

RatingsDirect®

Graubündner Kantonalbank

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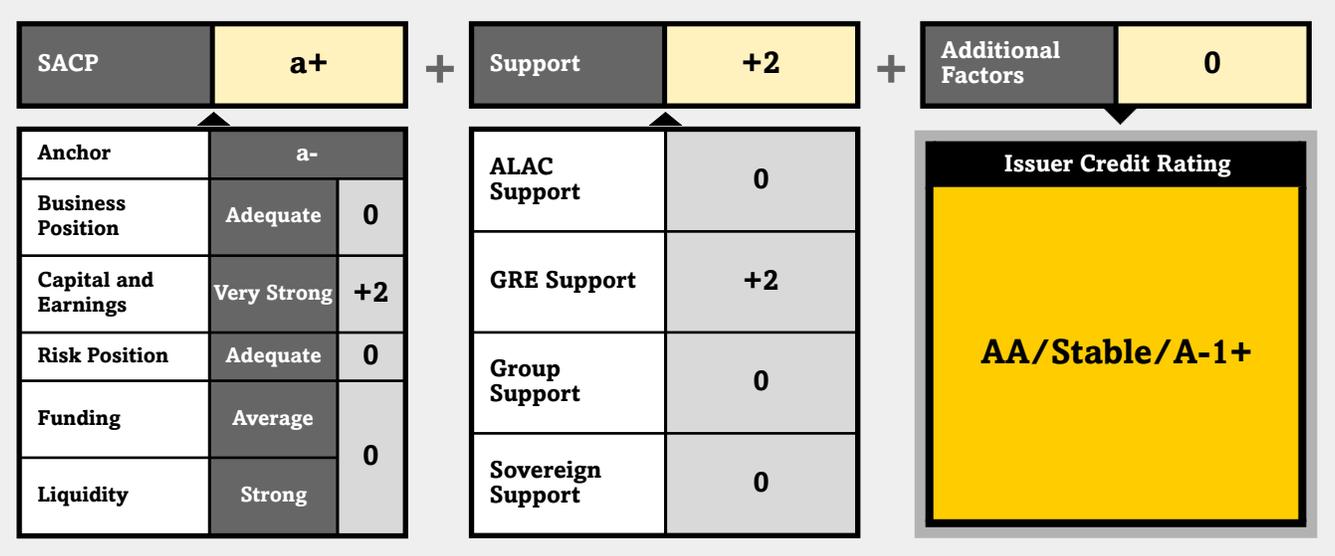
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Graubündner Kantonalbank



Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Very strong capitalization, supported by stable earnings. • A strong retail franchise in the home market. • Close ties with the Swiss canton of Graubünden, due to the canton's majority ownership of the bank and a statutory guarantee. 	<ul style="list-style-type: none"> • Limited growth potential due to regional focus and lack of diversity. • Concentration risk owing to focus on residential real estate lending, and exposure to the volatile tourism sector in the home market, Graubünden. • Low interest rates make it difficult to maintain high earnings capacity.

Outlook: Stable

Standard & Poor's Ratings Services' stable outlook on Switzerland-based Graubündner Kantonalbank (GKB) reflects our view that it benefits from being a government-related entity (GRE). We consider that there is an "extremely high" likelihood that the Graubünden (Canton of) (AA+/Stable/A-1+) would provide future timely and sufficient extraordinary support to GKB in the event of financial distress. Moreover, the stable outlook on GKB reflects our view that its capital and earnings sufficiently buffer potential domestic financial risks.

The potential of a downgrade is very low as long as the bank's stand-alone credit profile (SACP) is at or above our threshold of 'bb+'. In the event of a small deterioration of the SACP, the ratings would be cushioned by potential extraordinary support from the canton. Further negative rating actions may be triggered by a change in GKB's role for or link with the Canton of Graubünden or changes in the statutory guarantee, which may lead to a weaker assessment of GKB's status as a GRE. However, we currently consider this scenario unlikely and would expect GKB's existing obligations to be grandfathered.

We are unlikely to raise the ratings in the next 12-24 months. However, all else remaining equal, we could raise the ratings on GKB if we raised our ratings on the canton of Graubünden.

Rationale

Our ratings on GKB reflect our 'a-' anchor for Swiss banks, GKB's "adequate" business position, "very strong" capital and earnings, "adequate" risk position, "average" funding, and "strong" liquidity, as our criteria define these terms. The SACP is 'a+'.

We consider GKB to be a government-related entity (GRE) with an extremely high likelihood of receiving timely and sufficient extraordinary support from Graubünden if needed. We base this opinion on GKB's very important role for, and integral link with, the local government, the canton of Graubünden. This provides a two-notch uplift to our assessment of GKB's SACP, leading to the long-term rating of 'AA'. In our view, the Swiss bank resolution regime coming into effect on Jan. 1, 2016 does not impede cantonal owners' ability to provide extraordinary support to banks, like GKB, that we consider to be GREs.

Anchor: 'a-' for banks operating only in Switzerland

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating (ICR). Our anchor for a commercial bank operating only in Switzerland is 'a-'.

The BICRA score includes our evaluation of economic risk. In this respect, we view Switzerland as a highly diversified and competitive economy, benefiting from one of the highest GDPs per capita in the world and very robust government finances. We believe that large parts of the Swiss banking market demonstrate a conservative risk and lending culture, which has accompanied moderate growth of house prices and loan portfolios.

The Swiss banking industry is supported by its sizable and very stable customer deposit base. Pure domestic Swiss banks have not loosened credit standards in recent years, thanks to sound earnings potential from core products. We consider regulatory standards to be more stringent than in other developed countries.

Table 1

Graubuendner Kantonalbank Key Figures					
	--Year-ended Dec. 31--				
(Mil. CHF)	2015*	2014	2013	2012	2011
Adjusted assets	22,695.7	20,591.0	20,000.7	19,363.6	17,861.8
Customer loans (gross)	16,858.6	16,365.2	15,840.4	15,296.2	14,529.2
Adjusted common equity	2,260.1	2,204.0	2,116.3	2,033.7	1,936.9
Operating revenues	183.4	382.4	386.7	393.0	391.3
Noninterest expenses	89.4	186.8	183.4	188.0	195.7
Core earnings	90.0	185.4	190.6	193.8	193.7

*Data as of June 30.

CHF--CHF-Swiss Franc. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Business position: A strong regional franchise complemented by private banking activities

We consider GKB's business position to be "adequate" compared with that of domestically focused Swiss banks because we project GKB's extraordinary business stability to continue, partly offsetting its highly concentrated business model by region and product.

GKB is a midsize cantonal bank with total assets of Swiss franc (CHF) 22.6 billion as of June 30, 2015. It is the leading commercial bank in its home canton, enjoying continued high and stable market shares in retail and corporate banking (50% of business customers and 45% of private customers). The customer base has proven to be very stable, and we expect it to continue to provide GKB a sustainable source of revenues for the next two years. Operating revenues in mid-2015 are derived from net interest income at about 62%, fee income at 28%, and a 6% market-sensitive income. We expect the distribution to stay about the same over the next two years. Consequently, we expect the bank's stability in the future to be superior to that of larger domestic and international peers in countries with similar industry risk as Switzerland.

Like most other Swiss cantonal banks, GKB operates almost solely in its home region, Graubunden, with a focus on residential mortgage lending and lending to small and midsize companies, a business model we do not think the bank will change any time soon. GKB engages selectively in corporate syndicated lending across Switzerland as a partner to larger cantonal or commercial banks, mainly to highly rated large Swiss corporate entities. However, in our opinion, this selected expansion does not provide any meaningful diversification in terms of risk and earnings.

The lending activities are complemented by the private banking operations, which focus mainly on domestic clients and some cross-border business with German and Italian clients owing to the geographic proximity (total assets under management estimated at CHF16 billion). These activities are partly conducted through GKB's subsidiaries Privatbank Bellerive AG (not rated; 62.5% participation) and Private Client Bank AG (not rated; 50% participation). We believe that this niche activity will expand moderately, fueled by domestic clients, and continue to contribute stable earnings of about 15%-20%. We also think that the private banking operations will provide some diversification, but not lead us to revise our business position assessment upward.

In our view, the bank's management continues to demonstrate a strong track record, underpinned by prudent underwriting standards and conservative risk management. We expect this to provide ongoing stability to GKB's sound

financial position.

Table 2

Graubündner Kantonalbank Business Position					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Total revenues from business line (mil. CHF)	200.6	383.5	388.6	394.9	393.9
Return on equity	7.7	7.1	7.3	7.4	7.6

*Data as of June 30.

Capital and earnings: One of the highest risk-adjusted capital ratios worldwide, supported by strong earnings capacity

We view GKB's "very strong" capital and earnings position, in a domestic and global context, as a key rating strength. Our view is based primarily on our projection that the risk-adjusted capital ratio (RAC) for GKB will gradually increase to 24%-25% in the next 12-18 months, from 24.0% at year-end 2014. The drop in the RAC ratio by approximately 200 basis points (bps) compared with 2013 was primarily driven by the change in our adjustments owing to our revision of Switzerland's BICRA to '2' from '1' in November 2014. We still believe that GKB's capitalization will remain at the upper end of our range for a "very strong" assessment and superior to that of other cantonal banks, and other banks we rate globally.

In our view, GKB's earnings are predictable and stable, and we do not expect any changes to the bank's dividend policy of distributing 50%-60% to the home canton and other shareholders. The low-interest-rate environment continues to put pressure on GKB's net interest margin and operating revenues, and we estimate operating income after loss provisions at around CHF170 million-CHF180 million for the next two years down from CHF190 million-CHF200 million for the past four years. However, this will enable GKB to at least maintain its outstanding capital position. We estimate GKB's three-year average earnings buffer at 132bps, which indicates superior capacity for its earnings to cover normalized losses.

We view GKB's capital as very high quality because it includes only core Tier 1 capital in the form of share capital, a capital surplus, and reserves. We anticipate that GKB's majority owner, the canton of Graubünden, which holds 84.3% of its capital with 100% of the voting rights, will remain supportive of the current capital levels. We also believe that GKB will not experience pressure from major dividend distributions that could weaken its RAC ratio.

Table 3

Graubündner Kantonalbank Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Tier 1 capital ratio	18.6	18.9	18.9	18.4	17.3
S&P RAC ratio before diversification	N.M.	24.0	25.7	25.3	24.0
S&P RAC ratio after diversification	N.M.	22.5	24.8	24.4	21.5
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	61.7	62.1	63.0	64.4	65.6
Fee income/operating revenues	28.5	29.6	29.2	27.8	27.1
Market-sensitive income/operating revenues	6.6	6.4	5.3	5.2	5.4

Table 3

Graubuendner Kantonalbank Capital And Earnings (cont.)					
Noninterest expenses/operating revenues	48.8	48.8	47.4	47.8	50.0
Preprovision operating income/average assets	0.9	1.0	1.0	1.1	1.1
Core earnings/average managed assets	0.8	0.9	1.0	1.0	1.1

*Data as of June 30.

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 4

Graubuendner Kantonalbank Risk-Adjusted Capital Framework Data					
(CHF 000s)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)
Credit risk					
Government and central banks	1,258,289	65,488	5	37,749	3
Institutions	2,365,926	1,061,983	45	247,731	10
Corporate	5,413,596	3,248,537	60	3,854,601	71
Retail	10,982,219	5,619,293	51	2,832,363	26
Of which mortgage	10,572,385	5,347,220	51	2,537,372	24
Securitization§	0	0	0	0	0
Other assets	810,732	701,203	86	671,552	83
Total credit risk	20,830,763	10,696,504	51	7,643,995	37
Market risk					
Equity in the banking book†	70,693	168,685	239	358,880	508
Trading book market risk	--	43,311	--	64,966	--
Total market risk	--	211,995	--	423,846	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	718,586	--	1,119,478	--
(CHF 000s)		Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA
Diversification adjustments					
RWA before diversification		11,627,086		9,187,318	100
Total Diversification/Concentration Adjustments		--		586,628	6
RWA after diversification		11,627,086		9,773,946	106
(CHF 000s)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio					
Capital ratio before adjustments		2,192,739	18.9	2,203,997	24.0
Capital ratio after adjustments‡		2,192,739	18.9	2,203,997	22.5

*Exposure at default. §Securitisationexposure includes the securitisation tranches deducted from capital in the regulatory framework. †Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. CHF--Swiss Franc. Sources: Company data as of Dec. 31, 2014, Standard & Poor's.

Risk position: Exceptional loan loss experience despite regional concentration in Graubunden

We consider GKB's risk position to be "adequate," owing to its business model, which is focused mainly on low-risk collateralized residential mortgage lending and lending to small and midsize companies based on prudential underwriting standards.

We still regard GKB's regional concentration in a canton that relies considerably on the cyclical tourism sector as a key risk to its lending activities. This is because it exposes the bank to fluctuations in the local economy. However, thanks to GKB's prudent management of risks and consistent very low risk appetite, we expect it to be able to demonstrate resilience against economic stress. We believe, however, that risk costs will gradually surpass the currently unsustainably low level of 3-6 bps as shown in the past four years.

Residential real estate loans, mainly from the home region, represented about 64% of GKB's loan book at June 30, 2015. High granularity and adequate collateralization on the loan portfolio mitigate the concentration risk; we estimate the average loan-to-value ratio at about 60% for mortgage loans. Moreover, we observe that the share of nonresidential mortgage loans, at about 20% of GKB's portfolio, is higher than that of its cantonal bank peers. Although we consider this to elevate GKB's risk profile compared with its peers', we believe that the financing is mainly to small and midsize corporate clients in the home canton, and our RAC framework adequately captures these exposures. We expect GKB's lending growth to stay at 3% in the coming two years like at mid-2015 and in 2014, in line with the trend we have observed at some other cantonal banks.

Like its domestic peers, GKB is exposed to the risks related to the steady increases in residential real estate prices in Switzerland. We continue to observe a moderately high rise in real estate prices in Graubunden, especially in the winter-tourism resort areas. We view positively, however, that the majority of the bank's mortgage loan book relates to borrowers in residential rather than tourist areas, and that the tourism sector represents 6% of the overall mortgage portfolio by object type.

Furthermore, we expect the bank to maintain its conservative underwriting practices in mortgage lending. According to our projections, we will see this in the high asset quality of the bank's credit portfolio, with projected nonperforming loans at about 0.30% of customer loans in the next two years, compared with 0.27% in June 2015 and 0.18% in December 2014. However, we expect this level to be unsustainable over the full economic cycle.

To diversify its loan book geographically and by sector, GKB participates in syndicated corporate loans across Switzerland. Although corporate lending increases the credit risk in GKB's loan book, mitigating factors are that borrowers are mainly large rated Swiss corporations, and GKB participates selectively and with small amounts. We don't believe that this activity, today representing less than 5% of GKB's loan book, will provide any significant diversification benefit nor, at its current magnitude, increase GKB's credit risk to an extent that would lead us to revise down our capital or risk assessments.

On Sept. 25, 2015, GKB announced its settlement in a non-prosecution agreement with the U.S. Department of Justice's investigation of Swiss banks' role in tax evasion against a one-time payment of \$3.6 million. We also understand that GKB had prudently provisioned to meet fines relating to its acceptance of undeclared funds from U.S. clients in previous years. In line with our base case, the fine was offset by these provisions and GKB's annual earnings capacity in 2015 was not affected, partly because GKB's private banking activities have never focused on offshore

business.

Table 5

Graubuendner Kantonalbank Risk Position					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Growth in customer loans	6.0	3.3	3.6	5.3	5.0
Total diversification adjustment / S&P RWA before diversification	N.M.	6.4	3.7	3.4	11.7
Total managed assets/adjusted common equity (x)	10.0	9.3	9.5	9.5	9.2
New loan loss provisions/average customer loans	0.0	0.0	0.1	0.1	0.0
Net charge-offs/average customer loans	0.0	0.1	0.0	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	0.3	0.2	0.4	0.3	0.3
Loan loss reserves/gross nonperforming assets	534.3	847.3	351.3	462.0	570.2

*Data as of June 30.

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: A favorable funding profile, owing to stable retail deposits

We assess GKB's funding as "average" and its liquidity position as "strong" because of its strong base of customer deposits. GKB holds a very granular and stable core deposit base, which accounted for 74% of its total funding on June 30, 2015. We also view favorably the bank's superior capital base. We don't consider GKB's deposits to be very confidence sensitive because of the bank's public-sector ownership, the statutory guarantee from the canton of Graubunden, and GKB's sound brand. Moreover, the shareholder and guarantee structure gives GKB access to low-cost unsecured funding (15% of the funding base) and the ability to issue covered bonds (7%). In our view, GKB will continue to benefit from a so-called "flight to quality," with customers steering away from riskier banks during difficult economic periods toward banks with a sound reputation. Therefore, we expect GKB's stable funding ratio to remain at a comfortable 105%-110% over 2015-2017, compared with 107% as of June 30, 2015.

Our assessment of GKB's "strong" liquidity reflects our estimate that the bank's one-year liquidity ratio (broad liquid assets to short-term funding) was 3.3x at year-end 2014. In our view, the bank should withstand a market stress without access to capital market funding for more than 12 months. GKB's liquid assets comfortably cover its short-term wholesale funding needs, minimizing the risk of a gap in its liquidity profile. GKB's solid customer base will likely help it weather potential capital market stress, in our opinion.

Table 6

Graubuendner Kantonalbank Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2015*	2014	2013	2012	2011
Core deposits/funding base	73.5	81.4	82.1	82.7	82.0
Customer loans (net)/customer deposits	113.5	111.6	110.8	109.8	115.5
Long term funding ratio	89.5	95.8	95.1	94.5	96.0
Stable funding ratio	106.6	107.3	106.8	105.8	103.1
Short-term wholesale funding/funding base	11.8	4.7	5.5	6.2	4.5
Broad liquid assets/short-term wholesale funding (x)	1.7	3.3	2.9	2.6	2.8
Net broad liquid assets/short-term customer deposits	12.5	13.7	13.5	12.5	10.6

Table 6

Graubündner Kantonalbank Funding And Liquidity (cont.)					
Short-term wholesale funding/total wholesale funding	44.4	25.4	30.7	35.6	25.2
Narrow liquid assets/3-month wholesale funding (x)	1.9	4.1	5.3	4.7	2.9

*Data as of June 30.

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

External support: Two notches of uplift for likely support from Graubünden

We regard GKB as a GRE and assess the likelihood that GKB's owner, the canton of Graubünden, would provide timely and sufficient support to GKB as extremely high. We base our assessment on our view of the bank's:

- Integral link with the canton. We expect Graubünden to provide considerable and timely credit support in all circumstances to GKB, due to the canton's majority ownership of GKB and of possession of 100% of the voting rights, as well as its provision of a statutory guarantee for GKB; and
- Very important role in the canton, owing to the large impact of GKB's activities on the local economy.

Because of these factors, we incorporate a two-notch uplift into the long-term rating on GKB. We do not envisage that the bank's GRE status or our view of an extremely high likelihood of extraordinary government support will change in the foreseeable future.

GKB benefits from Graubünden's statutory guarantee, which ultimately covers all of its liabilities, excluding those of its subsidiaries Privatbank Bellerive and Private Client Bank, subordinated liabilities, and nonvoting participation certificates ("Partizipationskapital"). We note, however, that the guarantee does not ensure timely repayment, as defined by our criteria, but we believe that the canton has strong incentives to help GKB meet its obligations on time, due to the bank's importance to the regional economy.

Additional rating factors: None

No additional factors affect the ratings.

Related Criteria And Research

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 4, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of December 16, 2015)

Graubuendner Kantonalbank

Counterparty Credit Rating AA/Stable/A-1+

Counterparty Credit Ratings History

01-Dec-2014 AA/Stable/A-1+
 03-Jul-2012 AA+/Negative/A-1+
 17-Dec-2010 AA+/Stable/A-1+

Sovereign Rating

Swiss Confederation AAA/Stable/A-1+

Related Entities

Graubunden (Canton of)

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

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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