earning assets (NIM)	2.6	2.3	2.3-2.5	2.3-2.5	2.3-2.5
Cost to income ratio	57.0	57.3	54.9-57.7	54.1-56.9	53.7-56.4
Return on average common equity	4.8	5.3	10.5-12.1	8.1-9.4	7.8-9.1
Return on assets	0.4	0.4	0.7-0.9	0.6-0.7	0.6-0.7
Gross nonperforming assets/customer loans	1.8	1.5	1.5-1.7	1.4-1.6	1.3-1.4
Risk-adjusted capital ratio	11.3	11.2	10.4-10.9	10.4-11.0	10.4-10.9

All figures are S&P Global Ratings-adjusted. a--Actual. e--Estimate. f--Forecast. NIM--Net interest margin.

**Anchor: 'bbb+' For Banks Operating In Israel**

We use our 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 Israel is 'bbb+'.

We think that the Israeli economy is likely to rebound by 6.5% in 2021, after a decline in GDP by 2.6% in 2020. A sizable support package to the private sector pressured the government's fiscal balance and we expect government debt to increase to 72.8% in 2021. One of our key assumptions is that the new government will contain public debt and so ease pressure on the economy.

The support measures provided to the private sector and the banking system have helped to contain pandemic-related financial damage. We expect economic recovery to be supported by ongoing demand for credit, mostly from business- and real-estate-related segments, especially mortgages. After a few years of slower growth, residential real estate prices are accelerating, fueled by growing demand from households and investors. We note banks' growing exposure to the residential property market, either through mortgage lending or financing construction projects. While current indicators suggest that the level of risk in this segment is manageable, we are mindful that this could change if house prices continue to escalate, triggering growing imbalances. We could see problem loans emerge in banks' balance sheets in the near future as support measures wind down, but they should be non-material and not challenge banks' capital positions. We think most problem loans will come from SME lending exposures and we might see higher loss provisioning and more write downs in unsecured retail lending. In 2021, we expect banks to release the precautionary credit loss provisions they made in 2020 before credit losses return to more normalized levels of 0.2%-0.3% in 2022-2023. One of the key risks to our assumption is pandemic risks resurfacing, undermining recovery and reintroducing economic uncertainty.

At the same time, Israel's ongoing exposure to geopolitical and domestic security risks renders it vulnerable to shocks.

The pandemic has hit banking sector profitability, but has not weakened its fundamental strengths. The banks are well capitalized, liquid, and have sound funding bases comprising domestic deposits. Regulatory oversight is prudent and has led banks to reduce their most risky exposures over the past decade and further tighten their lending standards. Macroprudential measures applied to mortgage lending have reduced banks' exposure to risks from the booming housing market, in our view.

We expect more nonbank players to enter the credit market and customers to have greater control of their personal financial information over the next few years as the Bank of Israel (BoI) promotes competition and technological adaptation. The banks are adjusting to the evolving operating landscape. They are becoming more efficient and we think they are well equipped to handle digitalization challenges. We do not therefore view attempts to spur competition in retail lending and the potential entrance of new players as materially undermining the sector's profitability in the near term. Nevertheless, some differences exist between the various players and we think smaller players with less diversified revenues might be more challenged by the effects of increasing competition and evolving customer needs, unless they adapt quickly.

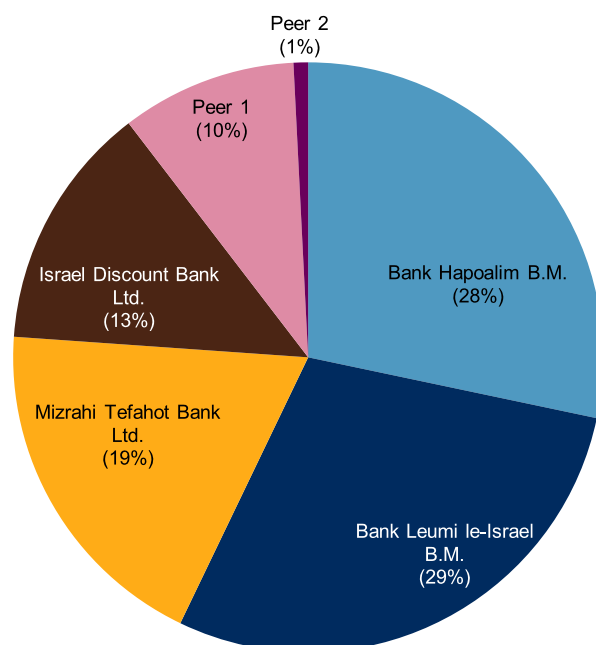
## **Business Position: One Of The Largest Banking Groups In Israel**

BNHP benefits from its leading position in most of the segments of Israeli market.

**Chart 1**

**Bank Hapoalim B.M Is One Of The Leading Banks In Israel**

Domestic deposits market share



Peer 1 and Peer 2 are domestic peers. Data as of Sept. 2021. Source: S&P Global Ratings.

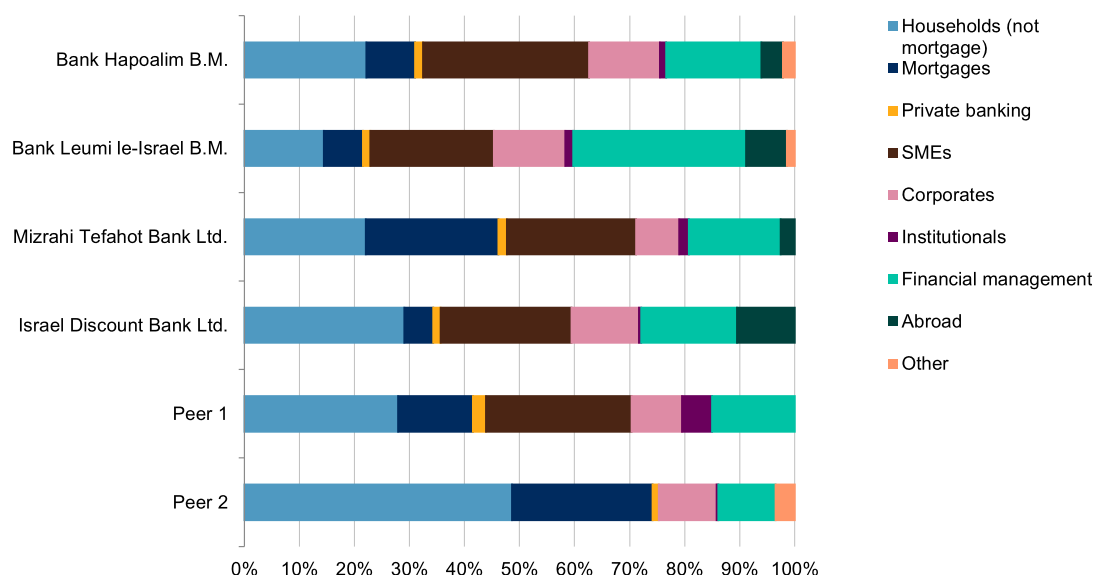
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BNHP's medium-term strategy and growth objectives consist of increasing its exposure to the mortgage, retail, and commercial and corporate sectors, with controlled risk appetite. At the same time, it targets to increase operational efficiency and digitalization.

Mortgages are a key target for the bank. While we see increasing competition in the sectors, eroding good margins, we anticipate that the risk associated with mortgage exposures will be contained, owing to macroprudential measures that the BoI introduced in the past (such as increasing banks' regulatory capital requirements and limiting mortgages' loan-to-value and payment-to-income ratios).

**Chart 2****Bank Hapoalim B.M. Has A Diversified Revenue Base**

Business segment contribution to revenues



Peer 1 and Peer 2 are domestic peers. Corporate's contribution to revenue for Peer 1 includes all-size businesses. S&P calculations based on bank's regulatory disclosures. Data as of June 2021.

Source: S&P Global Ratings.

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BNHP also aims to gradually build up a portfolio of investments in private small and midsize companies. We consider this segment to be associated with a higher risk profile, but we expect BNHP to approach it carefully.

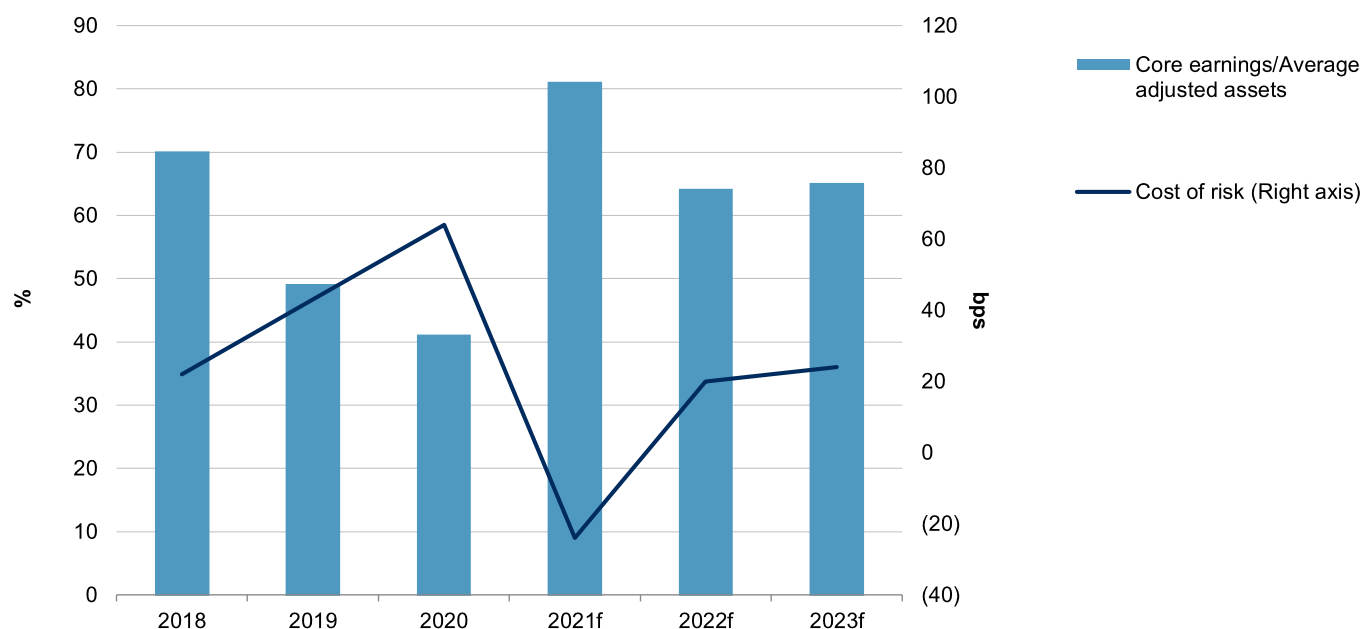
## Capital And Earnings: Recovered Profitability Will Sustain Capitalization

We expect BNHP's profitability to recover in 2021 after the COVID-19-related impact.

Specifically, we anticipate lending to strongly expand by 6%-7% on average in 2021-2023, amid sustained demand, and fees to gradually recover, thus supporting revenues.

We expect the bank's credit losses to be exceptionally low in 2021 and then normalize to 20-25 basis points (bps) in 2022-2023, in line with the system average. The bank started releasing some provisions in the first nine months of 2021, after the strong provisioning efforts of 2019 (BNHP had already included some COVID-19 provisions in Q4 2019 financial results) and 2020. The latter will help contain the impact on the bottom line of an increase in nonperforming loans (NPLs), particularly in the tourism sector, which we expect to materialize over the next couple of quarters.

Chart 3

**Bank Hapoalim B.M.--BNHP's Profitability To Recover From 2021**

f--forecast. 2019 Include COVID-19-related loan loss provisions. Source: S&P Global Ratings.

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The bank resumed its dividend distribution in H2 2021 and we anticipate that this will continue, but we expect the distribution to remain cautious given the uncertain market conditions.

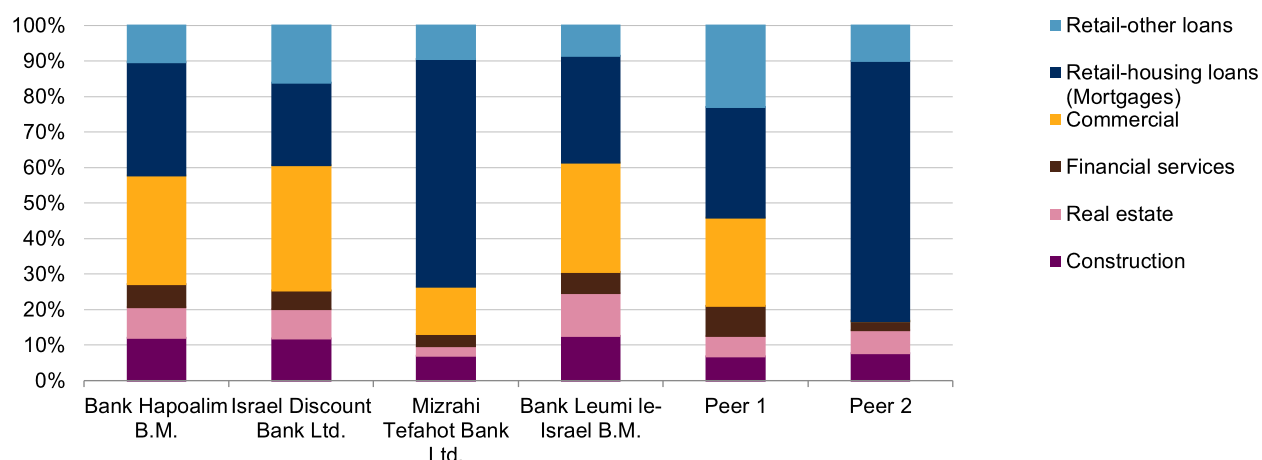
We therefore forecast that BNHP's risk-adjusted capital (RAC) ratio will be about 10.5%-11% in 2023, compared with 11.2% as of December 2020.

## Risk Position: Concentrated Loan Book

BNHP's risk exposures are more concentrated than those of most international peers, in our view. Given the small size of Israel's economy, BNHP's leading position in corporate lending means that single-name borrower concentration represents a source of risk, compared with banks in larger, more diverse economies.

A key risk factor for BNHP and its local peers is the high exposure to property-related lending, namely for construction, and income-producing property. This exposure could weigh on the bank's capital and earnings if there's a material property price correction, or if the pandemic hits the economy or labor market harder than anticipated. We consider the exposure to income-producing real estate as more vulnerable.

Chart 4

**BNHP's Domestic Property-Related Lending Exposure Is A Source Of Risk**

Peer 1 and Peer 2 are domestic peers. S&P calculations based on bank's regulatory disclosures. Source: S&P Global Ratings.

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BNHP's nonperforming assets amounted to about 1.2% of total loans as of September 30, 2021. We consider this to be very good compared with global peers and adequate relative to local peers. As a result of the pandemic, however, we might see some deterioration in asset quality indicators.

As of September 2021, BNHP's share of problematic but not impaired loans amounted to about 1.6% of total loans. Loans under payment deferral are a further source of potential deterioration, but they significantly declined from the peak. As of July 31, 2021, BNHP has deferred roughly Israeli new shekel (ILS) 346 million of payment (principal and interest) on a stock of loans amounting to about ILS2.2 billion (or about 0.7% of the total) due to the pandemic. About 87% of this amount is still reported as non problematic on the bank's books, in line with domestic and international peers, but its resilience has yet to be tested.

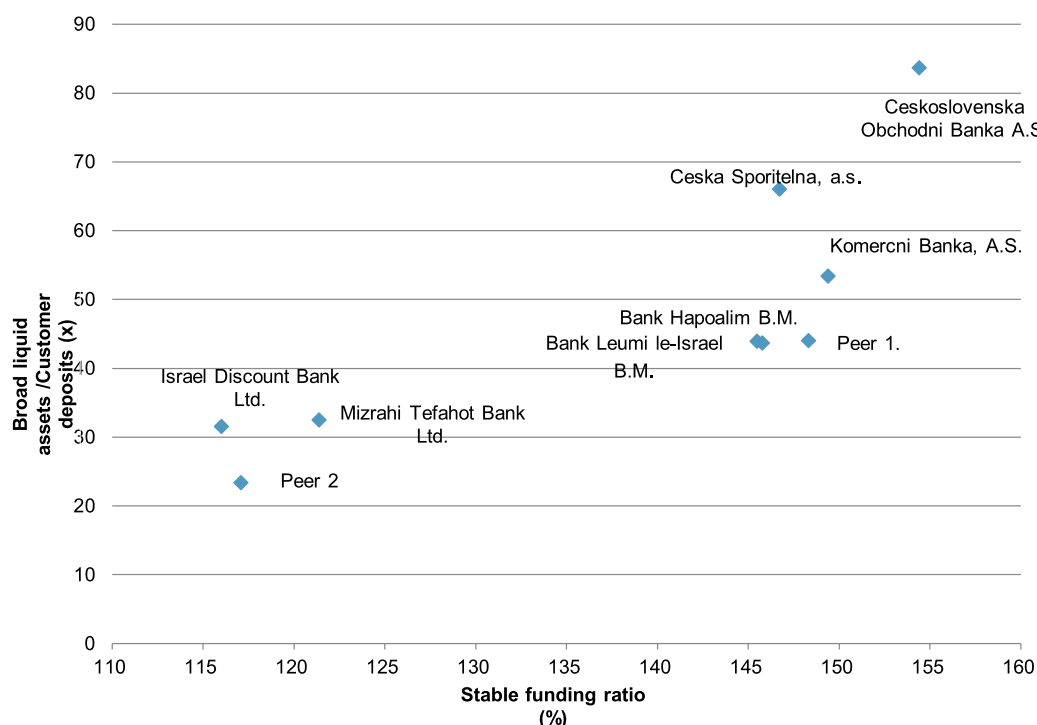
Operational risks are material, but not bank-specific. They mainly relate to geopolitical tensions in the region and potential damage in the event of adverse events, such as terrorist attacks or wars. We reflect these risks in our anchor for Israeli banks. At the same time, we consider that the bank has adequate protection from cyber-risks.

## **Funding And Liquidity: Diversified Funding Base And Good Liquidity**

In our view, BNHP benefits from sound liquidity, supported by its deep domestic funding sources, including a strong retail base.



Chart 5



Peer 1 and Peer 2 Are Domestic Peers. Data as of June 2021.

S&P Calculations Based On Bank's Regulatory Disclosures.

Source: S&P Global Ratings.

Liquid assets are sizable, with cash at central bank and other bank placements and investment securities constituting more than one-third of assets on September 2021. The securities are hedged against interest rate risks.

## Support: One Notch Of Uplift For Government Support

The long-term rating on BNHP is one notch higher than the stand-alone credit profile (SACP), reflecting our view that it has high systemic importance in Israel and that the government is supportive toward the domestic banking sector.

We would reconsider our assessment of government support if regulatory authorities introduce an updated bank resolution framework. However, we don't anticipate this development in the medium term, and we continue to include one notch of government support in our issuer credit rating on BNHP.

## Environmental, Social, And Governance

We think environmental, social, and governance credit factors influence BNHP's credit quality similarly to its industry and local peers. In 2019, some changes occurred within top management and we regard the management team as

professional and experienced. Environment and social factors do not affect credit quality differently from industry peers. We expect the bank's investment in digitalization will gradually have positive environmental implications. Regarding social risk, we note that BNHP will continue its staff reduction as part of its strategy. We believe the layoffs will be handled carefully.

## Hybrids

We rate BNHP's hybrid instruments by applying our standard notching from the group's SACP as we do not expect these instruments to benefit from state support. This means we currently rate Tier 2 subordinated contingent capital notes 'BBB' by applying one notch for default risk and one notch for subordination.

## Key Statistics

**Table 1**

<b>Bank Hapoalim B.M. Key Figures</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(Mil. ILS)</b>	<b>2021*</b>	<b>2020</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>
Adjusted assets	604,324	539,602	463,688	460,926	454,424
Customer loans (gross)	342,369	310,170	299,624	288,693	271,797
Adjusted common equity	40,227	37,845	36,623	36,726	34,254
Operating revenues	10,782	13,098	13,250	13,722	12,590
Noninterest expenses	5,898	7,501	7,548	7,385	7,529
Core earnings	3,963	2,055	2,278	3,207	2,783

\*Data as of Sept. 30. ILS--New Israeli Sheqel.

**Table 2**

<b>Bank Hapoalim B.M. Business Position</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2021*</b>	<b>2020</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>
Total revenues from business line (currency in millions)	10,797	13,186	13,190	14,142	12,908
Commercial banking/total revenues from business line	26.3	27.0	26.1	39.1	40.9
Retail banking/total revenues from business line	44.7	50.5	56.3	35.7	36.6
Commercial & retail banking/total revenues from business line	71.0	77.5	82.3	74.8	77.5
Trading and sales income/total revenues from business line	23.7	17.6	12.3	16.1	12.0
Other revenues/total revenues from business line	5.3	4.9	5.4	9.0	10.5
Investment banking/total revenues from business line	23.7	17.6	12.3	16.1	12.0
Return on average common equity	12.9	5.3	4.8	7.1	7.6

\*Data as of Sept. 30.

Table 3

Bank Hapoalim B.M. Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2021*	2020	2019	2018	2017
Tier 1 capital ratio	11.2	11.7	11.8	11.4	11.6
S&P Global Ratings' RAC ratio before diversification	N/A	11.2	11.3	10.0	9.5
S&P Global Ratings' RAC ratio after diversification	N/A	10.1	10.6	9.3	9.0
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	67.8	67.2	70.3	64.9	66.9
Fee income/operating revenues	22.8	24.1	24.5	24.2	26.5
Market-sensitive income/operating revenues	7.9	8.1	4.6	10.1	5.1
Cost to income ratio	54.7	57.3	57.0	53.8	59.8
Provision operating income/average assets	1.1	1.1	1.2	1.4	1.1
Core earnings/average managed assets	0.9	0.4	0.5	0.7	0.6

\*Data as of Sept. 30.

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 4

Bank Hapoalim B.M.--Risk-Adjusted Capital Framework Data					
(Mil. ILS)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
<b>Credit risk</b>					
Government & central banks	63,052.6	4,311.8	6.8	2,071.8	3.3
Of which regional governments and local authorities	6,584.6	2,270.0	34.5	266.8	4.1
Institutions and CCPs	16,534.1	4,377.7	26.5	3,859.2	23.3
Corporate	204,071.7	195,342.7	95.7	187,449.0	91.9
Retail	150,777.8	93,037.8	61.7	67,456.8	44.7
Of which mortgage	100,255.7	54,898.7	54.8	29,516.6	29.4
Securitization§	26.0	13.0	50.0	26.0	100.0
Other assets†	12,516.5	21,220.8	169.5	23,284.2	186.0
Total credit risk	446,978.7	318,303.7	71.2	284,147.0	63.6
<b>Credit valuation adjustment</b>					
Total credit valuation adjustment	--	2,748.5	--	0.0	--
<b>Market Risk</b>					
Equity in the banking book	2,941.0	2,941.0	100.0	24,330.0	827.3
Trading book market risk	--	3,446.7	--	5,170.0	--
Total market risk	--	6,387.7	--	29,500.0	--
<b>Operational risk</b>					
Total operational risk	--	23,166.1	--	25,728.8	--
	Exposure	Basel III RWA	Average Basel II RW (%)	S&P Global Ratings RWA	% of S&P Global Ratings RWA
<b>Diversification adjustments</b>					
RWA before diversification	--	350,606.1	--	339,375.8	100.0

Table 4

Bank Hapoalim B.M.--Risk-Adjusted Capital Framework Data (cont.)					
Total Diversification/ Concentration Adjustments	--	--	--	35,591.9	10.5
RWA after diversification	--	350,606.1	--	374,967.7	110.5
			</		

\*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions.

‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets.

RW--Risk weight. RAC--Risk-adjusted capital. ILS -- New Israeli Shekel. Sources: Company data as of 'Dec. 31 2020', S&P Global Ratings.

Table 5

Bank Hapoalim B.M. Risk Position					
	--Year-ended Dec. 31--				
(%)	2021*	2020	2019	2018	2017
Growth in customer loans	13.8	3.5	3.8	6.2	(2.5)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	10.5	7.2	7.6	5.3
Total managed assets/adjusted common equity (x)	15.0	14.3	12.7	12.6	13.3
New loan loss provisions/average customer loans	(0.6)	0.6	0.4	0.2	0.1
Net charge-offs/average customer loans	(0.1)	0.1	0.1	0.2	0.2
Gross nonperforming assets/customer loans + other real estate owned	1.2	1.5	1.8	1.3	1.3
Loan loss reserves/gross nonperforming assets	119.1	130.2	87.5	104.1	100.9

\*Data as of Sept. 30.

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 6

Bank Hapoalim B.M. Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2021*	2020	2019	2018	2017
Core deposits/funding base	94.4	93.4	92.3	91.1	91.3
Customer loans (net)/customer deposits	66.7	69.7	81.4	80.8	77.1
Long-term funding ratio	98.0	98.7	97.8	97.5	97.6
Stable funding ratio	145.8	141.9	124.8	120.5	125.9
Short-term wholesale funding/funding base	2.1	1.4	2.4	2.8	2.6
Broad liquid assets/short-term wholesale funding (x)	18.8	27.0	13.2	10.8	12.7
Net broad liquid assets/short-term customer deposits	50.5	50.2	39.3	37.4	42.4
Short-term wholesale funding/total wholesale funding	38.1	21.8	30.8	31.3	30.5

\*Data as of Sept. 30.

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

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-	-	-	-
3	a-	a-	bbb+	bbb+	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 2, 2021)\*

#### Bank Hapoalim B.M.

Issuer Credit Rating

A/Stable/A-1

Junior Subordinated

BBB

#### Issuer Credit Ratings History

10-Jul-2019 *Foreign Currency*

A/Stable/A-1

24-Oct-2017

A-/Positive/A-2

07-Oct-2014

A-/Stable/A-2

10-Jul-2019 *Local Currency*

A/Stable/A-1

24-Oct-2017

A-/Positive/A-2

## Ratings Detail (As Of December 2, 2021)\*(cont.)

07-Oct-2014	A-/Stable/A-2
<b>Sovereign Rating</b>	
Israel	AA-/Stable/A-1+
<b>Related Entities</b>	
<b>Bank Hapoalim B.M. (New York branch)</b>	
Issuer Credit Rating	A/Stable/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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