

# Bank of North Dakota

October 27, 2022

## Ratings Score Snapshot

SACP: a



Support: 0



Additional factors: 0

Anchor	bbb+	
Business position	Adequate	0
Capital and earnings	Very strong	+2
Risk position	Adequate	0
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment	0	

ALAC support	0
GRE support	+1
Group support	0
Sovereign support	0

Issuer credit rating
<b>A+/Stable/</b>

**PRIMARY CONTACT**

Nicholas J Wetzel, CFA  
Centennial  
303-721-4448  
nicholas.wetzel  
@spglobal.com

**SECONDARY CONTACT**

Hanryano Y Lethe Sarungallo  
New York  
1-212-438-0464  
hanryano.l  
@spglobal.com

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

## Credit Highlights

### Overview

#### Key strengths

Very strong risk-adjusted capital

Stable ownership by state of North Dakota since 1919

Strong credit quality and conservative management

#### Key risks

Geographic concentration in North Dakota

Direct and indirect lending exposure to energy and agriculture, which are cyclical sectors

Subject to annual capital transfers paid to North Dakota

*Bank of North Dakota (BND) has a century of stable operating performance as a state-owned bank focused on promoting industry, agriculture, and commerce in North Dakota.* The bank is unique as the only remaining state-owned bank in the continental U.S. It partners with private-sector banks in providing credit to North Dakota-based businesses, holds the deposits of the state and certain

## Bank of North Dakota

agencies, and provides disaster assistance lending through numerous programs. As a government-related entity (GRE), we see a high likelihood of support from the state of North Dakota if the bank experiences stress.

**BND has one of the highest risk-adjusted capital (RAC) ratios for rated U.S. banks.** We expect the bank to maintain very strong capital levels, though capital ratios could decline if net income is less than capital transfers (dividends) to the state's general fund and various other initiatives funded by BND. The North Dakota legislature determines appropriations from the general fund every legislative session, and the amounts designated from BND's capital will vary based on the state's needs and BND's capital and liquidity levels. However, these dividends have typically not exceeded net income by a large enough amount to significantly affect capital levels.

**While nonperforming assets (NPAs) are typically higher at the bank, it rarely translates to high credit losses, and BND maintains a robust loan loss reserve.** As of June 30, 2022, gross NPAs are 2.59% of loans and real estate owned, though about half of these loans are residential loans guaranteed by the federal government or student loans guaranteed by the state of North Dakota. BND has elevated exposures to cyclical industries such as energy and agriculture given its concentration in North Dakota, but credit losses have been minimal. Over the past 10 years, the net charge-off (NCO) rate has been under 15 basis points (bps) annually despite significant energy and agricultural commodity price volatility, which we think reflects BND's strong credit selection and underwriting. Furthermore, the bank maintains a loan loss reserve of 2.21% of total loans and 3.10% of non-guaranteed loans--among the highest of rated U.S. banks.

## Outlook

The stable outlook on BND is based on S&P Global Ratings' view that over the next two years the bank will continue its conservative strategy by maintaining very strong capital and appropriately managing its credit risk. We also expect that there will be no change in BND's policy role or link to the state of North Dakota. In addition, we expect the bank to continue to its prudent management of its funding and liquidity as market interest rates rise.

## Downside scenario

Because we base our issuer credit rating on BND on a combination of its stand-alone credit profile (SACP) and likelihood of support from the state of North Dakota, we do not expect to lower the rating absent a sharp negative change to either the SACP or our rating on North Dakota, or some combination of more modest changes to both of those. For instance, we would lower the rating if either the SACP or our rating on the state fell by at least three notches.

Since we factor in more uplift to our 'AA' deposit ratings for BND, we would lower those ratings even if our rating on the state fell by a notch.

## Upside scenario

An upgrade of BND would require a one-notch improvement in either the rating on the state of North Dakota or BND's SACP. We see a higher SACP as unlikely given the cyclicity of the state's revenue and the interdependence between the state and BND.

## Key Metrics

### Bank of North Dakota Key Ratios And Forecasts

	--Fiscal year ended Dec. 31 --				
(%)	2019a	2020a	2021a	2022f	2023f
Growth in operating revenue	6	-11	-4	9.8-12.0	15.0-18.3
Growth in customer loans	-1	5	-2	3.6-4.4	2.7-3.3
Growth in total assets	1	10	29	(1.5)-(1.9)	2.2-2.7

## Bank of North Dakota

Net interest income/average earning assets (NIM)	3	3	3	2.3-2.6	2.4-2.7
Cost to income ratio	14	16	18	16.7-17.5	15.0-15.8
Return on average common equity	19	15	15	15.5-17.1	17.8-19.7
Return on assets	2	2	2	1.5-1.8	1.7-2.1
New loan loss provisions/average customer loans	0	0	0	0.1-0.2	0.1-0.3
Gross nonperforming assets/customer loans	3	4	3	2.5-2.7	2.5-2.7
Net charge-offs/average customer loans	0	0	0	0.1-0.2	0.1-0.2
Risk-adjusted capital ratio	23	22	23	19.6-21.0	19.4-21.0

All figures are S&P Global Ratings-adjusted. a--Actual. e--Estimate. f--Forecast. NIM--Net interest margin.

## Anchor

Our anchor for a bank operating mainly in the U.S. is 'bbb+', based on an economic risk score of '3' and an industry risk score of '3'. The U.S.'s diversified, high-income, and resilient economy underpins our assessment of economic risk, which we see on a stable trend. While the economy has slowed and may enter recession, we believe banks in the country generally have strong enough balance sheets and earnings power to weather a moderate downturn.

Our view of industry risk in the U.S. balances the regulatory enhancements made after the global financial crisis, a high level of core deposits, and deep capital markets against the risks that come with the country's large nonbank financial system. The trend on industry risk is positive, reflecting an improving track record of bank regulation and the steady performance of banks over many years. We could positively revise the industry score as well as the anchor to 'a-' in the next two years if the stringency of regulation remains in place, the economy avoids a protracted downturn, and banks maintain strong balance sheets.

## Business Position

BND's business position reflects the bank's well-entrenched history in North Dakota, record of high profitability and robust credit quality, and good financial governance. However, factors like high geographic concentration, a very low proportion of noninterest income, small domestic market share, and less regulatory oversight relative to most commercial banks roughly offset BND's positive factors.

BND has a long, stable history in North Dakota. Headquartered in Bismarck, the state's capital, BND is the only state-owned lender in the continental U.S. The bank was established by the state legislature in 1919 in response to a shortage of lenders in the state willing to support the credit needs of North Dakota farmers and businesses. Driven by its primary role in financing economic development in the state, BND grew rapidly, particularly from 2012, when North Dakota became a large producer of shale energy.

The bank acts as a lender, a correspondent bank to private financial institutions in North Dakota, the agent of several state-legislated programs, and a depository for state agency funds (which have grown substantially following the start of the COVID-19 pandemic)--supporting our view of BND's very strong link to the state's government.

We view BND's management strategy as conservative and supportive of the bank's business goals, as well as the larger North Dakota community. BND's management closely monitors economic activity in the state and coordinates disaster relief programs to assist borrowers in stress and identify borrowing needs of communities in North Dakota.

## Capital And Earnings

BND's capital and earnings assessment benefits from its high RAC ratio, strong core earnings generation, and very low operating costs. We expect BND to generate strong earnings and maintain high capital ratios aided by the higher interest rates benefitting the net interest margin (NIM).

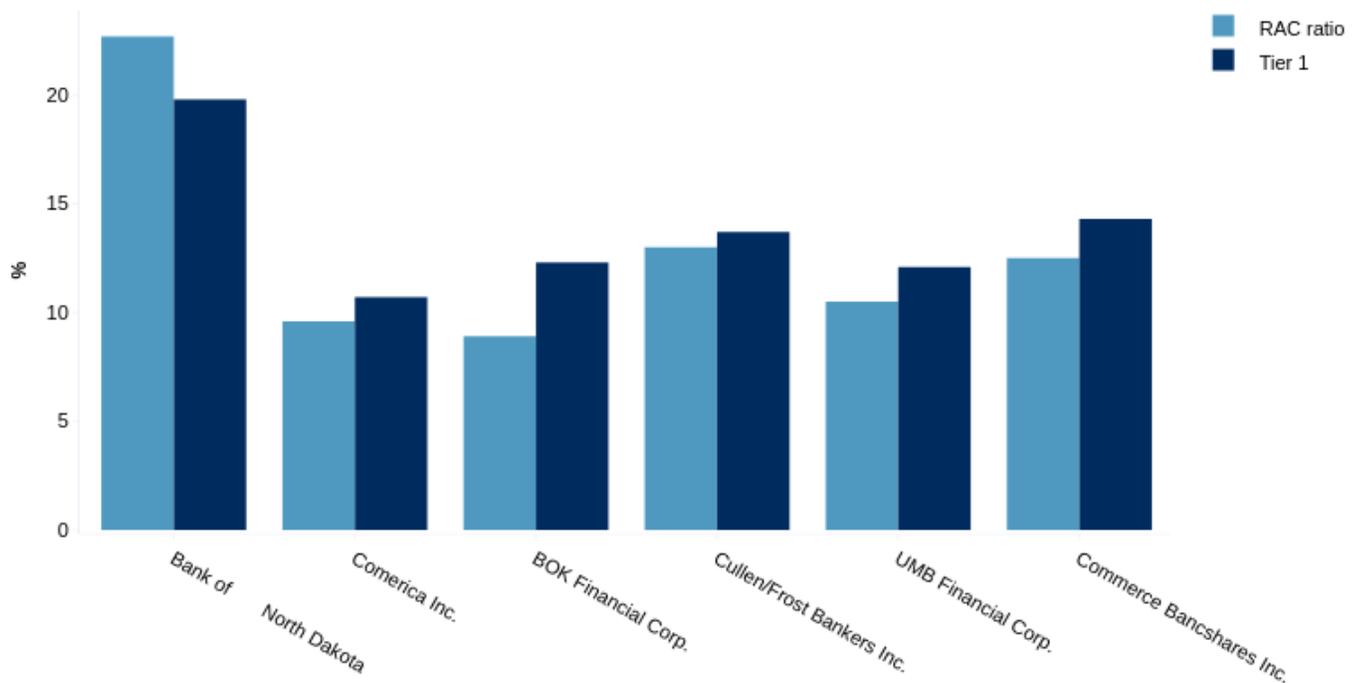
## Bank of North Dakota

S&P Global Ratings' RAC ratio was 22.0% as of June 30, 2022, by our calculation, which is among the highest of rated U.S. banks. We expect the RAC ratio could decline modestly as earnings may not exceed capital transfers over the next several years. However, we expect the RAC ratio to remain comfortably in the very strong category (above 15%) over the next two years.

The bank makes capital transfers to the state's general fund and assists other state programs through dividend contributions. Historically, these dividends have fluctuated depending on the state's needs and the capital needs of the bank. In 2021, dividends were \$74.6 million out of BND's net income of \$144 million. For 2022 and 2023, the company expects total capital transfers will be \$87 million and \$84 million, respectively, which are lower than our net income forecasts and would support capital growth. However, the bank has remaining potential transfers of \$228.6 million under the 2021-2023 North Dakota biennium, which would likely lead to a decline in capital ratios if the full amount is transferred before June 30, 2023.

BND's earnings have been strong and consistent over the past few years despite its heavy reliance on spread-based income. We expect earnings to remain somewhat stable for the remainder of 2022--absent any material credit issues--as the state economy continues to recover and benefit from higher energy prices. BND's very low operating costs, tax exemption, and lack of deposit insurance premiums bolster its earnings capacity. The company reported 9.5% higher preprovision earnings in the first half of 2022, reflecting the benefit of higher interest rates on net interest income (NII). Noninterest income remains minimal as 97% of revenue is from NII. Positively though, due to its low overhead expenses, BND's return on average assets remained high at 1.62% through the first six months of 2022.

### Bank Of North Dakota's Risk-Adjusted Capital Exceeds Regional Bank Peers



Data as of June 30, 2022. Source: S&P Global Ratings.

## Risk Position

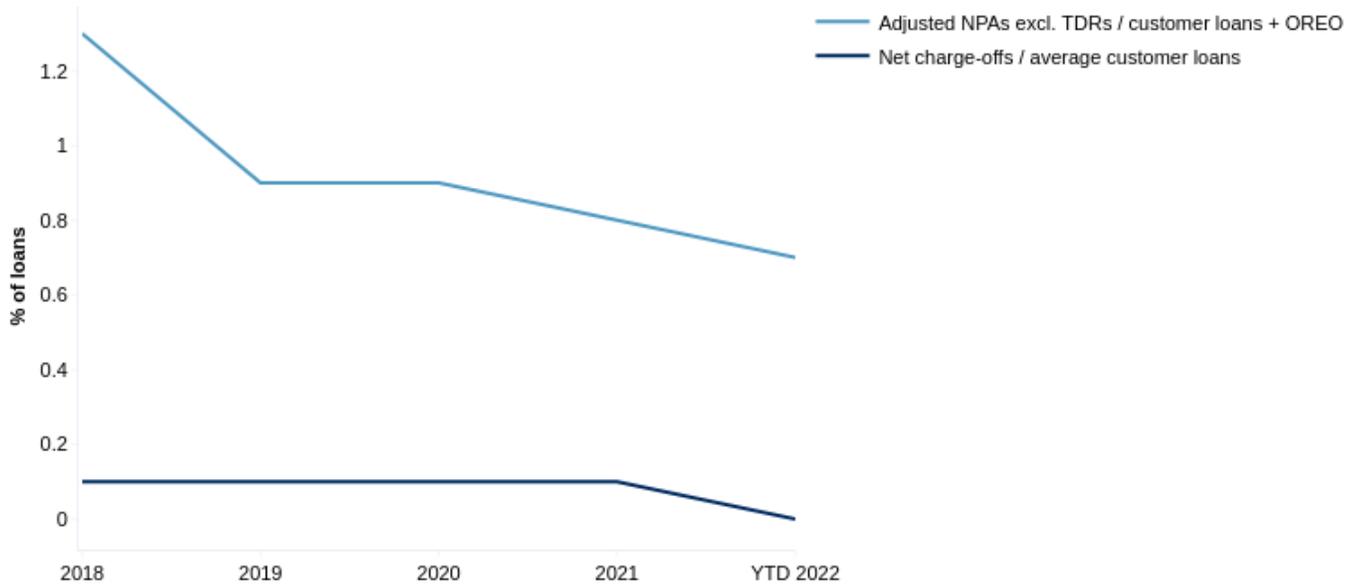
Our assessment of BND's risk position balances the company's historically strong asset quality and well-reserved allowance for credit losses with its substantial concentrations, including energy and agricultural lending. Overall, BND's asset quality remains strong, reflecting careful underwriting and good management of its concentrations.

BND continues to have higher energy exposures than most rated U.S. banks as energy is an important sector in the North Dakota economy--though, positively, the proportion of energy loans to total loans remained below the peaks in the previous decade. Direct energy lending (including oil services, refining, ethanol production, power generation, mining, energy marketing, and natural gas distribution) amounted to \$465 million as of June 30, 2022, which is 9.6% of total loans. Indirect energy lending, including commitments (such as hotel, multifamily, and municipal loans) to the state's oil-producing regions, were meaningful at 8% (\$380 million) of total loans. Energy prices have rebounded since the pandemic, and hotel occupancies in the oil-producing regions have improved. Unemployment rates have considerably improved in 2022 and are at pre-pandemic levels. The rebound in energy prices has supported the direct and indirect energy loan portfolios' credit performance as oil production and employment in oil-producing geographies has considerably improved over the last two years.

Overall, the level of gross NPAs has decreased 88 bps from a year ago to 2.59% due to a decrease in past due loans. The high degree of guarantees helps support the bank's credit quality, with 29% of the total loan portfolio either fully or partially guaranteed: residential loans by the federal government and student loans by the state of North Dakota. The commercial portfolio (excluding agriculture), which has the lowest level of guarantees, has generally maintained a steady level of NPAs and currently only 0.20% of that portfolio is over 90 days past due. We expect the proportion of guaranteed loans and loan portfolio diversification to decline over time as BND has exited the underwriting and servicing of new residential loans and has collaborated with another state agency, North Dakota Housing Finance Agency, which performs similar services.

Agricultural loans represented 15% of total loans and residential real estate loans represented 9% as of June 30, 2022. The bank transitioned all of its residential originations to Housing Finance Agency in August 2021, and the transition of nearly all residential servicing and collections to Housing Finance Agency occurred in October 2021. As a result, the residential loan portfolio decreased by \$31 million during the first half of 2022 and will continue to decline with paydowns. The state's agricultural economy has been resilient after facing severe drought conditions in 2021 followed by heavy snowfall. Despite these challenges, delinquencies in the farm loan portfolio have steadily declined in recent years.

**Improving Asset Quality Metrics And Low Credit Losses**

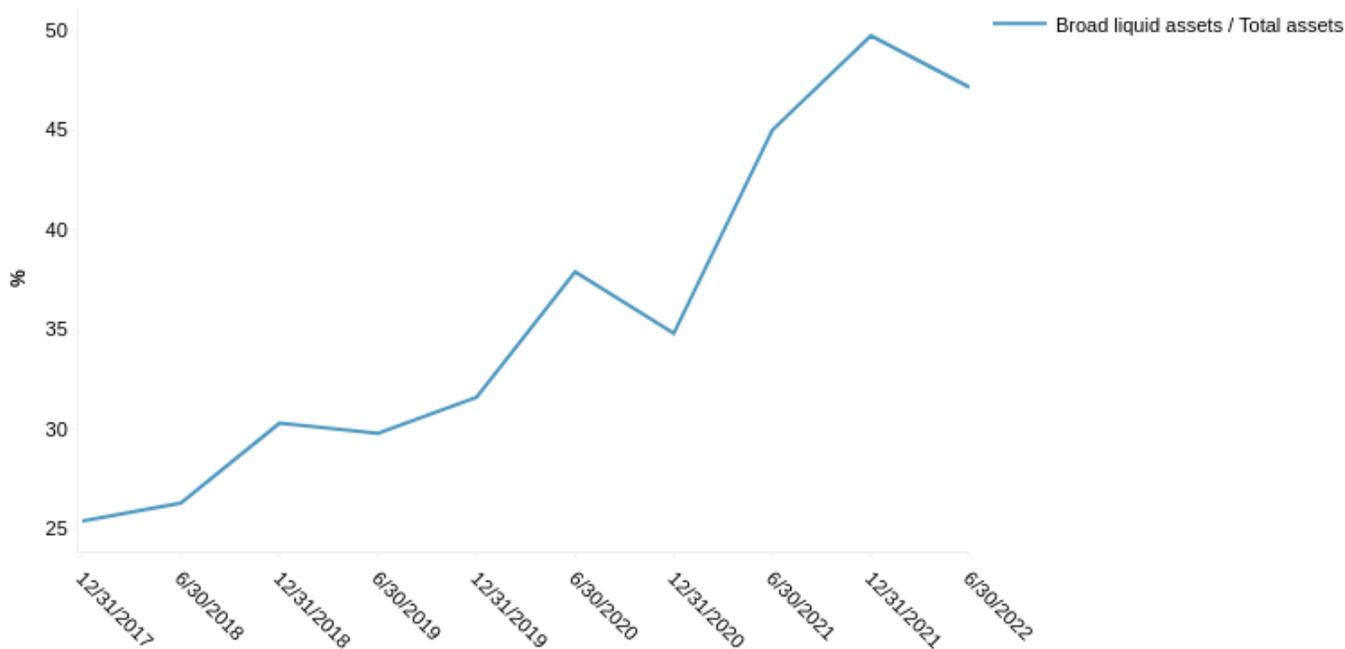


NPA--Nonperforming assets. TDR--Troubled debt restructuring. OREO--Other real estate owned. Source: S&P Global Ratings.

**Funding And Liquidity**

Our assessment considers the state-sourced captive deposits--mandated by legislation--as core to the bank. After experiencing substantial deposit growth in 2020 and 2021, funding metrics remain quite good relative to other U.S. regional banks. The loan-to-customer deposit ratio was 55% as of June 30, 2022. Further, the stable funding ratio, calculated as available stable funding as a proportion of stable funding needs, declined slightly to 176% as of June 30, 2022, from 183% at year-end 2021. There is some concentration given that captive certificates of deposit have generally accounted for a significant portion of the company's total balance sheet funding. Positively, the bank has no brokered deposits and short-term wholesale funding is manageable at only 5% of the funding base as of June 30, 2022. We expect funding metrics could decline modestly over the next year as government agencies withdraw their stimulus-related deposits and spend their budgets.

**Bank Of North Dakota's Balance Sheet Remains Liquid**



Source: S&P Global Ratings.

BND's liquidity metrics have improved as of June 30, 2022. The ratio of broad liquid assets to short-term wholesale funding improved to 10.3x as of June 30, 2022, from 8.5x at year-end 2021. The company had roughly \$4.7 billion of liquid assets, or 46% of total assets as of June 30, 2022--among the highest for regional U.S. bank peers. Liquid assets include cash due from banks, federal funds sold, and unpledged securities. We believe BND has an adequate liquidity contingency plan, which includes Federal Home Loan Bank availability of \$1.2 billion, Federal Reserve Discount Window availability of \$28 million, unused federal funds lines of \$180 million, and unused repurchase agreements of \$1.1 billion as of June 30, 2022.

**Support**

Based on our criteria for GREs, we incorporate one notch of uplift into our issuer credit rating on BND to reflect our view that it is highly likely the state of North Dakota would provide extraordinary support to BND, if necessary. We base this view on BND's important role in promoting the state's economic development and its very strong link to the state government.

The 'AA' rating on the bank's deposits includes three notches of uplift from the SACP and reflects our assessment that the likelihood of extraordinary support for the bank's deposits--which the state explicitly backs--is extremely high, as there is a very strong link between the state and the bank's deposits, and the critical role the deposits play in the state's public finances. State law requires all monies of the state and state institutions to be deposited with BND; any changes to this arrangement would necessitate a change in the state legislative code. These arrangements serve to maintain trust in and the financial stability of BND and state finances, in our view.

We believe defaulting on the deposits would have a critical impact on the government. A default on these state-guaranteed deposits has never happened in the bank's 100-year history.

## Additional Rating Factors

None

## Environmental, Social, And Governance

### ESG Credit Indicators

E-1	E-2	<b>E-3</b>	E-4	E-5	<b>S-1</b>	S-2	S-3	S-4	S-5	G-1	<b>G-2</b>	G-3	G-4	G-5
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ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

Environmental factors are a moderately negative consideration in our credit rating analysis of BND. We factor into our analysis that the bank has higher direct exposure to the oil and gas industry and much higher indirect exposure through North Dakota's greater economic dependence on this industry, offset by a history of very good credit performance. Social factors are a positive consideration in our rating analysis. BND's key role in funding North Dakota's policy initiatives--through specific lending programs or direct cash appropriations--supports our assessment of the bank, under our GRE methodology.

### Bank of North Dakota Key Figures

Mil. \$	2022*	2021	2020	2019	2018
Adjusted assets	10,034	10,028	7,744	7,058	7,016
Customer loans (gross)	4,862	4,639	4,757	4,538	4,584
Adjusted common equity	1,078	1,014	944	941	852
Operating revenues	97	181	188	211	199
Noninterest expenses	16	32	30	29	29
Core earnings	81	144	141	176	158

\*2022 data is for the 6 months to end-June.

### Bank of North Dakota Business Position

(%)	2022*	2021	2020	2019	2018
Loan market share in country of domicile	-	-	-	-	-
Deposit market share in country of domicile	-	-	-	-	-
Total revenues from business line (currency in millions)	98	182	189	212	200
Commercial & retail banking/total revenues from business line	97.5	97.6	97.9	98.2	98.8
Trading and sales income/total revenues from business line	0.0	0.0	0.0	0.0	0.0
Corporate finance/total revenues from business line	0.0	0.0	0.0	0.1	(0.0)
Brokerage/total revenues from business line	0.0	0.0	0.0	0.0	0.0

**Bank of North Dakota Business Position**

(%)	2022*	2021	2020	2019	2018
Insurance activities/total revenues from business line	0.0	0.0	0.0	0.0	0.0
Agency services/total revenues from business line	0.2	0.2	0.1	0.1	0.1
Payments and settlements/total revenues from business line	1.4	1.5	1.4	1.2	1.1
Asset management/total revenues from business line	-	-	-	-	-
Other revenues/total revenues from business line	0.8	0.6	0.6	0.5	0.0
Investment banking/total revenues from business line	0.0	0.0	0.0	0.1	(0.0)
Return on average common equity	16.7	15.2	15.3	18.8	18.8

\*2022 data is for the 6 months to end-June.

**Bank of North Dakota Capital And Earnings**

(%)	2022*	2021	2020	2019	2018
Tier 1 capital ratio	19.0	19.8	19.2	20.9	19.3
S&P Global Ratings RAC ratio before diversification	22.0	22.7	21.9	23.1	21.4
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	99.4	97.1	98.1	97.2	97.1
Fee income/operating revenues	2.4	2.6	2.1	1.6	1.6
Market-sensitive income/operating revenues	(1.9)	0.3	(0.4)	1.2	1.1
Cost to income ratio	16.6	17.7	16.1	13.8	14.5
Provision operating income/average assets	1.6	1.7	2.1	2.6	2.4
Core earnings/average managed assets	1.6	1.6	1.9	2.5	2.3

\*2022 data is for the 6 months to end-June. N.M.--Not meaningful.

**Bank of North Dakota Risk Position**

(%)	2022*	2021	2020	2019	2018
Growth in customer loans	9.6	(2.5)	4.8	(1.0)	(6.6)
Total diversification adjustment/S&P Global Ratings RWA before diversification	35.6	36.1	36.7	37.3	38.3
Total managed assets/adjusted common equity (x)	9.3	9.9	8.2	7.5	8.2
New loan loss provisions/average customer loans	N.M.	0.1	0.4	0.1	0.3
Net charge-offs/average customer loans	0.0	0.1	0.1	0.1	0.1
Gross nonperforming assets/customer loans + other real estat	2.6	3.0	3.7	3.3	3.0
Loan loss reserves/gross nonperforming assets	85.3	77.6	59.9	64.6	66.4

## Bank of North Dakota Risk Position

\*2022 data is for the 6 months to end-June. N.M.--Not meaningful.

### Bank of North Dakota Funding And Liquidity

(%)	2022*	2021	2020	2019	2018
Core deposits/funding base	94.9	92.9	87.75	82.7	74.7
Customer loans (net)/customer deposits	55.2	54.2	78.4	88.3	97.8
Long-term funding ratio	95.4	94.1	90.6	87.7	83.3
Stable funding ratio	176.3	182.8	135.4	125.7	117.8
Short-term wholesale funding/funding base	5.1	6.5	10.7	14.3	19.0
Regulatory net stable funding ratio	--	--	--	--	--
Broad liquid assets/short-term wholesale funding (x)	10.3	8.5	3.8	2.6	1.8
Broad liquid assets/total assets	47.1	49.7	34.8	31.6	30.3
Broad liquid assets/customer deposits	55.0	59.6	45.5	44.3	46.3
Net broad liquid assets/short-term customer deposits	62.0	65.8	41.7	33.8	26.1
Regulatory liquidity coverage ratio (LCR) (x)	--	--	--	--	--
Short-term wholesale funding/total wholesale funding	100.0	91.4	87.0	82.4	75.1
Narrow liquid assets/3-month wholesale funding (x)	N/A	N/A	N/A	N/A	N/A

\*2022 data is for the 6 months to end-June.

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Potential Rating Implications Of The Proposed Rules To Resolve Large U.S. Regional Banks, Oct. 24, 2022
- Comparative Statistics: U.S. Banks, Oct. 12, 2022

## Bank of North Dakota

- Rating Component Scores For U.S., Canadian, And Bermudian Banks (September 2022), Sept. 30, 2022
- U.S. Regional Banks Benefit From Higher Interest Rates Amid Rising Caution, Aug. 16, 2022
- After A Tougher Fed Stress Test, Capital Requirements Will Rise For Some U.S. Banks, June 28, 2022

## RatingsDetail

### Ratings Detail (as of October 27, 2022)\*

#### Bank of North Dakota

Issuer Credit Rating A+/Stable/--

#### Issuer Credit Ratings History

19-Feb-2016 A+/Stable/--

06-Dec-2011 AA-/Stable/--

30-Jul-2009 A+/Stable/--

#### Sovereign Rating

United States AA+/Stable/A-1+

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings 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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