

RatingsDirect®

IBG LLC

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IBG LLC

Major Rating Factors

Strengths:

- Very strong capitalization
- Growing, geographically diverse, low-cost brokerage business
- Modest risk appetite

Weaknesses:

- Consolidated group's operational risk stemming from the complex model-driven options market-making business
- Lower recurring revenue than some retail peers
- Sensitivity to changes in brokerage customers' confidence

Issuer Credit Rating

BBB/Positive/--

Outlook

The positive outlook on IBG LLC reflects S&P Global Ratings' view of the potential for growth of less-confidence-sensitive brokerage clients and shrinkage in the market-making business to reduce the firm's risk and bolster its business and financial stability. We expect that the firm will maintain its risk-adjusted capital (RAC) ratio well above 25%, gross stable funding ratio (GSFR) in excess of 110%, and a liquidity coverage metric (LCM) above 90%.

Over the next 12-24 months, we could raise the ratings on IBG if:

- The firm's new pricing option does not materially erode profitability;
- Its portion of more stable and less-confidence-sensitive retail and financial adviser clients grows to provide improved diversification and stability;
- It remains committed to holding very strong levels of capital and successfully manages its margin loan exposures with minimal losses; and
- Its options market-making risk runs down materially.

Over the same time horizon, we could revise the outlook to stable if we expect the firm's RAC ratio to weaken to below 20%, or if its business displays less stability, higher risk, or losses.

Rationale

Our ratings on IBG and its subsidiary, Interactive Brokers LLC, reflect the consolidated firm's solid market position, very strong capitalization, good earnings, and adequate funding and liquidity. We believe model and operational risks and the highly competitive and transactional nature of the firm's businesses will continue to at least partially offset

these strengths.

IBG is a holding company that, through its regulated broker-dealer subsidiaries, is a major global electronic broker serving both retail and institutional clients. We believe IBG's market position and profitability benefit from its technology-enabled, low-cost provider status, which supports unique, low-cost, and high-functionality offerings. While the firm's brokerage has been the leader in daily average revenue trades, it is substantially smaller than its main retail peers in terms of total client assets, with \$167.3 billion as of November 2019. While net interest income has grown to over 50% of total net revenue, IBG remains reliant on market-sensitive revenues. IBG continues to grow its retail, financial adviser, and other stickier clients, but, unlike its peers, it has more institutional trading clients, which we view as more confidence-sensitive.

We believe that IBG's profitability will be less hurt by discount brokers' recent move to zero commissions on trades of U.S. equities and exchange-traded funds (ETFs) and the per-trade commission on listed options. This is because IBG chose to offer a zero-commission option that includes revenue-increasing measures that offset the reduction in commission, alongside its existing pricing platform.

The continued wind-down of IBG's options market-making business has reduced its footprint on the balance sheet and exposure to market risk, model-driven trading operational risk, and funding risk. Continued run-off of trading assets has lowered value at risk and market risk risk-weighted assets (RWAs), which has supported a RAC ratio above 36% despite the growth of the brokerage business. That said, we believe IBG's continued market-making operations to support its brokerage business and international market making in profitable locations globally leaves some market and operational risk.

Anchor: Reflects U.S. securities firms economic and industry risks

The anchor is 'bbb-', in line with other securities firms in the U.S. rated under our criteria for nonbank financial institutions (NBFIs). Our 'bbb-' U.S. securities firm anchor reflects our view of the sector's economic and industry risk. The firm's economic risk reflects its geographic mix of revenue, which includes 55% from outside the U.S.

The securities firm anchor reflects risks shared with the 'bbb+' U.S. bank anchor, but it is two notches lower to reflect our view of U.S. securities firms' incrementally higher industry risk relative to banks. The 'bbb+' U.S. bank anchor is based on the diversified, high-income, and resilient U.S. economy that underpins our assessment of economic risk. There is some potential for increasing credit risk in the economy from lending areas that have grown quickly in recent years--such as auto and corporate lending. It also reflects our industry risk view that regulatory enhancements made since the financial crisis, high levels of core deposits, and deep capital markets balance the risks and competition that come with the country's large nonbank financial sector.

The securities firm anchor is two notches below the bank anchor to reflect U.S. securities firms' lower, but still material, regulatory oversight and institutional framework; higher competitive risk; and typically less stable, more transactional, revenue. Also, even accounting for the liquidity of domestic capital markets, differences in assets, and the U.S. investor insurance scheme (The Securities Investor Protection Corp.), funding risk for securities firms is higher than banks, in our view, because securities firms typically lack central bank access.

We believe the anchor for U.S. securities firms is relatively stable, mirroring the U.S. BICRA's stable economic and

industry risk trends (see "Banking Industry Country Risk Assessment: U.S.," published Oct. 9, 2019). The stable trend incorporates our expectations for industry and economic conditions, including economic growth, market volatility, interest rates, regulatory reform, and competition, as well as our expectations for no material change to securities firm-specific industry risks.

Table 1

| IBG LLC--Key Financial Data | | | | | |
|------------------------------------|-----------------------|-------------|-------------|-------------|-------------|
| (Mil. \$) | YTD Sept. 2019 | 2018 | 2017 | 2016 | 2015 |
| Adjusted assets | 67,771 | 60,514 | 61,133 | 54,645 | 48,728 |
| Adjusted common equity | 7,620 | 7,123 | 6,404 | 5,792 | 5,338 |
| Total Adjusted Capital | 7,620 | 7,123 | 6,404 | 5,792 | 5,338 |
| Operating revenues | 1,437 | 1,900 | 1,609 | 1,396 | 1,189 |
| Noninterest expenses | 547 | 703 | 651 | 629 | 583 |
| Net income | 117 | 169 | 76 | 84 | 49 |
| Core earnings | 795 | 1,122 | 723 | 699 | 417 |

Business position: Market position is growing, but brokerage business is sensitive to investor confidence

We believe IBG has a solid market position as a global electronic broker to direct and indirect retail as well as smaller institutional clients. It allows clients to trade exchange-listed options, stocks, bonds, foreign exchange, futures, and mutual funds at more than 125 market centers worldwide.

The contribution of trading-related income, which we view as potentially less stable than contractually recurring fees and stable sources of net interest income, is higher than most rated retail brokerage peers. The firm's main source of revenue other than trading is net interest income, which accounted for 55% of revenue in the first half of 2019.

The firm's mix of business has shifted from market making to brokerage. Currently, 97% of revenue is from brokerage as market making is wound down and the brokerage business continues to grow. The company will retain some market-making functions, including in a couple of countries where it still trades profitably, and in the U.S. to support its brokerage business in specific products (such as some "delta one" products). While we believe the wind-down of the market-making business reduces the firm's business risk, it also reduces its contribution to diversification and increases exposure to customer confidence sensitivity.

The firm offers brokerage clients a high-functionality platform. IBG has differentiated its platform to serve the specific needs of its customer segments beyond retail traders and investors, introducing brokers, registered investment advisers, and institutional clients like hedge funds. The capabilities of the firm's trading platform, its tailored functionality to meet the needs of a broad range of client types, aggressive pricing, and geographic expansion continue to foster strong growth of the electronic brokerage business. These strengths have allowed the firm to continue to grow its brokerage business, with total accounts and customer equity up 19% and 14% year over year, respectively.

IBG has been the leader in daily average revenue trades (DARTS) among the U.S. brokers that report DARTS and has grown client assets much more rapidly than peers. However, with \$167.3 million in total client assets as of June 30, 2019, IBG remains much smaller than some rated U.S. retail discount brokerage peers.

Given its unique customer mix and response, we believe that IBG is much less affected by the recent move by leading discount brokers to reduce retail commissions on U.S. equities and ETFs and the per-trade commission on listed options to zero. IBG instead had already announced its own stripped-down "zero commission" platform IBKR Lite, while maintaining its existing platform and pricing structure, now rebranded IBKR Pro. The IBKR Lite platform includes revenue-increasing features like higher rates on margin loans, lower rates paid on customer cash balances, and selling customer order flow that should limit any erosion of profitability, particularly compared to peers, which did not include revenue increasing measures in their shift to "zero commissions." We believe that unlike the other firms, IBG's new pricing model option will not materially reduce revenue and profitability. Further, we believe that IBG's low cost base and greater flexibility to further adjust rates on margin loans and cash balances if needed give it more capacity to absorb potential additional future competitive price pressures. While the reduction in commissions at the other firms has eliminated IBG's former commission pricing advantage, to the extent that IBG's new pricing option enables growth of more stable, less confidence-sensitive retail customers, it could improve business stability and support a higher rating on IBG.

We believe that retail customers, including direct retail customers and those served through registered investment advisors and introducing brokers, are more stable and less confidence-sensitive than institutional clients. IBG continues to grow these accounts with direct and indirect retail customers accounting for 51% and 26% of commissions in the first half of 2019, respectively, up slightly from 2018. They also accounted for 35% and 46% of customer equity, respectively, with some shrinkage in financial advisors more than offset by growth of introducing brokers.

Unlike its purely retail peers, IBG has a material amount of hedge funds and proprietary trading clients, which accounted for 24% of IBG's commissions and 19% of client equity at the end of the second quarter, about flat with 2018. We consider these clients more confidence-sensitive and higher risk given their use of portfolio margining. We would view negatively a material increase in IBG's portion of institutional clients.

With operations spread across 31 countries in Europe, Asia, and the Americas, IBG has good and growing geographic diversification. Foreign operations include some market making, but mostly electronic brokerage, as well as support clearing and customer service, across multiple product types, predominantly exchange traded or settled. Brokerage clients from outside of the U.S. accounted for 41% of client equity and 45% of commission revenue in the last 12 months ended March 31, 2019, up from 35% and 43%, respectively, in 2017. A large portion of IBG's international clients activity is in U.S.-listed stocks.

We view IBG's management and governance as a neutral rating factor. The recent promotion of long-time president Milan Galik to Chief Executive Officer addresses questions about succession. Founder and majority shareholder Mr. Peterffy will continue as Chairman of the Board and remain closely involved in the operations. We view favorably senior management and ownership's commitment to very strong capitalization and limited risk appetite.

Table 2

| LBG LLC--Business Position | | | | | |
|-----------------------------------|-----------------------|-------------|-------------|-------------|-------------|
| (Mil. \$) | YTD Sept. 2019 | 2018 | 2017 | 2016 | 2015 |
| Total revenues | 1,437 | 1,900 | 1,609 | 1,396 | 1,189 |

Table 2

| LBG LLC--Business Position (cont.) | | | | | |
|--|-----------------------|-------------|-------------|-------------|-------------|
| (Mil. \$) | YTD Sept. 2019 | 2018 | 2017 | 2016 | 2015 |
| Total revenue growth (year over year) | N.M. | 18.09 | 15.26 | 17.41 | 13.97 |
| Business line revenue contributors: (%) | | | | | |
| Trading and Sales/total revenues | 3.62 | 4.00 | 5.34 | 13.61 | 25.06 |
| Brokerage/total revenues | 99.86 | 96.95 | 87.32 | 88.75 | 92.26 |
| Other revenues/total revenues | -3.48 | -0.95 | 7.33 | -2.36 | -17.33 |
| Net interest income/operating revenues | 55.39 | 48.89 | 42.45 | 37.75 | 35.74 |
| Fee income/operating revenues | 44.54 | 48.32 | 46.30 | 50.00 | 58.96 |
| Market-sensitive income/operating revenues | 1.39 | 2.05 | 2.49 | 11.68 | 22.62 |
| Pretax profit/operating revenues | 58.80 | 62.95 | 65.20 | 54.51 | 38.52 |
| Core earnings/average adjusted common equity | 14.38 | 16.59 | 11.85 | 12.56 | 7.93 |

N.M.--Not meaningful.

Capital, leverage, and earnings: Very strong risk-adjusted capital

We view capitalization as very strong given an expected RAC ratio of more than 32%, management and ownership's commitment to maintain conservative capital levels, and strong risk-adjusted earnings. As of June 30, 2019, the RAC ratio was 36%, reflecting the firm's commitment to capital and reduced market-making trading risk.

Further, the firm has no additional risks not covered in the RAC given its minimal illiquid and Level 3 assets. We expect the firm to continue to grow equity through good retention of earnings, with very limited stock buybacks, and an annual capital payout ratio remaining around 35%. Interactive Brokers Group Inc.'s status as a public company gives IBG some flexibility to raise additional capital if needed. At the same time, Mr. Peterffy's controlling ownership limits investor pressure to distribute capital.

IBG's extensive use of technology gives it a low expense base, which allows it to be a low-cost provider while still generating pretax margins typically above 50%. Earnings are also strong on a risk-adjusted basis, with average core earnings to S&P Global Ratings RWAs of 4.36%.

All of IBG's regulated subsidiaries have considerable excess regulatory capital, except its U.S. market-making broker Timber Hill LLC, whose capital has been reduced in line with its shrinking operations. We do not expect further material reductions in the amount of capital at this and the European Timber Hill broker given how low they have pushed it already.

Table 3

| IBG LLC--Capital | | | | | |
|--|-----------------------|-------------|-------------|-------------|-------------|
| (%) | YTD Sept. 2019 | 2018 | 2017 | 2016 | 2015 |
| Leverage ratio (U.S. GAAP) | 11.24 | 11.77 | 10.48 | 10.60 | 10.95 |
| S&P Global Ratings' RAC ratio before diversification | 36.24 | 40.95 | 39.18 | 36.05 | N/A |
| Adjusted total equity/adjusted assets | 11.24 | 11.77 | 10.48 | 10.60 | 10.95 |
| Adjusted common equity/total adjusted capital | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |
| Total equity double leverage | N.M. | 101.56 | 102.94 | 98.97 | 97.33 |

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

Table 4

| LBG LLC--Earnings | | | | | |
|---|----------------|-------|-------|-------|-------|
| (%) | YTD Sept. 2019 | 2018 | 2017 | 2016 | 2015 |
| Personnel expenses/operating revenues | 14.82 | 13.89 | 15.48 | 17.34 | 19.09 |
| Cost-income ratio | 38.07 | 37.00 | 40.46 | 45.06 | 49.03 |
| Core earnings/operating revenues | 55.32 | 59.06 | 44.92 | 50.07 | 35.07 |
| Internal capital generation/prior year's equity | 1.76 | 2.19 | 0.83 | 1.09 | 0.46 |
| Core earnings/S&P Global Ratings' RWA before diversification | 5.34 | 3.32 | 4.42 | 4.35 | N/A |
| Three-year average core earnings/S&P Global Ratings' RWA before diversification | 4.36 | N/A | N/A | N/A | N/A |

N/A--Not applicable.

Risk position: Excess capital helps offset operational risks

We believe the firm's good risk management, relatively modest risk appetite, and loss experience remain supportive of the rating, despite some periods with higher-than-peer losses on client margin loans, including during the first quarter of 2019. That said, the firm also had lower-than-peer losses during some market events, including the February 2018-2019 equity market volatility spike.

The company's market-making business uses proprietary models and trading systems to execute a large volume of trades. Consequently, the wind-down of the market-making business has reduced the firm's overall operational and market risk considerably. That said, we believe that even with the reduced scale of the firm's market-making operations, the firm is exposed to operational risk from a complex model-based trading system and automated trade execution and risk systems. While we view positively IBG's very good long-term track record of careful management, which we believe can lower the probability of material operational events like malfunctioning systems potentially resulting in large principal losses, no system is foolproof. We believe that the strength of IBG's capitalization offsets the firm's exposure to low-probability high-impact events given it has a cushion of approximately \$4.4 billion of total adjusted capital above our 15% RAC ratio threshold for very strong capitalization.

In its brokerage business, IBG limits its credit risk and collateral-posting requirements by trading almost exclusively in listed securities and cash foreign exchange. Counterparty risk with clearinghouses is limited given their high credit ratings and mutualization of risk. Cash foreign exchange, metals, and contracts for difference transactions are done only with large, highly rated banks. The firm performs credit due diligence and surveillance on its counterparties and limits its net exposures to individual counterparties.

For margin lending, the firm employs real-time margin compliance monitoring technology, which allows it to quickly liquidate customers' positions if their equity falls below margin requirements. Based on the firm's assessment of client exposures, concentration or leverage, and market conditions, it will also limit exposure or client risk through its pricing, imposing additional limitations or increasing margin requirements.

While we view IBG's management of its margin loan risk as adequate, it has had some notable losses. IBG recognized an aggregate loss of approximately \$42 million on margin loans in the first quarter of 2019. This was related to some customers' relatively large positions in a U.S.-listed company whose price fell precipitously in January, causing the customer's accounts to be in deficit. The rapid decline in price and lack of liquidity in the stock made it difficult to liquidate the stock to bring clients back into margin compliance. IBG continues to pursue collection of this debt. We

believe that this demonstrates the risks of margin lending, particularly with a global customer base. That said, the amount is very small relative to IBG's total capital, and the firm still posted net income of \$324 million in the quarter.

Independently from margin lending, the firm incurs some market risk from clients' trading options. For example, in a market crash scenario (with stock prices down or volatility up), clients selling put options might be unable to meet their financial commitments, putting IBG on the hook vis-a-vis the counterparties (most likely clearinghouses) to absorb the losses. We believe such risk is well-monitored through adequate margining, with the firm constantly revising its volatility stress assumptions based on market conditions.

The firm keeps minimal fixed-income inventories so that its exposures to depreciating marked-to-market valuations (stemming from idiosyncratic credit events or a general rise in interest rates) are very small.

Table 5

| IBG LLC--Risk Position | | | | | |
|---|----------------|-------|-------|-------|-------|
| (%) | YTD Sept. 2019 | 2018 | 2017 | 2016 | 2015 |
| Annualized adjusted assets growth rate | 15.99 | -1.01 | 11.87 | 12.14 | 12.32 |
| Adjusted common equity/managed assets | 11.24 | 11.76 | 10.47 | 10.59 | 10.95 |
| RACF scaled-up VaR (x10,000)/total adjusted capital | NA | N/A | N/A | 7.00 | 14.39 |

N/A--Not applicable.

Funding and liquidity: Neutral to the rating

We view IBG's funding and liquidity as neutral to the rating given its very liquid balance sheet, excess stable funding of its less liquid assets, and good liquidity management.

IBG's GSFR--available stable funding to the illiquid portion of its assets--was solid at 196% as of June 30, 2019. However, this is partially offset by the firm's shrinking but still material derivatives portfolio, which represents additional needs not captured in the GSFR. We expect the derivatives portfolio to continue to slowly shrink as the market-making business winds down.

Additionally, we believe that IBG's institutional customers expose the firm to more customer confidence-sensitivity than purely retail peers given the firm's reliance on client balances to support client activity.

IBG's LCM--balance sheet liquidity sources relative to balance sheet liquidity needs--was 1.17x as of June 30, 2019, and we expect it to remain above 90%. IBG has a very liquid balance sheet composed of cash; margin loans; exchange-listed marketable securities, which are marked-to-market daily; segregated customer assets; receivables from trade counterparties; and margins posted at central counterparties. Illiquid assets comprise less than 10% of total adjusted capital, and less than 1% of assets are Level 3.

The firm is exposed to margin and collateral calls on its open exchange-traded derivatives positions as well as its securities loaned and open client positions. The firm maintains significant unencumbered liquidity to offset its exposure to margin and collateral calls, including approximately \$42 billion of re-pledgeable collateral available from securities lending transactions and customer margin assets. IBG has uncommitted secured broker bank lines both to fund everyday needs and to provide ready access to the liquidity of its unencumbered securities.

IBG's brokerage business doesn't carry securities inventory, so its funding needs are limited primarily to customer margin loans (\$25.6 billion as of Sept. 30, 2019), which are largely funded by customer free credit balances. We view positively the firm's practice of calculating its regulatory reserves daily. Further, we believe its practices and accounting for customer securities lending activity understate the firm's liquidity in the LCM given that all its securities-borrowed transactions are not for funding.

The securities portfolio, which primarily consists of market-making inventory and hedges, declined 44%, 34%, and 49% in 2019 YTD, 2018, and 2017 respectively. The focus on liquid exchange-traded products makes liquidity management more straightforward and limits the number of counterparties to post margin collateral with. Funding needs for options are limited and not reflected in the amounts reported on the balance sheet, while the rest of the inventory is almost all easily funded, liquid, exchange-traded equities. In addition, the firm has substantial latitude to adjust its positions and hedging based on the availability and economics of various funding sources or its liquidity needs.

Table 6

| IBG LLC--Funding And Liquidity | | | | | | |
|--|----------------|--------|--------|--------|--------|--|
| (%) | YTD Sept. 2019 | 2018 | 2017 | 2016 | 2015 | |
| Gross stable funding ratio | 195.33 | 192.58 | 136.33 | 151.27 | 149.79 | |
| Short-term wholesale funding/adjusted assets | 6.55 | 7.15 | 9.94 | 9.53 | 9.15 | |
| Liquidity coverage metric (x) | 1.15 | 1.06 | 0.88 | 0.89 | 1.04 | |
| Brokerage customer payables/adjusted assets | 80.38 | 79.31 | 77.78 | 76.37 | 76.10 | |

Comparable ratings adjustment: None

We do not make any further adjustment based on a comparison versus peers.

External influence: We deduct one notch from IBG LLC for structural subordination

Our rating on Interactive Brokers LLC, IBG's U.S. broker-dealer subsidiary, is at the same level as the 'bbb+' group credit profile because it is an operating company. Our issuer credit rating on IBG is one notch lower than the group credit profile, reflecting the entity's structural subordination as a nonoperating holding company for regulated subsidiaries.

Ratings Score Snapshot

Table 7

| IBG LLC--Ratings Score Snapshot | |
|--|--------------------------------|
| Issuer Credit Rating | BBB/Positive/-- |
| GCP | bbb+ |
| Anchor | bbb- |
| Business Position | Adequate (0) |
| Capital and Earnings | Very Strong (+2) |
| Risk Position | Adequate (0) |
| Funding & Liquidity | Adequate and Adequate-High (0) |
| Comparable Ratings Adjustment | 0 |
| External Influence | -1 |

Table 7

| IBG LLC--Ratings Score Snapshot (cont.) | |
|--|----|
| Government Influence | 0 |
| Group Influence | -1 |
| Rating above the Sovereign | 0 |

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- 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 | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- 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

Ratings Detail (As Of December 17, 2019)*

| | |
|--------------------------------------|-------------------|
| IBG LLC | |
| Issuer Credit Rating | BBB/Positive/-- |
| Issuer Credit Ratings History | |
| 22-Nov-2017 | BBB/Positive/-- |
| 11-Dec-2014 | BBB/Stable/-- |
| 19-Dec-2008 | BBB+/Stable/-- |
| Sovereign Rating | |
| United States | AA+/Stable/A-1+ |
| Related Entities | |
| Interactive Brokers LLC | |
| Issuer Credit Rating | BBB+/Positive/A-2 |

*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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