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## HSBC Bank Bermuda Ltd.

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# HSBC Bank Bermuda Ltd.

## Major Rating Factors

### Strengths:

- Strategically important subsidiary of HSBC Holdings PLC
- Formidable competitive position
- Very high capital ratios
- Adequate, albeit reduced, profitability
- Conservative funding and liquidity

### Weaknesses:

- Significant deterioration in loan performance given weak Bermuda economy
- Concentrated loan portfolio with large single-name exposures
- Weak, although increasing, loan loss reserves
- Rapid growth in the Americas portfolio in previous years

### Counterparty Credit Rating

A/Negative/A-1

## Outlook

Standard & Poor's outlook on HSBC Bank Bermuda Ltd. (HSBC BB) is negative given the negative economic trend on the Bermuda Banking Industry Country Risk Assessment (BICRA), as well as our belief that loan performance could weaken somewhat further throughout 2013 and 2014. We could lower the stand-alone credit profile (SACP) on HSBC BB, and therefore the rating, if the economy in Bermuda weakens further or if the bank's loan performance deteriorates more than we expect. Specifically, we could lower the rating if the bank's nonperforming asset (NPA) ratio fails to stabilize or if net charge-offs substantially exceed our expectations. We could also lower the rating if, in our view, HSBC BB's relationship with the HSBC group weakens--which we consider unlikely.

## Rationale

The ratings on HSBC BB, the largest bank in Bermuda, primarily reflect the bank's strategic importance to its parent, HSBC Holdings PLC; formidable competitive position; very high capital ratios; adequate profitability; and conservative funding and liquidity. The bank's capital ratios are very high, but we expect them to decline slightly over the next few years given that we see international loan growth and the continuation of its very high dividend payout policy. HSBC BB's loan performance has deteriorated significantly in recent years, particularly within its commercial and hospitality loan portfolios. We think the deterioration is largely due to the departure of a few thousand expatriates, increased unemployment levels, and a sharp slowdown in the local real estate market.

We do not see a rapid recovery in the local economy in the near term, and we expect some further weakening in the bank's loan performance throughout 2013 and 2014. However, the bank's loan portfolio is less than half 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 and risk assessments.

The long-term issuer credit rating also reflects our view of HSBC BB's strategic importance to its parent company, U.K.-incorporated bank holding company HSBC Holdings PLC (HSBC), and our view that it is likely that extraordinary U.K. sovereign support provided to HSBC would extend to HSBC BB if needed. The long-term rating on HSBC BB is three notches above its 'bbb' SACP and two notches below the 'aa-' group credit profile (GCP) of HSBC.

**Anchor: A small economy that is highly dependent on a few industries**

The 'bbb' anchor draws on our BICRA methodology and our view of the economic and industry risk in Bermuda, where HSBC BB operates. The indicative BICRA for Bermuda is group '4', according to our criteria. We believe Bermuda has a small economy that is highly dependent on the financial services, real estate, and tourism industries. In our view, the local economy has experienced a material slowdown in economic growth, in part because of the departure of a few thousand expatriates in recent years from the island, high and increasing unemployment levels, and a very sharp and an extended slowdown in the real estate market, which weighs on our evaluation of economic risk. With regard to industry risk, Bermudian banks have a high and stable core customer deposit base and have relatively low rivalry given the high concentration of banks. Furthermore, although Bermudian banks are concentrated by region, most are well diversified by business lines--which include private-banking, asset-management, and personal-trust services. As a result, noninterest income is generally a large portion of total revenue for Bermuda's banks. We view the absence of a central bank as a weakness, but our overall view of systemwide funding is "intermediate risk" because of factors such as a strong ratio of industry deposits to loans and a limited share of nonloan assets domestically.

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

HSBC BB has a strong competitive position in Bermuda, although its business position is only "adequate," in our view, since we compare it to the average bank in Bermuda. HSBC BB, a wholly owned subsidiary of HSBC, is the largest bank in Bermuda, with over \$13.2 billion in total assets as of Dec. 31, 2012. Established in 1889 and incorporated in 1891, HSBC BB provides retail and corporate banking, global markets, investment and wealth management, trust, custody, and insurance services. We estimate that HSBC BB has a deposit market share of roughly 50% in Bermuda--more than its nearest competitor.

We believe that HSBC BB's management is generally conservative and primarily focused on its core businesses and regions, given limited opportunities for loan growth in Bermuda and its excess of customer deposits relative to loans. However, management is increasing the bank's international loan exposures, which should benefit its net interest margins and geographic diversification but also likely increases the credit risk within the loan portfolio, in our opinion.

Furthermore, since HSBC acquired the bank, HSBC BB management has upstreamed the vast majority of the bank's earnings to its parent and sold several businesses, which has substantially reduced the bank's profitability and diversification. In 2006, HSBC BB transferred two businesses in Hong Kong to HSBC-affiliated entities. HSBC BB also disposed of its Singapore fund administration business in 2008. In 2010, HSBC BB sold HSBC Insurance (Bermuda) Ltd., one of the largest captive insurance subsidiaries in the world, to an affiliate of its parent, thereby recognizing a small capital gain and removing a capital guarantee. The captive had previously generated about one-third of the bank's total profits, a proportion that had grown in previous years as the subsidiary increased its penetration within HSBC and among its various affiliates.

HSBC BB'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, HSBC BB has relationships with the majority of all licensed captive insurance companies and the majority of fund managers and fund administrators. HSBC BB uses the HSBC network to emphasize its global capabilities to its international client base.
- Global banking and markets. HSBC BB 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. HSBC BB competes with several large global banks, and we believe that it has a competitive advantage as a result of its global reach, strong local presence, and expertise in multicurrency cash management and sweep products.
- Global private banking. HSBC BB 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. HSBC BB provides day-to-day banking services, including savings and checking accounts, credit cards, investment products, insurance, mortgage loans, and personal loans. In 2005, the bank introduced its premier banking products and services, which target affluent customers and require \$200,000 in investable assets. In 2010, the bank launched its advance banking products and services, which require \$50,000 in investable assets. HSBC BB has further integrated its technology platform with those of HSBC by offering customers services, such as Global View, cash transfers, and worldwide emergency cash services.
- 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). The bank's investor services business has significantly reduced its headcount in Bermuda by using its affiliated offices in New York and Dublin. HSS also provides traditional global custody services to insurance, reinsurance, and captive insurance companies, and it has a small custody and clearing business.

**Bermuda.** Bermuda's economy has weakened in recent years, in our view, as a result of the departure of a few thousand expatriates, a significant rise in the unemployment rate, and weakness in the real estate market. Furthermore, the economy is relatively small and highly dependent on the financial services, real estate, and tourism industries. However, home prices have appreciated considerably over the previous decade, resulting in generally high collateral values despite the substantial decrease in home prices in recent years. Residential homes in Bermuda are typically expensive and often have attached apartments, which are rented. The Bermuda government has imposed very high sales taxes and several restrictions on who can own property in Bermuda. We believe that these taxes and restrictions have hurt residential property values in recent years.

Bermuda, a popular tourist destination, has a substantial financial services industry--primarily because of the presence of a large number of insurance and reinsurance companies. There are several hundred captive insurance companies that are located on the island because of its favorable tax and regulatory conditions. Bermuda has its own currency, which is pegged one-to-one to the U.S. dollar. The Bermuda government earns a foreign-exchange currency purchase tax each time Bermuda dollars are exchanged for a foreign currency, and, similarly, banks earn foreign-exchange transaction fees when foreign currencies are bought or sold against Bermuda dollars.

**Capital and earnings: Risk-adjusted capital ratio is among the highest of globally rated banks'**

The bank's risk-weighted capital ratios are very high, but we expect them to decline somewhat over the next few years because we believe management will maintain its high dividend payout policy (typically representing 100% of the

yearly net income) at the same time it increases its risk-weighted assets through corporate loan growth. Capital and earnings are "very strong," in our opinion, largely based on our projection that HSBC BB's risk-adjusted capital (RAC) ratio will decline only slightly from over 29% to approximately 27% by the end of 2015. This projected RAC ratio is still among the highest of the banks we rate globally.

However, the bank's more-limited geographic and loan-type diversification relative to some other banks somewhat tempers our very positive view of its capital. HSBC BB's Tier 1 capital ratio was 28.1% as of Dec. 31, 2012, according to its Pillar 3 disclosures. HSBC BB's quality of capital is also very strong, in our view, given that the bank has no outstanding hybrid issues.

However, despite a decline in recent years, 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, which, although weaker in recent years, have contributed meaningfully to its results. Furthermore, we expect the bank to remain profitable over the next few years, even though we expect loan-loss provisions and net charge-offs to remain at levels higher than those experienced in previous years.

Although we expect loan performance to weaken somewhat further throughout 2013 and 2014, we expect the bank to remain profitable as a result of a rising net interest margin (NIM), significant fee-based revenues, and a continued focus on expense reductions. The NIM has been hurt in recent years by lower floating interest rates in the bank's commercial loan portfolio and the reinvestment of maturing securities in lower-yielding securities. The bank's sale of its captive insurance business in 2010 substantially and permanently reduced its profitability and revenue diversification, but it only slightly benefited its tangible capital ratios.

**Risk position: Loan performance could deteriorate somewhat further**

HSBC BB's loan performance has deteriorated significantly in recent years because of a weaker economy in Bermuda, challenges within its commercial loan portfolio (including large, single-name exposures to the hospitality sector), and weakening residential home prices. We think HSBC BB has performed substantially worse than its local bank peers over the past few years in terms of loan performance. For example, nonperforming loans (including restructured loans) increased to roughly 15% as of Dec. 31, 2012, by our calculation, from about 2% as of Dec. 31, 2009. Furthermore, we expect some further deterioration in overall loan performance throughout 2013 and 2014 within the bank's commercial and residential mortgage loan portfolios given a weak Bermudian economy, high unemployment, and substantially lower real estate prices. Growth in the bank's international corporate loan exposures has increased its risk-weighted assets, as well as its credit risk, in our view.

However, the bank's loan portfolio is much less than half of its earning assets as of Dec. 31, 2012. Real estate generally secures the bank's residential mortgages, and we believe that most of its commercial loans are guaranteed. The bank's loan-loss reserves increased significantly in 2012, but they are still low, in our opinion, relative to total nonperforming assets. As a result, we view loan-loss reserves as weak because we expect that net charge-offs could remain at elevated levels even though they were very low in the previous decade.

The loan portfolio is concentrated in residential mortgages, which we estimate represented nearly half of the bank's gross loans and advances to customers as of Dec. 31, 2012. Average loan balances are fairly high because residential homes and land are generally expensive in Bermuda. Loan losses have historically been extremely low, given the

significant appreciation in residential property values in Bermuda over the previous decade, the typically low loan-to-value ratios at the time of origination, and the generally conservative debt-to-income ratios among mortgage borrowers. However, residential foreclosures, which had historically been extremely rare in Bermuda, have risen materially in recent years and we expect them to remain at elevated levels over the next few years.

The bank has been diversifying its corporate loan portfolio through selective lending to HSBC customers in the Americas, which could increase credit risk, in our opinion. The bank's total loans also include loans to other financial institutions and the Bermuda government. Consumer loans include loans to individuals (including auto, student, and secured personal loans). The bank's credit scoring analysis on its consumer portfolio is largely based on income data because FICO scores on individuals are not available in Bermuda. We expect that the bank will use some of its maturing available-for-sale securities to help fund the growth in its international loan portfolio.

**Funding and liquidity: Bermuda benefits from large amounts of customer deposits**

HSBC BB's funding and liquidity are conservative in our opinion, and we score them as "average" and "strong," respectively, under our criteria. HSBC BB benefits from its core customer deposits, which significantly exceed the size of its loan portfolio. The bank's large deposit base includes large deposits from its captive insurance clients--which provide a relatively stable and inexpensive source of funding. Customer deposits exceed loan balances, and the bank invests these excess deposits primarily in financial instruments and loans to banks. However, the majority of the bank's customer deposits have very short maturities, typically one month or less, in part as a result of corporate clients depositing working capital. We view this as a minor concern given that deposits have grown substantially in recent years, in part because of the strength of the HSBC franchise.

There is no deposit insurance fund in Bermuda, but we expect that it could be implemented in late 2013 or early 2014. Furthermore, although the bank does not have a lender of last resort, such as the Federal Reserve Board for banks in the U.S., we believe that HSBC, with its substantial financial resources, would likely provide support to HSBC BB, if needed.

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

We view HSBC BB as a "strategically important" subsidiary of HSBC, its parent company under our group methodology criteria. In making our determination, we considered that HSBC BB is a wholly owned subsidiary of HSBC (purchased on Feb. 18, 2004), it changed its legal name in 2010 to include "HSBC," it has a solid track record of earnings and dividends, and it receives support for dealing with all back-office and administrative functions. HSBC BB also plays a broader role in the group, using some of its excess capital to support aspects of HSBC's corporate lending activities elsewhere in the Americas. However, HSBC BB is not in one of the group's priority growth markets and its connectivity with the rest of the group appears more limited than for subsidiaries in larger exporting economies. As a result of the "strategically important" group status, the 'A' rating on HSBC BB is three notches above our SACP of the bank and two notches below HSBC's 'aa-' GCP (the level at which we assign ratings on the group's "core" operating entities).

**Additional rating factors: None**

No additional factors affect this rating.

### Ratings Score Snapshot

Issuer Credit Rating	A/Negative/A-1
SACP	bbb
Anchor	bbb
Business Position	Adequate (0)
Capital and Earnings	Very Strong (+2)
Risk Position	Weak (-2)
Funding and Liquidity	Average and Strong (0)
Support	3
GRE Support	0
Group Support	3
Sovereign Support	0
Additional Factors	0

### Related Criteria And Research

- 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
- Banking Industry Country Risk Assessment Update: September 2013, Sept. 6, 2013
- General Criteria: Group Rating Methodology, May 7, 2013
- Research Update: Outlook On Bermuda To Negative On Growing Economic, Fiscal, And Banking-Sector Risks; Ratings Affirmed At 'AA-/A-1+', March 28, 2013
- HSBC Holdings PLC, Dec. 20, 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

### Ratings Detail (As Of October 4, 2013)

#### HSBC Bank Bermuda Ltd.

Counterparty Credit Rating A/Negative/A-1

#### Counterparty Credit Ratings History

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+
18-Oct-2010	AA-/Stable/A-1+
19-Dec-2008	AA-/Negative/A-1+

#### Sovereign Rating

Bermuda AA-/Negative/A-1+

#### Related Entities

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

Issuer Credit Rating	AA-/Stable/A-1+
Greater China Regional Scale	cnAAA/--/cnA-1+

## Ratings Detail (As Of October 4, 2013) (cont.)

**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/--/--

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

Senior Unsecured AA-

**HSBC Bank A.S.**

Issuer Credit Rating BB+/Stable/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+

Senior Unsecured A-1+

Short-Term Debt A+

Short-Term Debt A-1

Subordinated A

**HSBC Bank Brasil S.A.**

Issuer Credit Rating BBB/Negative/A-2

Senior Unsecured BBB

Subordinated BB+

**HSBC Bank Canada**

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

Certificate Of Deposit AA-/A-1+

Preference Stock  
*Canada National Scale Preferred Share* P-1(Low)

Preference Stock A-

Preferred Stock  
*Canada National Scale Preferred Share* P-1(Low)

Preferred Stock A-

Senior Unsecured A-1+

Senior Unsecured AA-

Subordinated A

**HSBC Bank Kazakhstan JSC**

Issuer Credit Rating BBB/Stable/A-2  
*Kazakhstan National Scale* kzAA+/-/--

**HSBC Bank (Panama) S.A.**

Issuer Credit Rating BBB-/Watch Neg/A-3

## Ratings Detail (As Of October 4, 2013) (cont.)

<b>HSBC Bank PLC</b>	
Issuer Credit Rating	AA-/Negative/A-1+
Commercial Paper	A-1+
Junior Subordinated	A-
Preferred Stock	A-
Senior Unsecured <i>Greater China Regional Scale</i>	cnAAA
Senior Unsecured	AA-
Short-Term Debt	A-1+
Subordinated	A
<b>HSBC Bank PLC (Madrid Branch)</b>	
Issuer Credit Rating	AA-/Negative/A-1+
<b>HSBC Bank (Taiwan) Ltd.</b>	
Issuer Credit Rating	A+/Stable/A-1
<i>Greater China Regional Scale</i>	cnAAA/--/cnA-1+
<i>Taiwan National Scale</i>	twAAA/Stable/twA-1+
Senior Unsecured <i>Taiwan National Scale</i>	twAAA
<b>HSBC Bank USA N.A.</b>	
Issuer Credit Rating	AA-/Negative/A-1+
Senior Unsecured	AA-
Subordinated	A
<b>HSBC Canada Asset Trust</b>	
Preferred Stock <i>Canada National Scale Preferred Share</i>	P-1(Low)
Preferred Stock	A-
<b>HSBC Capital Funding (Dollar 1) L.P.</b>	
Preferred Stock	BBB+
<b>HSBC Capital Funding (Dollar 2) L.P.</b>	
Preferred Stock	BBB+
<b>HSBC Capital Funding (Sterling 1) L.P.</b>	
Preferred Stock	BBB+
<b>HSBC Finance Corp.</b>	
Issuer Credit Rating	A/Negative/A-1
Commercial Paper <i>Local Currency</i>	A-1
Junior Subordinated	BBB+
Preferred Stock	BBB+
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	A-
<b>HSBC France</b>	
Issuer Credit Rating	AA-/Negative/A-1+
Certificate Of Deposit	AA-/A-1+
Senior Unsecured	AA-

Ratings Detail (As Of October 4, 2013) (cont.)	
Short-Term Debt	A-1+
Subordinated	A
<b>HSBC Holdings Luxembourg S.A.</b>	
Issuer Credit Rating	A+/Negative/A-1
Subordinated	A-
<b>HSBC Holdings PLC</b>	
Issuer Credit Rating	A+/Negative/A-1
Junior Subordinated	BBB+
Preference Stock	BBB+
Preferred Stock	BBB+
Senior Unsecured	A+
Senior Unsecured	AA-
Short-Term Debt	A-1
Subordinated	A-
<b>HSBC Insurance (Asia) Ltd.</b>	
Issuer Credit Rating	
<i>Local Currency</i>	A/Stable/--
<b>HSBC Insurance (Singapore) Pte. Ltd.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<i>ASEAN Regional Scale</i>	axAAA/--/--
<b>HSBC Life (International) Ltd.</b>	
Financial Strength Rating	
<i>Local Currency</i>	AA-/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	AA-/Stable/--
<i>Greater China Regional Scale</i>	cnAAA/--/--
<b>HSBC Markets (Bahamas) Ltd.</b>	
Senior Unsecured	
<i>Greater China Regional Scale</i>	cnAAA
<i>Greater China Regional Scale</i>	cnA-1+
Senior Unsecured	A-1+
Senior Unsecured	AA-
Subordinated	
<i>Greater China Regional Scale</i>	cnAA+
Subordinated	A+
<b>HSBC Mexico S.A.</b>	
Issuer Credit Rating	BBB/Positive/A-2
<i>CaVal (Mexico) National Scale</i>	mxAAA/Stable/mxA-1+
Senior Unsecured	
<i>CaVal (Mexico) National Scale</i>	mxAAA

## Ratings Detail (As Of October 4, 2013) (cont.)

<b>HSBC Private Bank (C.I.) Ltd</b>	
<b>HSBC Private Banking Holdings (Suisse) S.A.</b>	
<b>HSBC Private Bank (Monaco) S.A.</b>	
<b>HSBC Private Bank (Suisse) S.A.</b>	
<b>HSBC Securities (USA) Inc.</b>	
Issuer Credit Rating	AA-/Negative/A-1+
<b>HSBC SFH (France)</b>	
Senior Secured	AAA/Stable
<b>HSBC USA Capital Trust I</b>	
Preferred Stock	BBB+
<b>HSBC USA Capital Trust II</b>	
Preferred Stock	BBB+
<b>HSBC USA Inc.</b>	
Issuer Credit Rating	A+/Negative/A-1
Commercial Paper	
<i>Local Currency</i>	A-1
Preferred Stock	BBB+
Senior Unsecured	A+
Subordinated	A-
<b>Republic New York Capital I</b>	
Preferred Stock	BBB+
<b>Republic New York Capital II</b>	
Preferred Stock	BBB+
<b>The Hongkong and Shanghai Banking Corp. Ltd.</b>	
Issuer Credit Rating	AA-/Stable/A-1+
<i>Greater China Regional Scale</i>	cnAAA/--/cnA-1+
Certificate Of Deposit	
<i>Foreign Currency</i>	AA-/NR
Senior Unsecured	
<i>Greater China Regional Scale</i>	cnAAA
Senior Unsecured	A-1+
Senior Unsecured	AA-
<b>The Saudi British Bank</b>	
Issuer Credit Rating	A/Positive/A-1
Senior Unsecured	A
Senior Unsecured	A-1
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.

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