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Banque Cantonale Vaudoise

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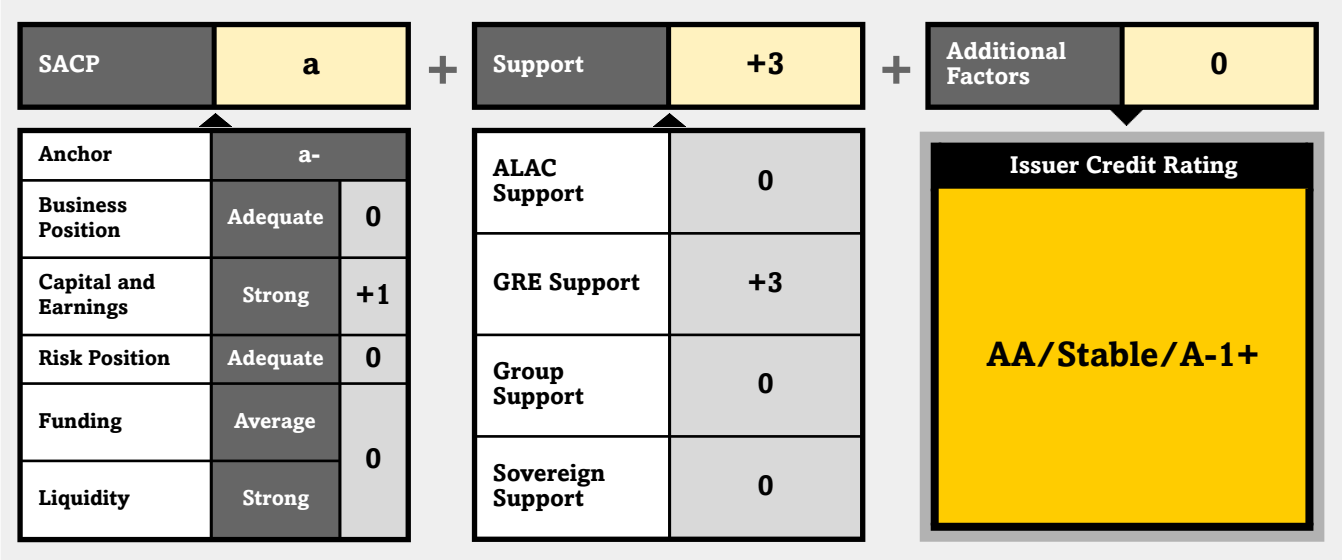
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Banque Cantonale Vaudoise



Major Rating Factors

Strengths	Weaknesses
<ul style="list-style-type: none"> • Very high likelihood of support from the Swiss Canton of Vaud in the event of stress. • Good franchise in Vaud's resilient economy. • More diverse business model than those of traditional Swiss cantonal banks. • Strong liquidity, despite management's intention to partly fund growth by drawing on excess liquidity. 	<ul style="list-style-type: none"> • High exposure to the real estate market in the Canton of Vaud. • Presence in the high-risk, low-granularity trade finance business.

Outlook: Stable

Our outlook on Switzerland-based Banque Cantonale Vaudoise (BCV) is stable, reflecting our current view that the Swiss bank resolution regime is unlikely to prevent the government of the Swiss Canton of Vaud from providing timely support to the bank in the event of stress.

Even if BCV's credit quality changed to the extent that we revised the bank's stand-alone credit profile (SACP) downward or upward by one notch, we would not revise our long-term rating on the bank, all else being equal. This is because, according to our criteria, and given our 'AAA' rating on the Canton of Vaud, any one-notch revision of the SACP would be offset by an opposite change in the uplift we attribute for extraordinary government support. All else being equal, a two-notch change in BCV's SACP, upward or downward, would result in a one-notch change (in the same direction) of the issuer credit rating, but we do not consider this likely in the next two years.

Rationale

The rating on BCV reflects the bank's 'a-' anchor, adequate business position, strong capital and earnings, adequate risk position, average funding, and strong liquidity. The SACP is 'a'.

Anchor: 'a-' for Swiss banks

Our bank criteria 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 operating only in Switzerland is 'a-'.

The BICRA score includes our evaluation of economic risk. In this respect, we view Switzerland as a highly diversified and competitive economy, benefiting from one of the highest GDPs per capita in the world and very robust government finances. We believe that large parts of the Swiss banking market demonstrate a conservative risk and lending culture, which has accompanied moderate growth of housing prices and loan portfolios.

The Swiss banking industry is supported by its sizable and very stable customer deposit base. Purely domestic Swiss banks have not loosened credit standards in recent years, thanks to sound earnings potential from core products. We consider regulatory standards to be more stringent than in other developed economies.

Table 1

Banque Cantonale Vaudoise Key Figures					
	--Year-ended Dec. 31--				
(Mil. CHF)	2015*	2014	2013	2012	2011
Adjusted assets	43,260.0	41,973.0	40,344.0	39,680.0	37,783.0
Customer loans (gross)	29,667.0	29,849.0	28,932.0	28,124.0	28,165.0
Adjusted common equity	3,012.5	2,971.0	2,937.0	2,920.0	2,906.0
Operating revenues	518.6	993.2	990.6	1,009.8	1,017.2
Noninterest expenses	322.0	630.9	645.9	613.2	627.1
Core earnings	157.6	294.1	271.6	309.5	304.0

*Data as of June 30. CHF--CHF-Swiss Franc.

Business position: Good franchise in Vaud and a more diverse business profile than a typical Swiss cantonal bank

We assess BCV's business position as adequate. With total assets of Swiss franc (CHF) 43.2 billion (about €40 billion) on Sept. 30, 2015, BCV is the sixth-largest banking group in Switzerland. It has a market share of about 33% in retail banking and among small and midsize enterprises (SMEs) in Vaud, one of the country's richest and most resilient cantons. Vaud's GDP growth has outperformed Switzerland's GDP growth by an annual average of about 0.5% over the past five years, with an average annual growth rate for Vaud of 2.4% compared with 1.9% for Switzerland.

With CHF84.8 billion of assets under management (AuM) on Sept. 30, 2015, BCV has a good franchise in asset and wealth management, although its market share in private banking is much smaller than that in retail banking. In the first three quarters of 2015, the CHF2.1 billion in net new funding from "onshore" AuM was partly offset by CHF0.7 billion in outflows of "offshore" AuM. BCV consolidated its wealth management franchise in 2011 with the acquisition

of Banque Franck Galland, which had about CHF3 billion in AuM. Banque Franck Galland then merged with Banque Piguet, one of BCV's subsidiaries, to become Piguet Galland & Cie SA.

We believe that control of immigration in Switzerland and ongoing reform of the country's corporate tax law could slow demand for bank services, but BCV is confident about the ability of the Swiss government and the Canton of Vaud to find appropriate solutions that will ultimately allow these changes to have a marginal impact on the bank's activities. In addition, the impact on BCV's private banking revenues, due to pressures on Swiss banks from foreign countries with regard to tax conformity, is limited, in our view, as most of BCV's assets are "onshore". BCV participates as a Category 2 bank in a U.S. Department of Justice (U.S. DoJ) program for Swiss banks (a Category 2 Swiss Bank is one requesting a non-prosecution agreement and that is not under criminal investigation but which might be considered by the U.S. DoJ to have committed tax-related or monetary transaction offenses).

In addition to its traditional activities as a Swiss cantonal bank, BCV has a structured product business and is one of the main players in French-speaking Switzerland in transaction-based commodity trade finance, which relates mainly to steel, agro-business, and petroleum derived products. Apart from issuing structured products, 80% of the bank's trading activity is focused on foreign exchange spot and derivatives transactions to serve clients' needs. We observe that volumes in foreign exchange transactions operated by BCV, and related revenues, increased strongly in 2015. This followed the Swiss National Bank's decision on Jan. 15, 2015 to drop the EUR/CHF floor of 1.20, that it had introduced in late 2011.

Table 2

Banque Cantonale Vaudoise Business Position					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Total revenues from business line (mil. CHF)	546.6	996.1	1,003.0	1,014.4	1,021.9
Commercial banking/total revenues from business line	24.0	27.4	27.5	28.2	28.1
Retail banking/total revenues from business line	17.9	19.4	19.5	20.6	20.9
Commercial & retail banking/total revenues from business line	41.9	46.8	47.1	48.8	49.0
Trading and sales income/total revenues from business line	6.4	5.0	6.1	5.6	6.1
Asset management/total revenues from business line	32.0	37.1	37.0	36.1	36.0
Other revenues/total revenues from business line	19.7	11.1	9.9	9.5	8.9
Investment banking/total revenues from business line	6.4	5.0	6.1	5.6	6.1
Return on equity	10.9	8.9	8.4	9.4	9.2

*Data as of June 30. CHF--Swiss franc.

Capital and earnings: Strong capital position

We view BCV's capital and earnings as strong overall. The quality of the bank's capital is high as it is composed almost entirely of common equity Tier 1 (CET1) capital. The bank's risk-adjusted capital (RAC) ratio was 12.9% as of Dec. 31, 2014, compared to 13.2% as of Dec. 31, 2013 (proforma our revision of the Swiss BICRA score to '2' from '1' on Dec. 1, 2014, and proforma all our risk parameters at end-2014). For the record, the RAC was 14.3% at end-2013 based on our historical risk parameters at that date. We do not expect the bank's RAC ratio to exceed 15% over the next 18-24 months, given planned growth of exposures and management's stated intention to continue paying high dividends. In April 2015, BCV distributed CHF275 million to shareholders, out of its CHF296 million post-tax net income for 2014.

BCV had a 17.0% CET1 ratio as of June 30, 2015 (the total capital ratio at the same date was 17.1%, reflecting marginal additional contribution from CHF21 million in Tier 2 capital). In order to address rising property prices, in 2013, the Swiss regulator (FINMA) implemented a counter-cyclical buffer based on total regulatory risk-weighted assets on mortgage exposures. This buffer was set at 1% in September 2013 then raised to 2% in 2014. In addition, in 2013, FINMA introduced a bank-specific multiplier for regulatory risk-weighted assets on mortgages to reduce the difference in risk weights between banks using an internal rating-based approach and those using the standardized approach. The multiplier for BCV will increase gradually until 2019, and we estimate that it will further cut the bank's CET1 ratio by 100 basis points (bps). BCV targets a minimum 13% CET1 ratio over time, while FINMA would intervene if the total capital ratio fell below 11%.

Margins on the liability side remain constrained by very low short-term interest rates. We expect BCV's annual post-tax profit to be above CHF300 million in 2015, including a one-off capital gain from the sale of the bank's participation in Swisscanto in the first half of the year. We expect BCV's profits to remain very stable at about CHF300 million in 2016-2017. We will continue to monitor the resolution of the U.S. DoJ's program and related costs that could be incurred by BCV. We see material upside potential for revenues if interest rates normalize or the yield curve steepens. We note that the bank's profitability, adjusted for risk, is strong, with a three-year average earnings buffer of about 1% in 2014, indicating adequate capacity for earnings to cover expected losses.

Table 3

Banque Cantonale Vaudoise Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Tier 1 capital ratio	17.0	17.1	17.8	18.4	16.8
S&P RAC ratio before diversification	N.A.	12.9	14.3	14.6	14.3
S&P RAC ratio after diversification	N.A.	12.5	14.0	14.3	14.1
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	47.5	50.7	50.6	51.4	50.8
Fee income/operating revenues	33.0	34.6	34.5	34.4	35.1
Market-sensitive income/operating revenues	15.3	10.7	11.4	11.2	11.3
Noninterest expenses/operating revenues	62.1	63.5	65.2	60.7	61.6
Provision operating income/average assets	0.9	0.9	0.9	1.0	1.1
Core earnings/average managed assets	0.7	0.7	0.7	0.8	0.8

*Data as of June 30. N.A.--Not available. RAC--Risk-adjusted capital.

Table 4

Banque Cantonale Vaudoise Risk-Adjusted Capital Framework Data					
	EAD (1)	Basel II RWA (2)	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Government and central banks	2,698	0	0	96	4
Institutions	3,734	1,055	28	472	13
Corporate	14,574	8,961	61	10,859	75
Retail	17,594	3,174	18	5,312	30
Of which mortgage	15,770	2,514	16	4,057	26
Securitization (3)	0	0	0	0	0

Table 4

Banque Cantonale Vaudoise Risk-Adjusted Capital Framework Data (cont.)					
Other assets	745	693	93	769	103
Total credit risk	39,345	13,883	35	17,508	44
Equity in the banking book (4)	252	612	594	1,992	790
Trading book market risk	--	350	--	525	--
Total market risk	--	962	--	2,517	--
Total insurance risk	--	--	--	0	--
Total operational risk	--	1,764	--	2,965	--
RWA before diversification	--	16,792	--	22,989	100
Total Diversification/Concentration Adjustments	--	--	--	705	3
RWA after diversification	--	16,792	--	23,694	103
		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio before adjustments		2,874	17.1	2,971	12.9
Capital ratio after adjustments (5)		2,874	17.1	2,971	12.5

Footnotes: (1) EAD: Exposure at default. (2) RWA: Risk-weighted assets. (3) Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. (4) Equity Exposure includes the minority equity holdings in financial institutions. (5) For Tier 1 ratio, adjustments are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons).

Risk position: Concentration of risk in the Canton of Vaud's real estate markets and sizable trade finance exposures

Our assessment of BCV's risk position as adequate reflects the balance between the bank's high exposure to Vaud's property markets, with about 80% of BCV's loans being for owner-occupier mortgages or income-producing real estate (we estimate that these loans traditionally account for only one-third of the bank's total income, however) and its good track record of very low cost of risk on real estate exposures over the last five years.

There has been strong cumulative growth in residential real-estate prices and domestic lending in Switzerland over several years, particularly mortgage lending. We consider this to represent an incremental risk for Swiss banks that have mainly domestic operations and large exposure to the Swiss real estate market. Moreover, with annual average growth of above 6% over the last 10 years, real estate prices in Vaud have increased by more than the Swiss average, which we estimate was above 4% over the same period. We acknowledge, though, that house price increases in Vaud partly reflect above-average economic growth in the canton and strong immigration-led demand compared with limited supply. Although house prices have been cooling locally since 2014, more particularly for luxury properties, they remain historically high in our view. Furthermore, given BCV's significant exposure to residential real estate, we consider that an unexpected deterioration in prices could increase the bank's loan losses. However, we consider that the risk of a sharp correction in property prices is low.

We regard BCV's stricter application of underwriting standards since 2011 as positive. For example, loan-to-value ratios on new mortgage lending are capped at 80% for owner-occupied housing (lower levels are applied to buy-to-let), and borrowers must provide a minimum down payment of 20% in cash. Moreover, the annual cost of borrowing (calculated on a theoretical 7% interest rate) must not exceed one-third of a customer's annual net income. We note that BCV limited the growth of its mortgage portfolio to 3% in 2014, after 2% in 2013 and 4% in 2012. We further

expect a low growth rate in 2015, as illustrated by the 1% achieved over the first three quarters of the year.

BCV is the only cantonal bank to whom the Swiss regulator has given approval to use the internal ratings-based approach for regulatory purposes. This reflects, in our view, the quality of BCV's credit risk management. Gross nonperforming loans stood at a low 0.9% of total customer loans at end-2014.

BCV's riskiest positions include trade finance exposures, which stood at about CHF1.6 billion at mid-2015, compared to CHF1.8 billion at end-2014. Due to low granularity in the portfolio, the cost of risk incurred in this business segment is volatile (it was zero in 2011, 2013, and 2014), but we estimate that, through the cycle, it would represent more than one-third of BCV's total credit risk.

Although BCV hedges market risk arising from its structured products and certificates businesses, some residual risk remains, mainly dividend and correlation risk. Revenues associated with structured products and certificates account for less than 2% of total revenues, according to our estimates.

Table 5

Banque Cantonale Vaudoise Risk Position					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Growth in customer loans	(1.2)	3.2	2.9	(0.1)	9.5
Total diversification adjustment / S&P RWA before diversification	N.A.	3.1	2.0	2.2	1.3
Total managed assets/adjusted common equity (x)	14.4	14.2	13.8	13.6	13.0
New loan loss provisions/average customer loans	(0.0)	(0.1)	(0.0)	(0.0)	(0.0)
Net charge-offs/average customer loans	N.A.	0.1	0.1	0.1	0.1
Gross nonperforming assets/customer loans + other real estate owned	0.8	0.9	1.2	1.6	1.8
Loan loss reserves/gross nonperforming assets	28.6	30.8	36.3	36.9	38.8

*Data as of June 30. N.A.--Not available. RWA--Risk-weighted asset.

Funding and liquidity: Largely funded by deposits, with strong cash liquidity buffers

We assess BCV's funding as average, and its liquidity as strong. Customer deposits were stable, and represented 74% of BCV's funding base on June 30, 2015, according to our calculations. This is in line with the levels of Swiss cantonal bank peers.

Like other cantonal banks, BCV issues covered bonds through the Centrale de lettres de gage (CLG). Through this mutualized source of funding, the bank benefits from the excellent creditworthiness of the CLG, which is backed by Swiss cantonal banks and ultimately by most cantons. BCV's stable funding ratio at end-2014 was 115%, which compares favorably with the ratios of domestic peers.

As of June 30, 2015, BCV's liquidity buffer comprised mainly cash held at the Swiss National Bank (SNB). In addition, BCV has a pool of unencumbered bonds that are eligible as collateral with the SNB. Investing the liquidity buffer in domestic repurchase agreements is a limited alternative because most banks actively using this option are cash rich and volumes have dropped.

BCV's ratio of broad liquid assets to short-term wholesale funding was a strong 2.9x at end-2014. However, a

significant portion of the deposit base contains private banking deposits and uninsured institutional investors' deposits, which are more volatile than traditional retail deposits, in our view. Preliminary data indicate a Basel III liquidity coverage ratio just above 100% at year-end 2014, far above the 60% minimum regulatory requirement at that date. BCV's aim is to exceed the minimum regulatory requirement by 10%. We believe BCV's liquidity position will remain strong, as we expect the bank to keep a sound balance between additional long-term issuance and use of its liquidity buffer, while preserving its capacity to attract deposits.

Table 6

Banque Cantonale Vaudoise Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Core deposits/funding base	74.2	77.3	77.7	76.4	76.4
Customer loans (net)/customer deposits	101.5	101.7	102.0	102.8	108.8
Long term funding ratio	90.0	92.8	93.1	91.4	92.5
Stable funding ratio	115.8	114.9	113.5	120.0	113.2
Short-term wholesale funding/funding base	10.8	7.8	7.6	9.3	8.2
Broad liquid assets/short-term wholesale funding (x)	2.4	2.9	2.8	3.0	2.8
Net broad liquid assets/short-term customer deposits	20.2	19.0	39.3	54.2	20.2
Short-term wholesale funding/total wholesale funding	41.9	34.2	33.9	39.5	34.6
Narrow liquid assets/3-month wholesale funding (x)	2.8	3.6	3.8	4.1	3.3

*Data as of June 30.

External support: Government-related entity status puts the long-term rating three notches above the SACP

We view BCV as a government-related entity (GRE). In accordance with our criteria for GREs, we believe that there is a very high likelihood that the Canton of Vaud would provide timely and sufficient extraordinary support to BCV in the event of financial stress, as it did in 2001-2003. For this reason, the long-term rating on BCV stands three notches above its SACP.

Our view that there is a very high likelihood of extraordinary support is based on our assessment of BCV's:

- Very important role in the local economy, reflecting its public policy role in the canton's economic development and the possibility that a default could damage the canton's reputation; and
- Very strong link with the canton. A law passed in March 2010 stipulates that the canton will keep a majority stake of at least 50% plus one share in the bank. The Canton of Vaud currently owns 67% of BCV. Unlike some other Swiss cantonal banks, however, BCV does not benefit from a cantonal statutory guarantee.

Based on enhancements to the Swiss bank resolution regime coming into effect on Jan. 1, 2016, we consider it uncertain that the Swiss sovereign would provide extraordinary government support to systemically important commercial banks. But, in our view, the Swiss resolution framework does not impede cantonal owners' ability to provide extraordinary support in going-concern to banks that we consider to be GREs.

Additional rating factors: None

No additional factors affect the rating.

We also consider the Swiss resolution regime to be effective--that is, likely to ensure an orderly bail-in of liabilities to ensure that stressed systemically important institutions remain a going concern. We can therefore include notches of uplift for systemically important commercial banks that we expect will build sizable bail-in capacity buffers (additional loss-absorbing capacity) up to end-2018. Potentially, this could include BCV. However, we consider the GRE support to be the stronger external support element given that it provides three notches of uplift to BCV, more than any uplift potentially available under our criteria for additional loss-absorbing capacity.

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - Jan. 29, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - Dec. 16, 2014
- Group Rating Methodology - Nov. 19, 2013
- Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework - June 22, 2012
- Banks: Rating Methodology and Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology and Assumptions, Nov. 9, 2011
- Bank Capital Methodology and Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Related Research

- Most European Bank Ratings Affirmed Following Government Support And ALAC Review, Dec. 2, 2015
- Credit FAQ: How Standard & Poor's Applied Its Government Support And ALAC Criteria To European Banks In December 2015, Dec. 2, 2015
- Standard & Poor's To Conclude Its Review Of Systemic Support For Remaining EU Banks By Early December, Oct. 1, 2015
- Banking Industry Country Risk Assessment: Switzerland, Sep. 9, 2015
- Supplementary Analysis: Vaud (Canton of), June 25, 2015
- S&P Takes Various Rating Actions On Certain U.K., German, Austrian, And Swiss Banks Following Government Support Review, Feb. 3, 2015
- Credit FAQ: The Rating Implications Of The Emerging Bank Resolution Frameworks In U.K., Germany, Austria, And Switzerland, Feb. 3, 2015
- Various Ratings Actions On Swiss Banking Groups On Rising Economic Imbalances, Dec. 1, 2014

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 15, 2015)

Banque Cantonale Vaudoise

Counterparty Credit Rating

AA/Stable/A-1+

Counterparty Credit Ratings History

18-Jun-2013

AA/Stable/A-1+

03-Jul-2012

AA/Negative/A-1+

05-Dec-2011

AA/Stable/A-1+

Sovereign Rating

Swiss Confederation

AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's 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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