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W&W Group

Primary Credit Analysts:

Silke Longoni, Frankfurt (49) 69-33-999-195; silke.longoni@spglobal.com

Benjamin Heinrich, CFA, FRM, Frankfurt + 49 693 399 9167; benjamin.heinrich@spglobal.com

Secondary Contacts:

Volker Kudzusz, Frankfurt (49) 69-33-999-192; volker.kudzusz@spglobal.com

Michal Selbka, Frankfurt +49 (0) 69-33999-300; michal.selbka@spglobal.com

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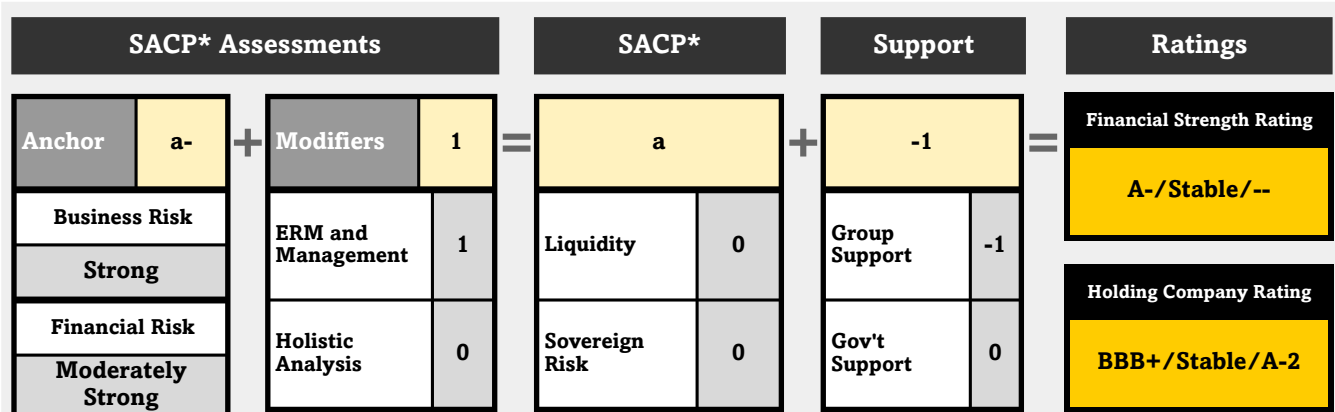
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W&W Group



*Stand-alone credit profile.
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

Wuestenrot Bausparkasse AG

Ratings Score Snapshot

Issuer Credit Rating	A-/Stable/A-1
Anchor	a-
Business Position	Moderate (-1)
Capital & Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding & Liquidity	Average & Adequate (0)
SACP	bbb+
Group Support	+1

SACP--Stand-alone credit profile.

Major Rating Factors

Strengths	Weaknesses
<ul style="list-style-type: none"> Diversified bancassurance group in Germany with a dual brand strategy. Favorable leverage and coverage ratios in the insurance segment. Strong enterprise risk management (ERM). 	<ul style="list-style-type: none"> Persisting difficult operating environment, with low interest rates affecting the highly sensitive building saving ("Bauspar") businesses, as well as life insurance and capital investments. Remaining restructuring needs weighing on earnings of both insurance and banking segments. Lower levels of capital adequacy than other rated peers in the 'A' range.

Rationale

S&P Global Ratings' assessment of the core entities of German insurance group W&W and the holding company Wuestenrot & Wuerttembergische AG (W&W AG)--collectively, W&W or the group--combines our views on both the insurance and the banking subgroups. In our view, the multiline insurance and banking group's business risk profile has proven resilient to ongoing difficult operating conditions, thanks to the strong performance of property/casualty (P/C) insurance. Furthermore, we think that W&W's sound consolidated capital and earnings position is supported by the group's conservative investment strategy and prudent dividend payments, which has offset restructuring costs in the insurance and banking segments.

W&W is a midsize player in the German financial services retail market and is involved in Bauspar activity, retail banking, life, P/C, health insurance, and asset management. W&W's core operating entities are joint-stock companies, owned by W&W AG.

W&W's core operating insurance entities are Wuerttembergische Lebensversicherung AG (WL; life) and Wuerttembergische Versicherung AG (WV; P/C). After the announcement in March 2018 to sell Wuestenrot Bank AG Pfandbriefbank (WBP; not rated) later this year, the group's core banking entity is Wuestenrot Bausparkasse AG (WBSK), a Bauspar bank, residential mortgage provider, and covered bonds issuer. The majority shareholder of W&W is the Wuestenrot Stiftung (foundation) with 67%. About 10% of the shares are held by Horus Finanzholding, and the remainder is free float. W&W AG has profit-and-loss transfer agreements with WBP and WV. As of June 30, 2018, the group had €75.3 billion in consolidated assets (versus €72.0 billion at year-end 2017).

Insurance represents about 61% of the group's revenues and regulatory capital.

Outlook: Stable

The stable outlook reflects our assumption that W&W's insurance and banking operations will at least maintain the revenue base, as per our base case and stable profitability metrics.

Downside scenario

We might lower the ratings over the next two years if, contrary to our expectations, W&W was unable over a prolonged period to:

- Further improve the cost structures and efficiency measures of its banking operations in order to offset negative effects on profitability from low interest rates, mainly on its Bauspar and residential real estate lending franchise; or
- Maintain capital adequacy close below our 'A' level on a consolidated basis. Deterioration could result from a stronger decline in earnings than we currently expect, for example, as a consequence of prevailing low interest rates, or due to an increase in capital requirements for market risks.

Upside scenario

We consider a positive rating action a remote possibility during the next two years, given the ongoing pressure of capital and earnings from the low-yield environment, both in the life insurance and the Bauspar banking businesses.

Macroeconomic Assumptions

- We assume moderate economic growth and inflation, as well as continuously low unemployment rates in Germany over 2018-2019.
- We expect the 10-year German government bond yield to increase modestly to 0.9% in 2018 and 1.4% in 2019.

Key metrics**Table 1**

W&W Group Insurance Operations -- Key Metrics						
	2019f	2018f	2017	2016	2015	2014
Gross premiums written	3,800-4,000	3,800-4,000	3,873	3,989	4,040	4,033
Net income	200-230	200-230	258	235	274	242
Return on shareholders equity	>6.0	>6.0	6.6	6.3	7.5	7.0
P/C net combined (loss and expense) ratio (%)	<92.0	<92.0	89.1	89.9	91.9	95.7
P/C return on revenue (%)	>7.0	>7.0	8.1	7.2	5.8	2.0
Life: Net investment yield (%)	>3.0	>3.0	3.0	3.3	3.8	3.5
P/C: Net investment yield (%)	>3.0	>3.0	2.7	3.4	5.2	3.4
S&P capital adequacy (indicate rating level of redundancy)	Moderately Strong	Moderately Strong	Moderately Strong	Moderately Strong	Upper Adequate	Moderately Strong

Table 1

W&W Group Insurance Operations -- Key Metrics (cont.)						
	2019f	2018f	2017	2016	2015	2014
Fixed charge coverage	>10	>10	18.0	15.1	14.1	13.3
Financial leverage (%)	Approx. 5.0	Approx. 5.0	4.4	5.1	8.5	10.2

P/C--Property and casualty. f--S&P Global Ratings' forecasts.

Table 2

Wuestenrot Bausparkasse AG -- Key Metrics					
	--Fiscal year ended Dec. 31--				
(%)	2017	2016	2015	2014	2013
Adjusted assets (mil. €)	28,353	20,779	21,897	23,067	22,544
Customer loans (gross) (mil. €)	19,943	13,595	14,039	14,210	14,629
Tier 1 capital ratio	16.00	14.20	12.80	12.60	10.50
S&P RAC ratio before diversification	13.7	17.2	16.1	16.6	14.4
Net interest income/operating revenues	60.1	67.2	71.3	89.8	85.5
Noninterest expenses/operating revenues	88.9	84.4	84.1	92.7	85.2
Gross nonperforming assets/customer loans + other real estate owned	1.3	1.3	1.8	2.1	N/A
Core deposits/funding base	82.1	98.0	90.5	85.3	86.7
Stable funding ratio	105.7	105.6	98.7	96.2	100.0
Broad liquid assets/short-term wholesale funding (x)	2.9	11.0	1.8	1.3	1.6

RAC--Risk-adjusted capital. N/A--Not applicable.

Business Risk Profile: Strong

Our view reflects the unique bancassurance model in favor of distribution and diversification for the insurance segment. We view the banking segment's business position to be moderate, in view of its more concentrated and moderately profitable business profile compared with that of banks with similar industry risk.

Insurance industry and country risk

Intermediate, because of its exposure to asset-liability management (ALM) and guarantee risk in the German life book. W&W writes the majority of its business in large and mature insurance markets. Of its total premiums, 56% is written in the German life market, which displays higher risks associated with its product offerings, with guarantees namely in ALM risk and weakening profitability. Forty-five percent of the group's premiums is written in the German P/C market, which we believe carries low risk. Both sectors are mature and highly competitive, offering limited growth prospects.

Anchor for the banking segment

Reflects Germany's highly diversified and competitive economy. We use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank like WBSK operating mainly in Germany is 'a-', based on an economic risk score of '1' and an industry risk score of '3'. We view both the economic risk trend in the German banking industry and the industry risk trend as stable.

Competitive position

Strong, based on a somewhat unique bancassurance structure, albeit concentration in the banking. W&W's life carrier offers a broad product portfolio whereby its back book is dominated by traditional annuities and endowment products. The group has started to shift its product portfolio toward less capital-intensive products and more flexible guarantees. In terms of new business, unit-linked, disability, and risk-term products already account for more than 80% of premiums. However, it will likely take time until the shift prompts a significant change in the back book.

For 2018-2020, we expect WL's gross premiums written (GPW) growth will increase moderately by about 1%-2%, depending on the volatile single-premium business and on how the market accepts new products.

WV, W&W's P/C segment, caters to individuals and small and midsize enterprises. WV's 2017 growth mainly stemmed from its business with corporate clients and in the motor segment. We believe that W&W will adhere to its profit-oriented underwriting policy, which should result in market equivalent increases in premiums at WV of about 2%-3% annually for 2018-2020.

The group's unique bancassurance structure is a strong basis for product diversification, with approximately 40% customer loans and about 60% insurance investments. However, the banking subgroup focus on relatively narrow range of products. Nevertheless, it benefits from geographic diversification with Germany and its solid franchise is underpinned by a sound track record of customer loyalty. W&W follows a dual-brand strategy, which we believe it has pursued successfully based on its strong and diverse tied-agent network benefitting both insurance and banking segments.

Within its strategic initiative "W&W Besser!", the group plans to invest €820 million into digital transformation, new services, and an improvement of operating skills. We believe these measures will facilitate the fulfilment of cost efficiency requirements and flexibility in meeting customers' demands. From our perspective, one of the main challenges is to align traditional distribution channels via tied-agents with online distribution.

A concentrated business profile in the banking segment. We assess WBSK's business position as moderate in view of its more concentrated business profile than that of banks domestically or with a similar intermediate industry risk for the German banking industry.

Like many of its peers, the bank focuses on a relatively narrow range of products, predominately building savings business, supplemented by residential real estate lending. Here, it benefits from geographic diversification within Germany, which we expect will remain unchanged. Moreover, the bank has a solid franchise, on the back of its sound track record of customer loyalty.

Over the past years, the bank continuously strengthened its market share in building savings business to about 14.6% at year-end 2017 and established itself as the No. 2 in the German market. We expect its market share in net new building-savings contracts will remain broadly at these levels, mainly reflecting existing long-term cooperation with larger financial service companies in Germany and due to further focus on cross-selling initiatives across the group. Nevertheless, the banking operation faces a high degree of competition and a revenue base materially under pressure amid the current low interest rates. However, we expect WBSK's operating revenues to remain under manageable pressure in the coming 12-24 months.

In March 2018, W&W announced the sale of WBP, which followed the transfer of most of assets and liabilities to

WBSK in April 2017. WBSK agreed on future cooperation with the new owner Bremer Kreditbank in order to allow clients uninterrupted access on all products previously offered by WBP and that remain prohibited for building societies', in particular to products linked to current accounts, credit cards, and asset management. We therefore do not expect any material weakening of the banking business profile because of the sale.

Financial Risk Profile: Moderately Strong

Combining the capital positions of the insurance and banking operations, we consider that the group exhibits moderately strong capital and earnings, and we expect W&W's capital adequacy will remain at the higher end of our benchmark for the 'BBB' category over 2018-2020. This stems from the strong earnings supported by benign claims and cost reductions in non-life business.

Overall, W&W's consolidated net income increased by 10% to €258 million in 2017 from €235 million in 2016, driven by benign claims in P/C and cost reductions. In our base-case scenario, we expect normalized net profits of about €200 million-€230 million annually over 2018-2020, based on prevailing low interest rates and investments in the strategic initiative "W&W Besser!". The non-life business operating performance has exceeded the market average, with five-year average net combined (loss and expense) ratios of about 94% over 2017-2013, with an even more favorable 89% in 2017 thanks to very benign claims. The storm events in Germany in early 2017 did not distort the net combined ratio because of the group's adequate reinsurance protection. We expect P/C business will remain the group's key earnings contributor, with our base-case expectation of a net combined ratio of below 92% through the cycle, barring any extraordinary natural catastrophe events. The pressure on investment income and life new-business margins will likely prevail if interest rates stay low, because WL's portfolio is still dominated by traditional products with an average guaranteed interest rate of above 3%. We expect that low interest rates will also entail ongoing additional reserving requirements, which will reduce the average guarantee in the back book, but squeeze the gross surplus. WL benefits from a cautious bonus policy, but we assume that a further reduction in bonuses will have only a marginal impact. Also, we acknowledge WL's new business strategy, which should gradually support and strengthen its capitalization under Solvency II requirement.

We expect this to result in risk capital requirements exceeding the consolidated group's total adjusted capital (TAC), with capital adequacy remaining in the upper 'BBB' range of our model.

The insurance subgroup displays favorable leverage and coverage ratios, with a financial leverage ratio of 4.4% and fixed charge coverage of 18x in 2017. In our base case, we expect these measures to be better than our thresholds.

We consider market risk to be the group's key risk, particularly regarding the life insurance and Bauspar operations, which are highly exposed to interest rate fluctuations.

We continue to assess capital and earnings for the banking business as strong, mainly mirroring our expectation that our risk-adjusted capital (RAC) ratio will remain comfortably above 10%. Our assessment is now purely based on WBSK following the announcement to sell WBP. In 2017, WBSK's RAC ratio weakened to 13.7% from 17.2%, mainly driven by the asset transfer, which excluded any additional capital transfer. The decrease was mitigated by retention of its full 2017 net income and a further €9.5 million allocation into the funds for general banking risks according to §340g

HGB (German GAAP), which we take into account in our TAC measure.

Overall, we confirm our expectation that WBSK will maintain a strong capital ratio of 14.0%-15.0% by end-2020. Here, we anticipate ongoing retention of its full net income and only slight growth in our RWA metric, as the expected customer portfolio growth will partially be mitigated by a further deleveraging of the balance sheet, in particular of the bank's security portfolio.

We also expect that WBSK will continue to draw remaining funds from the reserve fund "Fonds zur baupartechnischen Absicherung" (FbtA, balance of €109 million as of end-2017) in order to offset constraints on income in the current low interest rate environment.

We expect only slight improvements in the bank's moderate earnings buffer, which measures the capacity for a bank's earnings to cover normalized losses. We forecast the three-year average earnings buffer for 2017-2019 to remain between 30 and 40 bps over the coming years, indicating limited ability to retain earnings, in our view. The bank continues to suffer from somewhat costly deposits, exacerbated by continuously low interest rates, which also affect interest income on securities.

We regard WBSK's risk position as moderate, reflecting its exposure to significant risks not captured by our RAC analysis. We view market risk to be the bank's current key risk for its building-savings operations, which are highly exposed to interest rate fluctuations. In particular, WBSK remains highly vulnerable to low interest rates, owing to commitments for bonus payments (under tariff schemes and legacy tariff schemes from acquisitions) that led to substantially increased provisions and depressed earnings over the past years. We expect these schemes will continue to limit the bank's profits if interest rates remain low but this effect to lessen over time. Moreover, we still envisage reputational risks because of strengthened efforts to shrink the portfolio of historical tariff schemes with bonus commitments. Finally, building-savings products often feature customer options linked to interest rate movements, which we believe constricts earnings given the low interest rates. W&W has adjusted its tariffs, but we expect this to only slowly improve the banking operations' risk profile over the medium term. However, in terms of credit risk, we observe very low losses on its mortgage portfolio in line with that of its peers over the past years, and we forecast mortgage quality to remain favorable and credit provisions to remain low over the next years.

We view WBSK's funding and its liquidity as adequate based on a healthy mix of core deposits and capital market issuance through mainly covered bonds and high amounts of excess liquidity. Most of the funding base comprises of relatively stable and granular core customer deposits, mainly sourced from the building-savings business. We forecast our stable funding ratio to remain comfortably above 100%, with a ratio of 106% as of year-end 2017. We continue to observe very high coverage of short-term wholesale funding by broad liquid assets (2.9x as of year-end 2017), which is also a consequence from the low interest rate environment, in which customers often decide not to conclude a building-savings loan when allocated.

However, despite very high liquidity ratios, we do not assess WBSK's liquidity to be strong. This is because customer deposits from the building-savings operations and the business model have proven to be more interest-rate sensitive than retail banks' in the past. In particular, we believe that if interest rates were to rise only slightly building-savings loans would become more attractive again with material negative effects on the bank's liquidity buffers as more

customers will accept the loan when allocated.

Other Assessments

The strong ERM enhances the ratings of the insurance subgroup. The group has implemented a robust and consistent risk management culture across all insurance and banking segments and business units. The overall ERM score is also supported by our positive assessment of the group's risk controls and strategic risk management. We consider ERM highly important, owing to the bancassurance business model and sensitivity to interest rates in both subgroups.

The group has an established record of sound strategic planning, focusing on improving operational efficiencies, as well as conservative and sophisticated financial management. Management still has inroads to make in developing and leveraging an effectively run bancassurance model with efficient processes.

We view the group's liquidity as exceptional based on its favorable liability profile and liquidity ratio of 259% (per our liquidity model). It has minimal collateral-posting risk and no significant debt covenants or rating triggers.

Other Considerations

We rate the holding company, W&W AG, one notch lower than the group's core operating entities. This reflects the structural subordination of the holding company's creditors to the group's insurance policyholders and bank depositors. Given its diversified earnings streams, low financial leverage, and active internal re-insurance operations, we regard the holding company as a so-called operating holding and apply a one-notch differential to the operating core subsidiaries.

The ratings on a regulatory Tier 2 instrument issued by WBSK are notched down from the 'A-' issuer credit rating on the bank, given that the bank is a core subsidiary of W&W AG and because we expect the overall group will support these instruments. In determining the 'BBB' issue rating, we deduct one notch for subordination and one notch for the principal write-down; even in cases where this is not contractually documented, the relevant regulatory and legal frameworks in Germany create the equivalent of such a clause and we expect regulators to enforce this.

The short-term rating on WBSK is 'A-1', as we believe the parent's liquidity is exceptional and would be available to the subsidiary in case of distress. We assign a higher short-term rating to the group's core subsidiary to reflect this strength, if the long-term rating on the subsidiary is 'A-'.

One notch of group support for the banking subgroup

We see the SACP of the insurance subgroup at 'a' and we continue to see the SACP of the banking segment somewhat weaker at 'bbb+'. We combine the subgroups' SACPs to derive the group credit profile (GCP), reflecting the relative weight of the insurance and banking operations by risk capital, profit contributions, and considering diversification benefits. The GCP on W&W is one notch higher than the SACP of the banking subgroup, reflecting our view that the banking subgroup is core to the overall group. We consider the insurance operations and the banking subgroups to be core parts of the group, and assess their overall unsupported GCP at 'a-'.

Accounting considerations

W&W discloses consolidated financial statements under International Financial Reporting Standards (IFRS). Additionally, all group entities report under German generally accepted accounting principles (GAAP). We used the German GAAP figures to supplement our evaluation of the individual segments.

We assess the group's capitalization by combining the capital requirements for both the banking and insurance subgroups, based on our respective criteria, using IFRS data. We adjust W&W's capital position for the specific insurance and banking components, as follows:

- Crediting 50% of the life insurance value-in-force not included on the balance sheet;
- Crediting 50% of the P/C reserve redundancy;
- Adding the free and unallocated portion of the policyholder bonus reserve in life insurance; and
- Deducting WBSK's FbtA, a reserve fund aimed to protect the savings/loan collective, which is part of IFRS equity. WBSK does not have full discretion over these funds

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria - Insurance - Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves, Nov. 26, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct. 22, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Criteria - Financial Institutions - General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015

- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Risk-Adjusted Capital Framework Methodology, July 20, 2017
- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Rating Methodology And Assumptions, Nov. 9, 2011
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings Detail (As Of August 22, 2018)

Holding Company: Wuestenrot & Wuerttembergische AG

Financial Strength Rating

Local Currency BBB+/Stable/--

Issuer Credit Rating

Local Currency BBB+/Stable/A-2

Operating Company Covered By This Report

Wuerttembergische Lebensversicherung AG

Financial Strength Rating

Local Currency A-/Stable/--

Issuer Credit Rating

Local Currency A-/Stable/--

Junior Subordinated

BBB

Related Entities

Wuerttembergische Versicherung AG

Financial Strength Rating

Local Currency A-/Stable/--

Issuer Credit Rating

Local Currency A-/Stable/--

Wuestenrot Bausparkasse AG

Issuer Credit Rating

A-/Stable/A-1

Senior Secured

AAA/Stable

Subordinated

BBB

Domicile

Germany

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