

# RatingsDirect®

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## HSBC Bank Bermuda Ltd.

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# HSBC Bank Bermuda Ltd.

<b>SACP</b>	<b>bbb-</b>	+	<b>Support</b>	<b>+3</b>	+	<b>Additional Factors</b>	<b>0</b>
<b>Anchor</b>	<b>bbb-</b>		<b>ALAC Support</b>	<b>0</b>		<b>Issuer Credit Rating</b>  <b>A-/Negative/A-2</b>	
<b>Business Position</b>	Adequate	<b>0</b>	<b>GRE Support</b>	<b>0</b>			
<b>Capital and Earnings</b>	Very Strong	<b>+2</b>	<b>Group Support</b>	<b>+3</b>			
<b>Risk Position</b>	Weak	<b>-2</b>	<b>Sovereign Support</b>	<b>0</b>			
<b>Funding</b>	Average	<b>0</b>					
<b>Liquidity</b>	Strong						

## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• Strategically important subsidiary of HSBC Holdings PLC</li> <li>• Leading competitive position in Bermuda and high share of fee income</li> <li>• Capital ratios that remain very strong, despite recent weakening</li> <li>• Positive, albeit reduced, earnings</li> <li>• Strong liquidity</li> </ul>	<ul style="list-style-type: none"> <li>• Significant deterioration in loan performance in recent years, even compared with Bermuda peers</li> <li>• Concentrated loan portfolio with large single-name exposures</li> <li>• Large recent capital returns to shareholders, in the context of deteriorating loan performance, raise questions about forward-looking risk appetite</li> </ul>

### Outlook: Negative

Standard & Poor's Ratings Services' outlook on HSBC Bank Bermuda Ltd. (HBBM) is negative, reflecting our concern about ongoing economic weakness in Bermuda and the potential for related loan-quality deterioration at the bank. Furthermore, within this context, we view as somewhat worrisome (from a credit perspective) dividend payouts that have in several recent years exceeded net income. We expect that nonperforming assets (NPAs) will decline only slowly from current levels, and believe net charge-offs (NCOs) in the order of \$200 million remain to be incurred, through 2017. If either Bermuda's economy or HBBM's loan performance deteriorates meaningfully beyond our current expectations, or if capital ratios decline materially (for instance, a risk-adjusted capital (RAC) ratio approaching 15%) we might lower the stand-alone credit profile (SACP), and therefore, the rating.

## Rationale

The ratings on HBBM, the largest bank in Bermuda, primarily reflect the bank's strategic importance to its parent company, U.K.-incorporated bank holding company HSBC Holdings PLC, as well as its leading competitive position in its jurisdiction; "very strong" capital ratios; "weak" risk position; "average" funding profile; and "strong" liquidity profile (as our criteria define these terms). These assessments incorporate HBBM's strong share of the Bermuda market and high fee income, as well as much higher NPAs than peers', which we suspect may reflect weaker underwriting on some loans, in the past.

The bank's RAC ratio remains in our highest category (more than 15%), despite falling in recent years. We expect the RAC ratio to edge closer to but remain noticeably above 15%, as we expect the very high dividend payout rates of recent years to not resume until earnings recover from what we expect to be weak profitability in the 2015-2017 period. HBBM's loan performance has deteriorated significantly in recent years. We think the deterioration reflects lagged effects of the multiyear recession Bermuda has been suffering since 2009.

We expect only weak recovery in the Bermudian economy through 2017, and we expect some further weakening in the bank's loan performance throughout this period. We view Bermuda's economy as having substantially deteriorated since 2009, and expect significant lagged impact from this is yet to hit the Bermudian banking sector, particularly in terms of NCOs. However, HBBM's customer loan portfolio is only about one-quarter of its earning assets, thereby mitigating the impact of weaker loan performance on our risk assessment of the bank. We view the bank's geographic concentration of its loans and operations somewhat negatively in our business risk assessment.

The long-term issuer credit rating also reflects our view of HBBM's strategic importance to its parent. The long-term 'A-' rating on HBBM is three notches above the 'bbb-' SACP on the bank and three notches below the 'aa-' group credit profile (GCP) on HSBC's "core" operating subsidiaries.

### **Anchor: A small, exceptionally high-income economy, almost entirely dependent on two industries**

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor SACP, the starting point in assigning an issuer credit rating. The combination of a '6' economic risk score and a '3' industry risk score for Bermuda results in a 'bbb-' anchor SACP for a bank operating in Bermuda.

Regarding economic risk, Bermuda is a very small and largely open economy with exceptionally high income but almost complete dependence on two industries: international financial services (primarily provision of insurance and reinsurance), the main driver, and a much smaller and struggling tourism industry. We believe political risk is low, although macroeconomic policy flexibility is hampered by political and competitive constraints on fiscal policy, and a fixed exchange-rate regime (which precludes independent monetary policy, in light of a mostly open financial account), leading us to categorize economic resilience as "intermediate risk." In our opinion, Bermuda is in an extended "correction phase" of the local macroeconomic cycle. We believe the Bermudian banks are only about halfway through the full-cycle credit losses that we expect they will cumulatively incur during the 2009-2016 period. We believe the Bermudian banks have by now charged off the majority of the \$800 million-\$900 million in cumulative full-cycle (2008-2017) credit losses that we currently expect, although we believe the remainder will still be impactful,

and categorize the risks emanating from Bermudian economic imbalances as "very high." We view the risks resulting from Bermudian lending standards, payment culture, and rule of law as "intermediate."

Regarding industry risk, we view the risks resulting from Bermudian regulation and supervision, governance, and transparency as "intermediate," reflecting both a stable regulatory regime, consistent with international standards, and also the difficulties Bermuda's banks experienced in recent years. We view the jurisdiction's banking industry as highly concentrated and well-entrenched, with "low" risk as far as competitive dynamics. We view Bermuda's systemwide funding as "intermediate" risk, balancing a lack of lender of last resort against abundant and relatively stable deposits, and a general lack of either wholesale or external funding needs.

**Business position: A leading competitive position in Bermuda**

As the largest bank in the jurisdiction, HBBM has the leading competitive position in Bermuda, although this results in only an "adequate" business position, in our view, partly because we compare it to the entire Bermudian banking system -- and HBBM is a dominant share of it, with about \$11.5 billion in total assets (about half the system) as of Dec. 31, 2014. We believe the combination of the resources of the HSBC global network with the long-term local knowledge and well-established local presence of HBBM's predecessor (established in Bermuda in 1889) help HBBM to maintain its dominance. Moreover, HBBM provides a full suite of banking services, including retail and corporate banking, global markets, investment and wealth management, trust, custody, and insurance services. We estimate that it has a deposit market share of approximately 50% in Bermuda--significantly more than its nearest competitor.

In addition, in comparison with banks that we view as having similar industry risk by virtue of the countries they are based in (such as those based in the U.S.), we note that HBBM is highly dependent on a single industry (global reinsurance, and more narrowly those reinsurers who focus on Bermudian specialties, such as catastrophe reinsurance). Moreover, the Bermudian reinsurance industry has shown noticeable volatility, in terms of employment and income, in the past decade, and we believe pricing pressure will continue to spur consolidation in this industry. Many U.S. regional banks have more broadly diversified clients by industry, and often by geography, as well.

HBBM's loans to banks (about 25% of total assets) and securities held (about 46%) are relatively diversified among a number of geographies, somewhat mitigating the substantial geographic and single-name concentration in its customer loan portfolio (about 26%), which is principally exposed to Bermuda-based customers.

In addition, HBBM's payment of a large, discretionary dividend payment (resulting in a one-third decline in equity) to its parent in 2013, despite significant deterioration in loan performance in the same year, leads us to be somewhat skeptical with regards to the relative priority HBBM and HSBC place on risk mitigation, versus return.

HBBM's major business segments include the following:

**Commercial banking.** This segment provides commercial loans, payments and cash management, and investment management services to international and domestic corporations, small businesses, partnerships, and sole proprietorships. In Bermuda, HBBM has relationships with the majority of all licensed captive insurance companies and the majority of fund managers and fund administrators. HBBM uses the HSBC network to emphasize its global capabilities to its commercial client base.

**Global banking and markets.** HBBM provides payments and cash management services, foreign exchange and capital markets, strategic advisory, and investment solutions to corporate, institutional, private, and government clients through its global banking and markets segment. This segment serves international reinsurance and insurance clients in conjunction with HSBC and other affiliates. We believe that HBBM has a competitive advantage as a result of its global reach, strong local presence, and expertise in multicurrency cash management products.

**Global private banking.** HBBM provides wealth management and wealth preservation services including private banking, credit, treasury, trust and fiduciary, company incorporation and management services, philanthropy, investment management, and private family office services for corporations and wealthy individuals.

**Retail banking and wealth management.** HBBM provides day-to-day banking services, including savings and checking accounts, credit cards, investment products, insurance, mortgage loans, and personal loans.

**HSBC Securities Services (HSS).** This division provides fund administration services to a wide array of investment organizations, including hedge funds, fund of funds, and private equity funds (many of these organizations' managers are located in North America). HSS also provides traditional global custody services to insurance, reinsurance, and captive insurance companies, and it has a small custody and clearing business.

### **Capital and earnings: Risk-adjusted capital ratio remains very strong, despite declining**

The bank's RAC ratio remains "very strong" (our highest category), despite declining in recent years, at about 17%, as of Dec. 31, 2014. This decline represents a confluence of RAC-reducing influences, including increasing assets and increasing risk weights (associated with our decision to lower our economic risk score for Bermuda — see "Various Rating Actions Taken On Two Bermudian Banks Based On Higher Economic Risk," July 1, 2014). Although the current RAC remains high enough for us to consider it "very strong," and we think it most likely to remain so, we might reduce this assessment if it were to fall very close to 15%, particularly while the outlook for Bermudian loan quality remains doubtful.

In addition, HBBM's Tier 1 capital ratio was 23.6% as of Dec. 31, 2014, according to its Pillar 3 disclosures. HBBM's quality of capital is also very strong, in our view, as the bank has no hybrid issues outstanding. However, its more limited geographic and borrower diversification relative to those of some other banks somewhat tempers our very positive view of its capital.

As well, despite a significant decline in earnings since 2010, the bank is still profitable, partly because of strong earnings capacity before loan-loss provisions and reduced noninterest expenses. In addition, a very substantial portion of the bank's earnings are from fee-based businesses (about one-quarter of operating revenue, in 2014), which, although weaker in recent years, have contributed meaningfully to its results. Furthermore, we expect the bank to avoid negative earnings in the next few years, even though we expect loan-loss provisions and NCOs to remain elevated.

### **Risk position: We expect loan performance to deteriorate somewhat further**

HBBM's risk position is "weak," in our opinion. The bank's loan performance has deteriorated significantly in recent years, reflecting both Bermuda's weakening economy and challenges in the bank's commercial loan portfolio -- including large, single-name exposures to the hospitality sector. We view HBBM's asset quality as having performed substantially worse than its local bank peers' during the past few years. For example: NPAs as a share of loans, for the Bermudian banking industry as a group, moved from 1.4% in 2008 to 8% in 2011, 11% in 2012, 12% in 2013, and 11%

in 2014; for HBBM, the comparable measure moved from 1.8% in 2008 to 13% in 2011, 16% in 2012, 22% in 2013, and 19% in 2014. We suspect the divergence may reflect weaker underwriting on some loans, compared with Bermudian peers, among other factors — although we believe HBBM's underwriting standards have since tightened. We expect NCOs to remain elevated through 2017, as we expect Bermuda's economic recovery to remain weak (see "Banking Industry Country Risk Analysis: Bermuda," published Dec. 31, 2015).

The loan portfolio is largely concentrated in residential mortgages, which represented nearly half of the bank's gross loans and advances to customers as of Dec. 31, 2014. We understand loan losses had been extremely low before 2009. After five years of unbroken recession, however, residential repossessions, which we understand had also been extremely rare in Bermuda before 2009, have risen materially. We understand many residential mortgage borrowers relied on rental income from non-Bermudian workers (ownership of real estate below a price-threshold is restricted to Bermudians), and rental income has suffered as local economic deterioration has reduced both employment and related incomes.

Bermuda is often in or near the path of Atlantic-Ocean hurricanes, although these tend to do more damage in the Caribbean. Hurricane Joaquin, the strongest Atlantic storm since 2010, had minimal impact on Bermuda (unlike the Bahamas).

In any case, the bank's customer loan portfolio is only about one-quarter of its earning assets as of Dec. 31, 2014, providing some cushion to earnings and capital, despite deteriorating loan performance.

**Funding and liquidity: Average and strong, the latter reflecting an exceptionally large share of balance sheet devoted to high-quality, liquid assets**

The bank's funding profile is "average," for a Bermudian bank, in our opinion. This acknowledges the advantage provided by deposits, which are generally plentiful (comprising almost HBBM's entire funding base), thus obviating the need for fickle capital markets funding — offset by our belief that a substantially smaller share of such deposits can be relied on to stay put (in time of crisis) in Bermuda than in most wealthy countries, given Bermudian institutional arrangements. Bermudian banks realize the need to maintain more conservative funding and liquidity profiles than they otherwise might because Bermuda has no lender of last resort and no deposit insurance. The local authorities expect to implement the latter in 2016; however, such insurance is to cover only up to B\$25,000 per person/account, and that only for accounts in Bermuda dollars (Bermuda dollar accounts make up only about 15% of deposits at Bermudian banks). Moreover, there is no Bermudian debt market, so any potential capital markets funding must come from abroad (accounted for via our BICRA).

In light of this, we use a more conservative estimate of "core" (reliable) deposits for Bermudian banks than for those in most countries. For Bermudian banks, we consider core deposits to include only half of deposits we believe to be by individuals (in other countries we give full credit), and only 25% of those deposits we believe corporate (in other countries we give credit to half). Even by this measure, core deposits provide more than enough funding for HBBM's net loans to customers. On the other hand, HBBM's deposit liabilities are typically extremely short term (as of Dec. 31, 2014, almost all were to mature within one month, and the majority were non-core).

Nevertheless, HBBM maintains liquid assets that are both ample in size (more than 70% of total assets, at Dec. 31, 2014) and high quality (all investment securities were investment-grade, as of Dec. 31, 2014, and half were rated 'AAA');

likewise, almost all banks with whom funds were placed were investment-grade, and two-thirds rated 'AA-' or better). Although we believe there to be a greater need for liquidity in Bermuda than in some other jurisdictions, we view HBBM's liquidity as "strong," even for a Bermudian bank.

### **External support: Uplift for strategic importance to parent company**

We view HBBM as a "strategically important" subsidiary of HSBC, under our group methodology criteria. Supporting factors include that HBBM is a wholly owned subsidiary of HSBC (purchased on Feb. 18, 2004); it has a leading market position within Bermuda; it changed its legal name in 2010 to include "HSBC;" and we think customers' belief that HSBC stands behind its subsidiaries is important to HSBC's global franchise. On the other hand, HBBM is not in one of the group's priority growth markets; its connectivity with the rest of the group appears more limited than for subsidiaries in larger exporting economies; and it is relatively small, representing only about 1% of group capital. All things considered, we do not assume HBBM is among those subsidiaries most important to HSBC, but we do believe it to have "strategically important" group status. As a result, the 'A-' rating on HBBM is three notches above our SACP on the bank and three notches below our 'aa-' unsupported GCP on HSBC's 'core' operating subsidiaries.

### **Additional rating factors: None**

No additional factors affect this rating.

## **Related Criteria And Research**

### **Related Criteria**

- Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Standard & Poor's National And Regional Scale Mapping Tables, Sept. 30, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- 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
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

### **Related Research**

- Banking Industry Country Risk Analysis: Bermuda, Dec. 31, 2015
- Banking Industry Country Risk Assessment: Bermuda, Aug. 15, 2014
- Various Rating Actions Taken On Two Bermudian Banks Based On Higher Economic Risk, July 1, 2014
- HSBC Bank Bermuda 'A/A-1' Ratings Placed On CreditWatch Negative On Weaker Loan Performance And Large Capital Payout, March 11, 2014
- Ratings On Bermudian Banks Lowered On Rising Economic Risk; Outlooks Negative, Sept. 26, 2013

- HSBC Bank Bermuda Ltd. Long-Term Rating Lowered To 'A' On Higher Economic Risk; Outlook Is Negative, Sept. 26, 2013

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 31, 2015)

#### HSBC Bank Bermuda Ltd.

Counterparty Credit Rating

A-/Negative/A-2

#### Counterparty Credit Ratings History

01-Jul-2014

A-/Negative/A-2

11-Mar-2014

A/Watch Neg/A-1

26-Sep-2013

A/Negative/A-1

23-Aug-2012

A+/Negative/A-1

29-Nov-2011

A+/Stable/A-1

13-Oct-2011

AA-/Negative/A-1+

#### Sovereign Rating

Bermuda

A+/Stable/A-1

#### Related Entities

##### Hang Seng Bank (China) Limited

Issuer Credit Rating

AA-/Stable/A-1+

*Greater China Regional Scale*

cnAAA/--/cnA-1+

##### Hang Seng Bank Limited

Issuer Credit Rating

AA-/Stable/A-1+

*Greater China Regional Scale*

cnAAA/--/cnA-1+

##### Hang Seng Insurance Co. Ltd.

Financial Strength Rating

*Local Currency*

AA-/Stable/--

Issuer Credit Rating

*Local Currency*

AA-/Stable/--

*Greater China Regional Scale*

cnAAA/--/--

## Ratings Detail (As Of December 31, 2015) (cont.)

**HSBC Bank A.S.**

Issuer Credit Rating BB/Developing/B  
*Turkey National Scale* trAA/--/trA-1

**HSBC Bank Australia Ltd.**

Issuer Credit Rating A+/Stable/A-1  
 Commercial Paper  
*Foreign Currency* A-1  
 Senior Unsecured A+  
 Short-Term Debt A+  
 Short-Term Debt A-1  
 Subordinated A

**HSBC Bank Brasil S.A.**

Issuer Credit Rating BB+/Watch Neg/B  
 Senior Unsecured BB+/Watch Neg

**HSBC Bank Canada**

Issuer Credit Rating AA-/Stable/A-1+  
 Certificate Of Deposit  
*Local Currency* AA-/A-1+  
 Preferred Stock  
*Canada National Scale Preferred Share* P-2  
 Preferred Stock BBB  
 Senior Unsecured A-1+  
 Senior Unsecured AA-  
 Short-Term Debt A-1+  
 Subordinated A-

**HSBC Bank PLC**

Issuer Credit Rating AA-/Stable/A-1+  
 Commercial Paper A-1+  
 Junior Subordinated BBB  
 Junior Subordinated BBB+  
 Preferred Stock BBB  
 Senior Unsecured AA-  
 Short-Term Debt A-1+  
 Subordinated A-

**HSBC Bank (Taiwan) Ltd.**

Issuer Credit Rating A+/Stable/A-1  
*Greater China Regional Scale* cnAAA/--/cnA-1+  
*Taiwan National Scale* twAAA/Stable/twA-1+  
 Senior Unsecured  
*Taiwan National Scale* twAAA

**HSBC Bank USA N.A.**

Issuer Credit Rating AA-/Stable/A-1+  
 Senior Unsecured AA-  
 Subordinated A

## Ratings Detail (As Of December 31, 2015) (cont.)

**HSBC Capital Funding (Dollar 1) L.P.**

Preferred Stock BBB-

**HSBC Finance Corp.**

Issuer Credit Rating A/Stable/A-1

Commercial Paper

*Local Currency* A-1

Preferred Stock BBB-

Senior Unsecured A

Subordinated A-

**HSBC France**

Issuer Credit Rating AA-/Stable/A-1+

Certificate Of Deposit

*Local Currency* A-1+

Senior Unsecured AA-

Short-Term Debt A-1+

**HSBC Holdings PLC**

Issuer Credit Rating A/Stable/A-1

Junior Subordinated BBB-

Preference Stock BBB-

Preferred Stock BBB-

Senior Unsecured A

Senior Unsecured AA-

Short-Term Debt A-1

Subordinated BBB+

**HSBC Insurance (Singapore) Pte. Ltd.**

Financial Strength Rating

*Local Currency* A+/Stable/--

Issuer Credit Rating

*Local Currency* A+/Stable/--*ASEAN Regional Scale* axAAA/--/--**HSBC Life (International) Ltd.**

Financial Strength Rating

*Local Currency* AA-/Stable/--

Issuer Credit Rating

*Local Currency* AA-/Stable/--*Greater China Regional Scale* cnAAA/--/--**HSBC Mexico S.A.**

Issuer Credit Rating BBB+/Stable/A-2

*CaVal (Mexico) National Scale* mxAAA/Stable/mxA-1+

Senior Unsecured

*CaVal (Mexico) National Scale* mxAAA**HSBC Securities (USA) Inc.**

Issuer Credit Rating AA-/Stable/A-1+

## Ratings Detail (As Of December 31, 2015) (cont.)

**HSBC SFH (France)**

Senior Secured	AAA
Senior Secured	AAA/Stable

**HSBC USA Capital Trust I**

Preferred Stock	BBB-
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**HSBC USA Capital Trust II**

Preferred Stock	BBB-
-----------------	------

**HSBC USA Inc.**

Issuer Credit Rating	A/Stable/A-1
Commercial Paper	
<i>Local Currency</i>	A-1
Preferred Stock	BBB-
Senior Unsecured	A
Subordinated	A-

**The Hongkong and Shanghai Banking Corp. Ltd.**

Issuer Credit Rating	AA-/Stable/A-1+
<i>Greater China Regional Scale</i>	cnAAA/--/cnA-1+
Certificate Of Deposit	
<i>Foreign Currency</i>	A-1+
Senior Unsecured	
<i>Greater China Regional Scale</i>	cnAAA
<i>Greater China Regional Scale</i>	cnA-1+
Senior Unsecured	A-1+
Senior Unsecured	AA-

**The Hongkong and Shanghai Banking Corp. Ltd. (Sydney Branch)**

Senior Unsecured	AA-
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**The Saudi British Bank**

Issuer Credit Rating	A/Negative/A-1
Senior Unsecured	A
Short-Term Debt	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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