AA Bond Co. Ltd. Class A12 U.K. Corporate Securitization Notes Assigned Rating; Class A2 And A8 To A11 Notes Upgraded

May 22, 2024

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Ratings list

Class	Rating*	Amount (mil. £)
Rating assigned		
A12	BBB (sf)	434.8
Ratings upgraded		
A2§	BBB (sf)	10.8
A8	BBB (sf)	325.0
A9	BBB (sf)	270.0
A10	BBB (sf)	250.0
A11	BBB (sf)	400.0
Rating affirmed		
B3-Dfrd	B+ (sf)	280.0

*Our ratings on the class A notes address the timely payment of interest and the ultimate payment of principal on the legal final maturity date. Our rating on the class B3-Dfrd notes addresses ultimate payment of interest and ultimate payment of principal by the legal final maturity date. §The proceeds from the issuance of the class A12 notes are used to partially repay the class A2 notes.

Overview

- We assigned our 'BBB (sf)' rating to AA Bond Co.'s class A12 notes. The issuer used the net proceeds from the issuance of £435 million of the class A12 notes to partially redeem the class A2 notes.
- The balance of the class A2 notes will reduce to £10.8 million from £439.4 million. The remaining £6.5 million of the surplus proceeds from the class A12 notes' issuance will be held in a mandatory prepayment account with the existing borrower transaction bank account provider, until they can be used to further repay the class A2 notes.
- At the same time, we raised our ratings on the outstanding class A2, A8, A9, A10, and A11 notes to 'BBB (sf)' from 'BBB- (sf)' and affirmed our 'B+ (sf)' rating on the outstanding class B3-Dfrd notes.

- We have not seen material changes to the business fundamentals for the borrowing group's holding company, AA Intermediate Co., so we continue to view the group's business risk profile (BRP) as satisfactory.
- Since we assigned our preliminary rating to the class A12 notes, the cost of funds (that is, the A12 notes coupon) achieved by the issuer is lower than our preliminary analysis. Therefore, our base-case analysis results in a higher minimum debt service coverage ratio (DSCR). The minimum DSCR maps to a 'bbb-' anchor, compared with the 'bb+' anchor in our preliminary rating analysis. After considering the resilience-adjusted anchor and modifiers, the maximum potential rating is 'BBB'.
- Following the March 2024 amendments to the transaction documents, which relate to eligible investments, we have revised the cap on the class A notes to 'BBB+'.

LONDON (S&P Global Ratings) May 22, 2024--S&P Global Ratings today assigned its 'BBB (sf)' credit rating to AA Bond Co. Ltd.'s class A12 notes. Our rating addresses the timely payment of interest and ultimate payment of principal on the legal final maturity date.

Our rating is primarily based on our ongoing assessment of the borrowing group's underlying BRP; the integrity of the transaction's legal and tax structure; and the robustness of its operating cash flows, supported by structural enhancements.

On the closing date, the issuer issued £435.0 million class A12 notes to partially redeem £428.5 million of the class A2 notes via tender purchase. The balance of the class A2 notes will reduce to £10.8 million from £439.4 million. The remaining £6.5 million surplus proceeds from the class A12 notes' issuance will be held in a mandatory prepayment account with the existing borrower transaction bank account provider, until they can be used to further repay the class A2 notes. While the surplus could be used to repay the class A2 notes on any interest payment date this is not a contractual obligation. Therefore, in our analysis we assume that the class A2 notes' balance will remain at £10.8 million until their expected maturity date (EMD) in July 2025.

AA Bond Co.'s financing structure blends a corporate securitization of the operating business of the Automobile Association (the AA) group in the U.K. with a subordinated high-yield issuance.

Overview of the new issuance

On the closing date, the issuer issued £435.0 million class A12 notes to partially redeem the class A2 notes. The class A12 notes have an EMD in July 2031 and a legal final maturity date in July 2050. These new notes rank pari passu among themselves and with the existing senior class A notes, and rank senior to the existing class B notes. The class A12 notes have access to the same security package as the existing class A notes.

The senior and total debt for the issuer is unchanged by this issuance.

Table 1

Sources and uses of funds

Sources	Mil. £	Uses	Mil. £
Class A12 issuance	434.8	Partial redemption of the class A2 notes	428.5
Cash from whole business securitization	17.2	Transaction fees	3.7
		Make whole price on A2 notes*	4.9
		Accrued interest on A2 notes*	8.3
		Mandatory prepayment account	6.5
Total sources	452.0	Total uses	452.0

*Assumes full amount is tendered and redeemed at the end of May 2024.

Tender purchase of class A2 notes

- £428.5 million of class A2 notes will be repaid via tender purchase.
- The surplus of £6.5 million from the class A12 notes' issuance will be deposited in the mandatory prepayment account at closing.
- The balance of the mandatory prepayment account will be used only to further repay the class A2 notes on or before their EMD in July 2025.

Senior term facility

The only interest rate swaps the AA Bond Co. has in place are to hedge the drawings on the senior term facility (STF).

Under our ratings scenario, we assume that the STF is fully utilized and it will remain fully drawn until its legal final maturity date. Thereafter, our analysis assumes that the STF will take a pro rata share of a 100% excess cash sweep, along with all other class A debt that has passed its respective EMD.

Liquidity facility

The liquidity facility has a balance of £200 million, which represents about 9.8% of the current outstanding senior debt. Our threshold for liquidity support to be assessed as significant is 10%. Therefore, we do not apply any uplift to the resilience-adjusted anchor for liquidity support. The current liquidity facility providers are Banco Santander S.A., London branch; Barclays Bank PLC; BNP Paribas S.A., London branch; Credit Suisse International; Goldman Sachs International Bank; and JPMorgan Chase Bank N.A., London branch.

Executive summary

We believe the transaction would qualify for the appointment of an administrative receiver under the U.K. insolvency regime. Accordingly, an obligor default would allow the noteholders to gain substantial control over the charged assets prior to an administrator's appointment, without necessarily accelerating the secured debt, both at the issuer and borrower levels.

AA Bond Co.'s primary sources of funds for principal and interest payments on the class A notes are the loan interest and principal payments from the borrower and amounts available from the liquidity facility, which is shared with the borrower to service the senior term loan (when the latter is drawn).

Principal and interest payments under the loan are supported by the operating cash flows generated by the borrowing group's two main lines of business: roadside assistance and insurance brokering.

Our rating on the class A12 issuance is based primarily on our ongoing assessment of the borrowing group's underlying BRP; the integrity of the transaction's legal and tax structure; and the robustness of operating cash flow, supported by structural enhancements.

On the closing date, the issuer issued £435.0 million class A12 notes to partially redeem £428.5 million of the class A2 notes. The balance of the class A2 notes will reduce to £10.8 million from £439.4 million. The remaining £6.5 million surplus proceeds from the class A12 notes' issuance will be held in a mandatory prepayment account with the existing borrower transaction bank account provider, until they can be used to further repay the class A2 notes. While the surplus could be used to repay the class A2 notes on any interest payment date this is not a contractual obligation. Therefore, we assume that the class A2 notes' balance will remain unchanged until their EMD in July 2025.

Business risk profile

We have not seen material changes to the business fundamentals for the borrowing group's holding company, AA Intermediate Co., so we continue to view the group's BRP as satisfactory. Our BRP assessment is based on the factors outlined below.

Table 2

Key credit considerations

Leading market position	With a market share of about 40% in the B2C and 60% in the B2B roadside segments, the AA is the market leader in the U.K.'s roadside breakdown services industry.
Membership-based business model	The AA had about 3.3 million paid members in the B2C roadside segment and about 11 million paid members in the B2B roadside segment in FY2024. Retention rates in the B2C segment are approximately 84% under the new reported measure, and it retained or extended all its key contracts in the B2B segment in FY2024. This membership-based business model provides good cash flow visibility, despite some churn in membership base and potential renewal risk for the longer-term B2B contracts.
Relatively high barriers to entry	The AA's long-standing brand name, strong customer loyalty, and retention rates, as well as its national roadside assistance fleet, create relatively high barriers to entry.
Strong profitability	The BRP is underpinned by above-average S&P Global Ratings-adjusted EBITDA margins of about 30%. We expect margins to be 31%-33%, going forward, because of the AA's lower exceptional costs, better efficiency, and higher volumes. Absent major operational issues related to the program's implementation and given its ability to largely pass on cost increases to its customers (especially in the roadside segment), adjusted EBITDA margins should remain comfortably above the 25% threshold we would expect from the group, and so will support the group's satisfactory BRP.
Limited scale	Despite the significant advantage in terms of size relative to its direct competitors, we view its base as relatively small compared with peers from across other business services sectors.
Limited service diversification and weak geographic diversification	The AA's roadside segment accounted for about 88% of the group's revenue base and about 92% of company-reported EBITDA in FY2024. The AA derives its revenue solely in the U.K.

Table 2

Key credit considerations (cont.)

Moderate customer concentration	Top 10 B2B clients account for about 15% of the group's revenue in that segment.

Rating Rationale for the Class A Notes

AA Bond Co.'s primary sources of funds for principal and interest payments on the class A notes are the loan interest and principal payments from the borrower and amounts available from the liquidity facility, which is shared with the borrower to service the senior term loan (if the latter is drawn).

Our ratings on the class A notes address the timely payment of interest and the ultimate payment of principal due on these notes. Our ratings are based primarily on our ongoing assessment of the borrowing group's underlying BRP; the integrity of the transaction's legal and tax structure; and the robustness of operating cash flow, supported by structural enhancements.

Our cash flow analysis serves to both assess whether cash flows will be sufficient to service debt through the transaction's life and to project minimum DSCRs in base-case and downside scenarios. In our analysis, we have excluded any projected cash flows from the underwriting part of the AA's insurance business, which is not part of the restricted borrowing group (only the insurance brokerage part is included).

Under our criteria, we typically expect liquidity facilities and cash trapped by a breach of a financial covenant or following an expected repayment date to be kept in the structure if:

- The funds are held in accounts or may be accessed from liquidity facilities; and
- We view it as dedicated to service the borrower's debts--specifically, that the funds are exclusively available to service the issuer/borrower loans and any super senior or pari passu debt, which may include bank loans.

In this transaction, although the borrower and the issuer share the liquidity facility, the borrower's ability to draw on it is limited to liquidity shortfalls related to the STF and does not cover the issuer/borrower loans. Therefore, we do not give credit to the liquidity facility in our base-case DSCR analysis.

Currently, as per AA Limited annual report, about £87 million of cash is trapped in the whole business securitization (WBS) structure, given the breach of the restricted payment condition (RPC). The RPC permits the upstreaming of unrestricted surplus cash if the class A net debt-to-EBITDA ratio is less than or equal to 5.5x. Since the unrestricted cash is not dedicated for debt service and may be upstreamed at any point the RPC is satisfied, we do not account for it in our DSCR analysis.

Base-case scenario

Our base-case EBITDA, short-term operating cash flow projections, and the company's satisfactory BRP rely on our corporate methodology. We discussed and received confirmation on the company's performance as well as expectations from its management. Considering the updates provided, we have revised our forecasts upward, primarily based on the higher contribution from the roadside segment, fueled by new business wins, pricing, and volume. We

gave credit to growth through the end of FY2026. Beyond FY2026, our base-case projections are based on our methodology and assumptions for corporate securitizations, from which we then apply assumptions for capital expenditure (capex), finance leases, pension contributions, and taxes to arrive at our projections for the cash flow available for debt service. For AA Intermediate Co., our assumptions were:

- Maintenance capex (including net finance leases): £89 million for FY2025 and about £84 million for FY2026. Thereafter, we assume £44 million, in line with the transaction documents' minimum requirements, which were recently revised to increase the minimum to £44 million from £35 million.
- Development capex: £23 million for FY2025, and £25 million for FY2026. Thereafter, because we assume no growth, we considered no investment capex, in line with our corporate securitization criteria.
- Working capital: A net inflow of £17 million in FY2025, and £2 million in FY2026, compared with our previous expectations of £5 million in FY2025 and nil in FY2026. Thereafter, we assume that the change in working capital is nil.
- Pension contributions: We considered the plan agreed by the company with the trustee in February 2023, accordingly we assume £29 million in FY2025, £24 million in FY2026, thereafter £16 million until FY2030.
- Tax: Our updated tax assumptions are £17 million for FY2024, £18 million for FY2025, and £27 million for FY2026. Thereafter, we considered £27 million tax exposure.
- Asset disposals: We assume inflow of £4 million in FY2024, nil in FY2025, and £1 million in FY2026 and thereafter. Cash from asset disposals can only be utilized toward debt repayment for the WBS.

The transaction structure includes a cash sweep mechanism for the repayment of principal following an EMD on each class of class A notes including the issuance of the class A12 notes. Therefore, in line with our corporate securitization criteria, we assumed a benchmark principal amortization profile where the class A12 notes are repaid over 15 years following the EMD based on an annuity payment that we include in our calculated DSCRs.

Based on our assessment of AA Intermediate Co.'s BRP as satisfactory, which we associate with a business volatility score of 3, and the minimum DSCR achieved in our base-case analysis, we established a 'bbb-' anchor for the class A notes.

Downside DSCR analysis

Our downside DSCR analysis tests whether the issuer-level structural enhancements improve the transaction's resilience under a stress scenario. AA Intermediate Co. falls within the business and consumer services industry, for which we apply a 30% decline in EBITDA relative to the base case at the point where we believe the stress on debt service would be greatest.

Our downside DSCR analysis resulted in a strong resilience score for the class A notes' issuance. The combination of a strong resilience score and the 'bbb-' anchor derived in the base-case results in a resilience-adjusted anchor of 'bbb+'.

The £200 million balance in the liquidity facility represents liquidity support of about 9.8% of the current outstanding senior debt, which is below the 10% level we typically assess as offering significant liquidity support. Therefore, we have not considered any further uplift adjustment to the resilience-adjusted anchor for liquidity.

Modifiers analysis

We have not applied any adjustments under our modifier analysis.

Comparable rating analysis

Due to its cash sweep amortization mechanism, the transaction relies significantly on future excess cash. In our view, the uncertainty related to this feature is increased by the execution risks related to the company's investment plan and the returns it will effectively generate. The company may need to invest periodically to maintain its cash flow generation potential over the long term, which could erode future excess cash. To account for this combination of factors, we applied a one-notch decrease to the senior class A notes' resilience-adjusted anchor.

Counterparty risk

Our 'BBB (sf)' ratings on the class A notes are not constrained by the ratings on any of the counterparties, including the liquidity facility, derivative, and bank account providers.

Eligible investments

Following amendments to the transaction documents, the counterparties can invest cash in short-term investments with a minimum required rating of 'BBB+'. Given the substantial reliance on excess cash flow as part of our analysis and the possibility that this could be invested in short-term investments, full reliance can be placed on excess cash flows only in rating scenarios up to 'BBB+'.

Table 3

Credit rating steps for class A notes

	Preliminary ratings	Final ratings
Business risk profile	Satisfactory	Satisfactory
Business volatility score	3	3
Base case minimum DSCR range	Upper end of 1.10x-1.40x	Lower end of 1.40x-3.25x
Anchor	bb+	bbb-
Downside case EBITDA decline	30%	30%
Downside minimum DSCR range	1.8x-4.0x	1.8x-4.0x
Resilience score	Strong	Strong
Resilience-adjusted anchor	bbb	bbb+
Liquidity adjustment	None	None
Modifier analysis adjustment	None	None
Comparable rating analysis adjustment	-1 notch	-1 notch
Maximum potential rating	BBB-	BBB
Counterparty cap	A	A
Eligible investment cap	BBB+	BBB+

Table 3

Credit rating steps for class A notes (cont.)

	Preliminary ratings	Final ratings
Rating	BBB- (sf)	BBB (sf)

DSCR--Debt service coverage ratio.

Rating Rationale For The Class B3-Dfrd Notes

Our rating on the class B3-Dfrd notes addresses the ultimate payment of interest and ultimate payment of principal on or before its legal final maturity date in July 2050. The class B3-Dfrd notes are structured as soft-bullet notes due in July 2050, but with interest and principal due and payable to the extent received under the class B3 loan. Under the terms and conditions of the class B3 loan, if the loan is not repaid on its EMD (January 2026), interest and principal will no longer be due and will be deferred. The deferred interest, and the interest accrued thereafter, becomes due and payable on the final maturity date of the class B3-Dfrd notes in 2050.

Our analysis focuses on the scenarios in which the underlying loan is not repaid on the EMD and the corresponding notes are not redeemed. We understand that the obligors will not be permitted to make interest and principal payments under the class B3 issuer/borrower facility agreement. Therefore, in our cash flow analysis, we assume that the class B3 notes do not receive interest following the class A2 EMD, and receive no further payments until the class A notes are fully repaid.

Moreover, under the terms of the class B issuer/borrower loan agreement, further issuances of class A notes, for the purpose of refinancing, are permitted without consideration given to any potential effect on the then-current rating on the outstanding class B notes. Both the extension risk, which we view as highly sensitive to the future performance of the borrowing group, given its deferability, and the ability to issue more-senior debt without consideration given to the class B3-Dfrd notes, may adversely affect the issuer's ability to repay the class B3-Dfrd notes. As a result, our rating on the class B3-Dfrd notes has limited uplift above the borrowing group's creditworthiness.

Our view of the borrowing group's stand-alone creditworthiness has not changed. Therefore, we affirmed our 'B+ (sf)' rating on the class B3-Dfrd notes.

We believe the transaction will qualify for the appointment of an administrative receiver under the U.K. insolvency regime. When the events of default allow security to be enforced before the company's insolvency, an obligor event of default would allow the then senior-most noteholders to gain substantial control over the charged assets before an administrator's appointment, without necessarily accelerating the secured debt.

However, under certain circumstances, particularly when the class A notes have been repaid, removal of the class B free cash flow DSCR financial covenant would, in our opinion, prevent the borrower security trustee, on the class B3-Dfrd noteholders' behalf, from gaining control over the borrowers' assets as their operating performance deteriorates. A borrower event of default would no longer be triggered under the class B3 loan before the operating company's insolvency or restructuring. This may lead us to conclude that we are unable to rate through an insolvency of the obligors, which is an eligibility condition under our corporate securitizations criteria. Our criteria state that noteholders should be able to enforce their interest on the assets of the business before the insolvency and/or restructuring of the operating company.

If the class B3-Dfrd noteholders lose their ability to enforce by proxy the security package we may revise our analysis, and may consider that the class B3-Dfrd notes' security package resembles covenant-light corporate debt, rather than secured, structured debt.

Outlook

A change in our assessment of the company's BRP would likely prompt a rating action on the notes. To achieve the same anchor, we would expect higher DSCRs for a weaker BRP and lower DSCRs for a stronger BRP.

Upside scenario

We do not expect to revise upward our assessment of the borrowing group's BRP because it is constrained by the group's weak geographic and service diversification, as well as its exposure to the insurance broker business. We may consider raising our ratings on the class A notes if our minimum projected DSCR reaches the middle of the 1.4x-3.25x range, under our base-case scenario.

Downside scenario

We could lower our anchor or the resilience-adjusted anchor for the class A notes if we were to revise the borrowing group's BRP to fair from satisfactory. This could occur if the group faced significant operational difficulties in relation to its investment plan or if trading conditions in its core roadside service market were to deteriorate, so that it saw a significant loss of customers or lower revenue per customer. Under these scenarios, we would likely observe margins falling below 25% with little prospect for rapid improvement, or an increase in the volatility of the group's profitability.

We may also consider lowering our ratings on the class A notes if our minimum projected DSCR falls below 1.4x in our base-case scenario or 1.8x in our downside scenario. This could happen if the cash flow available for debt service declines beyond our expected base-case level.

Surveillance

We will maintain active surveillance on the rated notes until the notes mature or are retired. The purpose of surveillance is to assess whether the notes are performing within the initial parameters and assumptions applied to each rating category. The transaction terms require the issuer to supply periodic reports and notices to S&P Global Ratings to enable it to maintain continuous surveillance on the rated notes.

We view the AA's performance as an important part of analyzing and monitoring the performance and risks associated with the transaction. Although company performance will likely affect the transaction, we believe other factors, such as cash flow, debt reduction, and legal framework, also contribute to the overall analytical opinion.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

- Criteria | Structured Finance | General: Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- Criteria | Structured Finance | General: Methodology To Derive Stressed Interest Rates In Structured Finance, Oct. 18, 2019
- Criteria | Structured Finance | General: Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Criteria | Structured Finance | ABS: Global Methodology And Assumptions For Corporate Securitizations, June 22, 2017
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria | Structured Finance | General: Global Framework For Assessing Operational Risk In Structured Finance Transactions, Oct. 9, 2014
- General Criteria: Methodology Applied To Bank Branch-Supported Transactions, Oct. 14, 2013
- Criteria | Structured Finance | General: Global Derivative Agreement Criteria, June 24, 2013
- General Criteria: Global Investment Criteria For Temporary Investments In Transaction Accounts, May 31, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Credit Conditions Europe Q2 2024: Credit Heals, Defense Shields, March 27, 2024
- Economic Outlook Q2 2024: The U.K. Is Slowly Turning A Corner, March 26, 2024
- New Issue: AA Bond Co. Ltd. (A10 Tap Issuance), June 23, 2023
- Global Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016
- European Structured Finance Scenario And Sensitivity Analysis 2016: The Effects Of The Top Five Macroeconomic Factors, Dec. 16, 2016

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