

African Trade Insurance Agency

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African Trade Insurance Agency

Major Rating Factors

Strengths:

- Very strong capitalization.
- Strong financial flexibility.
- Strong liquidity.

Weaknesses:

- Industry and economic risks from undeveloped market.

Operating Company Covered By This Report

Financial Strength Rating

Local Currency

A/Stable/--

Rationale

The ratings on the African Trade Insurance Agency (ATI) reflect the company's very strong capitalization, strong financial flexibility, and strong liquidity. Constraints on the rating reflect the undeveloped nature of both the company's target African membership and insurance markets.

ATI is very strongly capitalized, following the norms of peer group supranational entities. Current capital adequacy is extremely strong, with total capital on Dec. 31, 2009 equivalent to 36% of gross and 76% of net outstanding underwriting commitments, and comfortably ahead of its internal required capital benchmark. Standard & Poor's Ratings Services expects capitalization to weaken as business volume grows, though we expect the internal capital utilization controls to ensure capitalization remains very strong (greater than 43% of net outstanding commitments).

Standard & Poor's views ATI's financial flexibility as strong, reflecting the key support to member states provided by the International Development Association (IDA; an arm of the World Bank) and the African Development Bank (AfDB; AAA/Stable/A-1+). In addition, ATI has access to committed contingent capital of \$53 million from the World Bank should ATI's actual capital level fall below its required level. The potential for adverse economic conditions in the African region are significant, but are partially offset by ATI's preferred creditor status with its member states, and by the terms of the financing of member states' subscriptions to ATI by the IDA.

ATI has strong liquidity, with total cash deposits on Dec. 31, 2009 covering 85% of net outstanding commitments. Though we expect this strength to weaken as transaction volume grows, liquidity will remain a strength for the rating. ATI's funds are invested in predominantly strongly-rated banking institutions in strongly-regulated countries, with funds overwhelmingly in U.S. dollars. However, these funds are concentrated in only two entities.

Outlook

The stable outlook reflects our expectation that ATI will maintain strong capitalization of no less than 43% of net outstanding commitments as business volumes expand. We do not expect reinsurance utilization to exceed 60% of ATI's gross commitment. Servicing regional economic growth will continue to be ATI's primary goal, with adequate profitability supporting the expansion.

Negative rating action could be caused by any wavering of shareholder support in terms of either capital raising,

provision of liquidity, or loss recoveries. Though positive rating action is unlikely in the medium term, this would be triggered by management sustaining strong operational control in realizing goals to increase the membership and income stream, and deliver profits that exceed expectations.

Corporate Profile And Membership: Supranational Political Risk Insurer And Credit Risk Insurer

ATI was established in January 2001 as a supranational organization, whose residence is recognized as the United Nations. It offers political risk (noncommercial) and export credit guarantee (commercial) insurance to support trade and investments in its African nation-state members. Event-risk losses derived from noncommercial business are fully recoverable from the respective member state causing the loss. Thus ATI, in effect, acts as funds flow manager, with no theoretical insured loss cost, but a potential credit/timing risk from non-, or delayed, recovery from the member state. Commercial risk event losses are for ATI's own account. Both commercial and noncommercial risks are protected in part by appropriate reinsurance, both treaty and facultative. In addition, ATI has preferred creditor status for recoveries from member states.

ATI membership was originally funded by Special Drawing Rights (SDR) borrowed by each member state from the IDA under a Development Credit Agreement (DCA) structure. This financing base was converted during 2007 and 2008 into that of a common, ordinary equity shareholding structure, under which each member state was required to convert the SDA funds advanced by the IDA into equity in ATI. The SDRs advanced by IDA to each member state had to be fully converted into shares in ATI--no such committed funds can be cancelled, or used elsewhere for other purposes.

ATI now has 4 classes of ordinary shares:

- 'A'--Minimum of 51% of total issued capital issued solely to African governments as per article 92 of the UN charter;
- 'B'--Non-African governments;
- 'C'--Private companies; and
- 'D'--Regional/International agencies.

The minimum government subscription is \$7.5 million. New members now subscribe to new ordinary 'A' class shares in ATI, for which IDA will loan moneys to qualifying African countries (those below a certain wealth threshold) to finance their membership. In the event of any noncommercial loss suffered by ATI through member state action, IDA has the ability to effectively suspend further support to that government pending full reimbursement to ATI of the losses suffered. If the member state does not ultimately settle the loss, then ATI will deduct the funds due from its capital contribution and revoke membership. Of note is that the AfDB has approached ATI to inject \$10 million of new capital, and to implement a Fund for African Private Sector Assistance (FAPA, a Japanese government-backed fund) grant of \$1 million, subject to certain key performance measures, which ATI expects to complete by mid-2011.

On Dec. 31, 2009, nine African states directly owned 89% of ATI's shares (99.5% in 2008), with the balance held by four international African organizations (themselves backed by African governments)--Atradius Participations Holdings B.V. (not rated; part of the Atradius Credit Insurance N.V., financial strength rating A-/Negative/A-2), and SACE SpA (not rated by Standard & Poor's; Italian government-owned export credit agency)--who invested \$10

million into ATI in 2009.

ATI is ultimately expected to distribute dividends, but these are likely not to be paid in the medium term whilst the company builds its operational base. Also, dividends are likely to be at a level no more than sufficient to repay member states' debt servicing costs on advances from both the IDA and AfDB, made to finance membership.

ATI's current plan targets new members--both African governments and others--contributing new capital in 2010/2011 of up to \$300 million, and \$100 million in 2012. Standard & Poor's believes this is unlikely to be fully achieved because of the protracted nature of the membership negotiation process, and the delivered track record to date. Nevertheless, if only half the target membership growth is achieved, the earnings benefits to ATI should be material, both in terms of direct underwriting revenues and investment yield growth. We believe that the joint funding of governments by IDA and AfDB is a favorable initiative.

Competitive Position: A Specialist Niche With An Overtly Regional Economic Focus

Table 1

African Trade Insurance Agency Competitive Position					
	--Year-ended Dec. 31--				
(000s \$)	2009	2008	2007	2006	2005
Total revenue	3,113.5	3,620.1	3,058.7	2,975.0	1,941.3
Annual change in gross premiums written (%)	88.5	79.9	139.3	34.8	N.M.
Net premiums written	1,743.0	1,017.5	526.1	304.3	296.4

N.M.--Not meaningful.

We consider ATI's competitive position as satisfactory, based on its supranational status and backing, and its overtly regional economic focus. Its charter requires it to only provide insurance cover to risks that are of demonstrable economic benefit to member states. It therefore has a specialist niche competitive position in the provision of political investment risk (noncommercial) insurance, amounting to 92% of gross commitment in 2009 (85% in 2008), and export credit (commercial) insurance, amounting to 8% of gross commitment in 2009 (15% in 2008). Export trade credit insurance (commercial risk) includes both whole turnover and single-obligor cover. Geographically, the spread of cover has been largely to central, eastern, and southern Africa, reflecting its current membership, but we expect this to expand across the continent in the medium term.

The economic development focus of ATI's business is particularly significant as the ultimate beneficiaries are its member states, both directly (as investors in ATI) and indirectly (through regional economic development). ATI's strategy is to increase its presence across Africa through expansion of its membership (see Corporate Profile And Membership, above), with the support of its business partners which include:

- Lloyd's of London (financial strength rating A+/Stable/--);
- Multilateral Investment Guarantee Agency (MIGA; not rated; member of the World Bank Group);
- African Reinsurance Corporation (A-/Stable/--);
- U.S.-based Overseas Private Investment Corporation (OPIC; not rated);
- Belgium state-owned credit agency Office National du Ducreire/Nationale Delcrederedienst (ONDD; AA+/Stable/A-1+);

- Zurich Financial Services Group (not rated); and
- Atradius Reinsurance Ltd. (A-/Negative/--).

ATI's targeted membership and capital expansion program is reflected in the following plans (see table 2).

Table 2

African Trade Insurance Agency Sources Of Business						
(Mil. \$)	2012e	2011e	2010e	2009a	2008a	2007a
Investment insurance	N.A.	N.A.	N.A.	233.5	95.9	59.8
Credit insurance	N.A.	N.A.	N.A.	21.2	17.1	8.4
Gross exposure volume	1190	905	656	254.7	113	68.2
Net exposure volume	690	525	380	134.1	68.2	36.6
Total shareholder funds	549	454	266	92.1	82.7	55.4
Required capital						
Per formula	316.7	241	174.4	57.6	31.1	17
Capital margin (%)	42	47	34	37	62	69
N.A.--Not available. e--Estimate. a--Actual.						

Management And Corporate Strategy: Clear, Focused Strategy To Develop And Expand In A Testing Period And Environment

In our view, ATI's management team has a clear, focused strategy to develop and expand the company's operations to the benefit of the African business community, though its business development to economic scales is tested through the difficult working environment. As ATI's presence expands and its service quality becomes recognized, Standard & Poor's expects the strengths of the management team to become more demonstrable.

Strategy and goals

ATI's current business plan for 2010-2012 sets the following financial targets:

- To expand membership by 30 additional African states (currently, nine), and increase the number of investing non-African states and International Financial Institutions;
- To achieve shareholder's funds of \$550 million by Dec. 31, 2012;
- To achieve a net combined ratio of no worse than 74%;
- To achieve gross and net commitment of \$1.2 billion and \$0.7 billion respectively, providing gross and net written premium of \$19 million and \$11 million, respectively;
- To achieve a return on average weighted paid in capital and reserves of 1.7%; and
- To remain a supranational, government-backed corporation.

On the basis of development to date, we view the medium-term plan to expand covered gross risk commitment of \$1.2 billion annually by 2012 (\$255 million in 2009) as ambitious, due to its dependence upon successful, and timely, expansion of the membership. Though there is significant execution risk in this business expansion plan, Standard & Poor's views the capital controls as prudent and able to support the plan.

Operational management

We assess ATI's operational management as satisfactory for the current operational scale. ATI is a small company, with around 30 staff mostly centered on Nairobi, but with a few regional offices across eastern and southern Africa

manned by single employees. This operational scale clearly creates a dependence risk, but ATI plans to expand these branches to provide better client/staff support. It has a fully documented operations manual covering all aspects of its underwriting and investment risk management, and we consider this appropriate for the targeted increase in flow of business. Changes to the operations manuals require the approval of the Board, which includes SACE and World Bank/AfDB, both of whom hold observer status at the board.

ATI's risk pricing considers fully documented country risk factors and credit term/concentration risk features. It has the support of its key reinsurer, Atradius Reinsurance (also a shareholder), in setting risk pricing for export credit insurance, as well as input from its other reinsurers, all of which are strongly rated.

Financial management

Standard & Poor's considers ATI's financial management and controls to be satisfactory. Its underlying regional economic development strategy drives transaction volume targets rather than profit targets. Its key long-term earnings target is to deliver a return on average weighted paid-in capital and reserves equal to the U.S. 10-year Treasury Bill rate, which is the same target level as the MIGA. However, the latest target for 2010 predicts a deficit, and no more than a break even in 2011. Control reporting is thorough and regular.

ATI's earnings targets have been severely impacted by the global economic downturn, which has reduced the ability of African states to become members, thereby reducing capital inflows and the consequent transaction growth. Standard & Poor's views ATI's financial targets as practical and achievable overall, but recognizes existing difficulties such as the potential for high volatility inherent in the credit insurance business, the impact of the very low transaction volume currently being handled by ATI, and the current dependence on investment yields to cover operating deficits.

Enterprise Risk Management: Adequate For The Current Operational Scale, But Unproven.

We view ATI's Enterprise risk management (ERM) as adequate. ATI's original feasibility report highlighted the need for robust risk management, and this is regularly reviewed and enhanced to support its expansion plans. Operational controls are fully documented with appropriate tiers of risk authorization. The overall risk matrix of ATI is driven by a capital model used by comparable supranational organizations in this sector. Operationally, IDA exercises a legal right of control and sets corporate governance controls. Key risks are those derived from:

- Commercial underwriting policies, for which ATI is exposed to underwriting losses;
- Credit risk from claims recoveries for noncommercial risks due by member states; and
- Bank counterparty concentration.

Investment risks are controlled by reference to minimum bank credit ratings, but Standard & Poor's notes that the current banking partners do not meet the minimum Standard & Poor's ratings levels specified. Also, funds are highly concentrated, with currently only four approved banks.

Accounting: International Financial Reporting Standards Fully Adopted

ATI reports using International Financial Reporting Standards, and presents its results in a conventional insurance accounting style. In our opinion, ATI's disclosure is satisfactory. PricewaterhouseCoopers were appointed external

auditors in 2007, succeeding Ernst & Young when it retired at the end of its three-year term.

Operating Performance: Currently Unsatisfactory, But Not Considered A Ratings Driver

Table 3

African Trade Insurance Agency Operating Performance					
	--Year-ended Dec. 31--				
(%)	2009	2008	2007	2006	2005
Return on revenue	(129.1)	(261.1)	(1,045.6)	(719.1)	(263.8)
Return on revenue including realized and unrealized gains/(losses)	(129.1)	(261.1)	(1,045.6)	(719.1)	(263.8)
Return on equity	(0.7)	0.4	0.2	(0.1)	N/A
Return on equity (adjusted)	(0.7)	0.5	0.3	(0.2)	2.3
Return on capital	(0.6)	0.4	0.2	(0.1)	N/A
Current-year loss ratio	0.2	0.0	0.0	0.0	0.0
Net loss ratio	0.2	0.0	0.0	0.0	0.0
Total net expense ratio	298.1	435.2	1,370.6	824.6	363.8
Net combined ratio	298.3	435.2	1,370.6	824.6	363.8

N/A--Not applicable.

Though ATI's earnings were unsatisfactory in 2009, and are likely to be so again in 2010/2011, Standard & Poor's does not view the short-term earnings record of ATI as a ratings driver. As a supranational institution, no profit targets are set by the member states and no dividends are expected to be paid in the medium term. ATI's key goal continues to be the value added to member states' economic development through its activity, rather than return on equity or revenue. The company will use surplus earnings to reinforce its capital and support its growth. Profitable earnings were adversely impacted in 2008 and 2009 by (i) slow membership growth, which has delayed underwriting volume, and (ii) the consequent reduction in new capital funds, which, at current depressed investment yields, is delivering inadequate returns to cover net running expenses in 2009, and likely so in 2010/2011.

In 2009, ATI delivered a net deficit of \$0.644 million (\$0.265 surplus in 2008) derived from net underwriting surpluses (premiums less claims) of \$1.8 million (\$1 million in 2008), and an interest income of \$1.6 million (down sharply from \$2.8 million in 2008) which failed to cover net running costs of \$3.9 million (\$3.3 million in 2008). The net deficit in 2009 reflects a marginally negative return on capital of negative 0.74% (0.32% profit in 2008).

ATI expects to move into sustainable profit from 2012, by when potentially substantial member funds will have been introduced which, combined with expansion of the underwriting program from new member states, will see the company achieve real economies of scale and cover the current cost base, which is capable of supporting substantial transaction volume growth without meaningful enhancement. On a conservative basis, assuming new capital of only \$150 million is introduced by the end of 2012 (37% of target), this cash injection could deliver annual interest earnings of \$750,000 at a notional rate of 0.5% per annum (below ATI's current yield), which would have covered the 2009 deficit. Whilst expansion of the membership will cause expenses to rise, the bulk of the business will remain political risk, which is fully serviced in Nairobi. Commercial (export credit) business will require local offices to be established to promote and support the business.

Investments: Strongly Rated Portfolio, But Concentrated

Table 4

African Trade Insurance Agency Liquidity And Investments					
	--Year-ended Dec. 31--				
(%)	2009	2008	2007	2006	2005
High-risk assets to total invested assets	0.0	0.0	0.0	0.0	0.0
Net investment yield	1.6	3.6	4.9	5.1	N/A
Net investment yield including all capital gains/(losses)	1.6	3.6	4.9	5.1	N/A
Investment portfolio composition					
Cash and cash equivalents	100.0	100.0	100.0	100.0	100.0
Total portfolio composition	100.0	100.0	100.0	100.0	100.0
N/A--Not applicable.					

ATI has a strong, but concentrated investment portfolio. Though it uses portfolio guidelines directly comparable to those of the World Bank Group, in that they restrict the portfolio to investing in entities bearing a Standard & Poor's rating of at least 'AA-', the banks used by ATI do not currently all meet this rating standard. Currently, no significant deposits can be held within an African state.

Credit risk

We consider ATI's credit risk to be very low, reflecting the predominantly "strong" ratings on the banking portfolio. Nevertheless, ATI has very few bank relationships, and funds are predominantly invested in just two banks.

Reinsurer credit risk is also monitored by reference to minimum financial strength ratings from Standard & Poor's 'A' range. Further, on the basis of current insured losses and reinsurers, we view exposure as very low.

Market risk

We believe that market risk is currently very low, with invested assets comprising bank deposits only.

Asset liability management

All deposits are on 6 month terms or less and cover likely liability maturities.

Liquidity: Strong, Highly Liquid Asset Base

We currently view liquidity as strong. On Dec. 31, 2009, total invested funds of \$102 million were equivalent to 84% of net outstanding commitments of \$121 million (funds of \$91 million, and net outstanding commitments of \$68 million in 2008). Of these net outstanding commitments, 87% were noncommercial risks, and therefore ultimately recoverable from member states with whom ATI maintains preferred creditor status, backed up by IDA resources. Whilst Standard & Poor's notes the ability to recover noncommercial losses from member states, the track record of timely recovery is wholly unproven. In 2009, reported claims were insignificant. Less than 1% of total assets and liabilities are held in currencies other than the U.S. dollar, substantially eliminating any currency exchange exposure.

In our opinion, the nature of ATI's underwriting exposures is currently very lumpy with exposure to large single value claims which could incur a corresponding large cash demand. ATI's funds are all deposited on 6 months or

less terms, and readily liquid.

ATI has a manageable amount of debt, with IDA Development Credits of \$9.9 million on Dec. 31, 2009 (\$7.9 million in 2008) out of a total facility of SDR7.2 million (\$10.7 million), and repayable in tranches extending to 2040, with a maximum annual fee set at 0.5% per annum. This arrangement has been put into place specifically to fund operating costs through ATI's development period. Standard & Poor's does not view this arrangement as representing any strain on liquidity or earnings, as it represents only 11% of capital and bears favorable servicing terms.

Capitalization: Very Strong, With Extremely Strong Risk-Based Capital Adequacy

Table 5

African Trade Insurance Agency Capitalization					
--Year-ended Dec. 31--					
(%)	2009	2008	2007	2006	2005
Reinsurance utilization	51.8	46.9	50.6	31.7	10.3

ATI currently has very strong capitalization, reflecting extremely strong risk-based capital adequacy, relative to the planned risk volumes insured through the medium term. Though Standard & Poor's expects this strength to reduce as insured volumes increase and ATI develops, we expect ATI's internal capital control model to enable very strong capitalization to be maintained.

Capital adequacy

Standard & Poor's views ATI's capital adequacy as extremely strong. ATI models its own capital requirement as 43% of net outstanding commitments, plus 4% of reinsured commitments. ATI's 2009 capital of \$92.1 million (\$82.7 in 2008) amounts to 76% (121% in 2008) of annual net outstanding underwritten commitments of \$120.6 million (\$68.2 million in 2008), compared with Standard & Poor's target of 43%. Also, the bulk (over 85%) is in respect of political (noncommercial) risk, for which any losses are fully recoverable from member states. Capital is further protected via the membership agreements with African states, in that they must settle any noncommercial losses or risk having their ongoing funding suspended from the IDA.

Standard & Poor's considers ATI's internal capital controls as very prudent in the light of the expected event loss incidence to ATI, and the event loss statistics of peer group companies in the private sector. ATI's maximum single country net exposure is limited to five times that country's paid-in capital, within the maximum capital exposure limit set above. ATI's maximum gross sums insured by country in 2009 were to the Democratic Republic of Congo and Malawi at \$64 million, or \$23 million and \$22 million net, respectively. The largest credit limits by country in 2009 were to Kenya, at \$6.3 million (\$10.2 million in 2008), and the UK at \$8.1 million (\$9.9 million in 2008).

Reserves

As ATI's exposures are to finite loss values, any claims should be reasonably easily determined and provided for on a case-by-case basis. Standard & Poor's expects its approach to reserving to be satisfactory in view of the business objectives.

Reinsurance

Standard & Poor's considers ATI's reinsurance program to be prudent. It is undertaken with strongly rated partners, two of which are shareholders in the entity. ATI is required to use only reinsurers that are either rated 'A' or better by Standard & Poor's, or approved by the Board. The treaty program is underwritten by Atradius. Facultative risks are protected by a range of international insurers with minimum financial strength ratings of 'A'. In 2009, 23% of commercial insurance risk commitments (51% in 2008) and 55% of the noncommercial risks (38% in 2008) were ceded.

Financial Flexibility: Strong Reflecting Implicit Support For Membership From World Bank Through IDA And The African Development Bank

Table 6

African Trade Insurance Agency Financial Flexibility					
	--Year-ended Dec. 31--				
(%)	2009	2008	2007	2006	2005
Debt leverage including additional pension deficit as debt	9.7	8.7	9.3	10.1	10.8
Financial leverage including additional pension deficit as debt	9.7	8.7	9.3	10.1	10.8

We consider ATI's financial flexibility as strong. Though we consider all the key member state shareholders to offer vulnerable security, the convention that ties them into membership promotes cohesion and support for the entity. ATI can demonstrate legal preferred creditor status with its member states. This is substantiated by the agreements of each member state to reimburse ATI for any noncommercial losses, and the parallel agreements between each member state and IDA that any nonperformance will cause the state to be declared in default on all IDA facilities made to the defaulting state. However, this remains unproven in practice.

When ATI's required capital exceeds \$80 million, it will trigger a further disbursement of committed IDA financing in an amount of \$26.5 million, which will bring the capital committed by member states up to at least \$112 million. This process will be repeated when ATI's required capital exceeds \$120 million, to bring the capital committed by member states up to at least \$138 million. ATI member states are supported in their membership by the World Bank (through the IDA) and the AfDB. In addition, the release of both disbursements could also be triggered should ATI's capital be inadequate to meet business continuity requirements.

Related Criteria And Research

- Analysis Of Insurer Capital Adequacy, Dec. 18, 2009
- Criteria for Multilateral Lending Institutions, Oct. 19, 2007

Ratings Detail (As Of August 12, 2010)*

Operating Company Covered By This Report

African Trade Insurance Agency

Financial Strength Rating

Local Currency

A/Stable/--

Counterparty Credit Rating

Foreign Currency

A/Stable/--

Ratings Detail (As Of August 12, 2010)***(cont.)**

Domicile

Kenya

*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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