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SBAB Bank AB (publ)

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SBAB Bank AB (publ)

SACP	a-	+	Support	+1	+	Additional Factors	0
Anchor	a-		ALAC Support	0		Issuer Credit Rating A/Stable/A-1	
Business Position	Moderate	-1	GRE Support	+1			
Capital and Earnings	Strong	+1	Group Support	0			
Risk Position	Adequate	0	Sovereign Support	0			
Funding	Average	0					
Liquidity	Adequate						

Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> Strong asset quality. Sound capitalization levels. Efficient business model delivers solid returns. 	<ul style="list-style-type: none"> Revenues highly concentrated on the Swedish property market. Limited product offering.

Outlook: Stable

The stable outlook on Sweden-based mortgage lender SBAB Bank AB (publ) reflects S&P Global Ratings' expectation that the bank will maintain robust capitalization over the next two years, with loan losses remaining low, despite its plan to target higher loan volumes. The outlook also incorporates our assessment that a change in ownership is unlikely in the short to medium term, given clauses in the documentation for SBAB's senior unsecured bond issuances until 2022-2023 that could accelerate their repayment in the event of an ownership change. Furthermore, even if the ownership ties loosened and SBAB's minimum required eligible liabilities (MREL) requirement were considered to be a part of a clearly defined resolution plan, we believe the bank would likely have a sufficient amount of additional loss absorbing capacity (ALAC) to continue supporting one notch of rating uplift.

We could take a negative rating action if SBAB's lending growth leads to a deterioration of asset quality or if the risk-adjusted capital (RAC) ratio were to fall below 10%, compared with our projection of about 14% over the next 18-24 months.

We currently view a positive rating action as remote because we consider an improvement of other bank-specific factors to be unlikely at present.

Rationale

Our ratings on SBAB account for the bank's revenue concentration, which tempers its business position, given that the business model relies on providing Swedish residential loans. We also consider that SBAB will maintain its strong capital and earnings position. In addition, the ratings reflect SBAB's improved risk position, as indicated by the bank's high coverage levels for its loan book. Lastly, we regard the bank's funding and liquidity positions as in line with peers.

We also include a one-notch uplift in our rating on SBAB to take into account that the Swedish government is the bank's sole owner, in addition to the bank's limited policy role as a profit-seeking entity active in residential mortgage lending. As a result, we regard SBAB as a government-related entity (GRE) and therefore consider that some support from the Swedish state is likely, in the event the bank experiences financial distress.

Anchor: 'a-' for Swedish banks

We use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for a commercial bank operating only in Sweden is 'a-', based on an economic risk score of '2' and an industry risk score of '3'.

We view the Swedish economy as highly diverse and competitive, with considerable and demonstrated monetary and fiscal flexibility given a historical focus on prudent management of public finances. We believe that high property valuations, along with high and increasing household and private-sector debt, have contributed to material economic imbalances. Nevertheless, making use of macro prudential tools, Sweden now mandates amortization on new residential mortgages, and will also require further amortization beginning in March 2018 for high debt-to-income levels. Combined with significant increases in the supply of housing in the past two years and, in the pipeline for the next few years, we now anticipate that house prices will recalibrate, contracting by 7%-10% from August 2017 highs, similar to what occurred as a result of the external shocks in 2008-2009 and 2011-2012. In addition, we believe that projected increases of around 100 basis points in the repurchase (repo) rate through 2019 should, combined with a high share of variable-rate loans, constrain worsening of existing imbalances in Sweden over the coming years. Household incomes remain high, and households' net financial assets and high savings continue to be supportive to our assessment of economic risks. In addition, we expect banks' credit losses and nonperforming loans (NPLs) will remain low in the low-interest-rate environment.

In our view, Sweden's high banking sector net external indebtedness is a key risk factor. However, core customer deposits have increased due to high savings rates from the private sector, meaning that both corporate and retail depositors and are now close to 40% of domestic loans. Banks are filling the resulting funding gap largely with domestic covered bonds and international senior debt. We view the regulatory environment in Sweden as in line with that of other EU countries, noting the comparatively high capital buffer requirements and a history of capital and liquidity support to the sector. We also view the relative stability of the banking sector and absence of significant complexity as sector strengths.

Table 1

SBAB Bank AB (publ) Key Figures					
	--Year-ended Dec. 31--				
(Mil. SEK)	2017*	2016	2015	2014	2013
Adjusted assets	415,311	375,004	374,496	338,933	334,893
Customer loans (gross)	324,640	296,257	297,234	261,687	259,030
Adjusted common equity	12,854	12,340	11,528	10,370	9,503
Operating revenues	2,321	2,918	2,341	2,622	1,893
Noninterest expenses	700	889	789	830	815
Core earnings	1,247	1,570	1,178	1,392	873

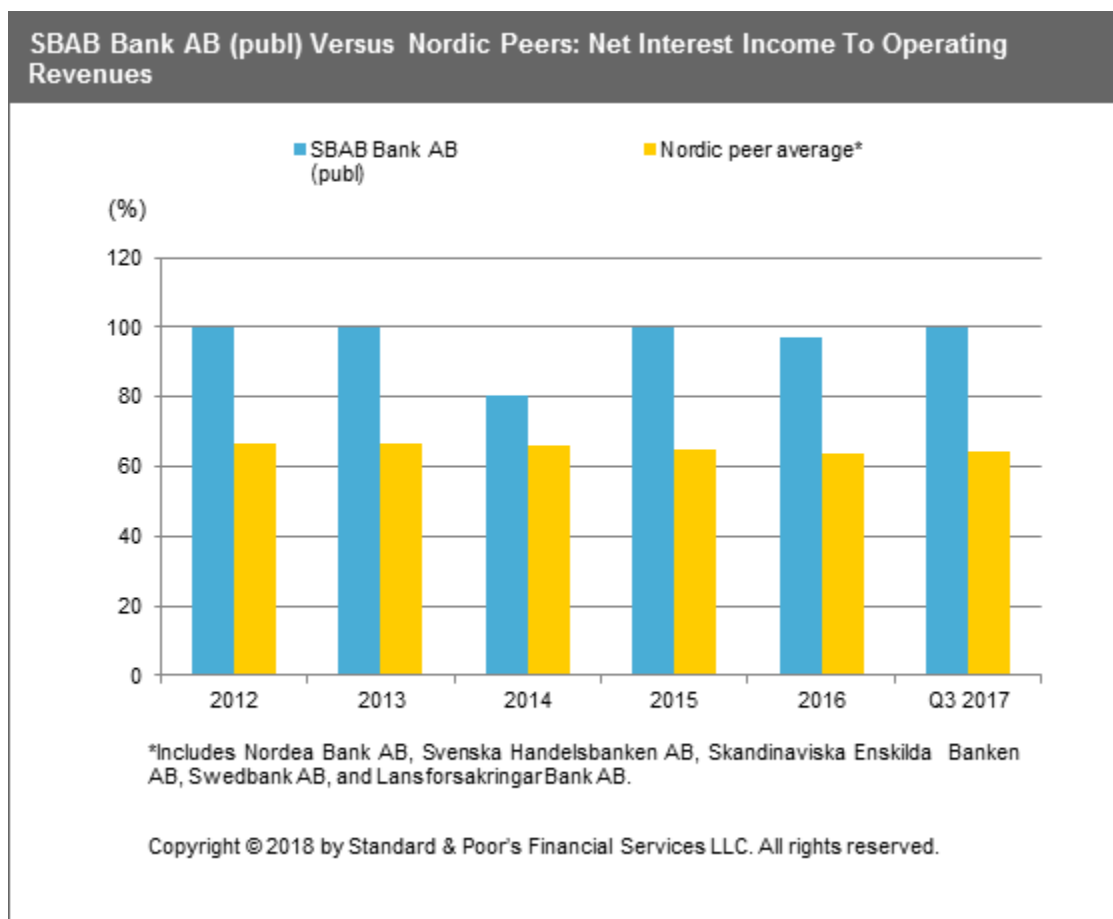
*Data as of Sept. 30. SEK--Swedish krona.

Business position: Business lines are limited to the Swedish property market

With about Swedish krona (SEK) 415 billion (€43 billion) in assets on its balance sheet as of Sept. 30, 2017, SBAB is Sweden's fifth-largest bank. The bank has increased its retail market share to about 8% in an operating climate that underpins domestic mortgage lending to private individual and tenant-owned associations. However, a less supportive climate for retail mortgage lending could lead to less stable revenue generation and restrains our business position assessment.

Compared with other Nordic peers, SBAB has a much narrower business mix, both from a product and geographic perspective. This is underscored by SBAB's lending growth, which has primarily been in large cities in Sweden and in urban areas where demand has increased in the past few years, as urbanization and immigration affect the country. As a result, net interest income has dominated SBAB's operating revenue stream (see chart 1).

Chart 1



This led to an increase of pre-tax profit of about 35% in 2016. Over time, we anticipate that the pace of profit growth will be more tempered. However, continued volume growth is likely to bolster profit over the next two years.

We therefore expect net interest income will continue to be the primary driver of SBAB's future revenue growth. Because much of SBAB's lending remains well-collateralized, we think credit losses will remain minimal.

SBAB maintains a more variable operating cost structure than many other banks because it serves clients only by phone and internet. Consequently, the bank boasts a cost-to-income ratio of about 30%, which compares favorably with both Nordic and European peers'. This supports our view that SBAB's earnings capacity will remain stable over the next few years.

Management remains committed to offering a cost-efficient platform, which supports the current strategy of delivering transparent mortgage loans and underpins SBAB's robust net profit performance. The board of directors includes one member that represents the government's 100% stake; however, the board is generally considered independent and supportive of management in order to allow for autonomous business decisions.

Table 2

SBAB Bank AB (publ) Business Position					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Loan market share in country of domicile	7.7	7.2	7.9	7.3	7.3
Deposit market share in country of domicile	4.2	4.1	3.8	3.5	2.9
Total revenues from business line (mil. SEK)	2,321	2,918	2,341	2,622	1,893
Commercial banking/total revenues from business line	23.1	21.0	22.2	22.2	33.3
Retail banking/total revenues from business line	78.7	77.5	76.6	53.5	65.5
Commercial & retail banking/total revenues from business line	101.8	98.5	98.8	75.7	98.8
Other revenues/total revenues from business line	(1.8)	1.5	1.2	24.3	1.2
Return on equity	12.0	12.3	10.2	12.1	9.5

*Data as of Sept. 30. SEK--Swedish krona.

Capital and earnings: Strong earnings power supports capitalization

We expect SBAB's RAC ratio--our measure of the bank's capital--will remain near 14.0% over the next 18-24 months. Supported by its good earnings capacity and capital instrument issuance, SBAB's RAC ratio increased by just over 200 basis points (bps) to 14.4% in 2016 from 2015 (see chart 2).

As of June 2017, SBAB's RAC ratio fell to 13.8% following growth in the bank's risk-weighted assets, as it continues to pursue above market lending growth of about 11%-13% annually over the next two years. Much of the planned growth is within retail mortgage lending. We anticipate that the bank will maintain strong underwriting guidelines to preserve high asset quality. Also, the majority of growth in 2018 will be under the bank's own brand because SEK20.5 billion (about €2.2 billion) loans held for Sparbanken Öresund (now Swedbank) were transferred in 2016, and the bank has also agreed to terminate origination agreements with other remaining partners (Ikano Bank, ICA Banken, and Sparbanken Syd) as of year-end 2017.

Our RAC ratio includes SEK3 billion (€0.3 million) of additional Tier 1 hybrid capital instruments that SBAB issued in 2015 and 2016. The instruments are EU Capital Requirement Directive IV compliant, and we assess their equity content to be intermediate and therefore include them in our total adjusted capital (TAC) measure, representing approximately 20% of TAC (see chart 2). We view SBAB as having average quality of capital, given that many European peers have higher quality of capital because they have greater shares of core capital, as measured by adjusted common equity. We exclude additional hybrid capital issuance from our forecast.

In 2016, SBAB paid out SEK628 million (approximately €65 million) in dividends, which corresponds to a 40% payout ratio. We expect the bank will pay a similar amount of net profits over the next few years. We anticipate SBAB's capital will continue to compare favorably with levels of other domestic banks, given that the bank's average earnings buffer will likely remain near 1.30% (an earnings buffer of 1.0% indicates adequate earnings capacity).

Decreased foreign currency funding and reduced use of basis swaps are likely to smooth large swings in SBAB's results, further supporting our view that the bank's earnings will remain stable. Increases in lending volumes and margins support forecasts for growth in net interest income. Coupled with costs that remain competitive relative to peers, we think the bank will achieve its return on equity (ROE) target of 10% or better. As of the third quarter of 2017,

the bank had posted ROE of 12.3%. Although the bank's targeted ROE target is lower than for larger Swedish commercial banks, it reflects lower risk in its lending portfolio.

Chart 2

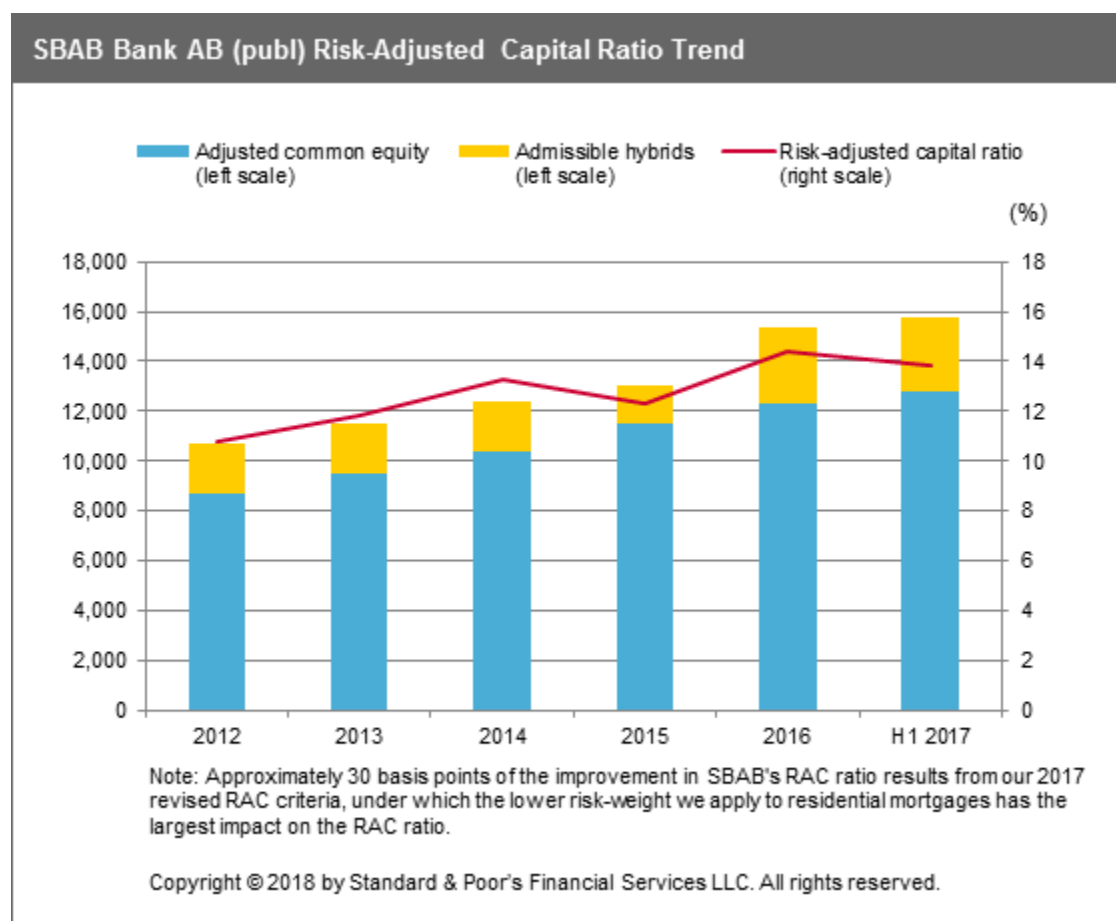


Table 3

SBAB Bank AB (publ) Capital And Earnings

	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Criteria reflected in RAC ratios	2017 RAC Criteria	2017 RAC Criteria	2010 RAC Criteria	2010 RAC Criteria	2010 RAC Criteria
Tier 1 capital ratio	8.6	9.1	8.1	8.8	9.0
S&P Global Ratings' RAC ratio before diversification	N/A	14.4	12.3	13.3	11.9
S&P Global Ratings' RAC ratio after diversification	N/A	9.4	9.3	9.4	8.7
Adjusted common equity/total adjusted capital	81.1	80.4	88.5	83.7	82.4
Double leverage	111.7	104.4	127.6	118.4	124.5
Net interest income/operating revenues	101.2	97.0	104.3	80.5	103.7
Fee income/operating revenues	(0.3)	0.2	(4.4)	(4.2)	(5.8)
Market-sensitive income/operating revenues	(1.8)	1.6	0.0	23.7	2.1

Table 3

SBAB Bank AB (publ) Capital And Earnings (cont.)					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Noninterest expenses/operating revenues	30.2	30.5	33.7	31.7	43.1
Preprovision operating income/average assets	0.6	0.5	0.4	0.5	0.3
Core earnings/average managed assets	0.4	0.4	0.3	0.4	0.3

*Data as of Sept. 30. RAC--Risk-adjusted capital. N/A--Not applicable.

Table 4

SBAB Bank AB (publ) Risk-Adjusted Capital Framework Data					
(Mil. SEK)	Exposure*	Basel III RWA	Average Basel III RW (%)	S&P Global Ratings' RWA	Average S&P Global Ratings' RW (%)
Credit risk					
Government and central banks	22,663	0	0	725	3
Institutions and CCPs	40,848	5,788	14	5,186	13
Corporate	42,426	12,550	30	30,779	73
Retail	288,226	14,263	5	68,174	24
Of which mortgage	285,105	11,925	4	66,116	23
Securitization§	0	0	0	0	0
Other assets†	717	550	77	709	99
Total credit risk	394,880	33,150	8	105,574	27
Credit valuation adjustment					
Total credit valuation adjustment	--	2,363	--	0	--
Market risk					
Equity in the banking book	0	0	0	0	0
Trading book market risk	--	1,388	--	2,081	--
Total market risk	--	1,388	--	2,081	--
Operational risk					
Total operational risk	--	4,138	--	6,196	--
(Mil. SEK)		Basel III RWA		S&P Global Ratings' RWA	% of S&P Global Ratings' RWA
Diversification adjustments					
RWA before diversification		41,038		113,851	100
Total diversification/ concentration adjustments		--		55,191	48
RWA after diversification		41,038		169,042	148
(Mil. SEK)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings' RAC ratio (%)
Capital ratio					
Capital ratio before adjustments		15,877	38.7	15,767	13.8
Capital ratio after adjustments‡		15,877	38.7	15,767	9.3

Table 4

SBAB Bank AB (publ) Risk-Adjusted Capital Framework Data (cont.)

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Other assets includes deferred tax assets not deducted from adjusted common equity. ‡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. SEK--Swedish krona. CCPs--Central counterparty clearing houses. Sources: Company data as of June. 30, 2017, S&P Global Ratings.

Risk position: Improved risk supports future asset quality

SBAB's focus on residential real estate leads to a loss history that is in line with overall Swedish banking industry risk. This is supported by our view that economic imbalances, which had been increasing in the past, now appear contained.

As a result of a transfer of loans to Sparbanken Öresund, SBAB's loan book saw very little lending growth in 2016. Over the next two years, as the bank pursues annual above-market lending growth of about 11%-13%, we think SBAB will maintain strict lending guidelines for new growth, which has typically been with established homeowners with lower average loan-to-value and debt-to-income ratios who have decided to refinance loans from other banks with SBAB.

As of third-quarter 2017, residential retail mortgage lending represents just under 75% of the loan book, with the remaining 25% split between tenant-owner associations (15%) and corporates (10%).

In addition to this, SBAB has also significantly reduced its exposure to the commercial real estate market, which we think would be more severely affected if Sweden faced a recession and now represents less than 2% of lending. Noncore lending, such as unsecured consumer and secondary-housing loans, are also a small portion of SBAB's loan portfolio, and we expect it will remain so.

As of Sept. 30, 2017, SBAB's ratio of gross nonperforming assets to customer loans remained marginal at 0.09%. Generally, we believe that asset quality, should continue to be supported by the central bank's low interest rate policy. Furthermore, particularly given SBAB's major focus on residential retail mortgage, which creates a naturally well-collateralized loan book, we expect SBAB's realized losses will be contained.

In line with prudent risk-management practices, SBAB does actively manage its reserves, having conservatively raised provisions for a few tenant-owned associations and corporate loans throughout 2015. We anticipate new loan loss provisions will be minimal, with net charge-offs remaining at or near 0% of gross lending, given the bank's average of 0.01% for the past nine years.

Table 5

SBAB Bank AB (publ) Risk Position

	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Growth in customer loans	12.8	(0.3)	13.6	1.0	1.1
Total diversification adjustment/ S&P Global Ratings' RWA before diversification	N/A	52.1	32.8	41.2	36.8
Total managed assets/adjusted common equity (x)	32.3	30.4	32.5	32.7	35.3
New loan loss provisions/average customer loans	(0.0)	0.0	0.0	(0.0)	(0.0)
Net charge-offs/average customer loans	0.0	0.0	0.0	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	0.1	0.1	0.1	0.1	0.2

Table 5

SBAB Bank AB (publ) Risk Position (cont.)					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Loan loss reserves/gross nonperforming assets	78.7	86.7	74.4	65.4	69.8

*Data as of Sept. 30. RWA--Risk-weighted assets. N/A--Not applicable.

Funding and liquidity: Increased deposit funding is underpinned by government ownership

Over the past several years, SBAB has been successful in attracting a deposit base, and although the bank is more reliant on wholesale funding, its broader funding metrics are now more in line with levels seen at Nordic peers. We therefore view its funding as average.

In third-quarter 2017, SBAB's deposits totaled SEK107 billion, accounting for about 30% of its funding base, and led to a market share of 4.2% of retail deposits in Sweden. Compared with 2011, when the bank had virtually no market share, the deposit base has grown quickly over a six-year period. Although the Swedish deposit guarantee covers most of the deposit base, we think growth has also been supported by the 100% government ownership of the bank. SBAB's loan growth over the coming years will likely be funded by a mix of deposit and wholesale funding and, as such, we anticipate that the bank's funding metrics will remain balanced.

In terms of wholesale funding, covered bonds issued via SBAB's covered bond subsidiary, SCBC, make up 75% of outstanding issuance and approximately 52% of the total funding base. Swedish krona issuance dominates, with only one quarter of the bank's issuance denominated in euros or U.S. dollars to minimize cross currency basis swap usage, which has created earnings volatility in the past.

We consider SBAB's liquidity to be adequate, reflecting ongoing government support for the domestic covered bond market, as well as the bank's own initiatives to strengthen its liquidity.

In 2013, SBAB actively worked to strengthen its liquidity position, in part owing to regulatory liquidity requirements. The bank's liquidity portfolio now stands at SEK72 billion (approximately €7.5 million), having increased by SEK40 billion (about €4 million) over the past five years. SBAB reported that its regulatory liquidity coverage ratio was 265%, or well above the 100% minimum. A decrease in short-term wholesale funding has also led to improvement in SBAB's ratio of broad liquid assets to short-term wholesale funding, to 1.5x as of third-quarter 2017 from 0.61x in 2011, and we expected the ratio will remain at or above 1x in 2018.

Table 6

SBAB Bank AB (publ) Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Core deposits/funding base	27.2	27.4	21.7	19.2	14.9
Customer loans (net)/customer deposits	303.1	305.9	387.5	431.4	564.1
Long term funding ratio	86.9	88.1	82.6	79.7	75.6
Stable funding ratio	106.8	108.6	99.8	98.3	91.9
Short-term wholesale funding/funding base	13.7	12.4	18.1	21.2	25.3
Broad liquid assets/short-term wholesale funding (x)	1.5	1.6	1.0	1.0	0.8

Table 6

SBAB Bank AB (publ) Funding And Liquidity (cont.)					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Net broad liquid assets/short-term customer deposits	23.4	26.9	3.8	(3.1)	(27.3)
Short-term wholesale funding/total wholesale funding	18.6	16.9	23.0	26.0	29.5
Narrow liquid assets/3-month wholesale funding (x)	N/A	1.6	1.4	N/A	N/A

*Data as of Sept. 30. N/A--Not applicable.

External support: One notch of uplift reflects a moderate likelihood of government support

Although we now consider extraordinary government support for banks in Sweden to be generally uncertain, we still think the Swedish government, SBAB's sole owner, would likely provide timely support to the bank if needed. This is due to the bank's strong link to Sweden, which has a track record of providing support. The uplift within our long-term rating on the bank is limited to one notch from SBAB's stand-alone credit profile (SACP), however, because we also factor in the currently limited importance of the bank's public policy role. SBAB is a profit-seeking entity and currently provides a service that we think a private-sector entity could undertake.

Like many of its government-related entity peers in the EU, SBAB is within the scope of the EU's Bank Resolution and Recovery Directive (BRRD), which includes restrictions on government support. However, we currently see no material impediment on timely support for SBAB from the Swedish government.

We note that the Swedish resolution authority (the National Debt Office) recently announced an MREL requirement for SBAB alongside other Swedish banks. At this stage, it is unclear if SBAB's MREL will need to be met with subordinated liabilities, but we expect this is likely to be clarified in 2018. Furthermore, a well-defined bail-in resolution plan for SBAB, supported by material buffers of subordinated bail-in-able liabilities that protect senior unsecured creditors, could render a bail-in resolution more likely than providing government support. We think the bank would likely have material buffers of capital and subordinated bail-in-able liabilities (ALAC), to provide additional protection to senior unsecured creditors in case of a resolution. As such, these buffers would likely continue to support one notch of rating uplift from SBAB's SACP, even if ownership ties were loosened.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015

- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Swedish Bank Ratings Affirmed Amid Housing Market Transformation; Five Outlooks Revised To Stable, Nov. 24, 2017
- Banking Industry Country Risk Assessment: Sweden, Nov. 24, 2017
- Banking Industry Country Risk Assessment Update: February 2018, Feb. 2, 2018

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 February 15, 2018)

SBAB Bank AB (publ)

Counterparty Credit Rating	A/Stable/A-1
Nordic Regional Scale	--/--/K-1
Commercial Paper	A-1
Nordic Regional Scale	K-1
Junior Subordinated	BB+
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB

Counterparty Credit Ratings History

24-Nov-2017	A/Stable/A-1
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Ratings Detail (As Of February 15, 2018) (cont.)

25-Sep-2013		A/Negative/A-1
19-Jul-2013		A/Watch Neg/A-1
22-Jun-2004	<i>Nordic Regional Scale</i>	--/--/K-1

Sovereign Rating

Sweden		AAA/Stable/A-1+
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*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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