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Kiwibank Ltd.

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Kiwi Capital Funding Ltd (KCFL)

Related Criteria And Research

Kiwibank Ltd.

SACP	bbb	+	Support	+4	+	Additional Factors	0
Anchor	bbb		GRE Support	0		Issuer Credit Rating A+/Stable/A-1	
Business Position	Adequate	0	Group Support	+4			
Capital and Earnings	Strong	+1	Sovereign Support	0			
Risk Position	Moderate	-1					
Funding	Average	0					
Liquidity	Adequate						

Major Rating Factors

Strengths:	Weaknesses:
- Support through an unconditional guarantee from New Zealand Post Ltd., the 100% parent - Nationwide presence and a meaningful competitor in the New Zealand banking landscape - Strong capital position relative to peers	- Elevated operational risk, but risk trend improving - Concentrated product suite focus

Outlook: Stable

The stable outlook reflects that on Kiwibank's parent, NZ Post. We expect the ratings on Kiwibank to remain equalized with those on NZ Post unless there is a significant dilution or withdrawal of the guarantee provided by the parent.

We expect to lower the ratings on Kiwibank by one notch if the same rating action is taken on its parent. The most likely triggers for a downgrade of NZ Post's rating are if:

- The group is unable to sustain its "minimal" financial risk profile, which would include debt to EBITDA (including dividends from Kiwibank) sustained above 1.5x; or
- Ineffective restructuring of the core mail operations causes sustained operating losses that undermine the overall profitability of the group.

Although less likely, downward ratings pressure on NZ Post could also arise if:

- We considered there to be a reduced likelihood that the New Zealand government would provide timely and sufficient extraordinary support to NZ Post; or
- We lowered our stand-alone credit profile (SACP) assessment on Kiwibank.

The most likely scenario for Kiwibank contributing to rating pressure on NZ Post would be a weakening in the bank's business profile. We believe the bank's business would be under pressure if there were a prolonged period of slower organic growth and reducing net interest margins relative to the New Zealand major banks and system average, which could be indicative of--among other things--a structural decline in Kiwibank's business franchise.

Although a one-notch downgrade of the NZ Post rating would be mirrored in the Kiwibank rating, the latter is insulated from any further downgrade in the parent rating, all other things remaining equal for Kiwibank. This is because we believe that Kiwibank has a "high" likelihood of receiving extraordinary support from the New Zealand government, reflecting the bank's "very strong" link and "important" role to the government.

Therefore, the rating on Kiwibank can factor in external support from either its parent or extraordinary support from the government, whichever is higher. While the rating on the bank currently benefits from parent support (because this offers the highest rating uplift benefit), external support from the two sources would provide equal rating uplift if the rating on NZ Post is lowered by one notch. If there is any further deterioration in the parent rating, the uplift in the bank rating due to extraordinary government support would exceed that from the parent support, and thus sufficient to maintain the long-term issuer credit rating on the bank at 'A', all other things remaining equal.

Rationale

The ratings and outlook on Kiwibank mirror our ratings and outlook on the bank's parent, New Zealand Post Ltd. (NZ Post, A+/Stable/A-1). The equalization reflects the benefit of NZ Post's unconditional guarantee for all of the bank's senior obligations. We note that a weakening in Kiwibank's SACP itself could be a trigger for lowering the rating on NZ Post, given that Kiwibank forms a material part of the NZ Post group.

Kiwibank's SACP reflects the bank's nationwide presence as a meaningful competitor in the New Zealand banking landscape, and its strong capital position relative to peers. We are of the view that operational risks are still elevated

(relative to peers that we assess as adequate) but note that the risk trend is improving. In our view Kiwibank remains concentrated in in terms of product, with residential mortgage loans constituting about 80% of its exposures at default.

Anchor:

The starting point for our ratings on Kiwibank--similar to our ratings on all other banks operating in New Zealand--is 'bbb', reflecting our assessment of New Zealand's macro environment. We view New Zealand as having a reasonably wealthy, resilient, market-oriented economy with flexible labor and product markets. We consider banking regulation and supervision in New Zealand as strong and more conservative than international standards; the governance and transparency in the New Zealand banking industry are adequate, and contribute to the strengthening of market discipline.

In our view, the risk of a significant change in the competitive landscape is minimized by an oligopolistic nature of the banking system. That said, we believe that the banking system's material dependence on net external borrowings and limited support from core customer deposits represent a weakness to the system. We also consider that economic imbalances caused by rising house prices and amplified by persistent current account deficits and the reliance on net external borrowings as a further weakness to the banking system. In our view, domestic credit to the private sector in New Zealand remains high, although offset by high income levels and conservative lending and underwriting standards.

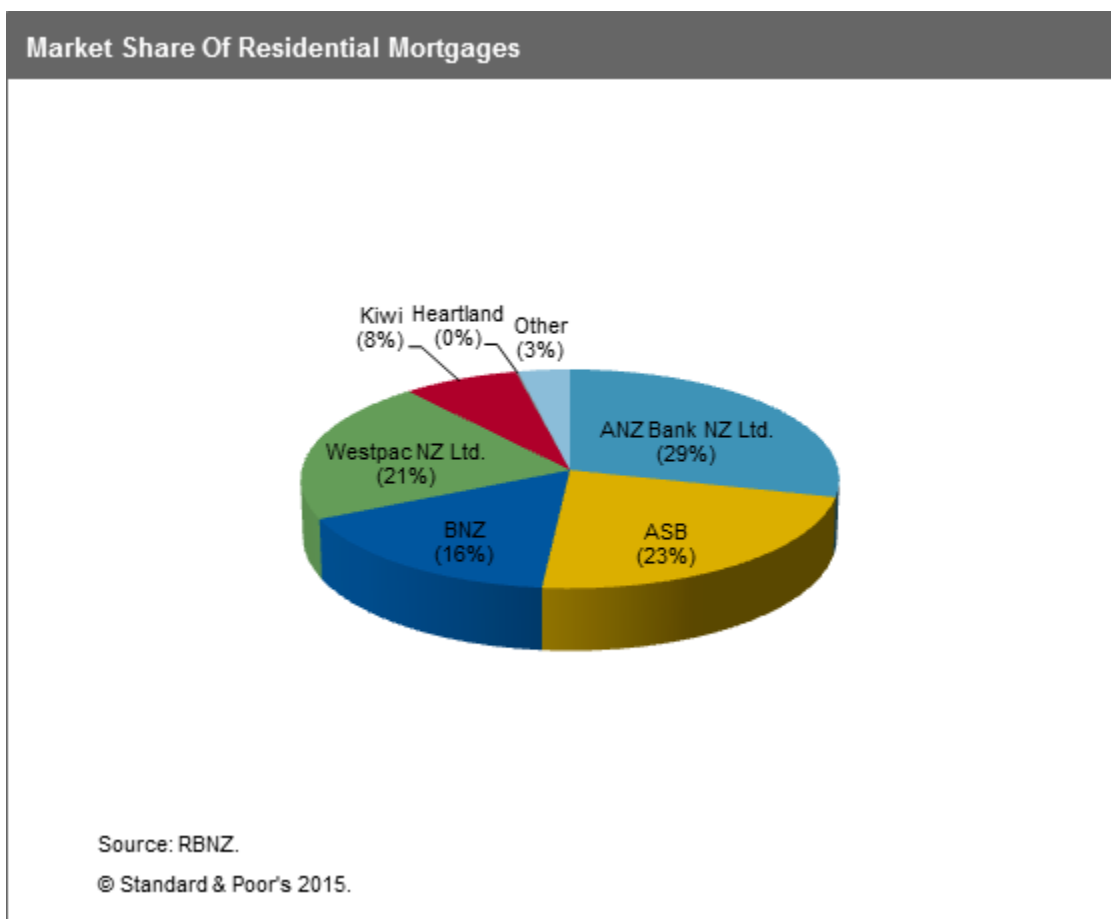
Table 1

Kiwibank Ltd. Key Figures					
	--Year-ended June 30--				
(Mil. NZ\$)	2015	2014	2013	2012	2011
Adjusted assets	18,228	16,590	15,145	14,696	13,828
Customer loans (gross)	15,651	14,689	13,274	12,536	11,582
Adjusted common equity	816	750	641	568	449
Operating revenues	560	479	446	419	353
Noninterest expenses	351	325	287	257	226
Core earnings	117	110	105	86	28

Business position:

Kiwibank is a 100% domestically owned full-service New Zealand bank with a nationwide presence and a meaningful competitor in the New Zealand banking landscape.

Chart 1



During the past two years Kiwibank has further strengthened its competitive advantages over the smaller financial institutions in New Zealand that target the same customer base, and narrowed the gap between itself and the major banks. Kiwibank's stronger business profile is reflected in a defendable and increasingly significant market share in New Zealand. We estimate that Kiwibank had an 8% share of residential mortgages and 5% share of customer deposits in New Zealand at June 30, 2015. Demonstrating the bank's franchise strength is its continued growth in residential mortgages, maintenance of its net interest margin, and the credit quality of its residential mortgage loan portfolio.

We believe that Kiwibank's restructuring of its distribution network and completion of the first phase to replace its core banking system in the quarter ending Sept. 30, 2015, will place it in a good position to cater to the evolving needs of its customer base and sustain its business growth.

Furthermore, in our view, Kiwibank has leveraged and consolidated its competitive advantage over the four major banks as well as the smaller financial institutions, by positioning itself as a domestically-owned full-service bank with a nationwide presence. We believe that this appeals to a significant section of the customer base, given that the New Zealand banking system is dominated by the four Australian-owned major banks, which account for about 90% of the market share.

Despite this strengthening in Kiwibank's business profile, we consider that it remains disadvantaged relative to the New Zealand major banks in its primary business of deposit-taking and residential-mortgage lending, which is becoming increasingly commoditized and price-sensitive. We consider that Kiwibank's larger competitors generally enjoy greater pricing power and operating efficiency due to greater economies of scale as well as business diversity.

In our view Kiwibank remains concentrated in in terms of product, with residential mortgage loans constituting about 80% of its exposures at default. In parallel we observe that Kiwibank aims to diversify its product revenue streams through the revision of its business banking strategy to expand its capacity to serve the SME business segment and to establish a reputation as a creditable, professional business bank. We are of the view that the successful rollout of the revised business banking strategy would have a positive impact on the bank's product diversification; in addition we note that new business lending is targeted away from commercial property loans, resulting in a broader cross section of SME customers by business type. We observe that the revised business banking strategy will have strong links to Kiwibank's core banking system-replacement project.

We are of the view that Kiwibank has made progress in the execution of its strategy. To date the strategy has focused on building a stronger platform by investing in people, processes, and systems to enable a low-cost operating model that will enable Kiwibank to create a platform for future growth. Main bank growth by deepening customer relationship through driving physical network transformation and diversification across various business sectors have also been key strategic priorities for the bank. We note that the future vision for Kiwibank is to be a customer-focused bank that is profit-driven, with a simple operating model and diversity of income sources. The initiatives in place to achieve the future vision include a revamp of the operating model; digital transformation; the development of a Kiwibank distribution blueprint, including the transition of company-owned branches to Kiwibank; and the modernization of platforms.

In our view, Kiwibank's corporate governance and risk management structures are adequate given the nature and extent of the bank's activities. We note that the executive management structure and composition remained fairly stable over the past year, with new appointments being made to the position of Chief Risk Officer.

Table 2

Kiwibank Ltd. Business Position					
	--Year-ended June 30--				
(%)	2015	2014	2013	2012	2011
Total revenues from business line (currency in millions)	560.0	479.0	446.0	419.0	353.0
Retail banking/total revenues from business line	55.4	60.3	60.1	60.4	60.4
Return on equity	10.2	11.7	13.5	13.3	2.8

Capital and earnings: strong capital position relative to peers

Our assessment of Kiwibank's capital and earnings reflects our expectation that Kiwibank's risk-adjusted capital (RAC) ratio will remain in the 10.25%–10.75% range over the next 12-24 months. This current forecast RAC ratio is lower than the prior 11.5%–12.5% primarily because of the lowering of New Zealand's economic risk score to '4' from '3', which was the result of the buildup in economic imbalances from rising national house prices (in particular Auckland).

Our forecast takes into account the following key assumptions:

- Kiwibank's loan growth reverting to around system levels as the bank continues to focus on profitable growth and the management of available capital.
- Interest margin pressure resulting from competitive pressures, but potentially being offset by margin management in the form of careful pricing strategies.
- Cost management initiatives continuing to be a focus area, noting that investment activities would remain elevated.
- Conservatively estimated credit loss provisions of about 20bps of gross loans and advances over the forecasting period.
- Adjusted retained earnings, with common dividends paid from 2015 onward.
- Kiwibank's investment in its core bank-replacement project being treated as a non-servicing intangible and deducted from total adjusted capital.

We believe that Kiwibank comfortably meets the minimum regulatory requirements in New Zealand. Kiwibank is also in the process of transitioning to the Basel II advanced ratings-based approach for the measurement of its credit risk exposures, possibly freeing up further capital and increasing Kiwibank's capital ratios above the regulatory minimums.

Importantly, we note that capital support is also available from the New Zealand government, through a committed NZ\$300 million uncalled capital facility for Kiwibank; the committed uncalled capital facility is only available to restore the prudential capital and liquidity ratios in specific circumstances.

In our view, Kiwibank has a satisfactory capital structure that includes a NZ\$150 million Basel III hybrid instrument--which is assessed as having "intermediate" equity content under Standard & Poor's hybrid debt rating criteria. The instrument has a non-viability contingent capital feature that allows the instrument to convert into common equity if the non-viability trigger is breached.

We are of the view that although Kiwibank generates sufficient earnings to cover our estimation of its normalised losses, the bank's key earnings metrics are still weaker relative to peers', largely due to its lower net interest margin and higher non-interest expenses (as a percentage of operating revenues).

Table 3

Kiwibank Ltd. Capital And Earnings					
	--Year-ended June 30--				
(%)	2015	2014	2013	2012	2011
Tier 1 capital ratio	11.0	10.4	10.4	10.4	9.0
Adjusted common equity/total adjusted capital	84.5	86.5	81.1	79.2	75.2
Net interest income/operating revenues	64.5	61.2	61.9	61.3	54.2
Fee income/operating revenues	34.6	38.2	38.1	37.5	41.1
Market-sensitive income/operating revenues	0.9	0.6	0.0	1.2	4.6
Noninterest expenses/operating revenues	62.7	67.8	64.3	61.3	64.0
Preprovision operating income/average assets	1.2	1.0	1.1	1.1	1.0
Core earnings/average managed assets	0.7	0.7	0.7	0.6	0.2

Risk position: elevated operational risk, but risk trend improving

We currently hold that Kiwibank's risk position is weaker compared to peers. Our assessment is based on our view that Kiwibank's operational risks are higher, mainly as a result of the bank replacing its ageing core banking system with more scalable and agile systems to meet the needs of the modern, digital-driven world. In our view, although the

replacement of the core banking system would also result in a simplification of the bank's operating model, we currently believe that in the interim the core banking replacement project introduce additional operational risks.

That said, we could reassess our risk position assessment if we were of the view that significant progress was made in the roll out of the core banking system and that implementation risks were appropriately managed. At the same time we also need to be comfortable that Kiwibank maintains its asset quality, the bank's business plans remain stable, and that there are no other indications of a significant increase in risk appetite from the bank that may impact other areas of its risk position assessment.

We note that Basel advanced accreditation could potentially result in improved risk-management tools. Nevertheless, this by itself was not considered an important driver of the risk position assessment.

We observe that Kiwibank's growth in loans and advances has reverted to around system levels and that Kiwibank is not disproportionately exposed to concentration risks such as single-name concentration and geographic concentration compared to peers who have a similar economic risk score and who operate in New Zealand. Kiwibank's product concentration is, however, higher compared to that of the other major banks.

From a complexity point of view we are also of the view that Kiwibank's business operations are relatively simple and uncomplicated compared to large, internationally active banks.

Table 4

Kiwibank Ltd. Risk Position					
	--Year-ended June 30--				
(%)	2015	2014	2013	2012	2011
Growth in customer loans	6.5	10.7	5.9	8.2	11.0
Total managed assets/adjusted common equity (x)	22.5	22.2	23.7	26.0	30.9
New loan loss provisions/average customer loans	0.1	(0.0)	0.1	0.3	0.7
Net charge-offs/average customer loans	0.1	0.1	0.2	0.3	0.1
Gross nonperforming assets/customer loans + other real estate owned	0.2	0.4	0.5	1.0	1.2
Loan loss reserves/gross nonperforming assets	155.9	107.3	101.4	75.8	62.8

Funding and liquidity: sizeable core deposit funding base

The funding assessment recognizes Kiwibank's stable funding ratio of 103% and long term-funding ratio of 93% are ahead of that of New Zealand peer banks. We also note that Kiwibank's loans-to-deposits ratio of 114% is lower than the average of the New Zealand peer banks. Compared to peers, Kiwibank also has a significant core deposit funding base.

We are of the view that Kiwibank's wholesale funding profile (about 15% of the total funding structure) is adequately diversified across various instruments and markets; the tenor of the wholesale funding profile is also relatively evenly spread across a number of years avoiding large maturities in a particular year.

In our view Kiwibank's funding profile also benefits from its stronger franchise, which is supported by its NZ Post shareholding and guarantee.

We believe that Kiwibank has adequate capacity to meet its liquidity needs, supported by its balance-sheet holdings of liquid assets, good and stable cash flows from amortising loans, and its large and reasonably stable retail deposit base. The bank's liquidity position also benefits from management's active and comprehensive liquidity-management practices, which include specific policies and plans to manage liquidity in a range of market or name-stress scenarios.

Table 5

Kiwibank Ltd. Funding And Liquidity					
	--Year-ended June 30--				
(%)	2015	2014	2013	2012	2011
Core deposits/funding base	82.3	83.1	85.9	84.0	81.5
Customer loans (net)/customer deposits	113.5	114.7	108.9	107.6	108.6
Long term funding ratio	93.8	91.4	92.9	90.1	87.8
Stable funding ratio	102.9	97.7	100.5	99.4	96.7
Short-term wholesale funding/funding base	6.6	9.1	7.5	10.4	12.7
Broad liquid assets/short-term wholesale funding (x)	1.5	1.0	1.3	1.0	0.9
Net broad liquid assets/short-term customer deposits	4.4	(0.2)	2.4	0.6	(1.4)
Short-term wholesale funding/total wholesale funding	35.7	51.2	49.4	60.8	64.7

Additional rating factors:

Our ratings on Kiwibank's nondeferrable subordinated debt instruments and perpetual capital notes are notched off the 'bbb' unsupported GCP of New Zealand Post group. While we regard Kiwibank as an integral part of the NZ Post group, and accept that NZ Post is highly supportive of all Kiwibank debt issues, timely government support for its subordinated debt instruments and perpetual capital notes is less likely than those for most of the other debt issued by NZ Post and Kiwibank.

The issue ratings on Kiwibank's non-deferrable subordinated debt are 'BB+', or two-notches below the unsupported GCP of New Zealand Post group, reflecting one-notch deduction for subordination to the senior debt in liquidation, and; one-notch reflecting that such instruments contain a contingency clause that requires a write-down of principal.

Table 6

Kiwibank Ltd. Risk-Adjusted Capital Framework					
(Mil. NZ\$)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	1,477	8	1	81	5
Institutions	522	142	27	169	32
Corporate	96	54	56	92	96
Retail	16,129	6,791	42	6,525	40
Of which mortgage	15,057	5,719	38	5,591	37
Other assets	700	130	19	406	58
Total credit risk	18,923	7,126	38	7,273	38
Trading book market risk	--	534	--	800	--
Total market risk	--	534	--	800	--
Total operational risk	--	1,075	--	1,035	--

Table 6

Kiwibank Ltd. Risk-Adjusted Capital Framework (cont.)					
		Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA
RWA before diversification		8,734		9,109	100
Total Diversification/Concentration Adjustments		--		2,088	23
RWA after diversification		8,734		11,197	123
		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio before adjustments	0	960	11.0	966	10.6
Capital ratio after adjustments‡	0	960	10.3	966	8.6

*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's 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. Sources: Company data as of June. 30. 2015. Standard & Poor's.

Kiwi Capital Funding Ltd (KCFL)

KCFL's Basel-III non-deferrable subordinated debt is rated 'BB+', or two notches below the unsupported GCP of New Zealand Post group, reflecting a one-notch deduction for subordination to the senior debt in liquidation, and another one-notch reflecting that such instruments contain a contingency clause that requires mandatory conversion into common equity or a write-down of principal on the activation of a non-viability trigger.

KCFL's Basel-III perpetual capital notes are rated 'BB-', or four notches below the unsupported GCP of New Zealand Post group, reflecting a one-notch deduction for subordination to the senior debt in liquidation, two notches for the risk of partial or untimely payment, one notch reflecting that such instruments contain a contingency clause that requires mandatory conversion into common equity or a write-down of principal on the activation of a non-viability trigger.

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- 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
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Commercial Paper I: Banks, March 23, 2004
- Guarantee Criteria--Structured Finance, May 7, 2013

Related Research

- New Zealand Post Ltd. Outlook Revised To Stable On Strengthening Financial Profile, 'A+/A-1' Ratings Affirmed, Nov. 17, 2015

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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 November 27, 2015)

Kiwibank Ltd.

Counterparty Credit Rating A+/Stable/A-1

Subordinated BB+

Counterparty Credit Ratings History

16-Nov-2015 A+/Stable/A-1

21-May-2013 A+/Negative/A-1

30-Oct-2012 A+/Stable/A-1

31-Jan-2012 AA-/Negative/A-1+

Sovereign Rating

New Zealand

Foreign Currency AA/Stable/A-1+

Local Currency AA+/Stable/A-1+

Related Entities

Kiwi Capital Funding Ltd.

Junior Subordinated BB-

Subordinated BB+

*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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