

Transaction Update: Deutsche Apotheker- und Aertztebank eG Mortgage Covered Bond Program

Hypothekenpfandbriefe

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Table Of Contents

Outlook

Rationale

Program Description

Rating Analysis

Related Criteria

Related Research

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Ratings Detail

Reference Rating Level	aa+	+	Jurisdiction-Supported Rating Level	aaa	+	Maximum Achievable Covered Bond Rating	aaa	=	Covered Bond Rating	
Resolution Regime Uplift	+2		Assigned Jurisdictional Support Uplift	+1*		Collateral Support Uplift	+3		AAA/Stable	
Systemic Importance	Very Strong		Jurisdictional Support Assessment	Very Strong		Overcollateralization Adjustment	-1		Rating Constraints	aaa
Resolution Counterparty Rating	Not applicable		Legal Framework	Very Strong		Liquidity Adjustment	0		Counterparty Risk	aaa
Issuer Credit Rating	AA-		Systemic Importance	Very Strong		Potential Collateral Based Uplift	+4		Country Risk	aaa
			Sovereign Credit Capacity	Very Strong						

*The maximum jurisdictional support uplift is three notches above the RRL. However, only one notch is required to achieve a 'AAA' rating on the covered bonds.

Strengths

- Granular and well-seasoned cover pool, predominantly exposed to German residential mortgages.
- Public commitment to address commingling risk by adding overcollateralization upon loss of the minimum issuer credit rating (ICR).
- Availability of five unused notches, which protects the ratings on the covered bonds if the issuer is downgraded.

Weaknesses

- Absence of commitment for specific overcollateralization level.
- Narrow focus of cover pool assets on German health care professionals.
- Exposure to assets with higher whole-loan loan-to-value (LTV) ratios, which we have taken into account in our estimated default rate at the 'AAA' rating level.

Outlook

S&P Global Ratings' stable outlook on the ratings on Deutsche Apotheker- und Aerztebank eG's (Apobank) mortgage covered bonds reflects the cushion of five unused notches--comprising two notches of jurisdictional support and three notches of collateral support--that would protect the ratings on the covered bonds if we were to lower the long-term ICR on the issuer.

We would lower our ratings on the covered bonds if the available credit enhancement became insufficient to cover 'AAA' credit risk, either because of a reduction by the issuer of the available credit enhancement, or because of deteriorations of the cover pool's credit risk profile.

Rationale

We are publishing this transaction update as part of our annual review of Apobank's mortgage covered bond program.

Our covered bond ratings process follows the methodology and assumptions outlined in our "Covered Bonds Criteria," published on Dec. 9, 2014 and our "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015.

Apobank's mortgage covered bonds are issued under the German Covered Bond Act (Pfandbriefgesetz; "PfandBG"). From our analysis of the legal and regulatory framework for German covered bonds, we have concluded that the assets in Apobank's cover pool are isolated from its bankruptcy or insolvency. This enables us to rate the covered bonds above Apobank's long-term ICR.

Based on our operational risk analysis, which covers a review of origination, underwriting, collection, and default management procedures, as well as cover pool management and administration, we conclude that the ratings on the covered bonds are not constrained by operational risk.

Under our resolution regime analysis, we determined a reference rating level (RRL) of 'aa+'. This is based on (i) Apobank is domiciled in Germany, which is subject to the EU's Bank Recovery and Resolution Directive (BRRD) and (ii) our very strong assessment of the systemic importance of mortgage covered bonds in Germany (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Oct. 16, 2018). These factors increase the likelihood that Apobank would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail-in of its senior unsecured obligations.

Our jurisdictional support analysis determined the jurisdiction-supported rating level (JRL) of the covered bonds as 'aaa'. We considered the likelihood for the provision of jurisdictional support of German mortgage covered bonds, which we assess as very strong, resulting in a jurisdictional support uplift from the RRL of up to three notches. Apobank's covered bonds only use one notch in order to achieve a JRL of 'aaa'.

Under our covered bonds criteria when the rating on the covered bonds is based on their JRL, the available overcollateralization must cover at least a 'AAA' level of credit stress which we have determined in our collateral

support analysis as 5.99%. Apobank's covered bonds exceed this requirement with an available overcollateralization of 15.13%.

Lastly, the ratings on the program and related issuances are not constrained by counterparty, legal, or sovereign risks.

Program Description

Table 1

Program Overview*	
Jurisdiction	Germany
Rating at closing/year	AAA/2008
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. €)	5.743
Redemption profile	Hard bullet
Underlying assets	Residential mortgages, commercial mortgages, and public sector assets
Assigned jurisdictional support uplift	1
Unused notches for jurisdictional support	2
Target credit enhancement (%)	8.17
Credit enhancement commensurate with current rating (%)	5.99
Available credit enhancement (%)	15.13
Assigned collateral support uplift	0
Unused notches for collateral support	3
Total unused notches	5

*Based on data as of March 31, 2019.

Apobank is the largest of 885 cooperative banks in Germany, with total assets of €45.4 billion and roughly 458.770 customers as of December 31, 2018. It is the market leader in its niche of lending business and payment services for Germany's medical profession. Apobank issues mortgage covered bonds under its €15 billion debt issuance program, or using standalone documentation. It is an established program with frequent issuances that we have rated since 2008. To date, there are €5.743 million of covered bonds outstanding.

The covered bonds constitute senior secured unsubordinated obligations of the issuer and rank pari passu with all other obligations secured by the cover pool register. Covered bondholders have recourse to Apobank, and should insolvency proceedings against the issuer be launched, to the assets in the cover pool register.

We base our collateral analysis on stratified data as of March 31, 2019. Compared to our previous review, the cover pool has increased by about 16%, while the amount of outstanding covered bonds increased by about 23% (see "Transaction Update: Deutsche Apotheker- und Aerztebank eG Mortgage Covered Bond Program," published on July 17, 2018). As a result, overcollateralization has reduced to 15.13% from 22.01%. The composition and credit quality of the cover pool have remained stable.

Apobank provides the bank account for the program. There are no swaps registered in the cover pool.

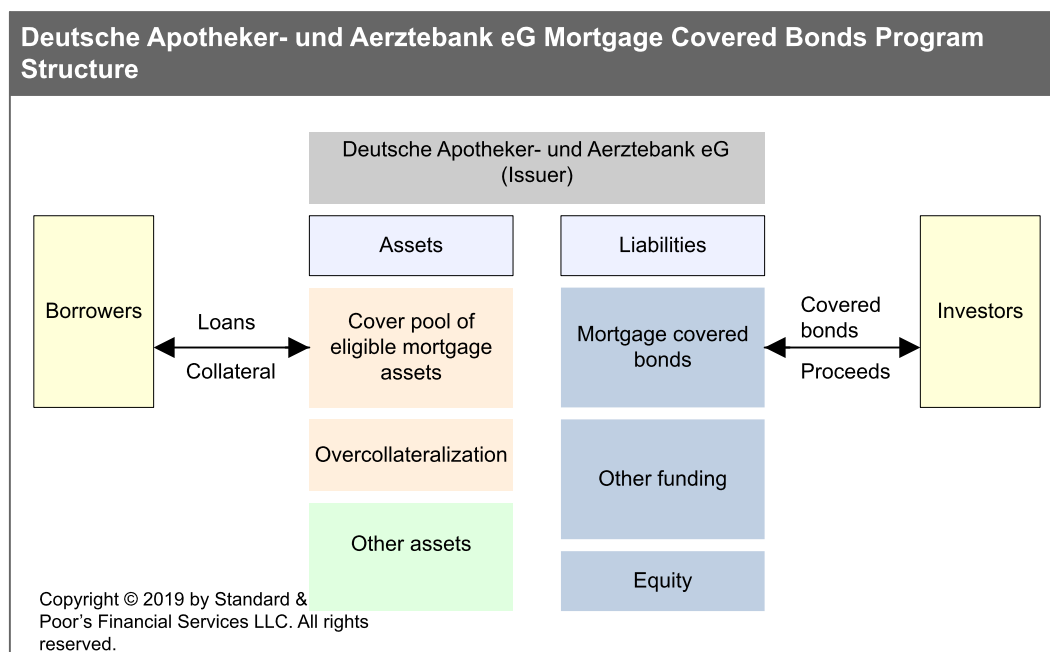


Table 2

Participants			
Role	Name	Rating	Rating dependency
Issuer/ bank account provider	Apobank	AA-/Stable/A-1+	Yes

Rating Analysis

Legal and regulatory risks

We base our legal analysis on our "Structured Finance: Asset Isolation And Special-Purpose Entity Methodology," criteria, published on March 29, 2017, and our covered bond ratings framework.

The German Covered Bond Act and the relevant secondary legislation provide the legal framework for the issuance of German covered bonds (Pfandbriefe). We consider that the German covered bond legal framework satisfies the relevant legal aspects of our covered bond criteria, which allows us to assign ratings to the covered bonds that exceed our long-term ICR on the issuer.

Covered bond investors have a preferential claim to a cover pool which for mortgage covered bonds, may comprise exposure to properties and rights equivalent to real property located amongst others in a member state of the European Union, the European Economic Area, Switzerland, the U.S., Canada, Japan, Australia, or Singapore. Mortgages can be included in the cover pool only up to the first 60% of the property's mortgage lending value, as estimated in accordance with the Pfandbriefgesetz. The cover pool can also comprise substitute assets that have to

meet the eligibility criteria outlined in the German Covered Bond Act.

The German Covered Bond Act requires the issuer to maintain overcollateralization of at least 2% on a net present value basis for the outstanding covered bonds, and ensure that 180 days of liquidity needs are covered by liquid assets at all times.

In case of the issuer's insolvency, an independent trustee is responsible for monitoring the cover pool (cover pool monitor) until an independent cover pool administrator is appointed. BaFin, the German supervisory authority for financial institutions, appoints and supervises the cover pool monitor and cover pool administrator. BaFin also regularly conducts a covered bond audit.

Operational and administrative risks

We review operational risk according to our covered bonds criteria.

In our opinion, there is no operational risk from the issuer's management of the cover pool and its loan origination that would constrain the covered bond rating to the long-term ICR.

Apobank's cover pool comprises loans granted to medical professionals in Germany secured by residential properties, as well as commercial properties including pharmacies, medical centers, rehabilitation and nursing homes, and office properties.

Loans are originated mostly through Apobank's branches, and to a lesser extent using Apobank's subsidiary ApoFinanz and sales partner teams. Lending is based on a cash flow assessment of all loan applications. Loans are either variable or fixed interest rate pay with a maximum fixed rate period of 15 years. The loans repay either on an annuity or constant repayment rate basis. Interest-only loans are only granted to the extent they are collateralized by additional assets such as life and pension insurance, and investment funds.

The cover pool does not include loans in arrears or defaulted loans as the issuer removes loans from the cover pool if a borrower's performance deteriorates beyond a predetermined threshold as measured by the borrower's bank internal rating.

Apobank has a track record of prudently managing refinancing risks within the covered bond program. These risks may arise if the issuer defaults, and depend on the magnitude of timing mismatches between the maturities of the cover pool assets and covered bonds. Apobank has to date maintained overcollateralization that exceeds the credit enhancement required for a 'AAA' rating on a voluntary basis.

We believe that a replacement cover pool manager would be available, if the issuer were to become insolvent. BaFin has the authority to appoint an independent administrator in such a scenario. Furthermore, we consider Germany to be an established covered bond market and believe that the mortgage assets in the cover pool do not comprise product features that would materially limit the range of available replacement cover pool managers.

Resolution regime analysis

The RRL on Apobank, which is the starting point for any further uplift in our analysis, is 'aa+'. The RRL reflects our assessment of the creditworthiness of the covered bonds considering the resolution regime.

In determining the RRL, we consider the following factors:

- Apobank is domiciled in Germany, which is subject to the EU's BRRD;
- Absent an assigned resolution counterparty rating (RCR) on Apobank, we add two notches of uplift to the ICR because we assess the systemic importance for German mortgage covered bonds as very strong.

These factors recognize that resolution regimes like the BRRD increase the probability that an issuer could service its covered bonds even following a default on its senior unsecured obligations because the law exempts covered bonds from bail-in. We consider this as an internal form of support, because the bail-in of certain creditors of the issuer does not require direct government support.

Jurisdictional support analysis

The JRL on Apobank's mortgage covered bonds is 'aaa'. The JRL is our assessment of the likelihood that the covered bonds in case of stress would receive support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market. Given our very strong jurisdictional support assessment of mortgage covered bonds in Germany, the covered bonds are eligible for three notches of jurisdictional support uplift above the RRL. Only one notch is used to achieve a "AAA" rating resulting in two unused notches for jurisdictional support.

We also consider that Apobank's cover pool continues to comply with legal and regulatory minimum standards in Germany and that the unsolicited long-term sovereign rating on Germany does not constrain the ratings on the covered bonds.

Collateral support analysis

Our analysis of the residential and the commercial share of the cover pool is based on the application of the specific stresses defined for Germany under our European residential loans criteria and our commercial real estate criteria (see "Methodology And Assumptions: Assessing Pools Of European Residential Loans," published on Aug. 4, 2017, and "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015).

We base our analysis on stratified data as of March 31, 2019. On that date, there were €5.74 billion of covered bonds outstanding backed by a cover pool of €6.61 billion. Available credit enhancement as of March 31, 2019 was 15.13%, down from the 22.01% as of our March 2018 review.

Since our last review the cover pool's composition has remained stable comprising exposures to German residential mortgages (74.74%), commercial mortgages (21.25%), and substitute assets (4.01%) (see table 3).

All mortgage cover pool assets are located in Germany, with the largest region being North Rhine-Westphalia (27.06% of the total mortgage exposure; see table 8). Within the residential portfolio, none of the exposures exceeds the concentration limits specified for Germany in our European residential loans criteria. For the commercial real estate portfolio, we assess regional exposures relative to the distribution of a country's GDP, or population. In this respect, the commercial cover pool includes regional concentrations of mortgages (relative to the distribution of Germany's GDP), in particular, in Berlin. In line with our CRE criteria, we took this into account by increasing our base-case foreclosure frequency assumption for the share of such exposures by 10%.

About 38% of residential loans are for buy to let purposes, which we took into account in our analysis by increasing our base foreclosure frequency assumption by 70%.

For the mortgage portfolio, we have applied stresses that are commensurate with a 'AAA' rating scenario to estimate the level of defaults as determined by the weighted-average foreclosure frequency (WAFF), and to estimate the level of losses as determined by the weighted-average loss severity (WALS). The product of these two variables estimates the required loss protection, in the absence of any additional factors. We assume that the probability of foreclosure is a function of both borrower and loan characteristics, and will become more likely--and the realized loss on a loan more severe--as the economic environment deteriorates.

As of March 31, 2019, the WAFF and WALS for the combined pool of residential and commercial mortgages were 24.55% and 23.24% respectively. The combined WAFF has remained stable since our last review. The combined WALS has reduced mainly due to our updated overvaluation assessment of German residential properties incorporated in our loss severity calculation for residential properties.

Our analysis of the commercial mortgages also takes into account obligor concentration risk by applying a largest obligor test as outlined in our commercial real estate criteria. The result of this test remained stable at 4.63%.

In addition, we have determined a stressed refinancing spread for the mortgage portfolio of 629.39 basis points (bps). This is based on our "Assessments For Target Asset Spreads According To Our Covered Bonds Criteria," published on Oct. 16, 2018. Accordingly, we apply a stressed refinancing spread of 425 bps to the German residential mortgages, and 1,000 bps to the commercial mortgages.

The substitute collateral pool represents about 4% of total cover pool assets, and comprises exposures to German regional governments and supranational institutions. Since the sub-pool has low granularity, we assume that all assets with an asset rating below 'AAA' would default and apply recovery assumptions in line with our largest obligor tests for public sector assets. As a result, for the substitute portfolio, our 'AAA' scenario default rate assumption is 39.62%, and the recovery rate is 28%. Our stressed refinancing spread assumption is 150 basis points (bps).

Table 3

Pool Composition					
	March 31, 2019		March 31, 2018		
Asset type	Value (mil. €)	Percentage of cover pool	Value (mil. €)	Percentage of cover pool	
Residential	4,942	74.74	4,221	74.18	
Commercial	1,405	21.25	1,144	20.11	
Substitute	265	4.01	325	5.71	
Total	6,612	100	5,690	100	

Table 4

Key Credit Metrics			
	March 31, 2019	March 31, 2018	
Average loan size (€)	91,285	87,299	
Weighted average cover pool LTV ratio (%)	55.70	55.00	
Weighted average loan seasoning (months) (% residential mortgage pool only)*	56.89	57.13	

Table 4

Key Credit Metrics (cont.)		
	March 31, 2019	March 31, 2018
Balance of loans in arrears (%)	0	0
Buy-to-let loans (%)	38.31	38.87
Credit analysis results:		
Weighted average foreclosure frequency (WAFF; %)	24.55	24.63
Weighted average loss severity (WALS; %)	23.24	27.32
AAA credit risk (%)	5.99	6.3

*Seasoning refers to the elapsed loan term.

Table 5

Cover Pool Assets By Loan Size		
	--March 31, 2019--	--March 31, 2018--
(€ '000s)	--Percentage of mortgage cover pool--(%)	
< 500	80.64	82.08
500 - 1,000	3.27	3.27
1,000 - 2,500	4.27	4.59
2,500 - 5,000	3.01	2.74
5,000 - 10,000	4.01	3.40
10,000 - 50,000	4.80	3.92

Table 6

Loan-To-Value Ratios (As of March 31, 2019)	
WAFF - original LTV/whole LTV ratios (%)	
Commercial mortgages - whole LTV ratio (%)	
0-60	52.06
60-80	24.05
80-90	5.56
90-100	2.17
Above 100	16.17
Residential mortgages - original LTV ratio (%)	
0-60	24.39
60-80	38.38
80-90	8.48
90-100	28.74
Above 100	0
Weighted-average original LTV ratio (%)	
75.78	
WALS - cover pool current LTV ratios (%)	
Commercial mortgages - current LTV ratio (%)	
0-40	7.56
40-50	7.50
50-60	84.94

Table 6

Loan-To-Value Ratios (As of March 31, 2019) (cont.)	
Weighted-average current LTV ratio (%)	56.68
Residential mortgages - current LTV ratio (%)	
0-40	11.31
40-50	7.28
50-60	81.41
Weighted-average current LTV ratio (%)	55.42

WAFF—Weighted-average foreclosure frequency. LTV—Loan to value. WALs---Weighted-average loss severity.

Table 7

Residential Mortgages Loan Seasoning Distribution*		
	--March 31, 2019--	--March 31, 2018--
Remaining term to maturity (months)	--Percentage of residential mortgage portfolio--	
Less than 18	15.51	18.41
18-60	51.48	47.11
More than 60	33.01	34.48
Total	100	100

*Seasoning refers to the elapsed loan term.

Table 8

Geographic Distribution Of Loan Assets		
	--March 31, 2019--	--March 31, 2018--
Top five concentrations	--Percentage of total mortgage cover pool--	
North Rhine-Westphalia	27.06	25.6
Bavaria	9.55	9.22
Lower-Saxony	8.26	7.78
Baden-Württemberg	8.23	7.45
Hesse	7.87	7.07
Other	39.03	42.88
Total	100	100

The results of our credit analysis, including the WAFF, the weighted-average recovery rate (1-WALS), weighted-average time to recovery, and refinancing costs, are the inputs to our cash flow analysis. We stress the cover pool's cash flows, incorporating among other factors, various default timings, interest rate stresses, prepayment rates, and delinquency assumptions, which we run at different points over the weighted-average life of the covered bonds.

Our cash flow analysis determines the target credit enhancement needed to achieve the maximum potential collateral-based uplift, inclusive of 100% refinancing costs, and the credit enhancement required to cover 'AAA' credit risk assuming no asset-liability maturity mismatch. Accordingly, we calculate a target credit enhancement of 8.17%, and an 'AAA' credit risk of 5.99%. Given that the covered bonds' JRL is 'aaa', under our covered bonds criteria, the overcollateralization required to maintain the 'AAA' rating equals 5.99% ('AAA' credit risk).

As the available credit enhancement (15.13%) that exceeds the target credit enhancement (8.17%), the maximum

potential collateral-based uplift from the JRL is four notches. However, we reduce these four notches by one because there is no commitment to maintain overcollateralization at the current rating level. This results in a maximum collateral-based uplift of three notches above the JRL of which none is currently needed to achieve a 'AAA' rating. As a result, the covered bonds benefit from five unused notches --comprising three unused notches of collateral-based support and two unused notches of jurisdictional support, that could protect the ratings on the covered bonds if the ICR is lowered.

Table 9

Collateral Uplift Metrics		
	--March 31, 2019--	--March 31, 2018--
Asset WAM (years)	5.79	5.42
Liability WAM (years)	7.39	8.65
Maturity gap (years)	-1.6	-3.23
Available credit enhancement (%)	15.13	22.01
Required credit enhancement for first notch of collateral uplift (%)	5.99	6.30
Required credit enhancement for second notch of collateral uplift (%)	7.08	8.34
Required credit enhancement for third notch of collateral uplift (%)	7.63	9.34
Target credit enhancement for maximum uplift (%)	8.17	10.39
Required credit enhancement for 'AAA' rating (%)	5.99	6.30
Potential collateral-based uplift (notches)	4	4
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	3	3

WAM--Weighted average maturity.

Counterparty risk

We have assessed counterparty risk by applying our counterparty criteria (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019).

Apobank collects payments from borrowers related to cover pool assets in an account on its own books. While the bank generally reinvests these balances promptly in cover pool assets, there is a risk that in case of its insolvency, cash received from the cover pool assets could be commingled with the cash belonging to the bank, resulting in a loss to the cover pool.

We have determined that the German Covered Bond Act effectively segregates cash received after the issuer's insolvency, but that cash received shortly before insolvency and not reinvested in the cover pool assets could be exposed to commingling risk. Apobank's covered bond program contain mitigating factors that are consistent with an 'AAA' rating to address such risk. To address this risk, Apobank has published a statement on its website by which it commits itself to increasing overcollateralization within 60 calendar days upon loss of the minimum ICR (as assigned by S&P Global Ratings) that would be required in accordance with our counterparty criteria to maintain the covered bond ratings. The minimum rating to support the 'AAA' covered bond ratings according to these criteria is 'A'.

There are no exposures to swap counterparties, as there are no derivatives in the cover pool.

Sovereign risk

We consider sovereign risk in line with our structured finance sovereign risk criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019).

Assets in the cover pool are located in Germany, except for a marginal exposure to a multilateral lending institution within the substitute asset sub-pool.

Since our unsolicited long-term sovereign rating on Germany is 'AAA/Stable', country risk does not constrain our ratings on the mortgage covered bonds.

Related Criteria

- Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Assessing Pools Of European Residential Loans, Aug. 4, 2017 Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- Covered Bonds Criteria, Dec. 9, 2014
- Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- Methodology: Credit Stability Criteria, May 3, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Covered Bond Characteristics And Rating Summary Q2 2019, June 27, 2019
- Global Covered Bond Insights Q2 2019, June 27, 2019
- Covered Bond Monitor: Technical Note, June 21, 2019
- S&P Global Ratings' Covered Bonds Primer, June 20, 2019
- German Covered Bond Market Insights 2019, Feb. 27, 2019
- Banking Industry Country Risk Assessment: Germany, Nov. 2, 2018
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Oct. 16, 2018
- Assessments for Target Asset Spreads according To Our Covered Bonds Criteria, Oct. 16, 2018
- Transaction Update: Deutsche Apotheker- und Aerztebank eG Mortgage Covered Bond Program, July 17, 2018

- Glossary of Covered Bond Terms, April 27, 2018

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