



**STANDARD & POOR'S  
RATINGS SERVICES**

McGRAW HILL FINANCIAL

# I rating: dall'approccio metodologico alla regolamentazione

## IR Seminar

**Milano, 16 ottobre 2014**

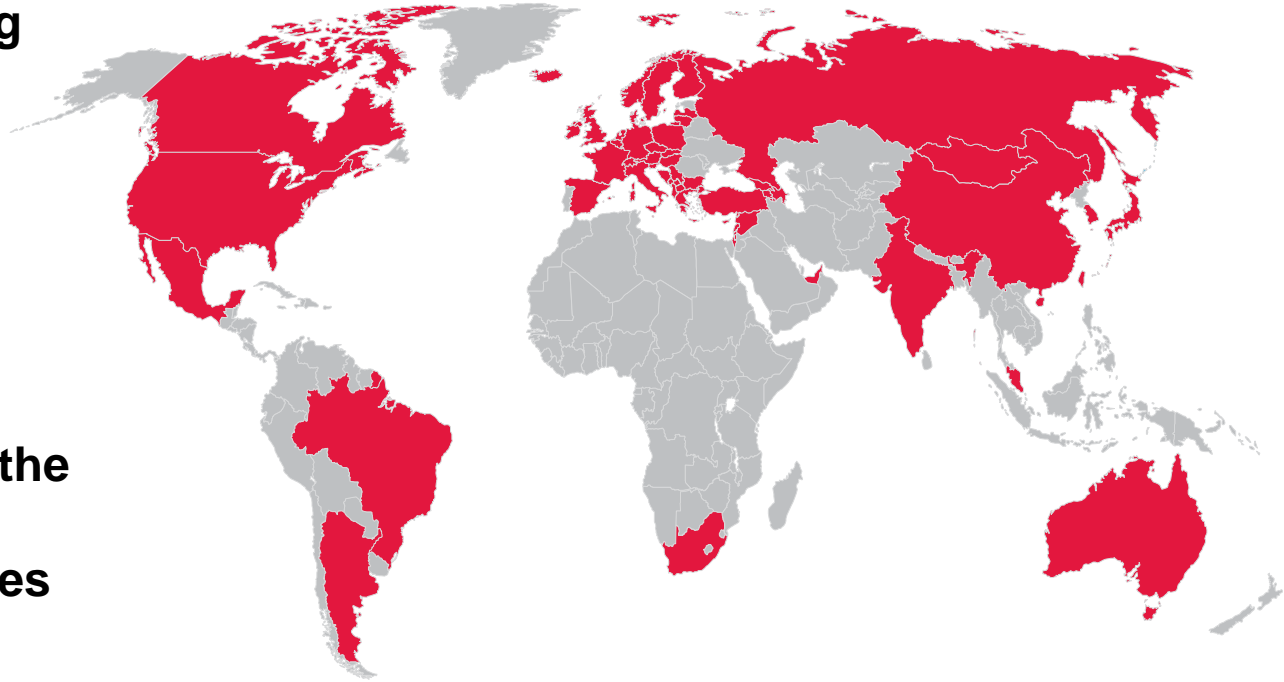
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# Standard & Poor's Ratings Services Today: A Snapshot

- **1,400+ analysts covering 125+ countries**
- **More than 1.1 million ratings outstanding**
- **\$6.6 trillion in new debt rated in 2013**
- **Provide perspective on the creditworthiness of an entity or the debt it issues**



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# What Is A Credit Rating?

## What It Is

- A forward-looking *opinion* about the ability of an issuer to pay back investors in full and on time
- Strives to be globally comparable across sectors
- Incorporates views on relative likelihood of default that are applied to entities (issuers) and securities (issues)
- One of many inputs available to investors as part of their decision-making process

## And What It Is *Not*

- A guarantee of credit quality or default probability
- Investment advice or recommendation (buy, sell or hold)
- A measure of liquidity or price
- A way of defining “good” or “bad” companies
- An audit of the company

# Ratings: Filling the Gap Between Issuers and Investors

## If Borrowers/Issuers Seek To:

- Optimize cost of funding
- Expand pool of investors and available capital
- Lengthen the terms of financing
- Diversify funding sources



## If Investors Seek:

- Independent opinion of credit quality
- A basis for comparison across asset classes, geographies and peers
- Information and benchmarks to make informed decisions



## Then Consider Credit Ratings

- Independent
- Comparable
- Forward-looking

# Standard & Poor's Ratings Services: Filling Marketplace Needs

## When You Want To:

## Consider:

**Access the Debt Capital Markets**

- **Issue ratings for bonds or bank loans**  
Assist in pricing discovery and market liquidity

**Find a Tool to Help Negotiate  
Credit Conditions With Banks and  
Other Financial Counterparties**

- **Bank loan ratings**  
Assist in pricing discovery and market liquidity

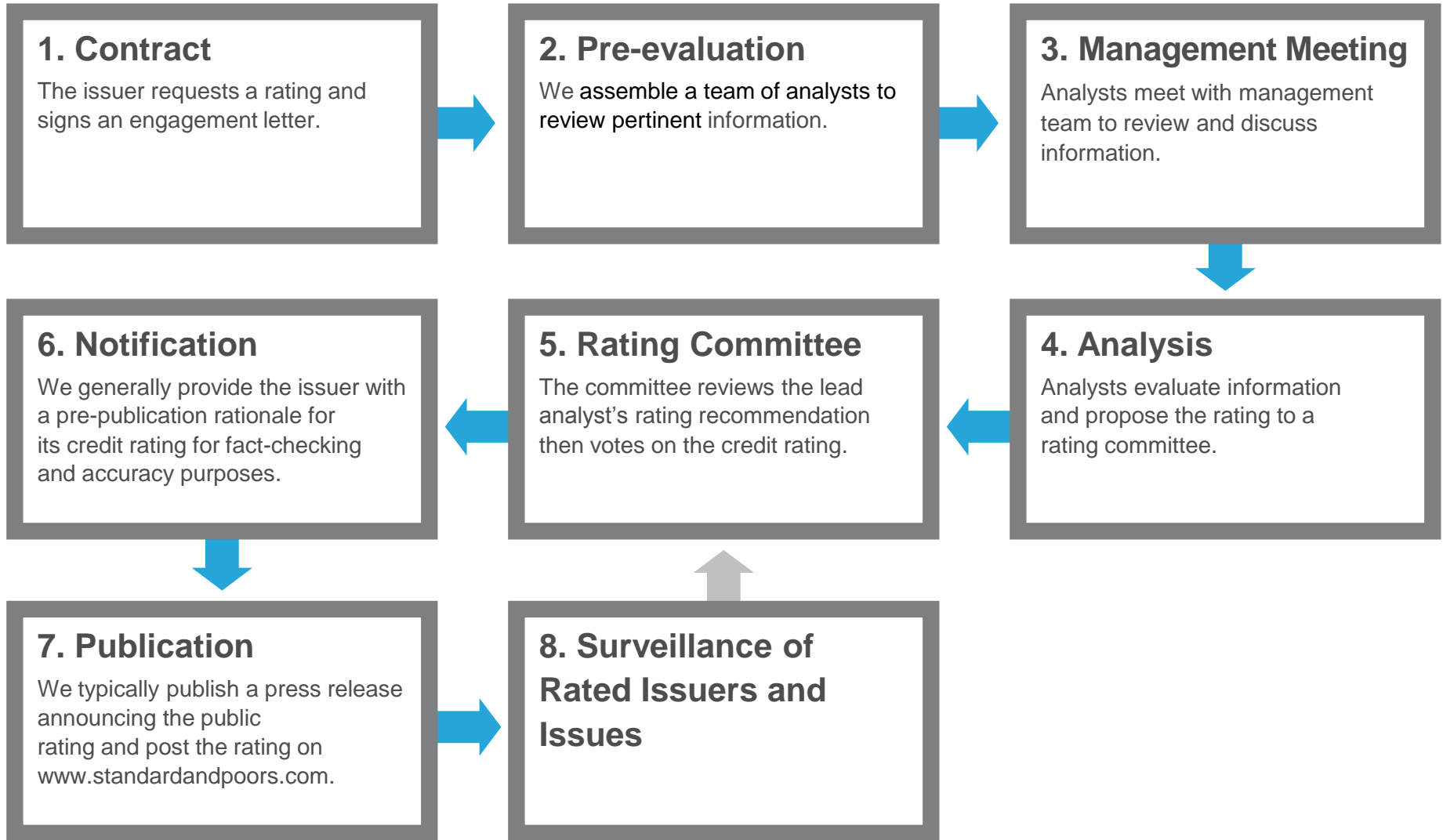
**Reduce Your Cost of Funding**

- **Issue ratings for bonds or bank loans**  
Assist in pricing discovery and market liquidity

**Improve Your Bargaining  
Power with Suppliers/Other  
Non-financial Counterparties**

- **Corporate credit ratings**  
Describe your credit strength, a credit credential

# Our Rating Process



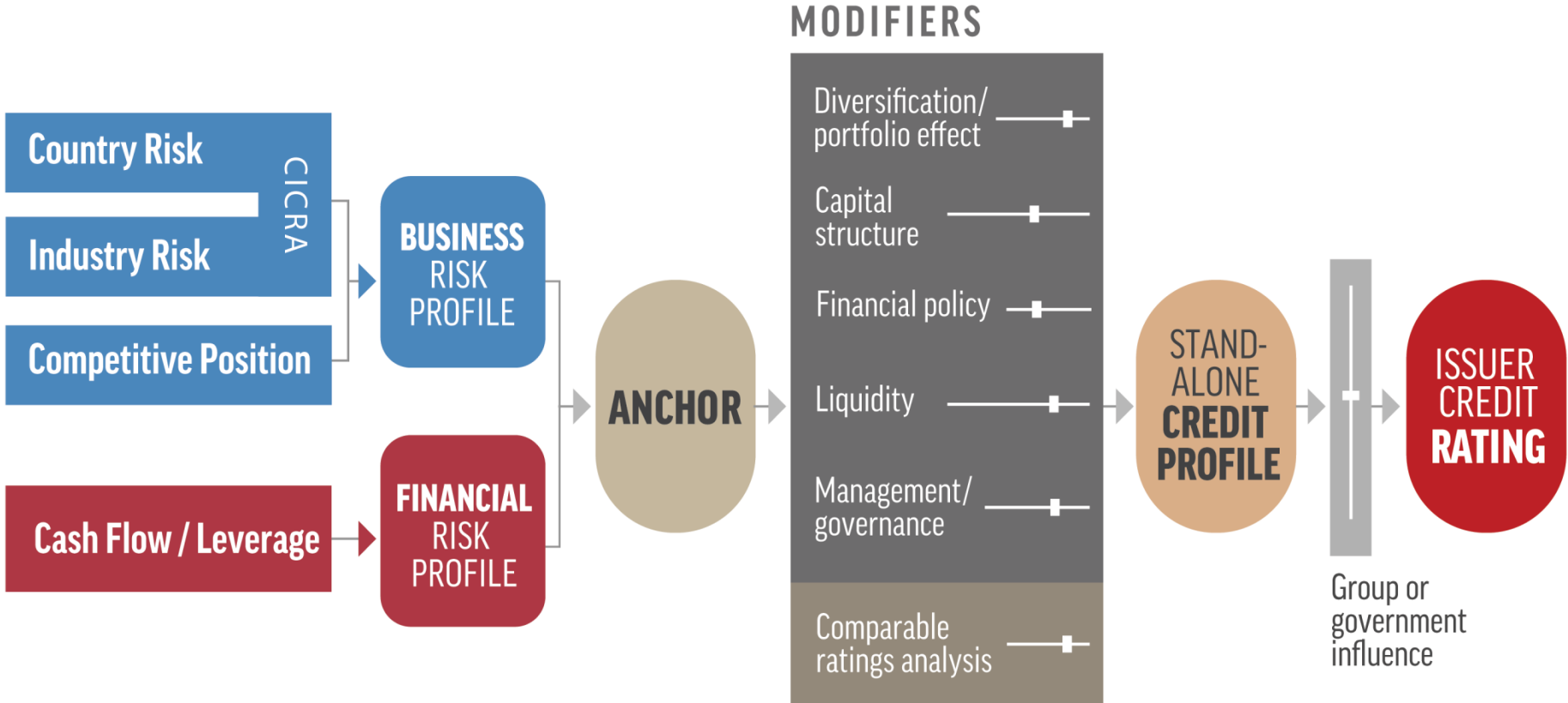
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# I criteri per l'analisi dei rating dei «Corporate»

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# The Corporate Ratings Criteria Framework

Greater **TRANSPARENCY**      Enhanced **GLOBAL COMPARABILITY**      Maintains **ANALYTICAL JUDGMENT**





# Business Risk Profile

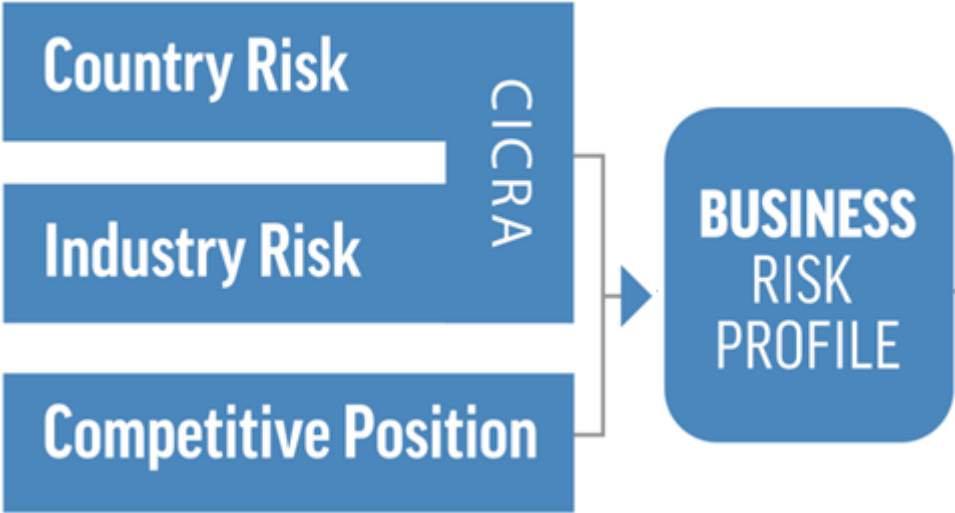
Business Risk Profile

Financial Risk Profile

Anchor

Modifiers

Group Methodology



# CICRA – Country Risk

Business Risk Profile

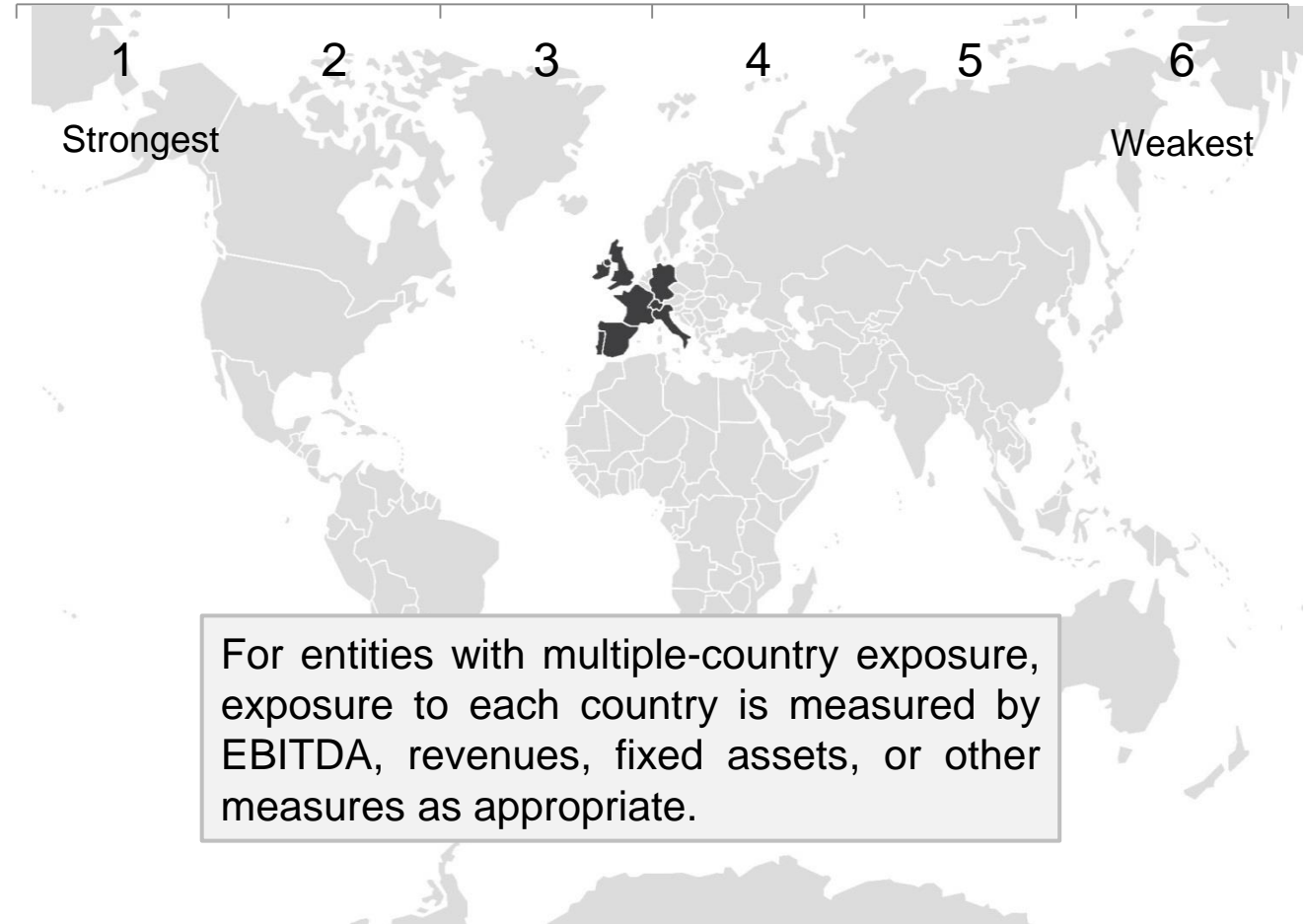
Financial Risk Profile

Anchor

Modifiers

Group Methodology

## Country Risk



# Country Risk – Score Determination

Business Risk Profile

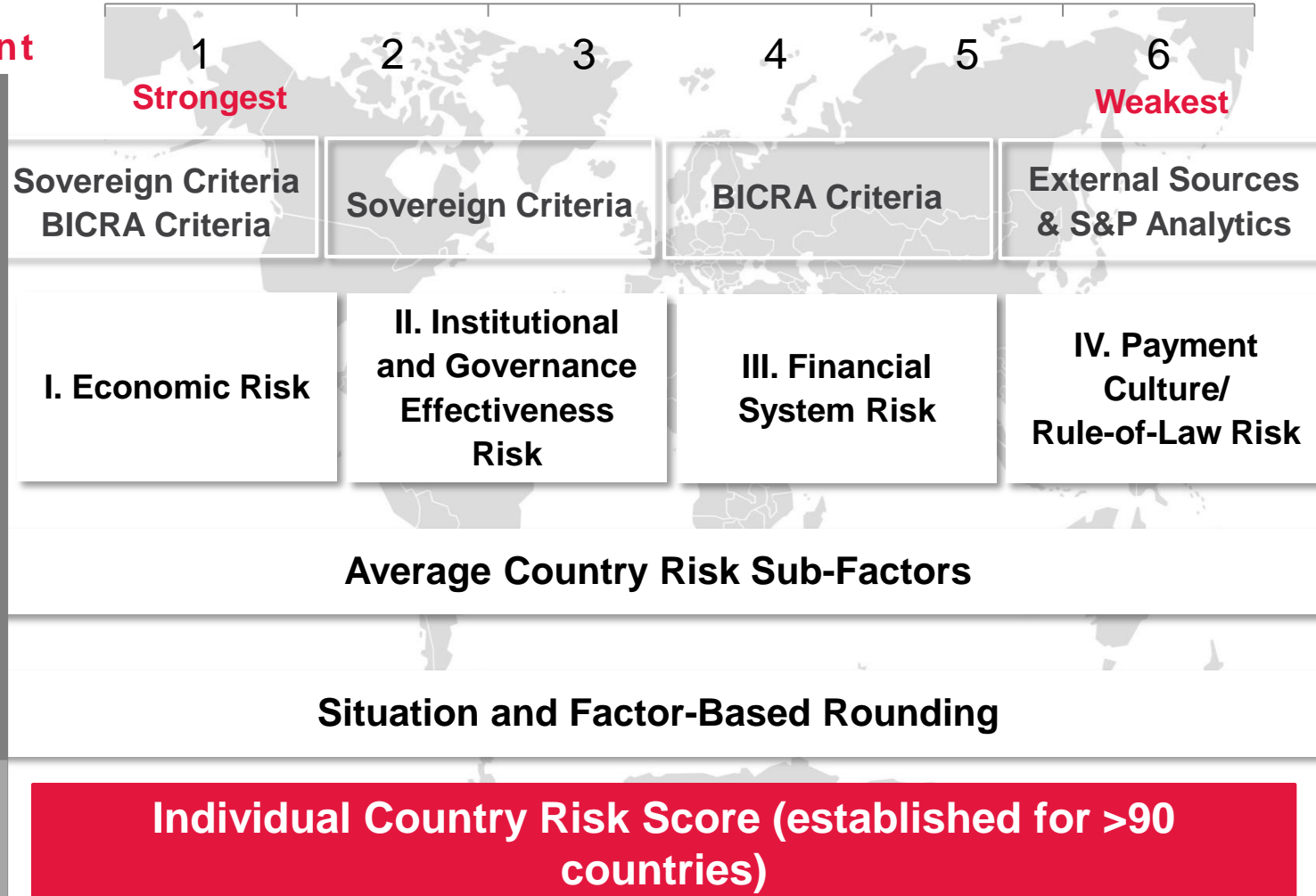
Financial Risk Profile

Anchor

Modifiers

Group Methodology

## Country Risk Score Assessment



1. Sources

2. Country Risk sub-factors (1-6)

3. Preliminary Country Risk assessment

4. Rounding

Final Country Risk assessment

# CICRA – Industry Risk

Business Risk Profile

Financial Risk Profile

Anchor

Modifiers

Group Methodology



**Incorporates 2 key components**

- **Industry cyclicality**
- **Industry competitive risk and growth environment**

Industry Risk scores for 38 industries have been established

# Competitive Position

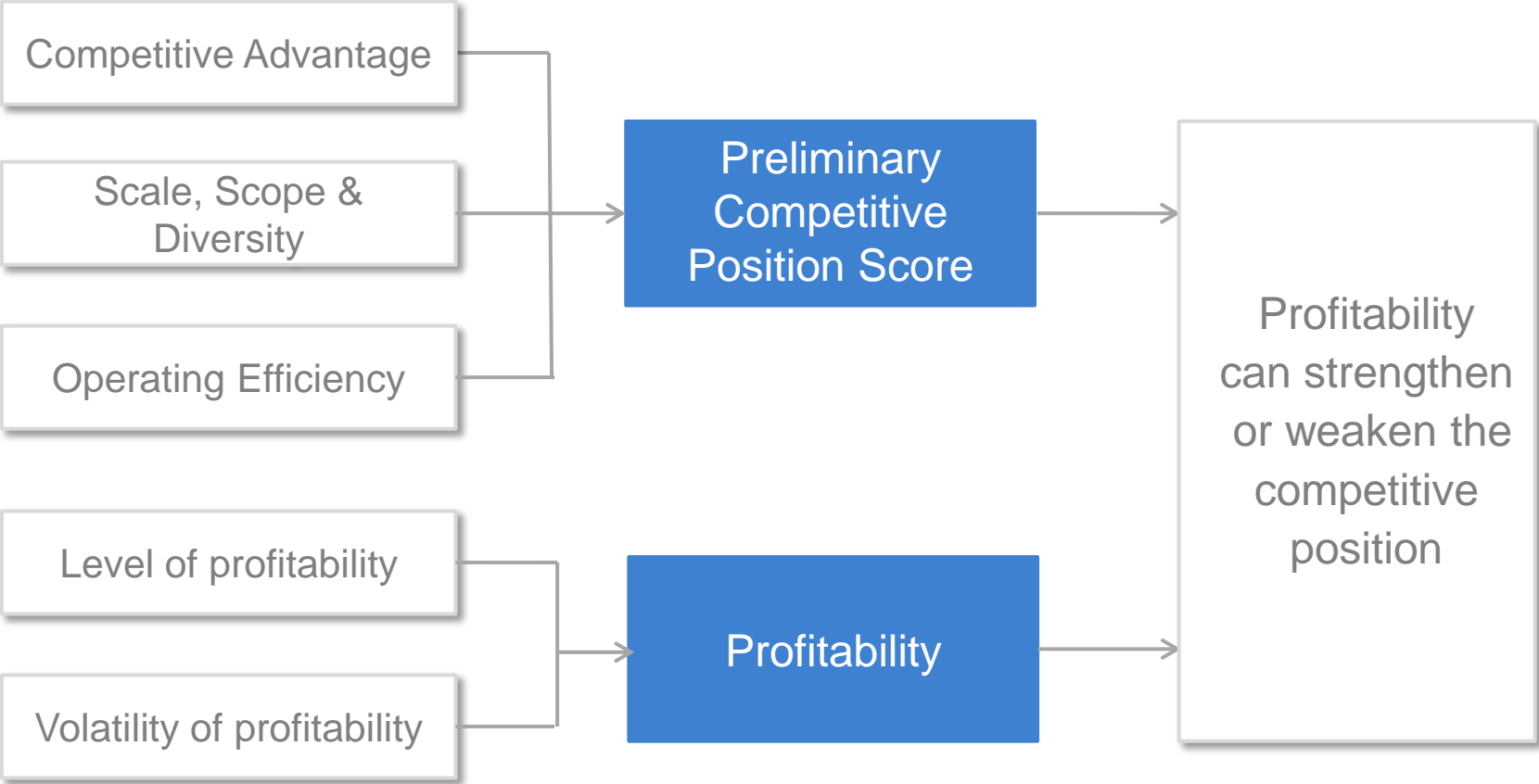
Business Risk Profile

Financial Risk Profile

Anchor

Modifiers

Group Methodology



# Competitive Position Group Profile

Business Risk Profile

Financial Risk Profile

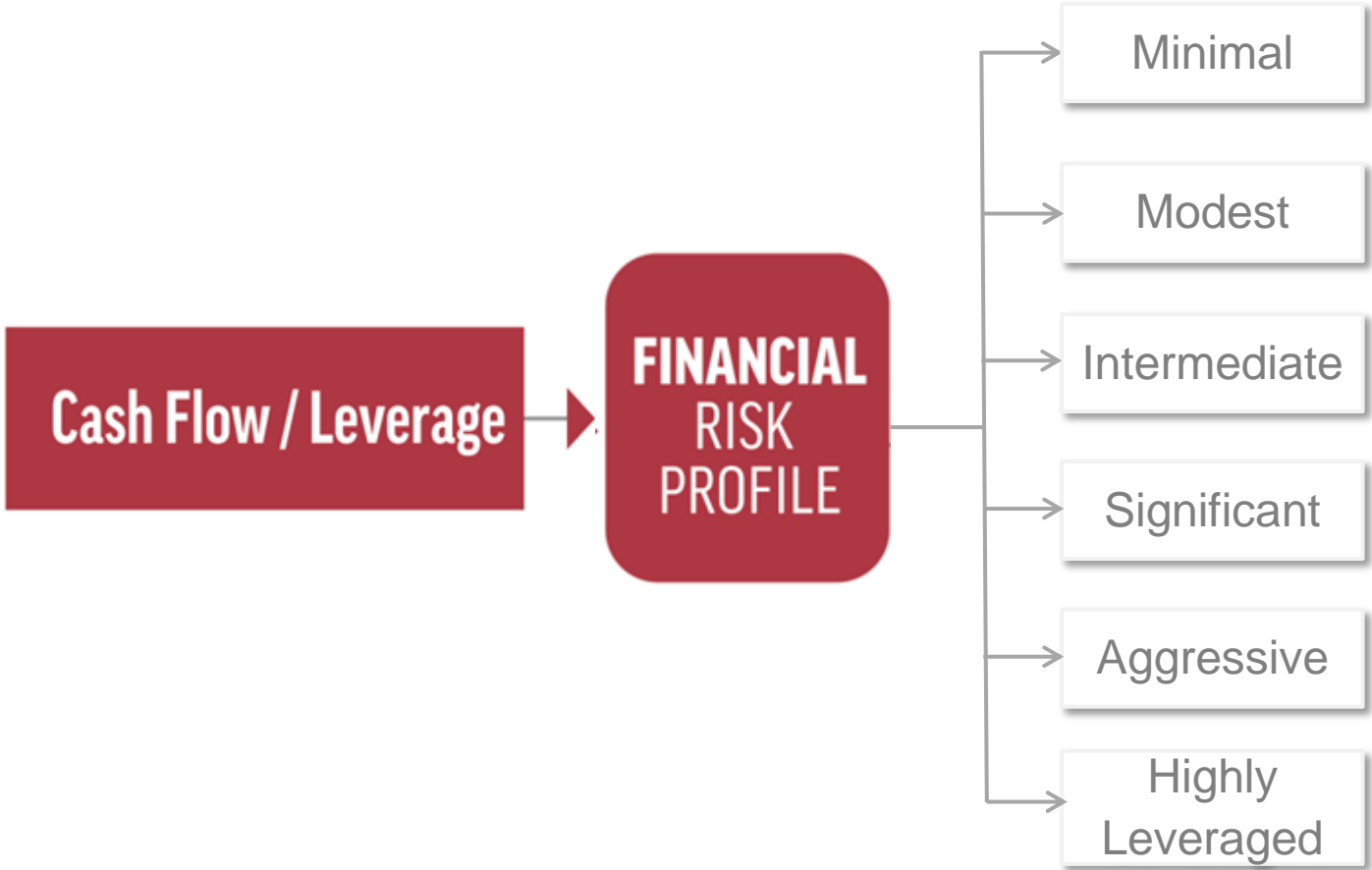
Anchor

Modifiers

Group Methodology

Component	Services and Product Focus	Product Focus/Scale Driven	Capital or Asset Focus	Commodity Focus/Cost Driven	Commodity Focus/Scale Driven	National Industries & Utilities
Competitive Advantage	45%	35%	30%	15%	10%	60%
Scale, Scope and Diversity	30%	50%	30%	35%	55%	20%
Operating Efficiency	25%	15%	40%	50%	35%	20%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

# Financial Risk Profile



## Core Ratios

FFO/Debt  
Debt/EBITDA

## Supplemental Ratios

If preliminary score is **Intermediate or stronger**:

- CFO/Debt
  - FOCF/Debt
  - DCF/Debt
- } Greater importance when preliminary assessment is minimal to intermediate

If preliminary score is **Significant or weaker**:

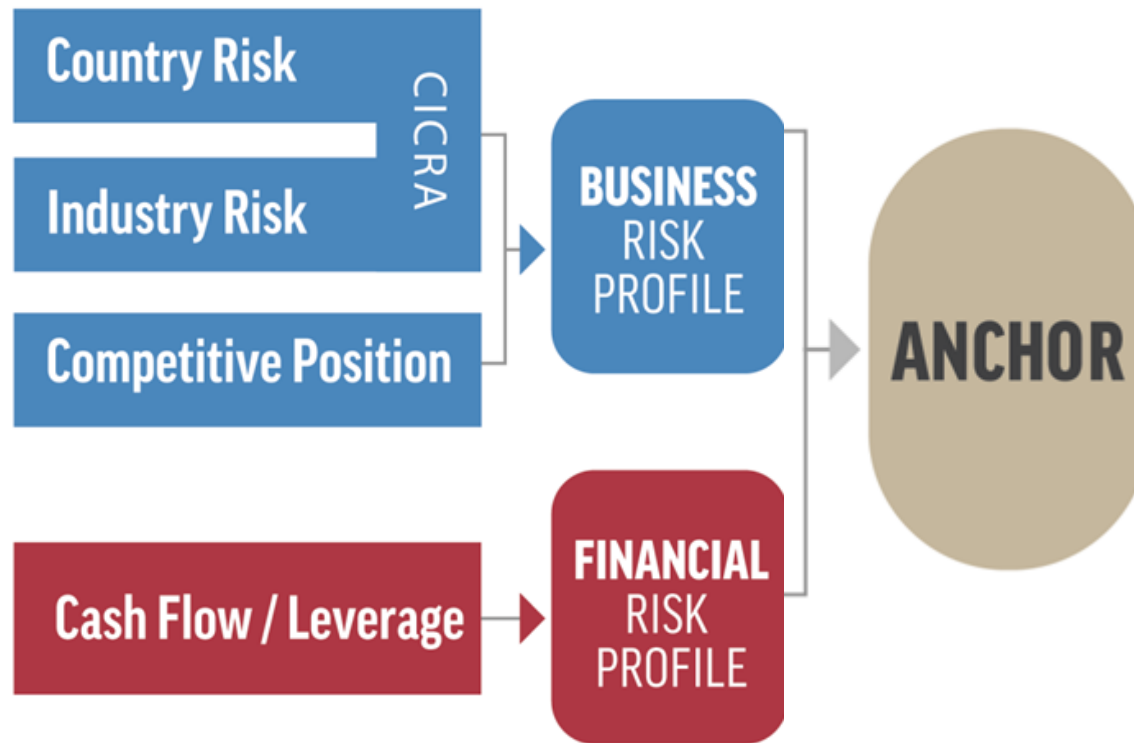
- EBITDA/Interest
  - (FFO + Interest)/Cash Interest
- } Greater importance when preliminary assessment is significant to highly leveraged

*Industry Key Credit Factor commentaries may identify additional supplemental ratio(s)*

Assessment of supplemental ratios may either **CONFIRM** or **ADJUST** the preliminary score

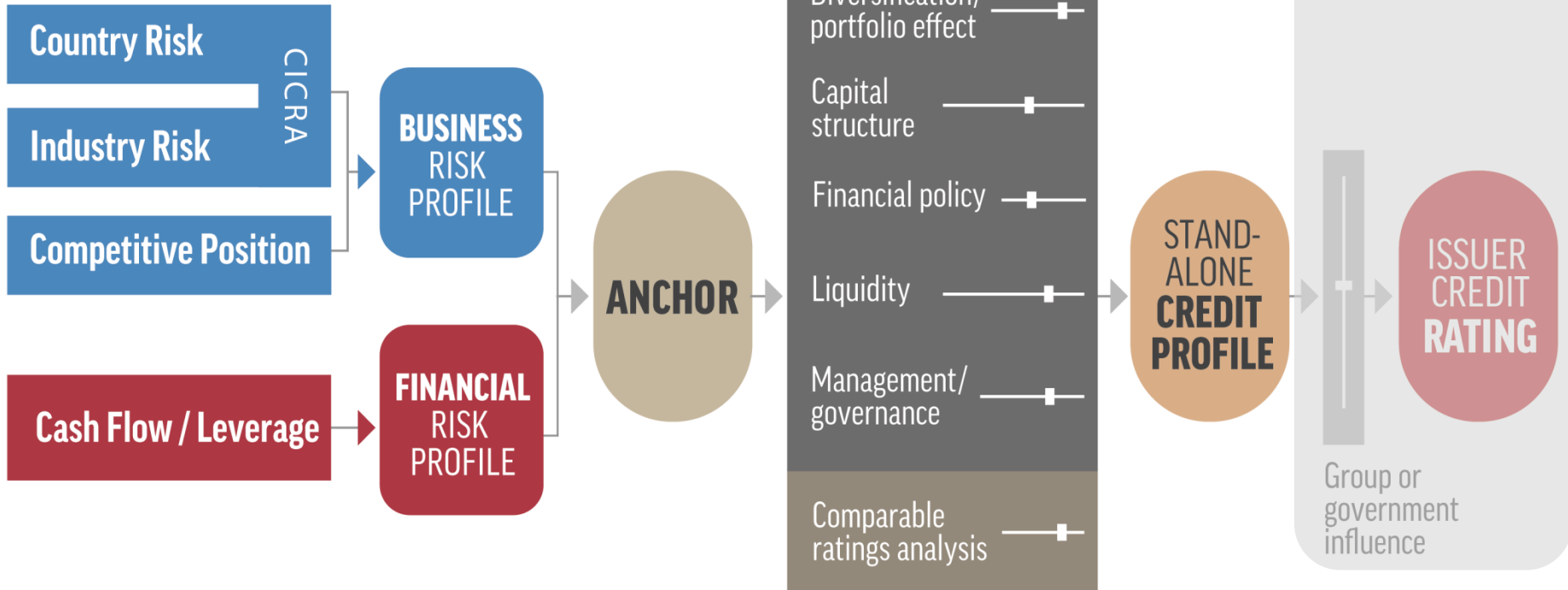


The business risk profile and the financial risk profile combine to determine the issuer's anchor



	Financial Risk Profile					
Business Risk Profile	1 (minimal)	2 (modest)	3 (intermediate)	4 (significant)	5 (aggressive)	6 (highly leveraged)
1 (excellent)	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
2 (strong)	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
3 (satisfactory)	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
4 (fair)	bbb/bbb-	bbb-	bb+	bb	bb-	b
5 (weak)	bb+	bb+	bb	bb-	b+	b/b-
6 (vulnerable)	bb-	bb-	bb-/b+	b+	b	b-

# Modifiers



# Modifying The Anchor

Business Risk  
Profile

Financial Risk  
Profile

Anchor

Modifiers

Group  
Methodology

## MODIFIERS

Diversification/  
portfolio effect



Capital  
structure



Financial policy



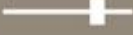
Liquidity



Management/  
governance



Comparable  
ratings analysis



**Specific score and descriptors**  
are used for these modifiers to  
determine the number of notches  
to apply to the anchor

Rating modifier categories  
**may raise or lower a company's  
anchor score by 1 or more  
notches – or have no  
effect, in some cases**

An issuer's **anchor cannot  
be lowered below 'b-'**  
using one or more  
of these categories

# Modifying The Anchor

Business Risk  
Profile

Financial Risk  
Profile

Anchor

Modifiers

Group  
Methodology

## MODIFIERS

Diversification/  
portfolio effect



Moderate +1

Significant +2

Capital  
structure



Financial policy



Liquidity



Management/  
governance



Comparable  
ratings analysis



Applies to **conglomerates**

- **>2** distinct business segments
- Each segment contributing **>10%** of earnings
- The largest segment contributing **<50%** of earnings

Conglomerates' distinct industry structure exposure provide a partial hedge against volatility if they are not highly correlated, and could result in a rating uplift

- A conglomerate with moderate diversification could enhance the Anchor by **up to 1 notch**
- A conglomerate with significant diversification could enhance the Anchor by **up to 2 notches**

# Capital Structure

## MODIFIERS

Diversification/ portfolio effect			
Capital structure		Very Positive	+2
		Positive	+1
		Neutral	--
		Negative	-1
		Very Negative	-2 or more
Financial policy			
Liquidity			
Management/ governance			
Comparable ratings analysis			

**Quality of Capital Structure is a modifier category.** The Capital Structure could adjust the Anchor upward or downward, depending upon the individual sub-factor scores.

Tier I Risk Sub-Factors	Tier II Risk Sub-Factor	Stand-Alone Sub-Factor
Currency Risk of Debt	Interest Rate Risk of Debt	Investments
Debt Maturity Profile		

# Financial Policy

Business Risk Profile

Financial Risk Profile

Anchor

Modifiers

Group Methodology

## MODIFIERS

Diversification/  
portfolio effect

Capital  
structure

Financial policy

Liquidity

Management/  
governance

Comparable  
ratings analysis

**Financial Policy adjustment** is a measure of risks outside of our base case assumptions for cash flow/leverage, capital structure and liquidity

**Financial Sponsor Control (>40% ownership):**

FS-4

FS-5

FS-6

FS-6-

FRP 4

FRP 5

FRP 6

**Not Controlled by Financial Sponsor:**

**Financial Policy Framework**

Supportive/  
Non-supportive

**Positive**

**Financial Discipline**

Positive, Neutral,  
Negative

**Neutral**

**Negative**

# Liquidity

Business Risk  
Profile

Financial Risk  
Profile

Anchor

Modifiers

Group  
Methodology

## MODIFIERS

Diversification/  
portfolio effect

Capital  
structure

Financial policy

Liquidity

Management/  
governance

Comparable  
ratings analysis

**Liquidity is an independent characteristic of a company** measured on an absolute basis, and the assessment is not relative to industry peers or other companies in the same rating category

### Liquidity descriptors:

Exceptional

Strong

Adequate

Less than adequate ICR < BBB-

Weak ICR < B



## MODIFIERS



Management			Governance	
Positive	Neutral	Negative	Neutral	Negative
<ol style="list-style-type: none"> <li>1. Strategic planning process</li> <li>2. Consistency of strategy with organizational capabilities and marketplace conditions</li> <li>3. Ability to track, adjust, and control execution strategy</li> <li>4. Comprehensiveness of enterprise-wide risk management standards and tolerances</li> <li>5. Standards for operational performance</li> <li>6. Management's operational effectiveness</li> <li>7. Management's expertise and experience</li> <li>8. Management's depth and breadth</li> </ol>			<ol style="list-style-type: none"> <li>1. Board effectiveness</li> <li>2. Entrepreneurial or controlling ownership</li> <li>3. Management culture</li> <li>4. Regulatory, tax or legal infractions</li> <li>5. Communication of messages</li> <li>6. Internal controls</li> <li>7. Financial reporting and transparency</li> </ol>	

# Comparable Ratings Analysis

Business Risk Profile

Financial Risk Profile

Anchor

Modifiers

Group Methodology

## MODIFIERS



**Sub-factors/ modifying factors** are considered midpoints within a possible range, and each of these sub-factors can be at the upper- or lower-end, or at the midpoint of such a range

A positive or negative assessment is therefore likely to be **common**, rather than exceptional

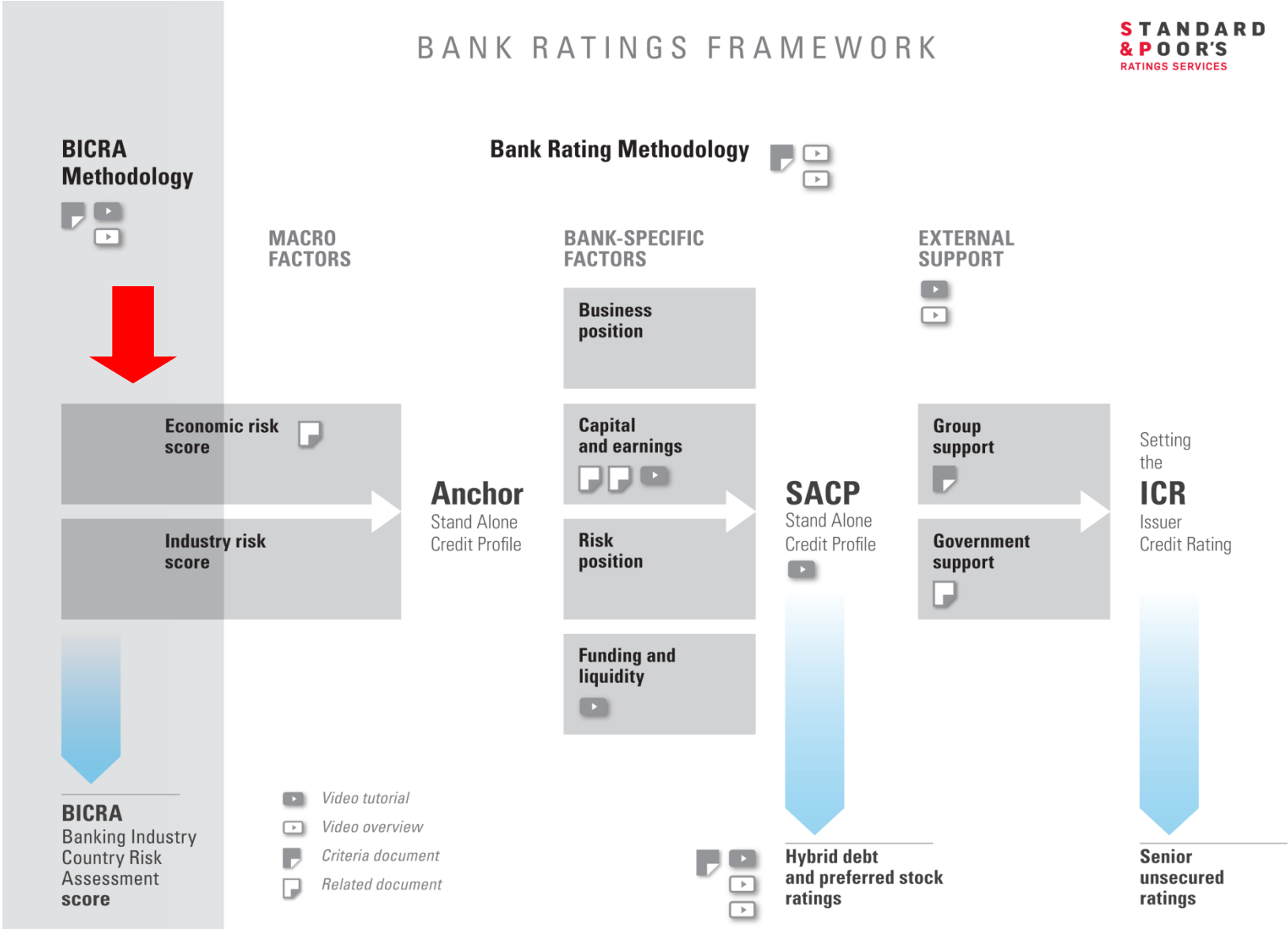
A company's rating may be changed **by one notch in either direction** in this comparable ratings analysis

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# I criteri per l'analisi di rating delle «Istituzioni finanziarie»

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# BANK RATINGS FRAMEWORK



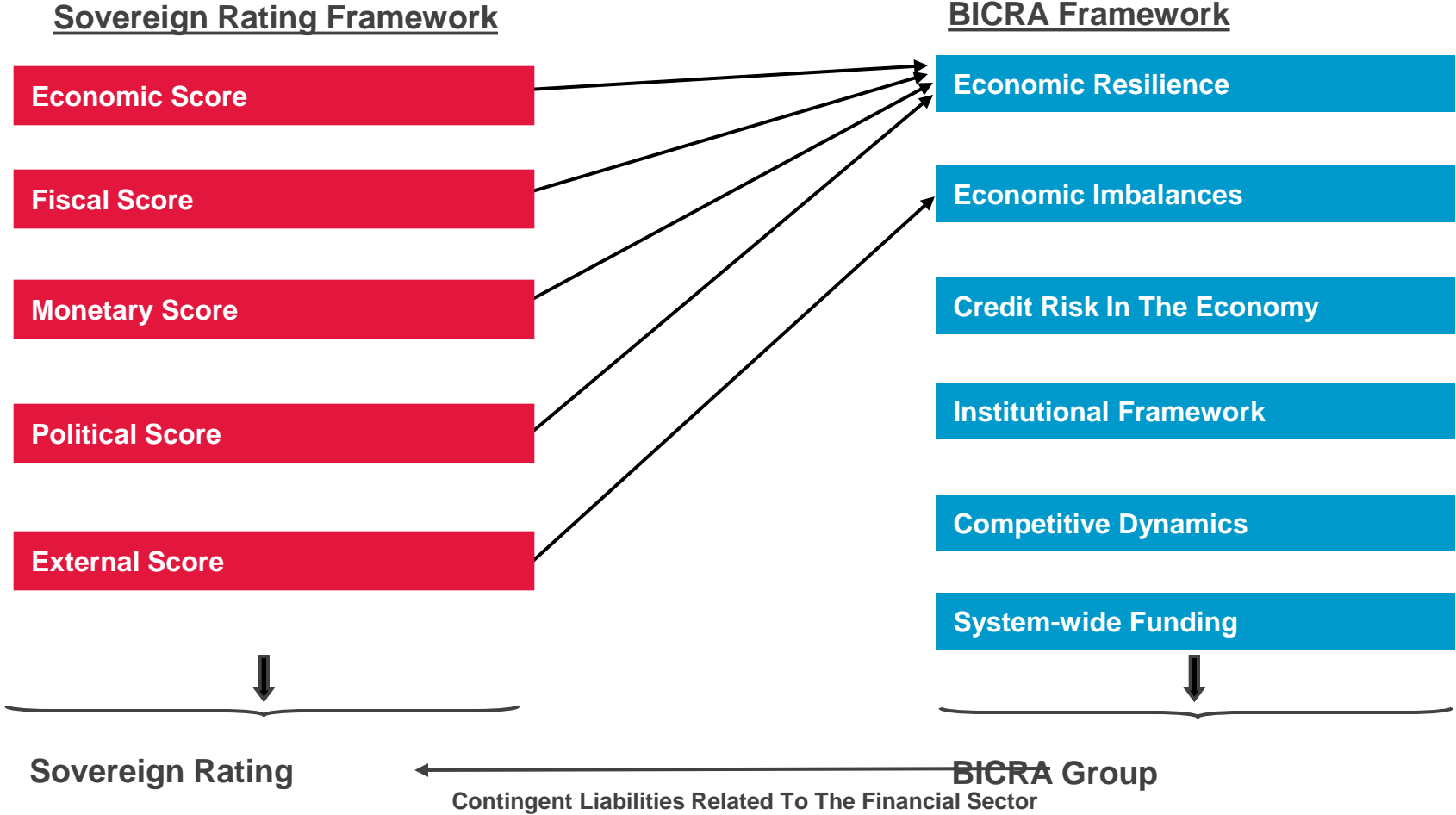
# BICRA – Fattori Principali

Rischio Economico	Rischio Settoriale
<b>A. Economic Resilience</b> <ul style="list-style-type: none"><li>• Struttura e stabilità economica</li><li>• Flessibilità politica macroeconomica</li><li>• Rischio Politico</li></ul>	<b>A. Quadro Istituzionale</b> <ul style="list-style-type: none"><li>• Regolamentazione Bancaria e di Vigilanza</li><li>• Track record dell'autorità di vigilanza</li><li>• Governance e Trasparenza</li></ul>
<b>B. Gli Squilibri Economici</b> <ul style="list-style-type: none"><li>• Andamento del credito al settore privato</li><li>• Prezzi degli immobili residenziali</li><li>• Prezzi del mercato azionario</li><li>• Bilancia dei Pagamenti e Posizione Patrimoniale sull'Estero</li></ul>	<b>B. Dinamiche Competitive</b> <ul style="list-style-type: none"><li>• Propensione al rischio del settore bancario</li><li>• Stabilità del settore bancario</li><li>• Distorsioni di mercato</li></ul>
<b>C. Rischi di Credito nell' Economia</b> <ul style="list-style-type: none"><li>• Capacità di indebitamento e leva finanziaria del settore privato</li><li>• Standard di concessione del credito</li><li>• Cultura di pagamento e norme giuridiche</li><li>• Stress del credito sovrano</li></ul>	<b>C. La Raccolta a livello di sistema</b> <ul style="list-style-type: none"><li>• Raccolta stabile dalla clientela</li><li>• Finanziamento Estero</li><li>• Mercato domestico del debito (DCM)</li><li>• Ruolo del Governo</li></ul>

• *Aggiustamenti aggiuntivi non inclusi sopra*

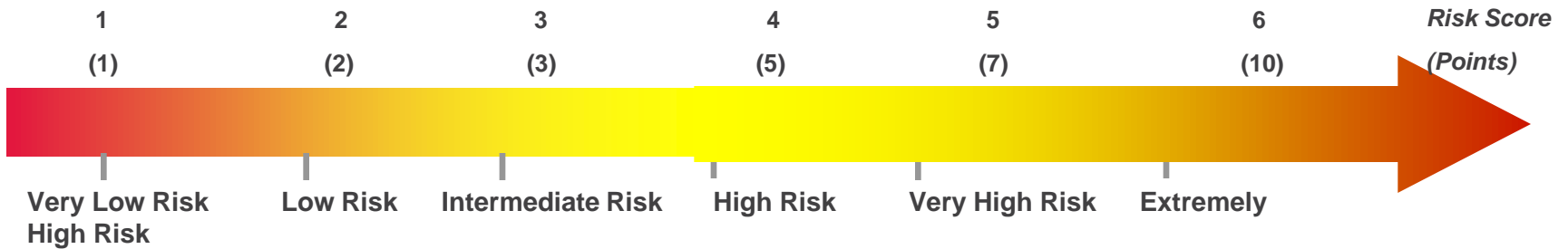
• *Fonte: Banks: Banking Industry Country Risk Assessment Methodology And Assumptions – Traduzione parziale della Tavola 1 (vedi tavola intera)*

# Rating del Sovrano e BICRA



Fonte: Standard & Poor's Financial Institutions Ratings

# BICRA: I Principali Fattori



Fonte: Tavola 2: Punteggi dei fattori del BICRA

<i>Point total for the three economic or industry risk factors</i>	<i>Economic risk or industry risk score</i>
3-4	1
5-6	2
7-8	3
9-10	4
11-12	5
13-14	6
15-17	7
18-20	8
21-23	9
24-30	10

# Matrice dell'Ancora

Table 2 - Determining The Anchor SACP From Economic Risk And Industry Risk

	Rischio Economico										
	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	Ancora del SACP per una banca italiana				bb	bb-	bb-	b+	b+	b+	b
10					b+	b+	b+	b	b	b-	

Fonte: Metodologia dei Rating delle Banche



# Stand-alone Credit Profile (SACP) – Fattori Specifici I

Table 3 Using Bank-Specific Analysis To Determine The SACP			
Rating factor/Ranking	Anchor SACP Adjustment		
<b>Business position (Section E.)</b>			
Very strong	+2 notches		
Strong	+1 notch		
Adequate	0 notches		
Moderate	-1 notch		
Weak	-2 to -3 notches		
Very weak	-5 notches		
<b>Capital and earnings* (Section F.)</b>			
Anchor	'bbb-' or better	'bb+' to 'bb-'	Below 'bb-'
Very strong	+2 notches	+2 notches	+2 notches
Strong	+1 notch	+1 notch	+1 notch
Adequate	0 notches	0 notches	+1 notch
Moderate	-1 notch	0 notches	0 notches
Weak	-2 to -3 notches	-1 notch	0 notches
Very weak	-5 notches	-2 notches	-1 to -2 notches
<b>Risk position (Section G.)</b>			
Very strong	+2 notches		
Strong	+1 notch		
Adequate	0 notches		
Moderate	-1 notch		
Weak	-2 notches		
Very weak	-5 notches		
<b>Funding and liquidity (section H.): See funding and liquidity matrix (table 17)</b>			
*The cap on the SACP is 'bb+' when regulatory capital is "at risk," at 'ccc+' when it is "subject to regulatory forbearance," and 'cc' when "insolvent." SACP--Stand-alone credit profile.			

Source: Banks: Rating Methodology And Assumptions

# SACP – Fattori Specifici II

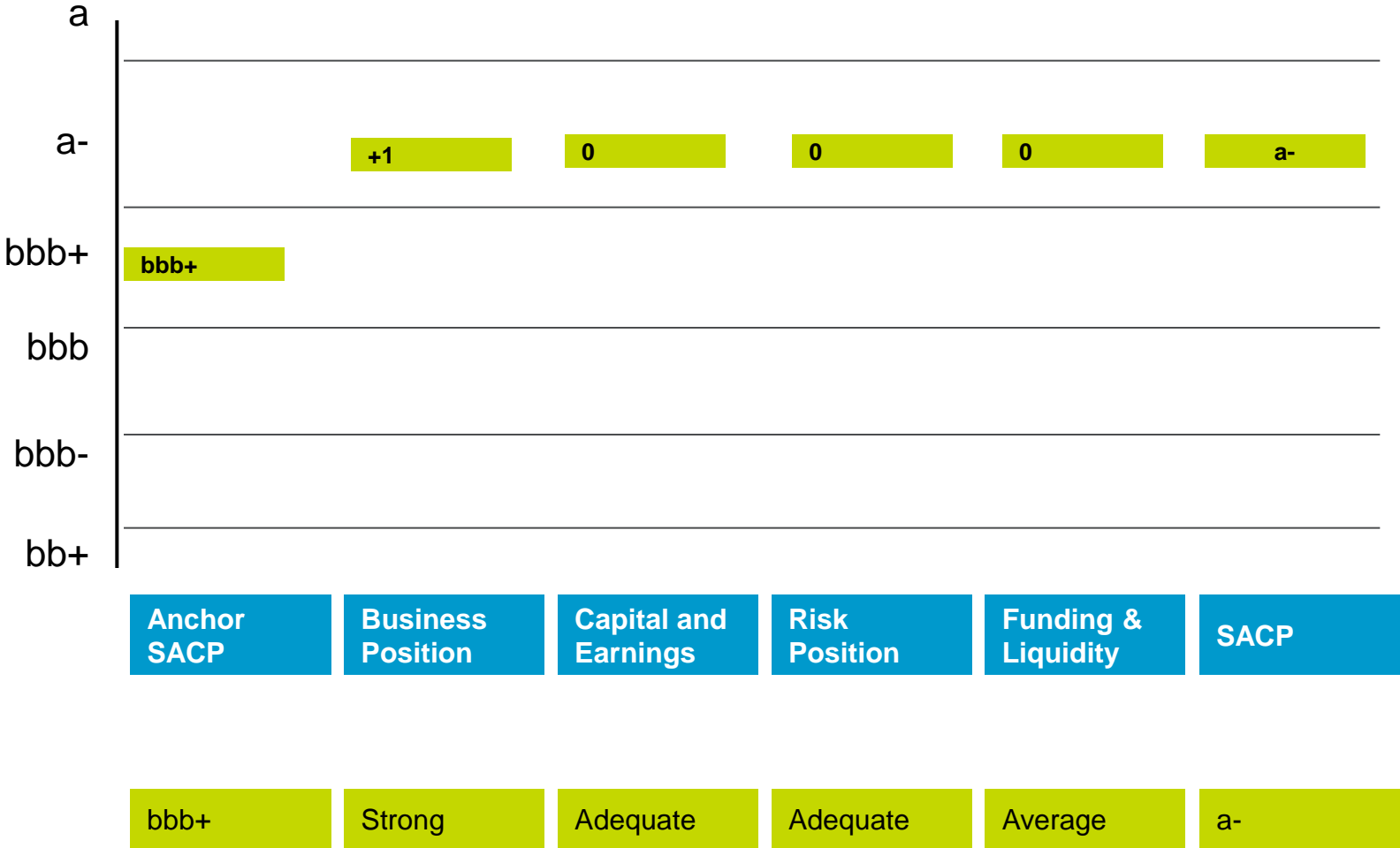
Table 17

Impact On The SACP Of Combining The Liquidity And Funding Assessments

Descriptor		LIQUIDITY				
		Strong	Adequate	Moderate	Weak	Very weak
FUNDING	Above average	+1	0	-1 Capped at 'bbb'	-2 Capped at 'bb'	-5 Capped at 'cc'
	Average	0	0	-1 Capped at 'bbb'	-2 Capped at 'bb'	-5 Capped at 'cc'
	Below average	-1	-1	-1 Capped at 'bb'	-2 Capped at 'b'	-5 Capped at 'cc'

© Standard & Poor's 2011.

# SACP – Esempio



# Componenti della Business Position

Tavola 5 - Business Position – Sotto-fattori e indicatori

Sotto-fattori	Spiegazione	Indicatori
<b>Stabilità del Business</b>	La stabilità o la fragilità del franchise di una banca	Stabilità dei ricavi, quote di mercato, e base di clientela
<b>Concentrazione o Diversificazione</b>	La concentrazione o la diversificazione delle attività di business	Contributo ai ricavi delle differenti linee di business e aree geografiche
<b>Management e Strategia Aziendale</b>	La qualità del management, della strategia, e la corporate governance	Posizionamento strategico, efficacia operativa, gestione finanziaria, e politiche di governance e finanziarie

Fonte: Banks: Rating Methodology And Assumptions

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# Componenti del Capital & Earnings

**Capitale Regolamentare**

**Risk Adjusted Capital (RAC) Ratio**

**Qualità del Capitale e degli utili**

**Capacità di generare utili**

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# Perché Ancora Un Altro Ratio Di Capitale?

## Tier 1 ratio Regolamentare

- **Misura chiave regolamentare, sensibile al rischio**
- **Molto complesso con Basilea 2 (e 3)**
- **Difficile da confrontare**
  - Scelte discrezionali nazionali (impatto sia sul numeratore sia sul denominatore)
  - Differenze metodologiche
  - Differenze tra le Stime interne delle banche
- **Transizione a Basilea 3 terminerà nel 2023**
- ***S&P ha anche delle visioni differenti su alcune calibrazioni***

## Ratio di Indebitamento

- **Molto semplice, ma con alcuni limiti al livello assoluto di indebitamento**
- **Non sensibile al rischio**
- **Non confrontabile (es. IFRS vs. US GAAP)**
- **Facile da gestire e da interpretare**

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# Componenti della Risk Position

**Crescita e Cambiamenti  
nell'Esposizione al Rischio**

**Concentrazione & Diversificazione di Rischio**

**Complessità**

**Rischi non coperti dal RACF**

**Perdite passate e Aspettative di Perdita**

# Definizione dei Peers

Fattori SACP	Gruppo di Confronto
Business Position	Banche con lo stesso rischio settoriale
Capital and Earnings	Tutte le banche a livello globale
Risk Position	Banche con rischio economico simile e mix di prodotti
Funding & Liquidity	Funding: Tutte le banche dello stesso paese Liquidity: Tutte le banche a livello globale

Fonte: Tavola 4 di Banks: Rating Methodology And Assumptions – Vedi tabella completa



# Inclusione del Supporto nell'ICR

Chart 6

## The Support Framework

The indicative issuer credit rating (ICR) results from adding notches for support uplift to the stand-alone credit profile (SACP)

Step 1 – Determine how many notches to add to the SACP for the likelihood of future extraordinary government support (see tables 20-23)

Step 2 – Determine how many notches to add to the SACP for the likelihood of future extraordinary support from a parent or affiliate within a subsidiary's group (see "Group Rating Methodology For Banks," published Nov. 9, 2011)

Step 3 – Use the greater of steps 1 and 2 to determine how many notches to add to the SACP for the indicative ICR

Step 4 – Apply the criteria in ¶¶206-212 to the indicative ICR for a bank

© Standard & Poor's 2011.

Fonte: Banks: Rating Methodology And Assumptions

# Probabilità Prospettica di Supporto Straordinario del Governo

**Tavola 20: Probabilità Prospettica di Supporto Straordinario del Governo**

	Propensione del Governo a sostenere banche commerciali private		
Importanza Sistemica	Highly supportive	Supportive	Uncertain
High	High (tavola 21)	Moderately high (tavola 22)	Low
Moderate	Moderately high (tavola 22)	Moderate (tavola 23)	Low
Low	Low	Low	Low

Fonte: Banks: Rating Methodology And Assumptions

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# European Regulation on Rating Agencies

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# External Regulations

Standard & Poor's Ratings Services is subject to regulations in countries around the world

- Provides detailed set of standards aimed at governing the integrity and transparency of the ratings process
- We believe regulation can help build market confidence in ratings through increased accountability, oversight and inspections

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# First round of ratings regulation in Europe: CRA 1

## Regulation 1060 introduced in 2009:

- Regulatory supervision of policies, processes, standards
  - Ban on authorities interfering in substance of ratings or methodologies
  - Overseeing independence of ratings (supervisory board; compliance function; restrictions on analyst investments; analyst rotation; ban on consulting/advising; audit trail etc)
  - Promoting transparency (disclosure of methodologies/models/assumptions; ESMA website showing ratings performance; disclosure of 5%+ clients etc )
- 
- **ESMA took over supervision in July 2011: regular “thematic” inspections and public reports**
  - **Major ratings agencies registered September 2011**

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# Latest EU rating agency regulations: CRA3

- **Reducing mechanistic reliance on ratings**
  - Removal of rating references from EU law by 2020
- **Establishing a pan-European liability regime for breaches of EU rules**
- **Sovereign ratings**
  - Specific process requirements for rating sovereigns and their debt, including the establishment of an annual calendar of rating announcements from 2014
- **Business model and competition**
  - Establishment of a European rating platform (a website established by ESMA which will allow investors to easily compare credit ratings for specific rated entities, and which will incorporate the existing “CEREP” central ratings repository)
  - Detailed fee disclosure to ESMA to avoid “discriminatory fee policies”
- **Management of potential conflicts of interest**
  - Internal and external insider lists
  - “Full working day” pre-publication notice for issuers
  - Several restrictions related to CRA shareholders



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