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Research Update:

Outlook On 10 Chilean Financial Institutions Revised To Stable From Negative On Lower Risk Of Credit-Fueled Asset Bubble

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Overview

- The continued moderate growth of credit and a softening of real estate prices are relieving pressure on Chile's slightly weaker capacity to face external shocks, while reducing the risk of a cyclical credit-fueled asset price bubble.
- We're keeping our Banking Industry Country Risk Assessment (BICRA) on Chile at group '3' and revising the economic risk trend to stable from negative. The industry risk trend remains stable.
- As a result, we're revising our outlook on 10 domestic financial institutions to stable from negative, reflecting diminished pressures on economic imbalances. We're affirming the ratings on these entities. At the same time, we're affirming and maintaining the stable outlook on three other entities.

Rating Action

On Aug. 22, 2018, S&P Global Ratings revised its outlook on the following entities to outlook to stable from negative and affirmed its ratings:

- Banco Santander-Chile S.A. (BSCh);
- Banco de Credito e Inversiones;
- Itau CorpBanca;
- Banco BICE;
- Banco Bilbao Vizcaya Argentaria Chile y Filiales (BBVA Chile);
- Banco Security;
- Cooperativa Del Personal de La Universidad de Chile Ltda-Coopeuch Ltda (Coopeuch);
- Tanner Servicios Financieros S.A. (Tanner);
- LQ Inversiones Financieras S.A. (LQIF); and
- Larrain Vial S.A. Corredora de Bolsa (LVCB).

At the same time, we affirmed the ratings and maintained a stable outlook on the following entities:

- Banco del Estado de Chile (Banco Estado);

- Banco del Estado de Chile Sucursal New York; and
- Banco de Chile.

Rationale

The rating actions reflect our view of diminished risks of potential cyclical credit fueled asset price bubbles. This stems from continued moderate growth of credit, despite the higher projected economic growth of Chile starting in 2018, and softer increases in real estate property prices. These factors are partly compensating for the sovereign's slightly lower capacity to face external shocks, while reducing the risks of credit losses and capital deterioration among domestic financial institutions. Also, we believe the following one-off factors have influenced real estate prices in the past few years that didn't result in higher risks of asset bubbles:

- The earthquake in 2010 that raised construction costs;
- The hike in properties' purchases in 2014-2016 before the implementation of value-added tax (VAT) on properties; and
- Tax benefits that were removed after the last tax reform and that incentivized the investment in real estate properties.

Nevertheless, dynamics in Chile's real estate prices depend on the following factors:

- Inventories of available units;
- Interest rates on mortgages, which are currently at historically low levels;
- The number of unrealized house purchases; and
- Construction regulations in Santiago, which is one of the biggest real estate markets in the country.

In addition, other factors have influenced the domestic real estate market such as the increased rental demand stemming from the immigration wave in the past two years, the appreciation in value of properties in areas near the extension of the metro in Santiago, and the development of real estate funds. All these factors have resulted in an average real estate price growth of 6.5% for the past five years (in real terms and based on the central bank's figures and on new and used home prices at national level). We expect credit to grow 8%-9% on nominal basis and real estate prices to increase by around 4% in real terms for the next two years, which in our view represents a manageable risk. However, we will continue monitoring these factors and if asset prices significantly rise above our expectations, we could revise our economic risk accordingly. Moreover, banks have remained resilient to the external conditions, posting relatively stable asset quality metrics and operating performance.

Banking Industry Country Risk Assessment

We maintained our BICRA score on Chile at group '3', which anchors banks operating in Chile at 'bbb+'. Our bank criteria uses our BICRA economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. A BICRA is scored on a scale from '1' to '10', ranging from the lowest-risk banking systems (group '1') to the highest-risk (group '10'). We revised the economic risk trend to stable from negative, while the industry risk trend remains unchanged at stable.

Chile's resilient economy reflects many years of sound and consistent economic policies, such as 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 countries and its BICRA peers. But at about \$15,400 at the end of 2017, it's among the highest in the region and gradually rising. In this sense, better global copper prices than in 2016 and renewed business confidence after the 2017 national elections have boosted GDP growth prospects to about 4.0% in 2018 and 3.3% in 2019 from 1.6% in 2017. In addition, we're seeing more moderate growth in credit and real estate prices than historical levels, which stave off pressure on the sovereign's slightly weaker capacity to face external shock, while reducing the risks of cyclical credit-fueled asset bubbles. We expect the Chilean banking industry's asset quality to remain adequate and in line with those of its peers amid better economic and business prospects.

In terms of industry risk, we believe that Chile has a sound and comprehensive regulatory 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 that 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. In June 2017, the government submitted a draft of a banking law that aims to align the country with Basel III standards for capital and to introduce tools such as an early regularization plan. At this point, we don't see an impact on potential government support to banks, but we'll monitor changes in the resolution framework.

BICRA Trends

Chile's stable economic risk trend incorporates our view of manageable risks of economic imbalances, given softer growth of credit and real estate prices. However, if asset prices rise sharply above our expectations, we could revise our economic risk accordingly. On the other hand, we expect the country's sound macroeconomic flexibility and manageable credit risk should continue to support the financial system's adequate performance.

In our view, the industry risk trend is stable. We believe that the industry's funding structure and competitive dynamics will remain adequate over the next

few years. We also think that Chile's institutional framework will continue to improve and that the banking system will adopt Basel III capitalization rules after the approval of the new banking law. We believe banks will maintain a balanced funding profile based on core customer deposits, the bulk of which are from institutional investors, while maintaining their diversified funding sources. Apart from the continued growth in the system's deposit base, we expect banks in Chile to have easy access to international and domestic markets to fund operations.

Outlook

BSCh

The stable outlook on BSCh incorporates our expectation that over the next 24 months, the bank will maintain sound risk management with credit losses consistently below 2% and in line with the system average while keeping its dominant business position in the highly competitive Chilean banking system.

Downside scenario

A downgrade could occur if our view of the economic imbalances of the banking system deteriorates because of significant speculative increase of the house prices or a sharp increase in banking penetration. Additionally, if our capital and earnings assessment on the bank deteriorates due to the risk-adjusted capital (RAC) ratio falling to levels consistently below 7%, we could downgrade the bank.

Upside scenario

An upgrade is unlikely over the next two years because if the bank's fundamentals improve, leading to an upgrade of its stand-alone credit profile (SACP), the rating on bank will remain the same because there won't be an uplift due to sovereign support, given the current sovereign rating.

Banco de Credito e Inversiones

The stable outlook on Banco de Credito e Inversiones over the next 24 months reflects our view that the bank will maintain its sound competitive position, improving its operations abroad; its high systemic importance within the Chilean financial system; a RAC ratio at 8.3% over the next two years; and stable asset quality metrics.

Downside scenario

We could lower the rating over the next 24 months if our view of the economic imbalances of the Chilean banking system deteriorates, if the bank's market position and business stability weaken in Chile or at its operations in the U.S., or if its RAC ratio falls to less than 7%.

Upside scenario

A rating upside is limited over the next 24 months given that if the bank's credit fundamentals improve, leading to an upgrade of its SACP, the rating would remain at the same level, because there won't be an uplift due to sovereign support stemming from the current sovereign rating.

Itau CorpBanca

The stable outlook reflects our expectations that Itau CorpBanca's credit fundamentals will remain stable in the next 24 months with the integration of the merged operations and healthy asset quality. We expect the bank's capital metrics to remain at moderate levels and funding and liquidity to be in line with Chilean banking industry average.

Downside scenario

We could lower the ratings if our view of the economic imbalances of the Chilean banking system deteriorates or if Itau CorpBanca's capital metrics weaken, which currently seems unlikely.

Upside scenario

We could upgrade the bank if its SACP improves by more than one notch due to a consistent rise in a RAC ratio above 7% and a strengthening in business position in terms of business diversity and stability.

Banco BICE

The stable outlook on Banco BICE in the next 24 months reflects our view that it will remain a moderately systemically important entity in the Chilean financial system. The outlook also reflects our expectation that the bank will keep a RAC ratio above 7% for the next two years and its asset quality indicators stronger than the industry average.

Upside scenario

A rating upside is limited at this point and would depend on an improvement in our assessment of the banking industry credit risks, or if Banco BICE's business profile improves sharply which could result from a more diversified business profile, while all other credit factors remain unchanged. However, we view this scenario as unlikely in the next two years.

Downside scenario

We could lower the ratings in the next 24 months if our view of the economic imbalances of the Chilean banking system deteriorates, if the bank's RAC ratio falls to less than 7% or if Banco BICE's asset quality indicators converge with the industry average.

BBVA Chile

The stable outlook on BBVA Chile for the next 24 months reflects our view that over the next few months the bank will maintain its credit fundamentals until it merges its operations with those of its new owner, The Bank of Nova Scotia (BNS; A+/Stable/A-1). We also expect BBVA Chile to continue to be a strategically important subsidiary of BNS.

Upside scenario

Rating upside is limited over the next 24 months and would depend on higher ratings on BNS, together with an improvement in BBVA Chile's credit fundamental or in our assessment of the banking industry credit risks.

Downside scenario

Although unlikely, we could lower the rating on BBVA Chile over the next two 24 months if we revise its group status to a lower category, or if we were to downgrade BNS. Also, a downgrade is possible if our view of the economic imbalances of the Chilean banking system deteriorates.

Banco Security

The stable outlook on Banco Security for the next 24 months reflects our expectation that it will maintain a stable business position and a healthy asset quality (with nonperforming loans to customer loans of less than 2% and net charge-offs below 1%). In addition, we continue to incorporate one notch of government support into the rating, based on the bank's moderate systemic importance.

Downside scenario

Deterioration in the bank's risk position for the next 24 months due to significantly weaker asset quality metrics (relative to the industry average) could lead to a downgrade. Also, we could lower the ratings if our view of the economic imbalances of the Chilean banking system deteriorates.

Upside scenario

We could raise the ratings on Banco Security in the next 24 months if the bank's business position significantly improves, which could be a result of greater diversification in its business profile and higher market share. Nevertheless, the latter is less likely to occur over the next two years, in our view, based on Chile's concentrated and stable banking system.

Coopeuch

The stable outlook on Coopeuch reflects our expectation that it will maintain its competitive business position in the Chilean consumer lending segment, a RAC ratio at 31.8%, and asset quality metrics fairly stable over the next 24 months.

Upside scenario

We could raise the ratings in the next 24 months if Coopeuch's asset quality metrics continue to improve and move close to the banking industry average, while all other credit fundamental remain unchanged.

Downside scenario

Although unlikely, we could take a negative action on Coopeuch over the next 24 months if we perceive deterioration in its business position, driven by a lower market share and profitability, and/or if our view of the Chilean banking industry weakens.

Tanner

The stable outlook on Tanner for the next 24 months reflects our expectation that the company will maintain a strong competitive position in the factoring and auto loan segments as well as its healthy commercial diversification. We also expect the company to continue to strengthen its profitability while maintaining healthy levels of risk.

Upside scenario

We could raise the ratings on Tanner if its results and profitability improve, and if its current business mix remains diversified while customer concentrations continue to decline.

Downside scenario

We could lower the ratings on the company adopts a more aggressive risk appetite, prompting us to revise our funding and liquidity assessment to a weaker category, a scenario that we see unlikely in the short term. Also, we could lower the ratings if our view of the Chilean banking industry weakens.

LVCB

The stable outlook on LVCB incorporates our expectation that for the next 24 months it will maintain a sound business position in the Chilean market, despite stiff competition, amid improvements in results and in volumes traded after agreements reached with pension funds on past allegations. The outlook also reflects LVCB's RAC metrics of 10%-15%, which are in line with a strong capital and earnings assessment, its maintenance of an adequate risk profile, adequate funding (with GSFR over 90%), and adequate-high metrics (with LCM above 100%).

Downside scenario

We could lower the ratings if risk levels at the firm increase, if capital drops sharply (resulting in RAC of less than 10%), or if funding and liquidity weaken to below adequate levels. In addition and although unlikely, a

downgrade is possible if industry conditions in Chile deteriorate.

Upside scenario

Rating upside is limited at this point and would depend on the improvement of the anchor for security firms operating in Chile while LVCB's credit factors remain unchanged.

LQIF

The stable outlook on LQIF reflects the outlook on that of its sole operating subsidiary, Chile-based universal bank, Banco de Chile. It also incorporates our expectation that the bank will continue to upstream dividends to LQIF to service its financial obligations.

Downside scenario

We could downgrade LQIF if we were to lower the ratings on Banco de Chile.

Upside scenario

We could upgrade LQIF if we were to raise the ratings on Banco de Chile.

Banco Estado

The stable outlook on 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 SACP at 'bb-' or above.

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.

Banco del Estado de Chile Sucursal New York

The stable outlook on Banco del Estado de Chile Sucursal New York for the next 24 months mirrors that on its parent, which, in turn, reflects that on the sovereign. It also reflects our expectation that the bank will maintain its strong market position and social policy role. Due to our belief that there is an extremely high likelihood of government support, the ratings on Banco Estado will move in tandem with the sovereign, as long as the bank maintains its SACP above 'bb-'.

Downside scenario

We could lower the ratings on Banco del Estado de Chile Sucursal New York in the next 24 months if we downgrade the sovereign and Banco Estado.

Upside scenario

We could raise the ratings on Banco del Estado de Chile Sucursal New York in the next 24 months if we upgrade the sovereign and its parent.

Banco de Chile

The stable outlook on Banco de Chile incorporates our expectation that over the next 24 months, the bank will maintain sound risk management with consistently lower-than-average credit losses while keeping its dominant business position in the highly competitive Chilean banking system.

Downside scenario

A downgrade could occur if Banco de Chile's SACP drops two notches, which could stem from a downward revision of our BICRA and anchor for banks operating in the country, in conjunction with worsening capital metrics and/or a deterioration in the bank's risk position. But we don't expect such scenarios.

Upside scenario

We could upgrade Banco de Chile in the next 24 months if our assessment of the bank's capital and earnings improves as a result of RAC levels consistently higher than 10%, combined with asset quality metrics that are materially stronger than those of peers.

Related Criteria

- 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
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Sovereign Rating Methodology , Dec. 23, 2014
- Criteria - Financial Institutions - General: Issue Credit Rating

Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014

- Criteria - Financial Institutions - General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- 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
- S&P To Publish Economic And Industry Risk Trends For Banks , March 12, 2013
- Analytical Linkages Between Sovereign And Bank Ratings , Dec. 6, 2011
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004
- Criteria - Financial Institutions - Finance Companies: Commercial Paper II: Finance Companies, March 22, 2004

Related Research

- Banking Industry Country Risk Assessment Update July 2018 , July 24, 2018
- Republic of Chile 'A+/A-1' Foreign Currency Ratings Affirmed; Outlook Remains Stable , June 28, 2018
- Ratings On Nine Chilean Financial Institutions Affirmed And Off Watch On BICRA Remaining At Group '3'; Outlook Negative , Aug. 4, 2017

Ratings List

Ratings Affirmed/Outlook Action

| | To | From |
|----------------------------|--------------|----------------|
| Banco Santander-Chile S.A. | | |
| Issuer credit rating | A/Stable/A-1 | A/Negative/A-1 |
| Commercial paper | A-1 | A-1 |
| Senior unsecured | A | A |
| Subordinated | A- | A- |

Banco de Credito e Inversiones

| | | |
|----------------------|--------------|----------------|
| Issuer credit rating | A/Stable/A-1 | A/Negative/A-1 |
| Commercial paper | A-1 | A-1 |
| Senior unsecured | A | A |

Itau CorpBanca

| | | |
|-----------------------|-----------------|-------------------|
| Issuer credit rating | BBB+/Stable/A-2 | BBB+/Negative/A-2 |
| Senior unsecured | BBB+ | BBB+ |
| National scale rating | clAA+/Stable/-- | clAA+/Negative/-- |
| Senior Unsecured | clAA+/Stable | clAA+/Negative |
| Subordinated | clAA/Stable | clAA/Negative |

Banco BICE

| | | |
|----------------------|----------------|------------------|
| Issuer credit rating | BBB+/Stable/-- | BBB+/Negative/-- |
|----------------------|----------------|------------------|

Banco Bilbao Vizcaya Argentaria Chile y Filiales

| | | |
|----------------------|--------------|----------------|
| Issuer credit rating | A/Stable/A-1 | A/Negative/A-1 |
|----------------------|--------------|----------------|

Banco Security

| | | |
|----------------------|----------------|------------------|
| Issuer credit rating | BBB/Stable/A-2 | BBB/Negative/A-2 |
|----------------------|----------------|------------------|

Cooperativa Del Personal de La Universidad de Chile Ltda-Coopeuch Ltda

| | | |
|----------------------|----------------|------------------|
| Issuer credit rating | BBB/Stable/A-2 | BBB/Negative/A-2 |
|----------------------|----------------|------------------|

Tanner Servicios Financieros S.A.

| | | |
|-----------------------|---------------------|-----------------------|
| Issuer credit rating | BBB-/Stable/-- | BBB-/Negative/-- |
| Senior unsecured | BBB- | BBB- |
| National scale rating | clAA-/Stable/clA-1+ | clAA-/Negative/clA-1+ |
| Senior Unsecured | clAA-/Stable | clAA-/Negative |
| Commercial Paper | clA-1+ | clA-1+ |

Larrain Vial S.A. Corredora de Bolsa

| | | |
|----------------------|---------------|-----------------|
| Issuer credit rating | BBB/Stable/-- | BBB/Negative/-- |
| Senior unsecured | BBB | BBB |

LQ Inversiones Financieras S.A.

| | | |
|----------------------|---------------|-----------------|
| Issuer credit rating | A-/Stable/A-2 | A-/Negative/A-2 |
|----------------------|---------------|-----------------|

Ratings Affirmed

Banco del Estado de Chile

| | |
|----------------------|---------------|
| Issuer credit rating | A+/Stable/A-1 |
| Senior unsecured | A+ |

Banco del Estado de Chile Sucursal New York

| | |
|----------------------|---------------|
| Issuer credit rating | A+/Stable/A-1 |
| Short-term debt | A-1 |

Banco de Chile

| | |
|----------------------|--------------|
| Issuer credit rating | A/Stable/A-1 |
| Commercial Paper | A-1 |
| Senior unsecured | A |

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