

# Banking Industry Country Risk Assessment: Israel

January 27, 2025

Banking Industry Country Risk Assessment Group				4	
4 Economic Risk		4 Industry Risk			
Economic resilience	High Risk	Institutional framework	Intermediate Risk		
Economic imbalances	Intermediate Risk	Competitive dynamics	High Risk		
Credit risk in the economy	Low Risk	System wide funding	Low Risk		

Government Support:  
**Supportive**

## BICRA Highlights

### Overview

Key strengths	Key risks
Wealthy and diversified economy.	Significant economic and geopolitical implications from the ongoing Israel-Hamas war.
Well capitalized and profitable banking system.	High exposure to real estate related lending.
Ample and stable domestic funding base.	Competitive environment, including nonbank players.

**Israeli banks benefit from the wealthy and diversified domestic economy, although they display some concentration in their lending books and are vulnerable to geopolitical and security risks.** High geopolitical and security risks are impeding Israel's economic performance. We expect real GDP to expand by a low 2.2% in 2025, after stagnating in 2024. Israel's real estate sector, which represents between a fifth and a fourth of banks' loan books, is among the most vulnerable to the current developments, as are tourism, small businesses, and the services sector. We think economic slowdown, coupled with prolonged high cost of debt service, will dent borrowers' creditworthiness. We therefore expect banks' asset quality to deteriorate over the near term. In our base case, we assume credit losses will increase to 30-35 basis points over 2025-2026 from estimated about 20 bps in 2024.

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**Low funding risk and the proactive regulator support Israel's banking industry.** The banking sector benefits from a large domestic funding base and a net external creditor position, which provide a cushion in the challenging environment. Prudent regulatory oversight from Bank of Israel (BoI) partly mitigates risks of concentration and geopolitical instability. Israeli banks' profitability is benefiting from still-high interest rates; durable inflation, amid the significant indexation of the balance sheet; strong cost containment efforts introduced after the pandemic; and high recourse to digital solutions. Competition among banks and nonbank financial institutions remains a potential constraint on margins and fees.

## **Economic And Industry Risk Trends**

The trend for economic risk is negative. Significant revamping of the war could severely impede the banking sector as it could lead to meaningful asset quality deterioration (particularly in the real estate sector), a considerable decline in profitability, or materially higher exposure to financial and nonfinancial risks.

The industry risk is stable. We expect banks to continue benefiting from a large customer deposit base and effective supervision from the BoI. Banks' profitability, benefiting from high interest rates, helps cushion the impact of higher credit losses.

### **4**

## **Economic Risk**

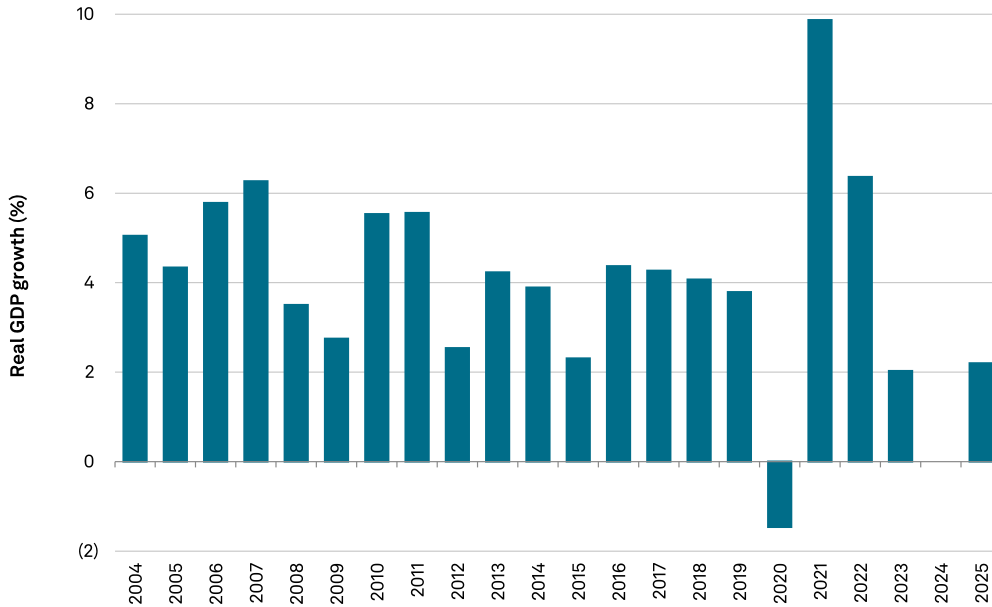
### **Economic resilience: Tested by the ongoing war**

Israel is facing very high geopolitical risk, which clouds our economic forecasts. The ceasefire agreement between Israel and Hamas that took effect on Jan. 19, could lead to de-escalation in Gaza and offer an opportunity for a permanent end to the 15-month long fighting. However, the deal is complex and depends on the outcome of additional negotiations, making it vulnerable to implementation risks. Our base-line forecasts suggest only a modest recovery this year, with real GDP growth of 2.2%, as consumption and investments pick up.

Even if the security situation normalizes, medium-term GDP growth rates will likely remain below the pre-war trend due to the lasting effects of the conflict. Labor supply constraints will likely persist, because of reservists and because Palestinian workers formerly employed in the construction industry (which constitutes 5% of GDP) are only partly being replaced by foreign workers. That said, the structure of the Israeli economy, which is centered on high-tech services exports, should somewhat cushion the impact of security disruptions.

Chart 1

**The war hits the economy and clouds forecast after historically resilient and sustained growth**



Source: S&P Global Ratings.  
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We expect Israel will continue to receive financial and military backing from its international allies, principally the U.S. However, we see risks that relations might deteriorate because of concerns over the dire humanitarian situation. A protracted lack of visibility on Israel's plan for political settings around Gaza after the war could erode public sentiment toward Israel in key ally countries, with potential consequences for trade or financial and military aid to Israel.

Beyond the ongoing conflicts, Israel's domestic political developments also remain difficult to predict. Israel has a history of short-lived governments and frequent elections.

We expect the ongoing conflict will result in an enduring increase in defence-related spending. We forecast a general government deficit of 9% of GDP for 2024 and 6% of GDP in 2025, followed by an average of 5% of GDP over 2026-2027. The 2025 central government budget is currently under discussion in the parliament. The deadline for passing the budget is March 31, 2025. As per Israel's legislation, failure to pass the budget by then would result in early elections.

Table 1

**BICRA Israel--Economic resilience**

(Mil. ILS)	--Fiscal year end Dec. 31--						
	2020	2021	2022	2023	2024f	2025f	2026f
Nominal GDP (bil. \$)	411.7	492.6	527.7	513.6	522.4	534.8	582.7

Table 1

**BICRA Israel--Economic resilience (cont.)**

(Mil. ILS)	--Fiscal year end Dec. 31--						
	2020	2021	2022	2023	2024f	2025f	2026f
GDP per capita (\$)	44,683.6	52,563.8	55,251.0	52,722.0	52,577.6	52,768.6	56,366.0
Real GDP growth (%)	(1.5)	9.9	6.4	2.0	0.0	2.2	5.0
Inflation (CPI) rate (%)	(0.6)	1.5	4.4	4.2	3.4	2.8	2.5
Monetary policy steering rate (%)	0.1	0.1	3.3	4.8	4.5	N/A	N/A

f--Forecast. N/A--Not applicable. ILS--Israeli shekel.

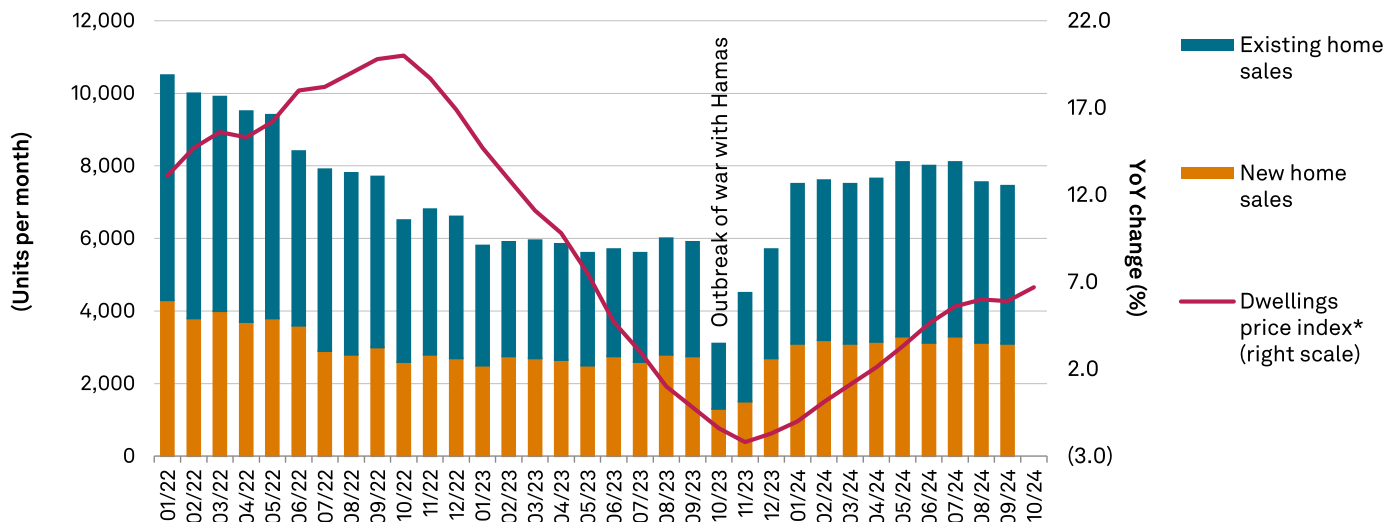
**Economic imbalances: real estate related exposure continue to drive credit demand**

Despite the ongoing war and tight financing conditions, lending and real estate prices increased during 2024. After a significant decline in transactions, house sales (and in turn mortgage loans) have recovered since end-2023 (see chart 2). We expect a stabilization in 2025, as we anticipate interest rates will remain high amid elevated geopolitical uncertainty, high risk premiums, and an accumulating stock of unsold apartments (estimated at about 69,000 housing units compared to about 46,000 in June 2022).

Uncertainty is very high, however. Upside pressure on prices can come from rising unsatisfied demand for apartments, as the construction industry is operating below pre-war capacity due to the worker shortage (estimated at about 20%), which remains despite efforts to replace Palestinian workers. A deterioration of the geopolitical situation might also have negative consequences.

Chart 2

Real estate prices and transactions have stabilized recently



\*Base average 1993=100. YoY--Year-on-year. Source: CBS.

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The construction and real estate sector is among the most vulnerable to the latest geopolitical events and current financing conditions. More than a third of the construction sector has been directly affected by the war due to security risks and the worker shortage. In addition, higher-for-longer interest rates and an increase in construction costs weigh on developers' and construction companies' profitability and cash flows. Furthermore, higher interest rates and a risk of some firms moving out of Israel if conditions remain uncertain, might depress commercial real estate valuations, particularly in the office sector. Also, we acknowledge that Israel's domestic price index performance does not consider the various types of promotions offered by developers, which lead to significant savings for buyers and erode developers' margins.

We expect Israel's balance of payments will remain a key rating strength. The country has been running a current account surplus for decades, primarily supported by the fast expansion of high-value-added information and communication-technology services exports. The Bol's gross international reserve keeps exceeding pre-war levels, at about \$220 billion (42% of GDP) as of Sept. 30, 2024. This is a significant buffer.

Table 2

BICRA Israel--Economic imbalances

(%)	--Fiscal year end Dec. 31--						
	2020	2021	2022	2023	2024f	2025f	2026f
Annual change in total private sector debt (% of GDP)	4.4	(0.0)	0.8	(2.3)	4.7	3.2	(0.5)
Annual change in inflation-adjusted housing prices (%)	4.5	10.0	12.5	(5.9)	3.7	4.2	2.5
Current account balance/GDP (%)	4.9	3.9	3.9	4.4	3.6	3.3	3.2

Table 2

**BICRA Israel--Economic imbalances (cont.)**

(%)	--Fiscal year end Dec. 31--						
	2020	2021	2022	2023	2024f	2025f	2026f
Net external debt/GDP (%)	(53.5)	(53.8)	(52.7)	(61.6)	(65.2)	(65.2)	(62.8)

f--Forecast.

**Credit risk in the economy: wealthy economy facing challenges**

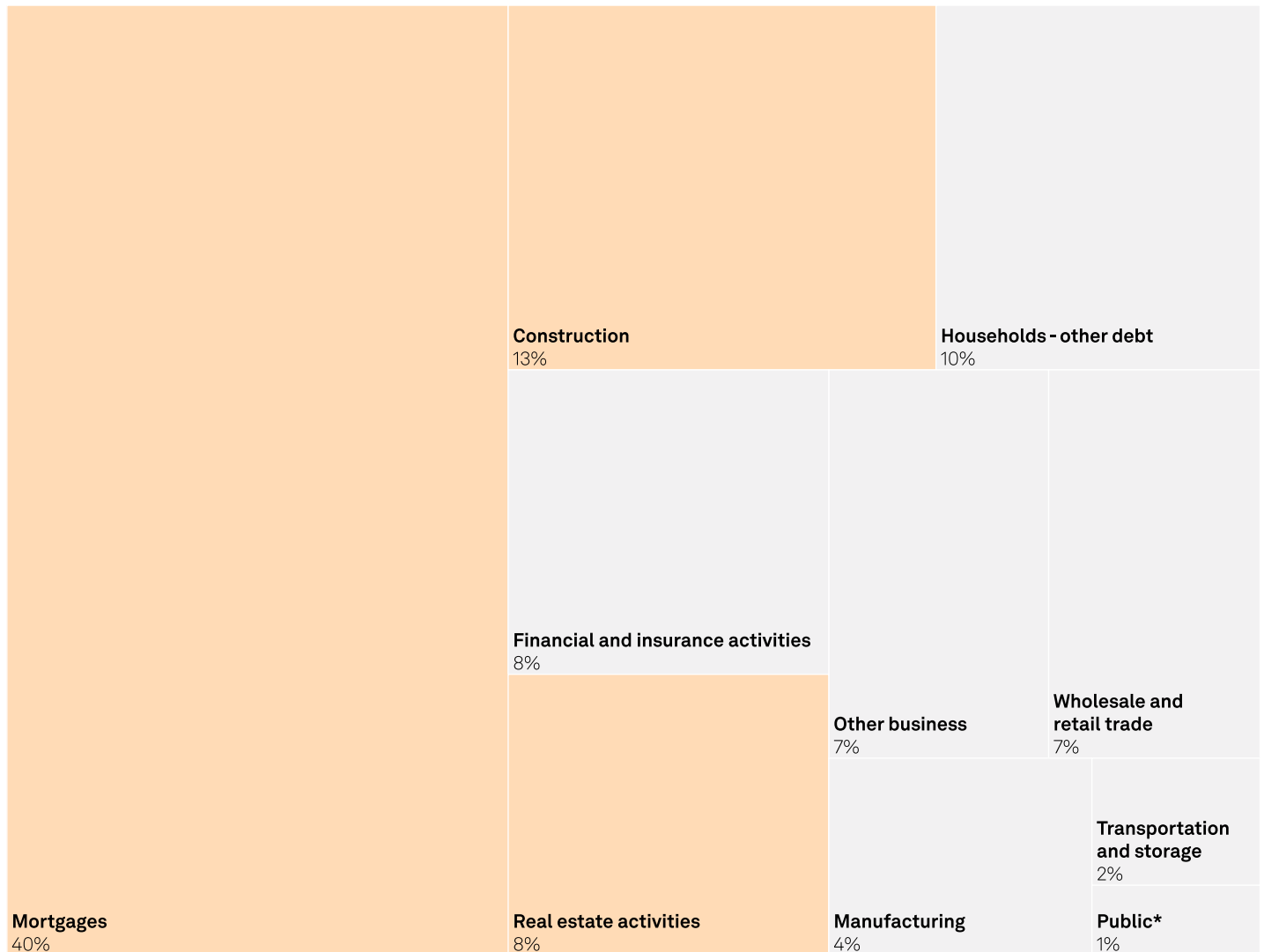
With GDP per capita above \$52,000, we consider Israel a wealthy country. Despite the strong increase in debt following the COVID-19 pandemic, and recent recovery in lending growth, private sector domestic debt (estimated at about 114% of GDP) remains lower than the peer average.

Corporate indebtedness reached about 71% of GDP at year end-2024 according to our estimate (from 67% before the pandemic) and we expect it to stabilize at about that level. Most of the lending expansion has been concentrated in the construction and real estate sector, accounting for about 21% of the total loan book (see chart 3). The majority of projects are in the residential subsegment, thus mitigating some of the risks. In our view, risks are represented by the unseasoned portfolio, the fact that projects originated between 2021-2022 might rely on assumptions that could prove to be challenging amid the weakened macroeconomic conditions, and the cash flow strain associated with higher financing and construction costs.

CHART 3

**Real estate-related lending accounts for most of the banks' books**

Banks' lending breakdown by sector in Israel



\*Public and community services. Source: S&P Global Ratings. Copyright © 2025 by Standard & Poor's Financial Services LLC. All rights reserved.

Offices and shopping malls have so far proved resilient. However, we see a risk of oversupply, particularly in the office sector, due to pressure on valuation from higher interest rates and the potential decline in demand if the economy does not rebound promptly. The high-tech sector, contributing to about 14% of Israel's GDP, has bolstered office demand since the pandemic.

Household debt accounts for about 44% of GDP according to our estimate, less than the European average.

Mortgages account for about 72% of total household debt or about 40% of banks' loans. We think moderate loan-to-value ratios (averaging 53% as of July 2024), conservative underwriting standards, and sustained housing demand due to population growth and limited housing supply somewhat mitigate the risks in this segment. However, strong growth in the real estate sector and prices over the past couple of years, tighter financial conditions, and the economic slowdown

## Banking Industry Country Risk Assessment: Israel

particularly affects lower income households and those that purchased in overvalued areas. Higher security and physical risks are also a downside.

Tight lending standards are in force for mortgages, and we forecast higher credit risk related to unsecured retail loans, although nonbank players are more affected as banks are reducing their appetite for this segment. We estimate substantial household financial assets of more than 300% of GDP at year-end 2024. The large size of these assets mitigates the leverage consideration, although we consider the liquidity of these assets, especially pension investments, to be limited.

We view the payment culture and rule of law in Israel as at least moderately strong. We consider the legal infrastructure as supportive for banks in terms of predictability and timeliness of recovery of collateral in the event of bankruptcy or foreclosure.

Since the war outbreak, Israeli borrowers have benefited from the possibility to change the terms and conditions of some of their loans. According to our estimate, about 1.5% of the total loan book (versus 6.5% as of December 2023) still benefits from this moratorium, but the banks consider a limited 10% of this amount to have financial difficulties.

Table 3

### BICRA Israel--Credit risk in the economy

(%)	--Fiscal year end Dec. 31--						
	2020	2021	2022	2023	2024f	2025f	2026f
GDP per capita (\$)	44,683.6	52,563.8	55,251.0	52,722.0	52,577.6	52,768.6	56,366.0
Total private-sector debt (% of GDP)	112.9	112.9	113.7	111.3	116.1	119.3	118.8
Household debt (% of GDP)	43.2	43.5	43.7	42.0	43.8	44.8	45.6
Household net debt (% of GDP)	(267.6)	(274.2)	(231.6)	(243.7)	(275.8)	(240.6)	(228.9)
Corporate debt (% of GDP)	69.7	69.4	69.9	69.3	72.3	74.5	73.1
Nonperforming assets (% of systemwide loans)	1.6	1.2	0.9	1.2	1.1	1.2	1.4
Loan loss reserves (% of total loans)	1.8	1.3	1.3	1.6	1.5	1.3	1.3

f--Forecast.

### Base-Case Credit Losses: The War And Tight Monetary Conditions Will Continue Weighing On Credit Losses

Despite limited deterioration recorded so far, thanks to supportive measures introduced by the government and high financial flexibility of the large customers, we expect asset quality to weaken over the next 12-24 months. Economic slowdown, low confidence, and past strong growth in real estate related lending will fuel nonperforming loan ratio from a very low 1% as of September 2024 to just below 1.4% as of end 2026. We think retail customers, small and midsize enterprises, and construction and real estate companies with limited financial flexibility are the most vulnerable asset classes.

Consequently, we expect credit losses to remain above the Israeli historical lows seen before the pandemic ..

Table 4

**BICRA Israel--Credit losses**

(%)	--Fiscal year end Dec. 31--						
	2020	2021	2022	2023	2024f	2025f	2026f
Credit losses (% of total loans)	0.7	(0.3)	0.1	0.5	0.2	0.5	0.3

f--Forecast.

**4 Industry Risk**

**Institutional framework: Regulation, supervision, and transparency are in line with international standards**

Israeli banking regulation is aligned with international best practice and banks operate under Basel III capital and liquidity requirements. The regulator closely monitors emerging risks, including cyber risks, and uses active macroprudential measures to contain them--particularly in the housing and construction segments. For example, banks must hold an additional capital buffer on their mortgage and construction portfolios and are subject to concentration limits. As a result, the required total capital ratios for Israeli banks are more conservative than the typical Basel III requirements.

The Israeli banking system has weathered major global and domestic crises. Those include the second intifada of 2000-2005, the bursting of the dot-com bubble in 2001-2003, the 2008 global financial crisis, the COVID-19 pandemic, and more recently, the Israel-Hamas war. The Bol's initiatives have helped to maintain liquidity and credit flows in the banking system, while preserving capitalization.

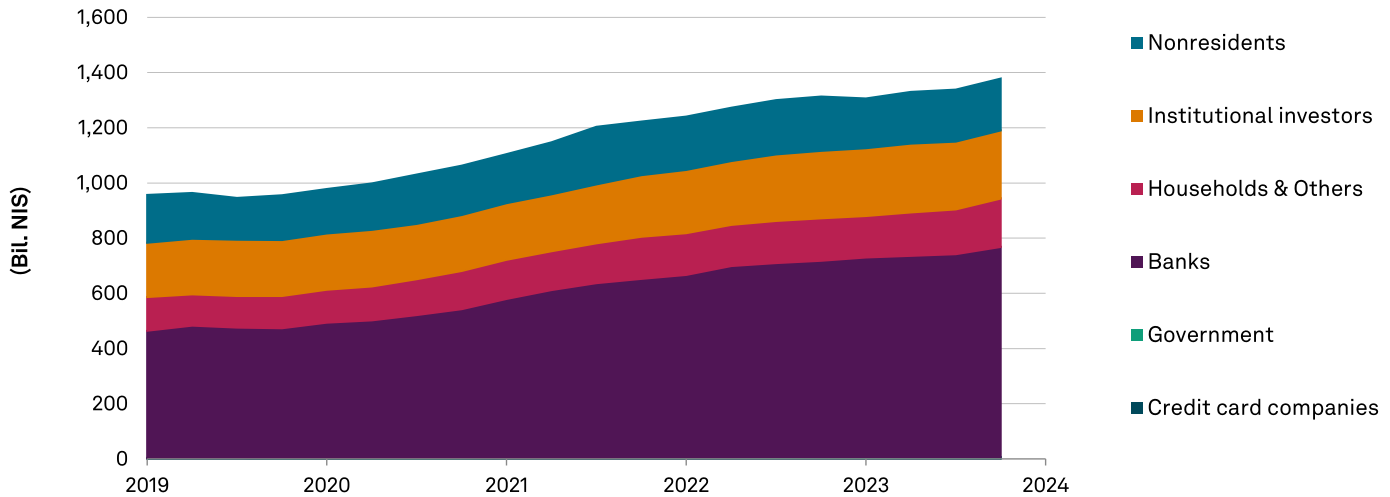
In 2023, the Bol issued a directive adopting the Basel principle aimed at improving climate risk management. The directive, which will take effect in June 2026, is based on 12 principles providing guidelines to banks on corporate governance, internal audit, capital adequacy, liquidity, and risk management, also including scenario analysis.

That said, the Bol does not supervise fast-expanding nonbank lenders, including financial service providers and insurance companies, which are supervised by the Capital Markets and Insurance Authority. Although the various regulatory bodies cooperate, differences in their approaches are sometimes apparent. This creates the potential for the emergence of risks that are not fully supervised (see chart 4).

Chart 4

**Non bank are relevant lender**

Nonfinancial business sector debt by lender



NIS--New Israeli Shekel. Source: Based on Tel Aviv Stock Exchange and reports to the Bank of Israel. Copyright © 2025 by Standard & Poor's Financial Services LLC. All rights reserved.

In our opinion, Israel's banking sector has adequate transparency. Quarterly reporting is extensive, accurate, and transparent. Financial reporting standards are an unusual mix of Israeli, generally accepted U.S. accounting principles, and International Financial Reporting Standards.

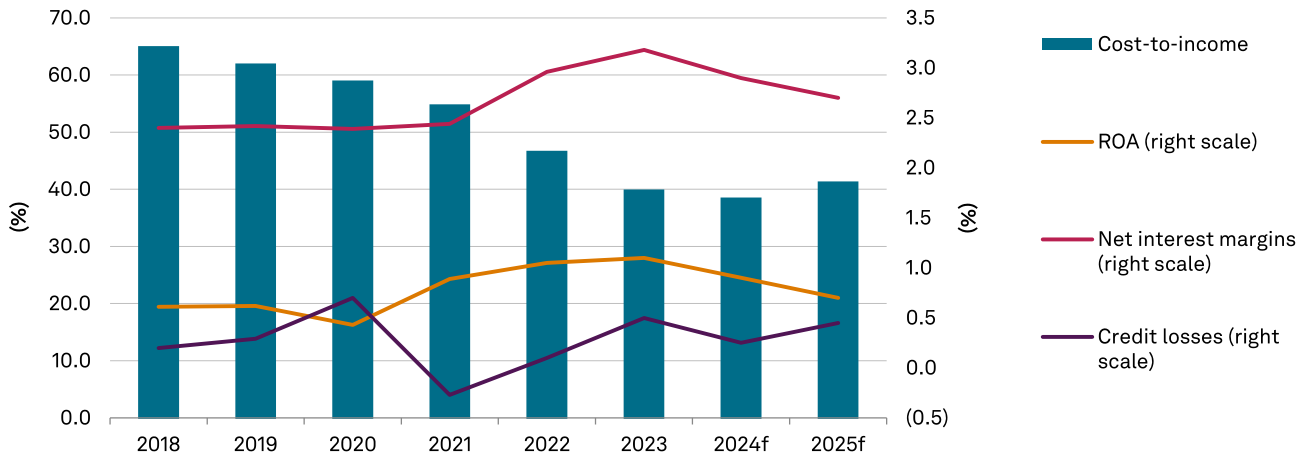
**Competitive dynamics: A traditional and concentrated banking sector**

The Israeli banking industry's resilient profitability and contained cost of risk reflect an adequate risk appetite. Israeli banks engage in simple and traditional banking and do not offer complex or high-risk innovative products. Competition is intense, however, from both bank and non-bank players.

Profitability has benefited from higher interest rates and strong lending expansion after the pandemic, although higher-for-longer interest rates coupled with geopolitical uncertainty weigh on demand. We expect competition and demand for higher return on savings will also continue to squeeze margins. In addition, provisions will be above their historically low levels, which will also strain banks' profitability. At the same time, efforts to reduce costs, particularly at the largest banks, have increased and are contributing to higher profitability. We expect banks to continue focusing on the use of digital channels as part of their efficiency efforts, which should translate into further cost savings and increase their loss-absorption capacity in the medium term. Tax expenses are on the rise amid higher budgetary needs. In 2024 and 2025, Israeli banks will have to pay an extra tax of 6% of their profits generated in the country.

Chart 5

Resilient margins and better efficiency will sustain profitability



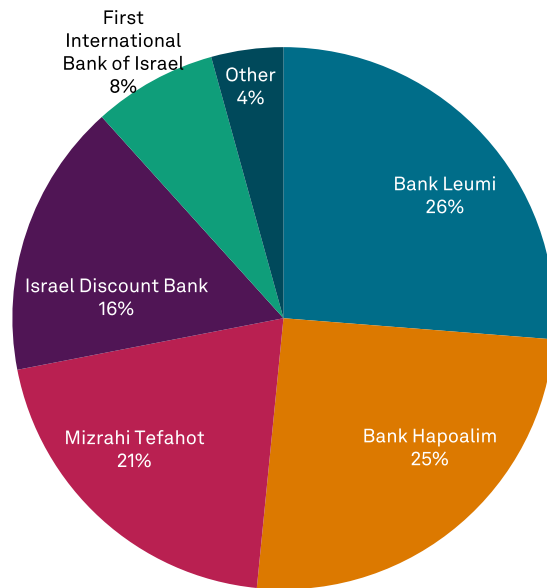
f--Forecast. Source: S&P Global Ratings.  
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The banking system is concentrated and the top-five banking groups represent almost the entire market.

Chart 6

**Israeli banking sector is concentrated**

Loans market share--Data as of September 2024



Source: S&P Global Ratings.  
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Competition is intense in certain plain-vanilla products and in corporate lending from nonbank players and institutional investors, which have expanded fast over the past years.

Fintechs have only a modest presence in Israel and, in general, seem to have little appetite for entering the market due to its limited scale and growth potential. However, we think that local banks are looking for opportunities to collaborate with fintechs that can help them adapt their business models to meet ongoing challenges.

Table 5

**BICRA Israel--Competitive dynamics**

(%)	--Fiscal year end Dec. 31--						
	2020	2021	2022	2023	2024f	2025f	2026f
Return on equity (ROE) of domestic banks (%)	5.9	13.9	15.0	14.5	14.5	10.0	10.4
Systemwide return on average assets (%)	0.4	0.9	1.1	1.1	1.1	0.7	0.7
Net interest income to average earning assets for banking sector (%)	2.4	2.4	3.0	3.2	2.9	2.7	2.5
Net operating income before loan loss provisions to systemwide loans (%)	1.9	1.8	2.5	3.1	3.0	N/A	N/A
Market share of largest three banks (%)	75.8	76.1	75.8	75.1	74.0	74.0	74.0

Table 5

**BICRA Israel--Competitive dynamics (cont.)**

(%)	--Fiscal year end Dec. 31--						
	2020	2021	2022	2023	2024f	2025f	2026f
Annual growth rate of domestic assets of resident financial institutions (%)	17.0	15.7	5.6	5.3	6.8	8.0	10.0

N/A--Not applicable. f--Forecast.

**Systemwide funding: A strong funding base with very low recourse to the international capital market**

Israeli banks' domestic deposit base is solid and benefits from high customer confidence. We expect banks to maintain a balanced funding profile and forecast that domestic loans, as a percentage of domestic core customer deposits, will remain below 130%. This is because they benefit from a loyal retail deposit base that reduces the need to use more expensive funding sources such as long-term debt issuance. That said, depositors' search for the higher yields associated with alternative savings products might weigh on deposit evolution in 2025 at Israeli banks. Interest-bearing deposits increased to 57% of the total compared with a low 34% in 2021.

Israel has an active domestic debt capital market. Private sector debt issued in the domestic market was about 25% of GDP as of Sept. 30, 2024. Bonds are usually oversubscribed and enjoy decent trading volumes in the secondary market.

The Israeli banking sector has very low use of external funding because of the sector's strong deposit base, and its robust and resilient demand from domestic investors. This is beneficial in times of domestic turbulence. The system is a net external creditor, which is unlikely to change in the foreseeable future.

Banks are generally liquid and net placers of funds with the central bank, which is materially above their required minimum. Historically, the banking system has not needed any large liquidity injections or government guarantees. However, should the need arise, the central bank is willing and able to support the industry's funding needs, in our view.

Table 6

**BICRA Israel--Systemwide funding**

(%)	--Fiscal year end Dec. 31--						
	2020	2021	2022	2023	2024f	2025f	2026f
Systemwide domestic loans (% of systemwide domestic core customer deposits)	99.8	101.8	107.6	107.6	110.7	116.7	124.8
Net banking sector external debt (% of systemwide domestic loans)	(7.1)	(7.7)	(9.2)	(10.1)	(8.6)	(8.0)	(7.1)
Outstanding of bonds and CP issued domestically by the resident private sector (% of GDP)	27.3	26.8	23.1	23.7	25.0	N/A	N/A

N/A--Not applicable. f--Forecast.

## Peer BICRA Scores

Table 7

### BICRA Isarel--Peer BICRA scores

	Israel	U.S.	U.K.	Ireland	France	Czech Republic	Spain	Iceland
BICRA group	4	3	3	3	3	3	4	4
Economic risk	4	3	4	3	3	3	4	4
Economic resilience	High	Low	Intermediate	Low	Low	Intermediate	Intermediate	Intermediate
Economic imbalances	Intermediate	Intermediate	Intermediate	Intermediate	Intermediate	Low	Intermediate	Intermediate
Credit risk in the economy	Low	Intermediate	Intermediate	Intermediate	Low	Intermediate	Intermediate	Intermediate
Industry risk	4	3	3	4	4	4	4	5
Institutional framework	Intermediate	Intermediate	Low	Intermediate	Intermediate	Intermediate	Intermediate	Intermediate
Competitive dynamics	High	Intermediate	Intermediate	High	High	Intermediate	High	Intermediate
Systemwide funding	Low	Very low	Low	Low	Low	Intermediate	Low	High

Source: S&P Global Ratings.

## Government Support

We expect the Israeli government to intervene directly in support of systemically important banks, if needed. In general, the government and the Bol have a strong interest in, and ability to, preserve the stability of the banking sector. The Bol's international reserves are healthy (at \$217 billion as of November 2024). At the outbreak of the Israel-Hamas war, the central bank announced a \$30 billion intervention strategy to smooth excessive exchange rate volatility.

## Related Criteria

- Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Financial Institutions Rating Methodology, Dec. 9, 2021
- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Sovereign Rating Methodology, Dec. 18, 2017
- Country Risk Assessment Methodology And Assumptions, Nov. 20, 2013

## **Related Research**

- Banking Industry Country Risk Assessment: December 2024
- Israel, Nov. 12, 2024
- Global Banks Outlook 2025: Cautiously Confident , Nov. 14, 2024
- Various Rating Actions Taken On Israeli Banks On Sovereign Downgrade; All Outlooks Negative, Oct. 9, 2024
- Bulletin: Israel-Hamas Ceasefire Deal Could Face Implementation Risks

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