

## Historically Low Ratings in the Run-Up to 2020 Increases Vulnerability to the COVID-19 Crisis

May 28, 2020



Global annual speculative-grade issuance doubled over the past decade, fueled by low interest rates



Nearly 85% of new corporate ratings originated at Speculative-Grade since 2017, Median rating of new issuers is now 'B'



Prior to the crisis, median ratings were lower than at any point in history across most industries and geographies



1/3 of corporate issuers in the US and 1/4 in Europe are rated 'B' or below, indicating greater vulnerability to changes in economic and financial cycle

The COVID-19 pandemic and its related social distancing measures—coupled with the sharp, sudden oil price decline—have put an abrupt halt to 11 years of global economic growth. As these events continue to play out, market participants and stakeholders have asked us many questions about the effect on ratings for nonfinancial corporate and sovereign borrowers globally and how this compares with prior periods. We have assembled 10 key points to address the most frequently asked questions.

### Key Takeaways

- We entered the global recession with a median credit rating for corporate and sovereign entities globally significantly weaker than at the onset of the global financial crisis ('BBB' versus 'BB+').
- Speculative-grade bond issuance more than doubled in the past decade, as low interest rates fueled demand for speculative-grade corporate debt.
- The median rating for new nonfinancial corporate issuers globally is 'B'; it fell to this historical low at the end of 2017, declining from 'BB-' in 2008.
- Speculative-grade borrowers are now almost twice more likely to be downgraded than their higher-rated peers with double the proportion of Negative Outlooks and Negative CreditWatch Placements.
- As of May 20, 70% of rated entities negatively affected by COVID-19 and a sharp drop in oil prices have been in the speculative-grade category, and almost half in the 'B' category and below, a rating level that indicates greater vulnerability to changes in economic and business cycles.

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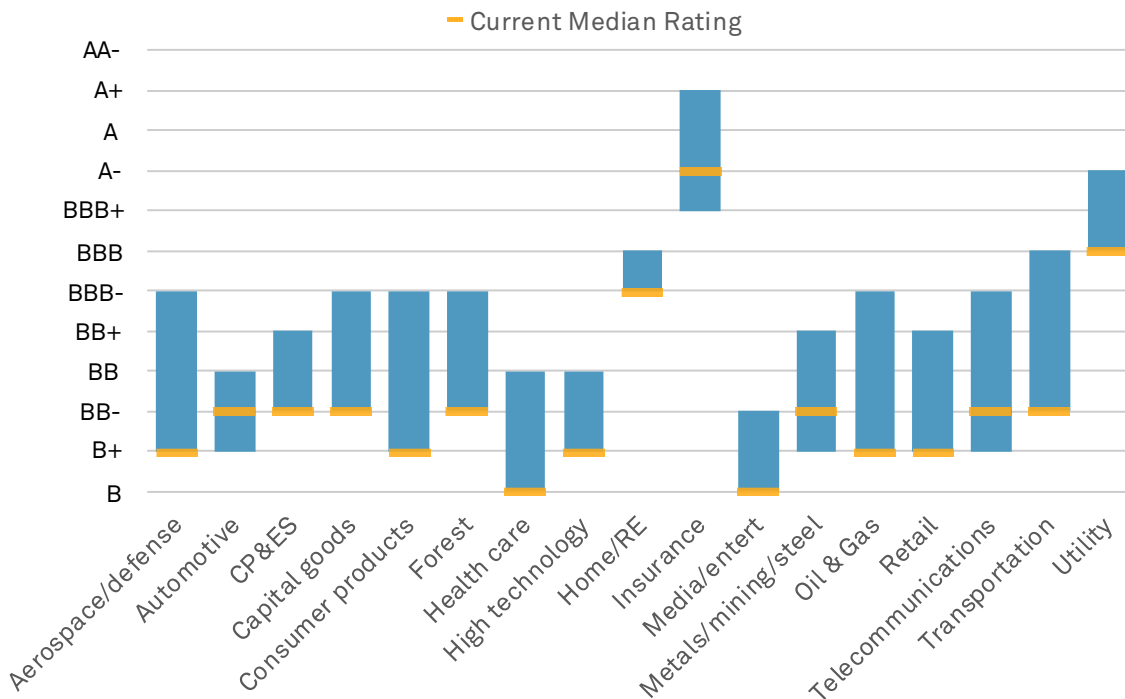
S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: [www.spglobal.com/ratings](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates accordingly.

**1. Median corporate ratings are at their lowest in the past 20 years for nearly all sectors, reflecting more aggressive financial policies, structural changes, and business transformation, such as evolving consumer preferences and regulations. This was the case prior to the current crisis.**

- The median ratings for the majority of sectors are at the lowest levels in two decades, though there is some divergence across industries.
- Aerospace and defense, insurance, and metals and mining (excluding thermal coal) saw ratings deteriorate more generally, but not at extreme lows compared with other periods in the past two decades.
- Other sectors saw structural deterioration, like changing consumer preferences for online sales hurting retailers. The automotive sector has been exposed to slower global demand and continues to bear a high cost of compliance for new environmental regulatory frameworks, as well as R&D expenditures for changing consumer preference for higher-fuel-economy vehicles and lower demand for vehicles in general. Others, like the media and entertainment, lodging, and transportation sectors, saw an abrupt drop in demand due to social distancing measures (see chart 1).

Chart 1

**Global median ratings are at the lowest levels seen in the past two decades for the majority of nonfinancial sectors**



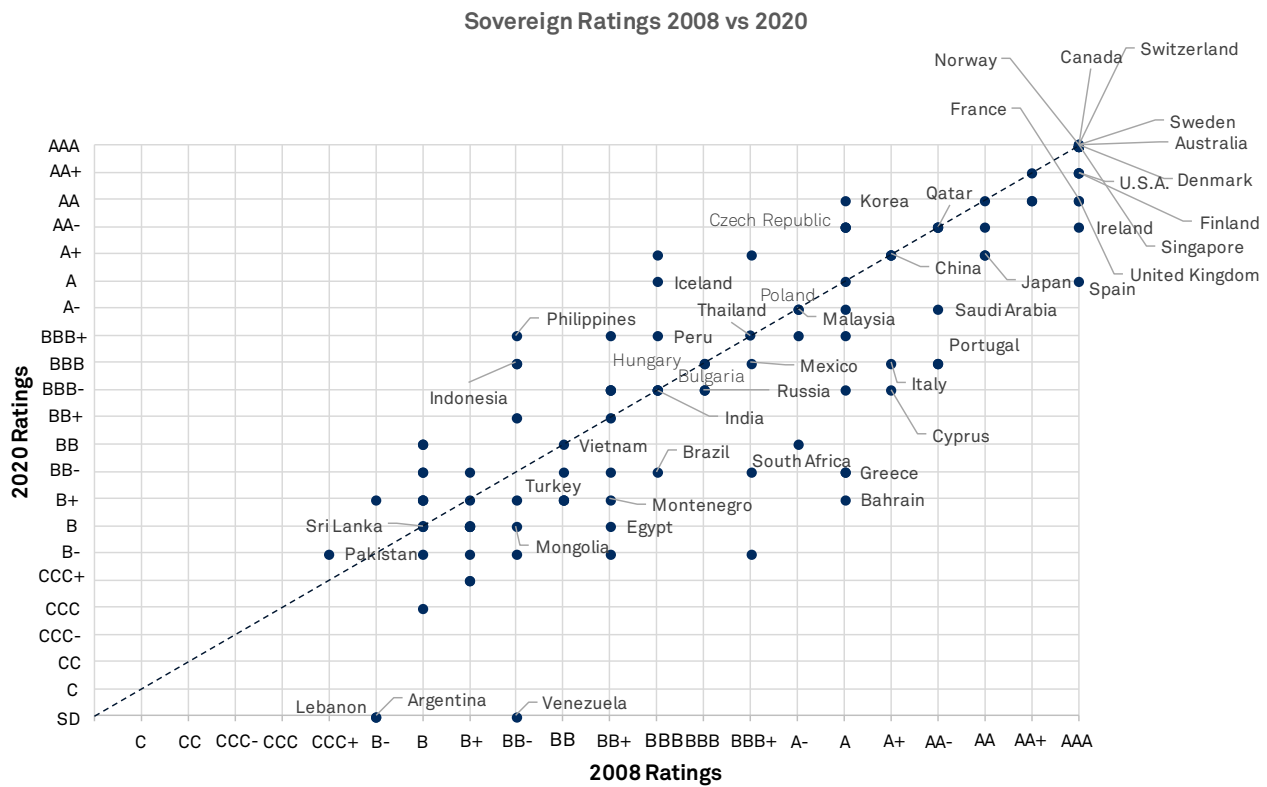
Source: S&P Global Ratings Research. Data as of April 30, 2020. Ranges computed from 2000-2020.

## 2. Many sovereign ratings deteriorated from 2008 to 2020, with a few exceptions in Asia and Eastern Europe.

- Many sovereign ratings were lowered in the aftermath of the global financial crisis and the European debt crisis, with Italy, Greece, Spain, and Portugal facing the most severe downgrades, and the U.K. affected more recently by Brexit.
- There have been a few bright spots though. China rapidly becoming more important to the global economy and the country changing its growth model led to growth opportunities for many of its trading partners in Asia, including Thailand, Philippines, and Indonesia. Others like Poland, with a large domestic market and a variety of economic and policy reforms, grew its economy steadily for years, improving its creditworthiness in the process. Korea and Peru saw significant boosts in their sovereign creditworthiness (see chart 2).
- On the other hand, many sovereigns faced default, including Argentina, Lebanon, and Venezuela.

Chart 2

**Many Asian, Eastern European, and Nordic countries have seen rising sovereign ratings since the global financial crisis, whereas the majority of developed economies saw deterioration**



Source: S&P Global Ratings

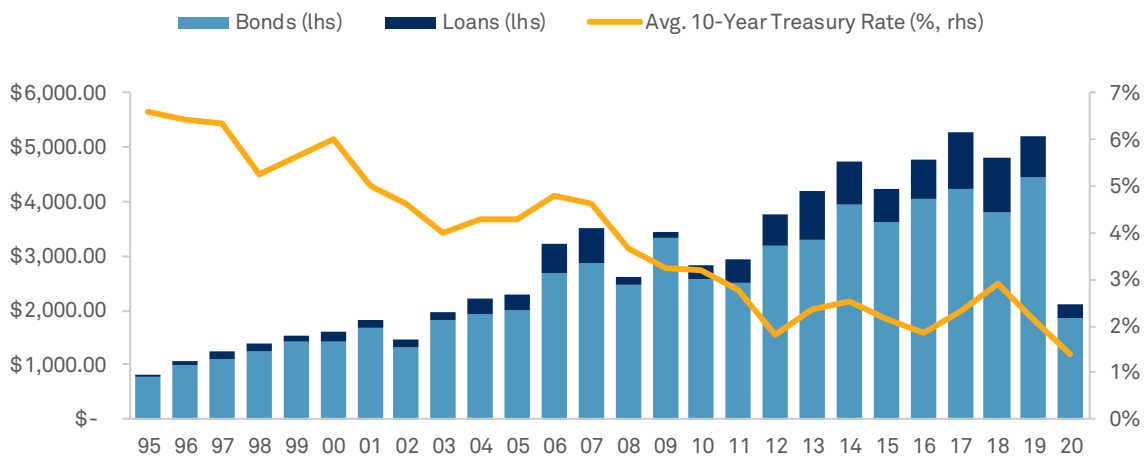
### 3. Global corporate issuance increased more than 50% in the past decade, while speculative-grade issuance doubled, fueled by investors' search for yields in a low interest rate environment.

- A decade of accommodative monetary conditions, with low interest rates and abundant liquidity, fueled smaller and more highly leveraged companies to tap capital markets and take on more aggressive financial policies. Global annual issuance (including bonds and loans) increased over 50% in the past decade, from \$3.4 trillion in December 2009 to \$5.2 trillion by the end of 2019 (see chart 3).
- Spec-grade issuance accounted for just 5% of total bond issuance in 1995, compared with a peak of 15% in 2013 and an average of 11% over the last decade (2009–2019). This reflects both investors' risk appetite in a lower-for-longer interest rate environment and the size of speculative-grade investment appetite from many players like private equity and hedge funds. Annual global speculative-grade bond issuance doubled during the global financial crisis, from \$211 billion by the end of 2009 to \$444 billion at the end of 2019 (see chart 4).
- By the end of 2019, exposure to loans from 'B-' rated obligors reached a record, constituting nearly 19% of U.S. broadly syndicated loan CLO transaction collateral pools. This reflects the trends playing out in the overall U.S. corporate loan market more broadly. The increase in loans from 'B-' obligors has drawn the market's attention, as ratings on these companies can be volatile. Even in relatively benign credit environments, about 10% of 'B-' issuers were downgraded, on average, every year between 2000 and 2020 (as of Mar. 31). During periods of economic stress, credit deterioration among 'B-' issuers can be particularly severe: In the last credit downturn, more than 40% were downgraded in a given year, some of which defaulted. (For more information, see "The Expansion Of The 'B-' Segment Is Feeding Growing Vulnerabilities," Sept. 25, 2019.)

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Chart 3

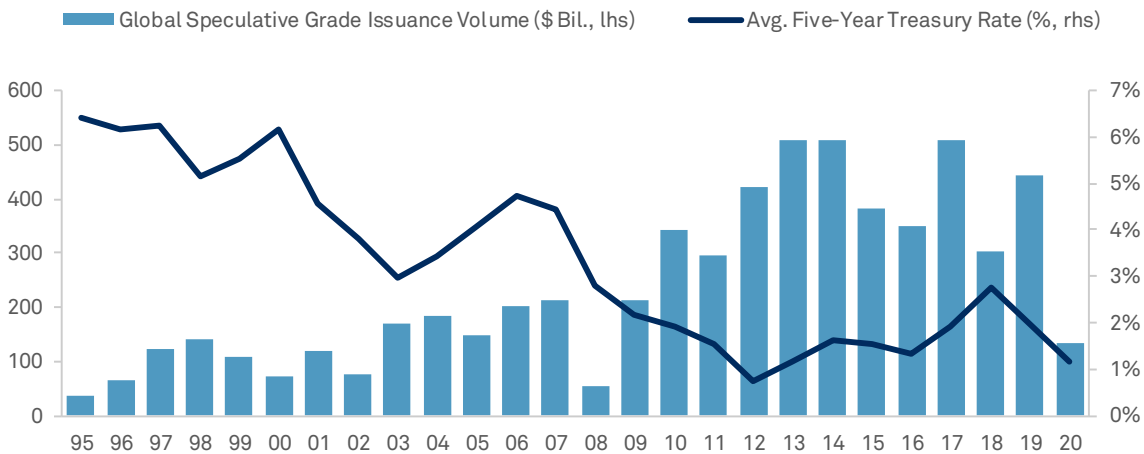
Total corporate bond and loan issuance soared as 10-year rates declined to historical lows



Source: Data as of April 30, 2020. Source: S&P Global Ratings; Thomson Financial; S&P Global Markets Intelligence Leveraged Commentary and Data (LCD); Federal Reserve Bank of St. Louis.

Chart 4

Speculative-grade volumes nearly doubled on low five-year rate—the typical tenor of speculative-grade issuance



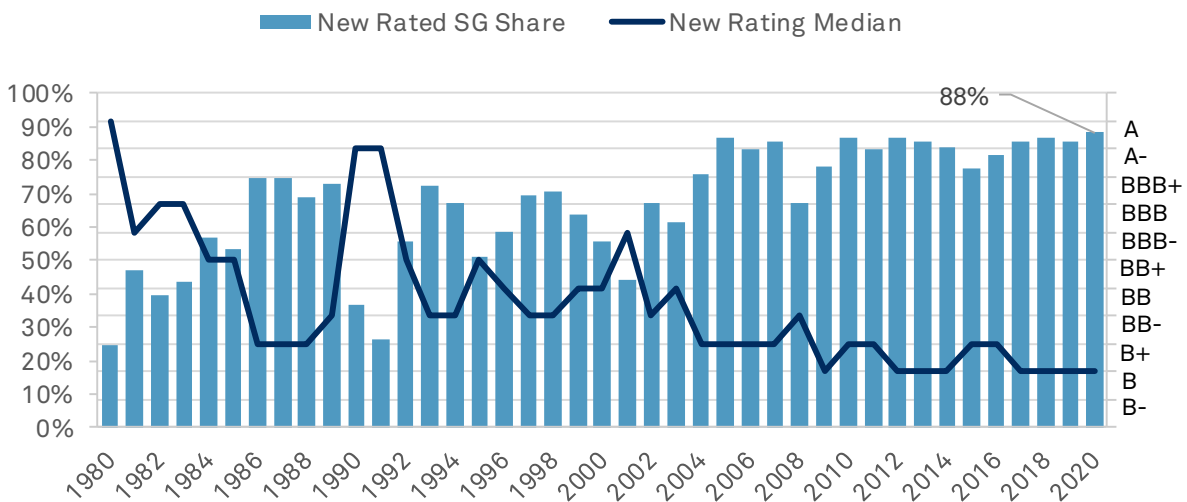
Source: S&P Global Ratings

#### 4. More aggressive financial policies and higher leverage drove the median rating on new issuer ratings down to 'B'.

- New nonfinancial corporate borrowers saw lower ratings, commensurate with their more aggressive financial policies and higher leverage, in a context where supply of money for investments exceeded demand, stimulating higher risk taking. This led to the median new ratings shrinking from 'BB-' in 2008 to 'B' by the beginning of this year.
- While downgrades did occur in the same period, newly rated speculative-grade nonfinancial corporate issuers accounted for 78% of the speculative-grade market by 2020, up from just 50% in 2008.
- Among the nonfinancial new issuers that came to market in 2020 (as of March 31), 88% of them received a speculative-grade rating, compared with 67% in 2008, and 44% were 'B-' or below, compared with 31% last year.
- Together, these trends laid the groundwork for a riskier mix of issuers in the credit markets, which are traditionally more susceptible to downgrades or, especially for the weakest issuers ('B-' or below), even defaults.

Chart 5

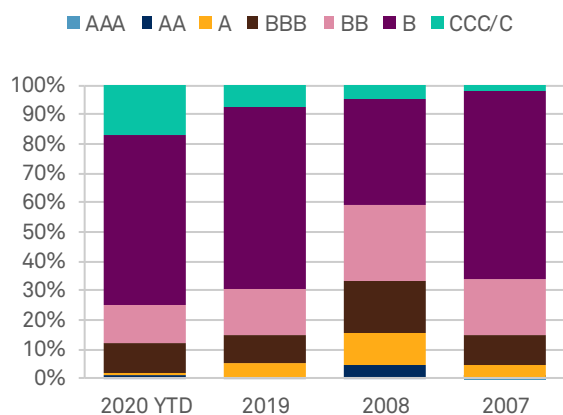
#### New nonfinancial corporate ratings are predominantly speculative grade, with a declining median rating



Data as of March 31, 2020. Source: S&P Global Ratings; S&P Global Market Intelligence's CreditPro®.

Chart 6

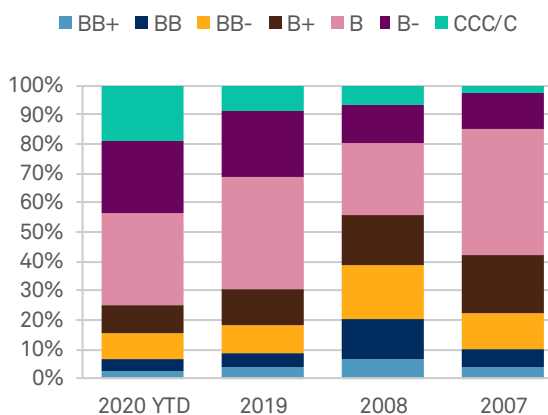
**Newly issued speculative-grade issuers grew exponentially by 2020...**



Source: S&P Global Ratings

Chart 7

**... especially in the rating levels of 'B' and below**



Source: S&P Global Ratings

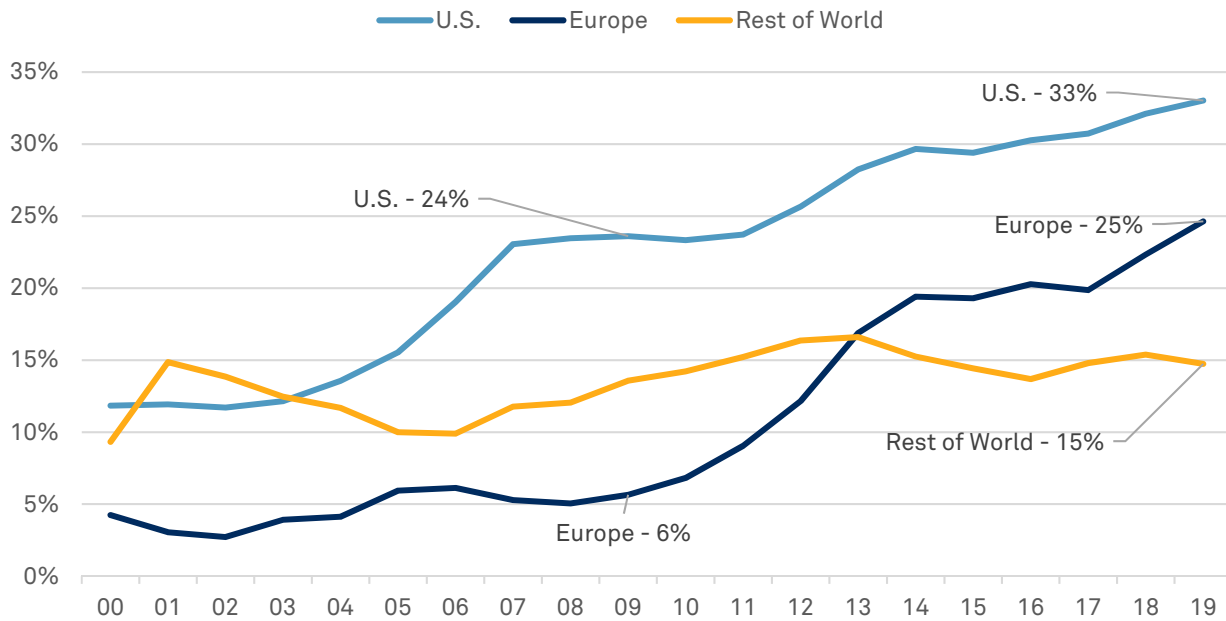
**5. The share of riskier credits rated 'B' and below has risen considerably since the global financial crisis, indicating higher susceptibility to economic and credit shocks, as per our criteria.**

- The global ratings distribution shifted toward speculative-grade dominance after the global financial crisis, with low interest rates fueling demand for riskier assets. Particularly in the U.S. and Europe, there were marked increases in 'B' and lower issuers as a share of the total rated population, rising from 24% to 33% in the U.S. and from 6% to 25% in Europe between 2008 and 2019. The rest of the world, on the other hand, remained range-bound, with about 15% of the rated portfolio at these riskier rating levels. This reflects, in part, the lack of market appetite for more risky corporate bond assets in emerging markets in favor of other funding sources, like bank loans or equity financing.
- During the global financial crisis, only strong, fairly well-capitalized new issuers were able to gain investor confidence and manage both a relatively higher cost of debt as well as market volatility. That is partially why we saw more investment-grade new issuers come to market, rather than more vulnerable issuers at the lower end of the speculative-grade spectrum (notably those 'B-' and below), which came after market dislocations abated. However, both 'BB' and 'B' credit saw a marked shift in appetite five years ago, which continued into the beginning of 2020 before COVID-19 and the compounding crush of low oil prices nearly instantly dissolved any appetite for riskier new issuance.
- Financial institutions are generally resilient now, owing to many structural reforms following the global financial crisis that resulted in better capitalization by many banks, especially in the U.S. and Europe. The bulk of financial institutions are now rated in the 'A' category. Emerging market financial institutions, however, continued to face pressure from sovereign deterioration, with an increasing number rated in the 'BBB' category, driving some financial institutions to potentially become fallen angels during the current crisis.

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Chart 8

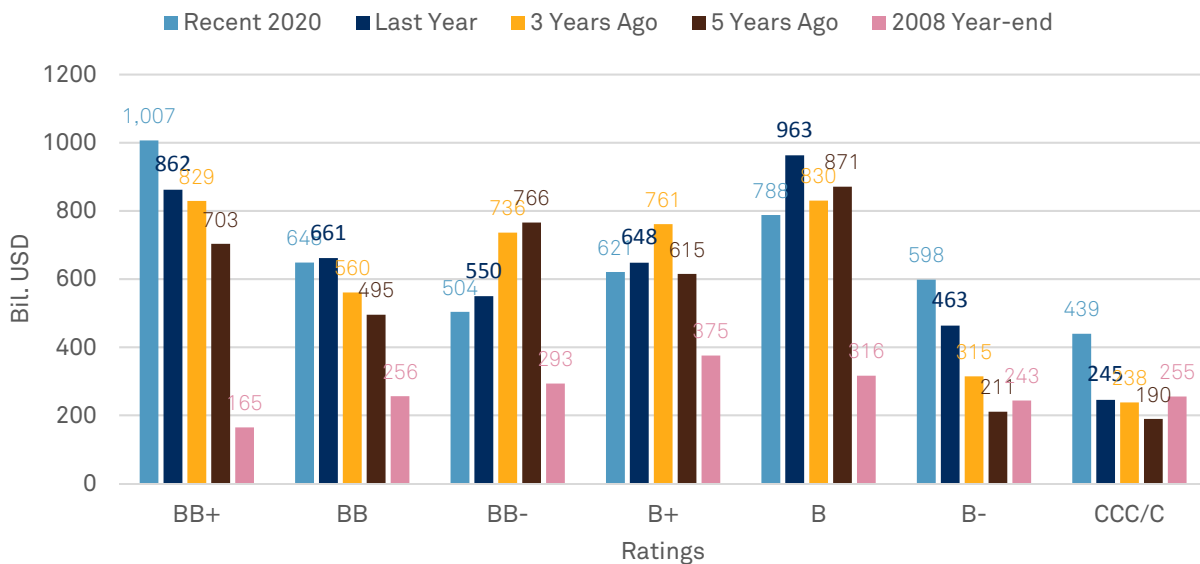
The share of 'B' and lower ratings for non-financial corporates markedly increased in both the U.S. and Europe over the last decade; the rest of the world, especially emerging markets, remains range-bound



Source: S&P Global Ratings Data as of April 30, 2020, and includes both non-confidential and confidential for total debt volume

Chart 9

Strong risk appetite from investors gave way to rising 'B' and lower rated debt issuance

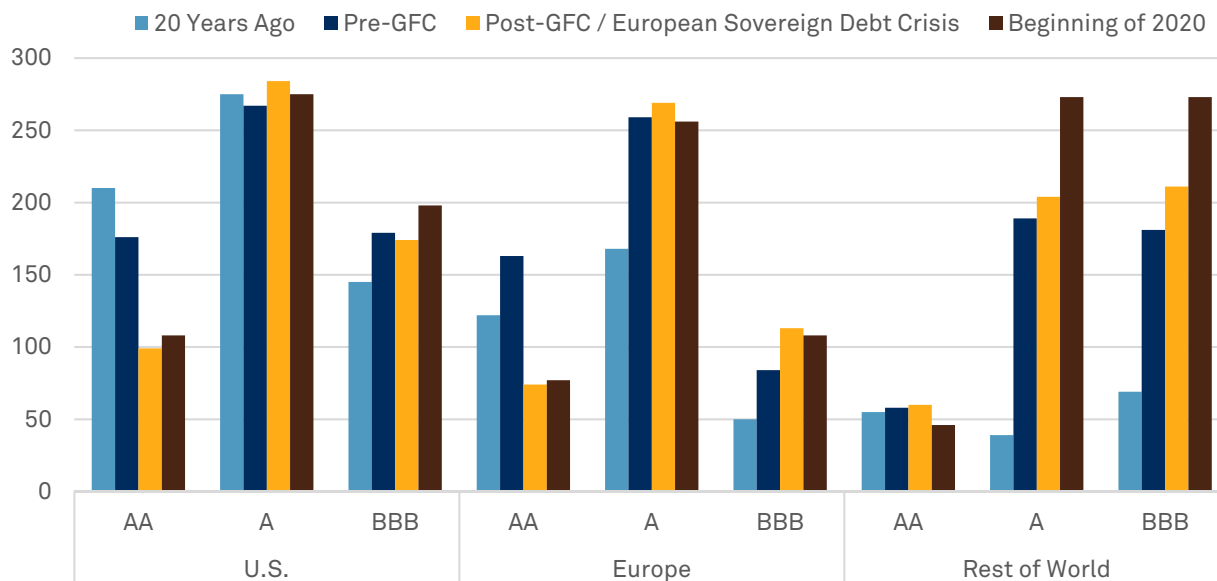


Source: S&P Global Ratings. Data as of April 30, 2020, and includes both non-confidential and confidential for total debt volume.



Chart 10

**Ratings on financial institutions were generally resilient after the global financial crisis due to crisis-driven structural reforms, yielding better bank capitalization**



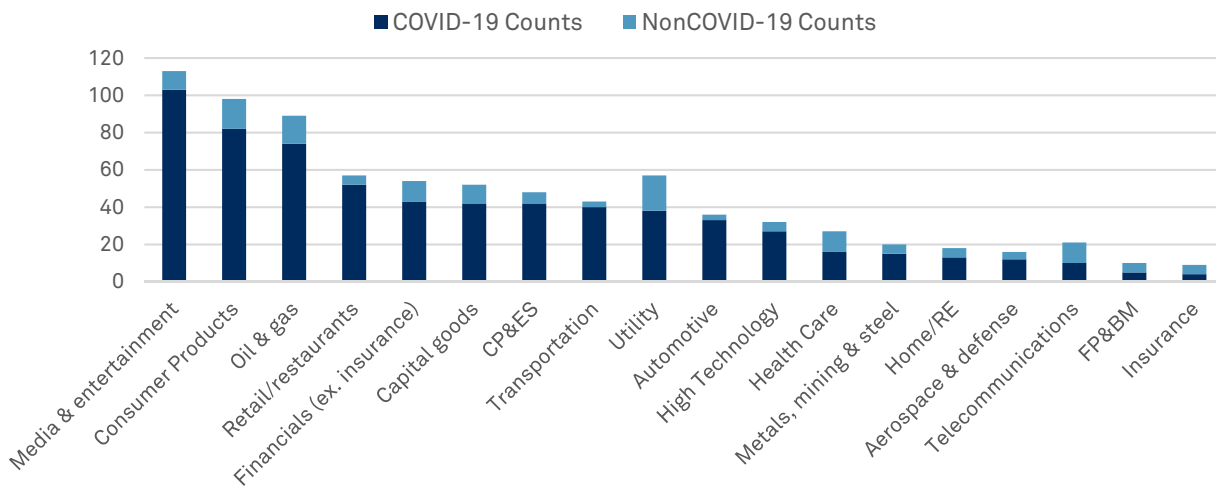
Source: S&P Global Ratings; S&P Global Market Intelligence CreditPro®. Data as of April 30, 2020

**6. About 20% of nonfinancial corporate ratings have been lowered so far in 2020 (as of May 20) as a result of the severe impact of the COVID-19-led global recession or the sharp drop in oil prices.**

- The COVID-19 pandemic prompted countries around the globe to shut down borders and engage in strict social distancing policies to minimize the health and human costs of the virus. This led to an abrupt shutdown of demand for many activities in the retail, leisure, and service sectors; the closing of borders (restricting travel); and a subsequent decline in demand for industrial production (curbing energy demand).
- Extended coronavirus-containment measures are pushing the world into the deepest recession since the Great Depression. Although we expect the drop in economic activity to be sharp in Q2 and followed by a very gradual recovery through 2021, the timing and trajectory of the recovery remain very uncertain, until an effective treatment or vaccine is in place.
- Further, a Saudi-Russian oil-price war compounded the demand-driven slowdown with a supply-driven effect, exacerbating the negative economic effects of COVID-19. Together, these forced a decline in credit quality (through downgrades) as revenues in many industries stopped with unprecedented speed, against an already vulnerable backdrop due to the development of the lower-rated portfolio of credit markets.

Chart 11

**Sectors with greatest exposure to COVID-19 and oil price impact show the highest downgrade tallies so far in 2020**

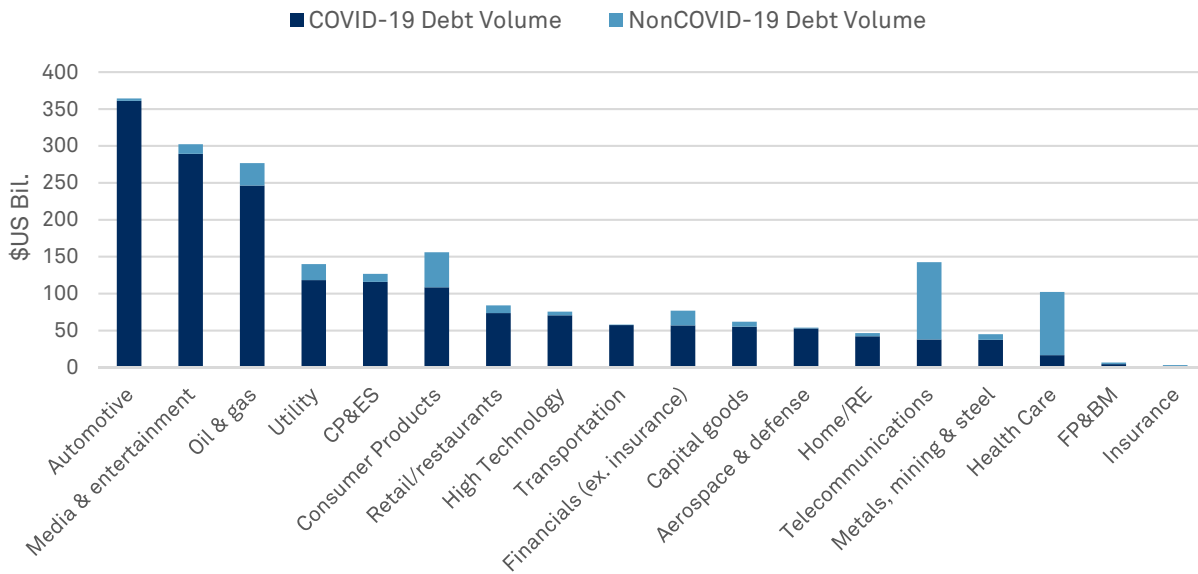


Source: S&P Global Ratings. Data as of May 20, 2020

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Chart 12

Large sectors with high vulnerability to weak economic prospects, like automotive, have a significant volume of downgraded debt

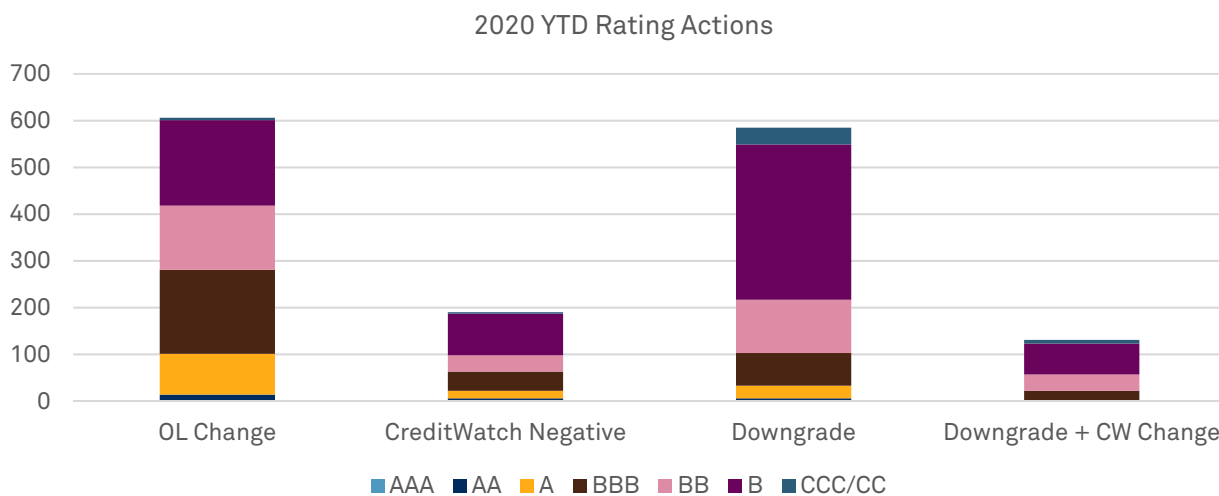


Source: S&P Global Ratings. Data as of May 20, 2020.

- While the majority of sectors were affected, as measured by downgrade activity, there was some differentiation across sectors. Sectors such as automotive, capital goods, media, entertainment, leisure, transportation, retail, energy, and chemicals are most affected, while others, like building suppliers, online retailers, and supermarkets, saw a boost in demand.
- The automotive sector faced the highest volume of downgraded debt, including names like Ford and Renault. Media and entertainment and oil and gas experienced the compounding effect of both numerous downgrades of smaller issuers as well as fewer downgrades of larger issuers, impacting a sizable amount of downgraded debt in aggregate (see chart 13).

Chart 13

Downgrades and negative outlook revisions dominate rating actions in 2020, particularly among speculative-grade issuers, which account for nearly three-quarters of negative actions for nonfinancial corporate entities



Source: Source: S&P Global Ratings. Data as of May 20, 2020.

## 7. Historical ratings performance shows that lower-rated issuers face faster credit deterioration and substantially higher default risks than their higher-rated counterparts, in line with our rating definitions.

- Prior to the current crisis, both issuers downgraded to lower ratings levels and new low-rated entities were vulnerable to deterioration when economic and credit shocks occurred, as per our rating definitions.
- To date, nearly 85% of downgrades affected companies that were rated speculative grade before the crisis. More specifically, 60% of downgrades were companies rated in the 'B' category or below prior to the crisis. This is in line with our rating definitions and historical performance, according to which lower ratings are typically commensurate with more frequent rating transitions and higher default rates. We've observed that 'B' issuers, the median for new issuers today, have a median one-year default rate of 3.4%, compared with 0.07% for the 'BBB' category (1981-2019)--the median rating two decades ago. The historical one-year default rate spikes further to 6.8% for nonfinancial issuers rated 'B-' and about 28% for 'CCC'/C' category issuers.
- Lower-rated entities are also typically less stable than their higher-rated counterparts, which can be measured using stability rates--effectively the absence of ratings transitions through upgrades and downgrades. For example, the stability rate of issuers (the absence of upgrades or downgrades) rated 'BBB-' globally stood at 72.4% over one year from 1981-2019, on average, compared with a one-year stability rate of just 53.6% for 'B-' during the same period.
- With this backdrop, we can expect default rates to rise considerably by the end of the year, reaching 11% in the U.S. and 8% in Europe in our base case, owing to a harsh economic landscape, pressured revenues, and liquidity concerns for many issuers vulnerable to stoppage in business operations due to social distancing as well as a sharp drop in oil prices.

Table 1

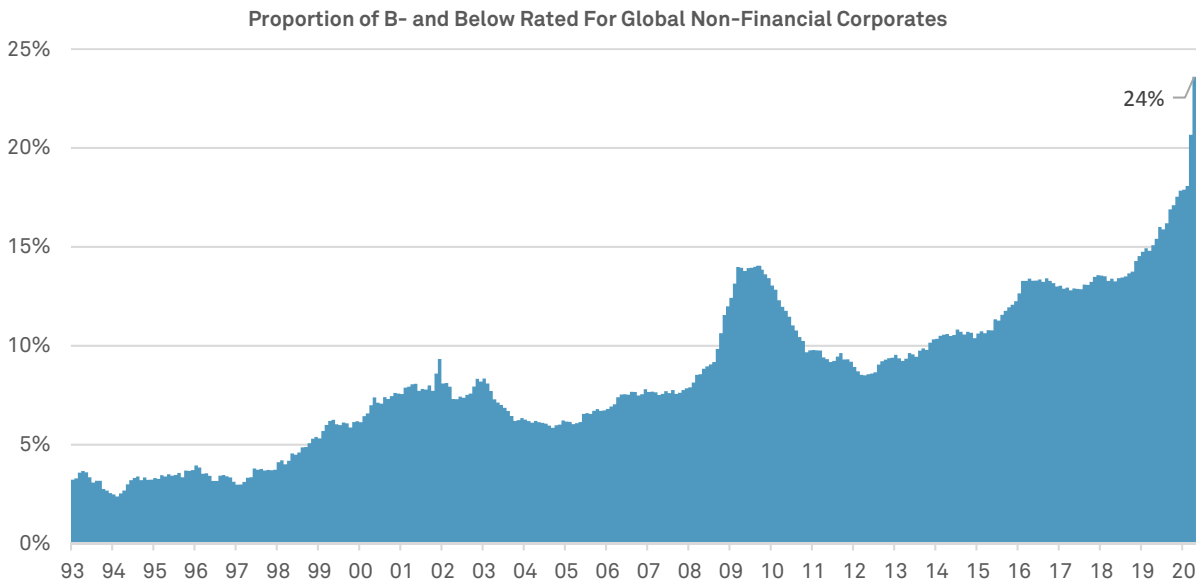
### Global nonfinancial cumulative default rates rise considerably for lower-rated issuers, with survivorship decreasing over time

Rating	Time horizon									
	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
<b>BB+</b>	0.18	0.93	1.74	2.58	3.48	4.33	5.02	5.59	6.29	6.97
<b>BB</b>	0.51	1.53	3.14	4.76	6.32	7.55	8.72	9.69	10.59	11.41
<b>BB-</b>	0.94	2.99	5.21	7.48	9.53	11.47	13.12	14.72	16.01	17.09
<b>B+</b>	1.98	5.49	8.95	11.95	14.29	16.10	17.81	19.32	20.69	21.93
<b>B</b>	3.28	7.69	11.60	14.72	17.21	19.35	20.85	21.85	22.78	23.76
<b>B-</b>	6.83	14.17	19.92	23.78	26.52	28.65	30.24	31.43	32.24	32.89
<b>CCC/C</b>	28.42	38.64	43.71	46.54	48.78	49.74	50.96	51.64	52.36	52.97
<b>CCC+</b>	20.94	31.83	37.86	41.53	44.45	45.67	46.92	47.74	48.41	48.90
<b>CCC</b>	28.36	38.86	43.82	46.08	47.96	48.93	50.10	50.92	52.08	53.16
<b>CCC-</b>	43.80	51.53	53.71	56.06	57.92	58.35	60.10	60.10	60.10	60.10
<b>CC</b>	60.09	66.89	69.65	69.65	69.65	69.65	70.18	70.18	70.18	70.18
<b>C</b>	64.29	85.71	92.86	100.00	n/a	n/a	n/a	n/a	n/a	n/a
<b>Investment Grade</b>	0.08	0.21	0.37	0.59	0.83	1.09	1.32	1.55	1.78	2.00
<b>Speculative Grade</b>	3.79	7.40	10.54	13.09	15.19	16.88	18.31	19.50	20.56	21.52
<b>All Rated</b>	1.90	3.72	5.30	6.62	7.72	8.63	9.40	10.05	10.63	11.16

Source: S&amp;P Global Ratings Research; S&amp;P Global Market Intelligence's CreditPro®. Data as of March 31, 2020

Chart 14

**Global nonfinancial corporate issuers rated 'B-' and below as a proportion of the total rose exponentially over the decade, signaling amplified default risk**



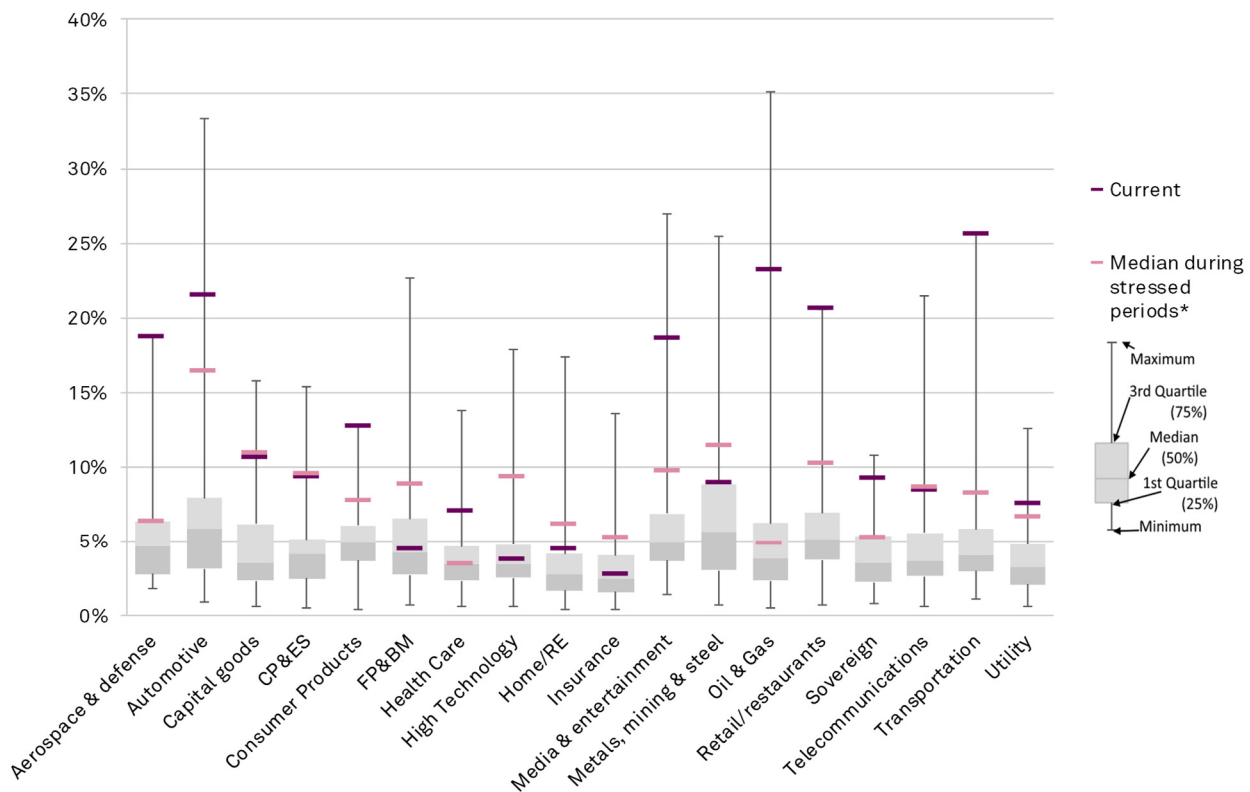
Source: S&P Global Ratings

**8. The pace and severity of the current economic contraction, combined with the collapse in oil prices, pushed the downgrade ratios in first-quarter 2020 to 25-year highs for the majority of sectors.**

- Globally, quarterly downgrade ratios quickly accelerated in first-quarter 2020 to near the highest levels in the past 25 years for 11 out of 17 sectors, surpassing those during prior stressed periods like the 1998 Asia currency crisis, the 2001 recession, and the global financial crisis. These sectors include global automotive, media and entertainment, lodging, retail, and consumer sectors.
- In the current stress, a large number of borrowers suffered a direct hit to revenues as the economy effectively ground to a halt. However, high technology, and forest products and building materials (often supplying essential construction services) remain closer to historical medians.
- Aerospace and defense, oil and gas, midstream and energy, and transportation were heavily hit, owing to both lockdowns and a halt in travel and the compounding oil-price collapse.

Chart 15

**In many sectors, the current downgrade rate eclipses that seen in prior stressed periods**



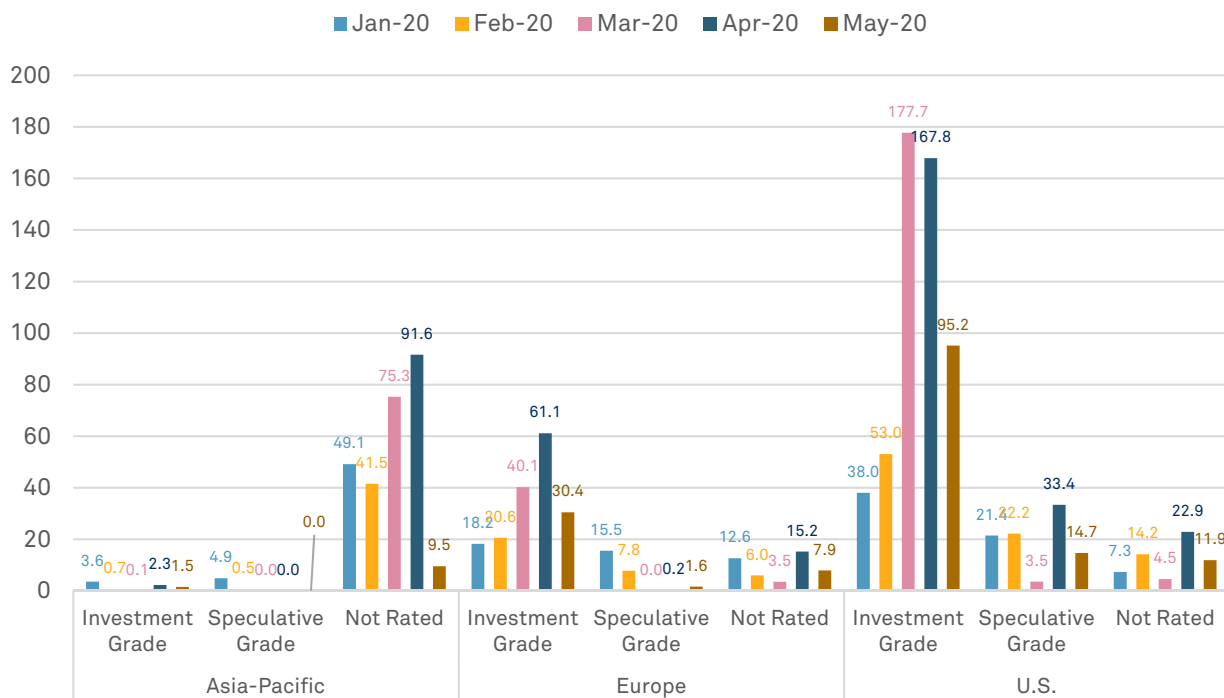
Source: S&P Global Ratings Research. Data as of March 31, 2020. Ranges computed from 1994-2020.

**9. Central banks' and governments' rapid and sizable support programs helped reduce capital costs for many borrowers, but speculative-grade issuers continue to see wider spreads.**

- Various programs by central banks globally led the reopening of credit markets through lower interest rates, quantitative easing programs, liquidity injections, and asset purchases. But, the effect has varied across geographies and credit grades. Investment-grade nonfinancial credit markets have generally opened up in response to the actions by central banks on a global basis. On the other hand, speculative-grade credit has been, up until now, limited to the U.S. market (in a meaningful capacity).
- Further, the cost of capital, measured by average yields to maturity, has risen considerably for those speculative-grade issuers able to issue new debt. This means that investors command a significant premium for the perceived risk they're taking on, which invariably is elevated given revenue and cash flow strains on many nonfinancial corporations.

Chart 16

**After COVID-19 severely disrupted on economies in Europe and the U.S. in March, the speculative-grade markets effectively shut off; investment grade has returned with force, but speculative grade still sees little risk appetite**

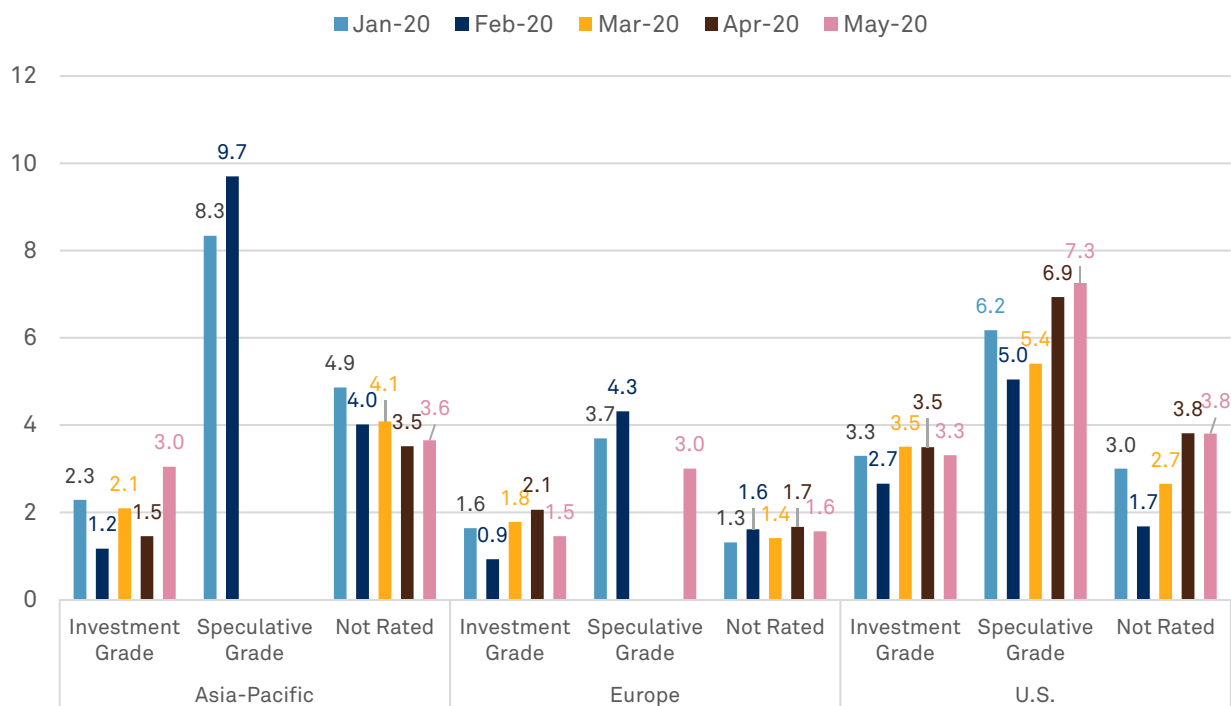


Source S&P Global Ratings; Thomson Financial. Data as of May 13, 2020.

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Chart 17

For issuers able to come to market, speculative-grade issuers must pay a premium, while investment grade has generally returned to pre-crisis primary yields to maturity



Source: S&P Global Ratings; Thomson Financial. Data as of May 13, 2020.

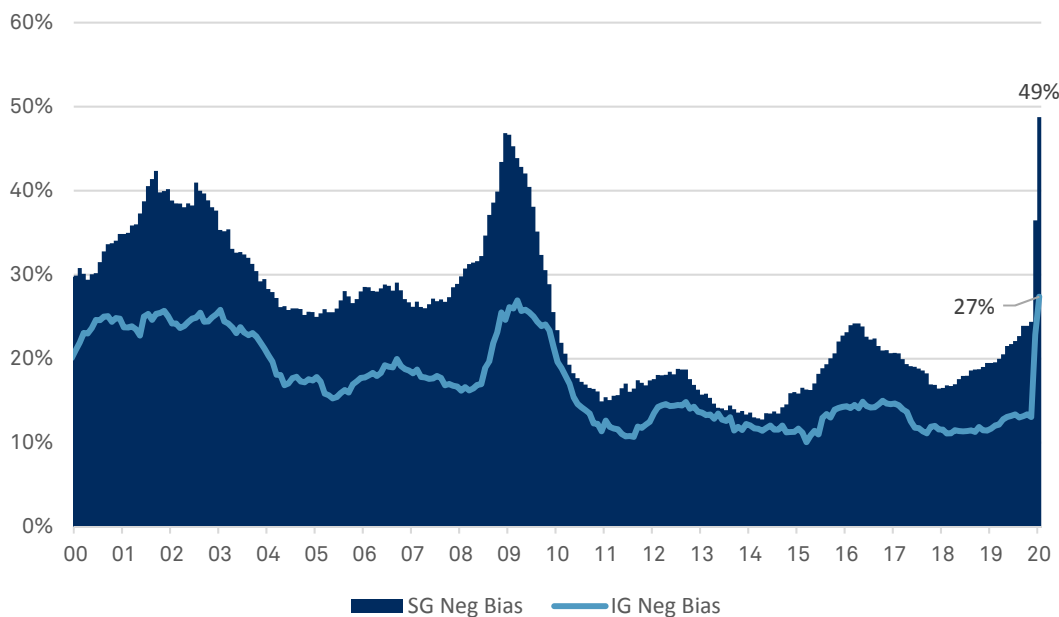


**10. Nearly half of nonfinancial corporations rated speculative grade and one-third rated investment grade globally have a negative outlooks and CreditWatches with negative implications, indicating a possible rating downgrade in the months ahead.**

- S&P Global Ratings uses negative outlooks and CreditWatch with negative implications to help investors anticipate the sectors and entities most exposed to further rating changes.
- We expect the drop in economic activity to be sharp, and the timing and trajectory for recovery uncertain. We now see global GDP falling 2.4% this year, with the U.S. and eurozone contracting 5.2% and 7.3%, respectively. We expect global growth to rebound to 5.9% in 2021. The balance of risks remains on the downside, since much uncertainty weighs on our baseline path on the health, economy, and policy fronts--which will likely leave further credit deterioration in its wake. As such, nearly half of nonfinancial corporations globally with ratings in the speculative-grade category may see deterioration (based on 38% with negative outlooks and 10% with ratings on CreditWatch negative), compared with less than one-third of their investment-grade counterparts (based on 22% with negative outlooks and 4% with ratings on CreditWatch negative) (see chart 15).
- We will also likely continue to see sector differentiation as industries' exposure to social distancing measures varies significantly. Sectors such as media and entertainment, lodging, gaming, and others hurt by social distancing will likely see revenue pressures, leading, in some cases, to financial distress and possibly default in the near term. Nearly 26% of the speculative-grade portfolio is so-called weakest links ('B-' or lower rated issuers with negative outlooks or ratings on CreditWatch negative), which typically default at a rate of 50% during times of stress. Additionally, many sovereigns and corporations have increased their debt loads in response to the crisis, to finance fiscal stimulus (sovereign) and refinance revolvers and bridge loan facilities (corporates). Thus, the vulnerability that increased in the last decade, with debt-fueled growth, may continue over the next several years, reflecting the cost of the economic damage caused by COVID-19, oil prices, and resultant market dislocations.

Chart 18

**Nearly half of speculative-grade issuers and one-third of investment-grade issuers are now poised for downgrades, and over one-quarter of speculative-grade issuers face significant default risk in the next year**



Source: S&P Global Ratings

Table 2

Travel-related (transportation), automotive, energy, consumer-facing (retail and restaurants, media and entertainment, and consumer products), and transportation sectors have amplified downgrade potential

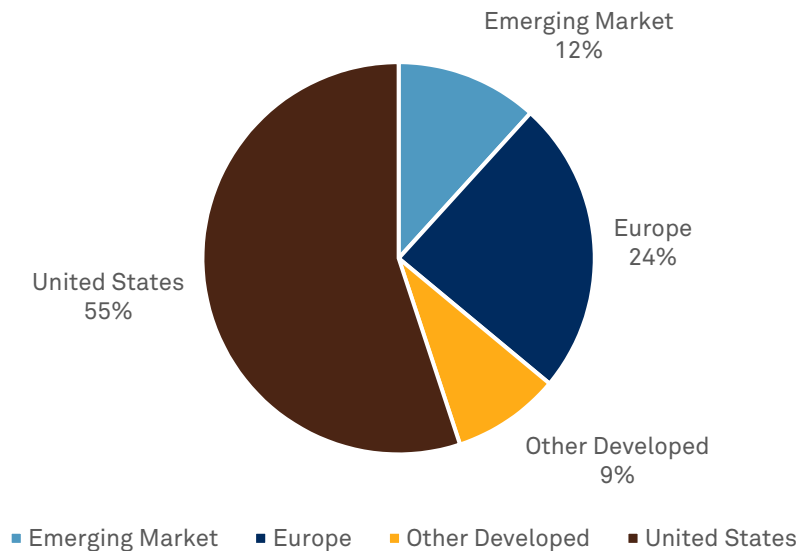
Negative Bias	Current			Historical		
	Apr. 30 2020	Beginning of 2020	% change since Jan. 1, 2020	10 Year Average	GFC* Average	Energy Crisis Average
<b>Aerospace and Defense</b>	42	24	73%	16	12	16
<b>Automotive</b>	78	34	131%	14	54	8
<b>Capital Goods</b>	41	21	93%	16	26	15
<b>Chemicals / Packaging</b>	41	19	111%	14	28	13
<b>Consumer Products</b>	45	24	83%	17	36	15
<b>Financial Institutions</b>	28	15	90%	25	29	30
<b>Forest Products / Building Materials</b>	34	14	143%	14	52	11
<b>Health Care</b>	37	23	64%	13	18	13
<b>High Technology</b>	22	11	99%	12	27	12
<b>Homebuilders / Real Estate</b>	24	12	93%	12	30	10
<b>Insurance</b>	15	8	79%	12	23	10
<b>Media and Entertainment</b>	62	25	152%	19	44	15
<b>Metals and Mining</b>	28	17	63%	23	32	32
<b>Oil and Gas</b>	69	29	137%	25	21	31
<b>Retail and Restaurants</b>	56	28	101%	19	32	16
<b>Telecommunications</b>	22	23	-5%	15	18	14
<b>Transportation</b>	50	6	807%	17	35	14
<b>Utility</b>	28	16	77%	16	23	17

Source: S&P Global Ratings Research Data as of April 30, 2020. \*GFC refers to Global Financial Crisis

# Appendix

Chart 19

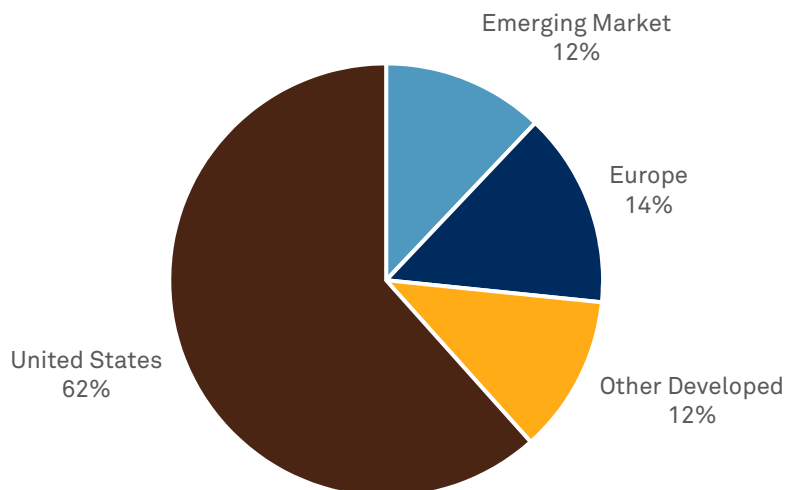
April 2020 regional rating distribution for nonfinancials



Source: S&P Global Ratings

Chart 20

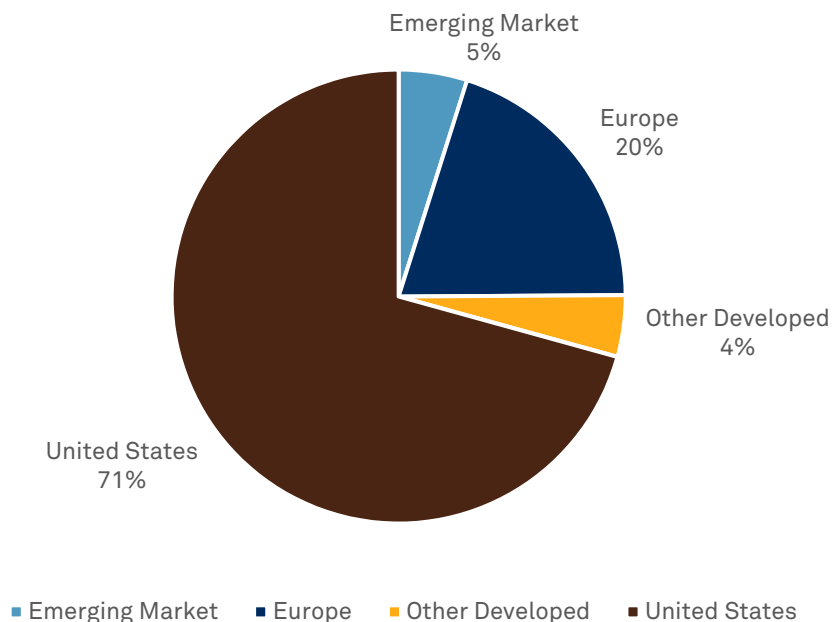
Global financial crisis (year-end 2008) regional rating distribution for nonfinancials



Source: S&P Global Ratings

Chart 21

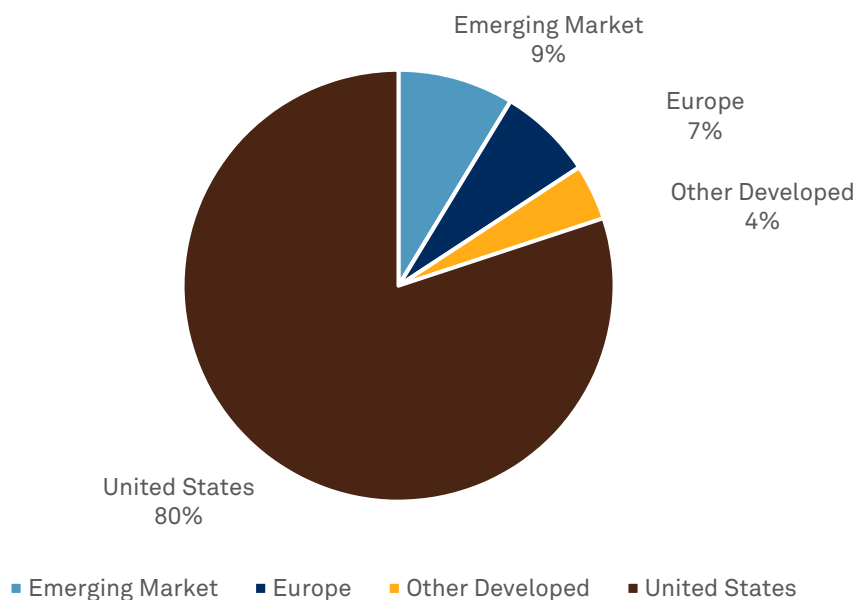
April 2020 regional rating distribution for nonfinancials rated 'B-' and below



Source: S&P Global Ratings

Chart 22

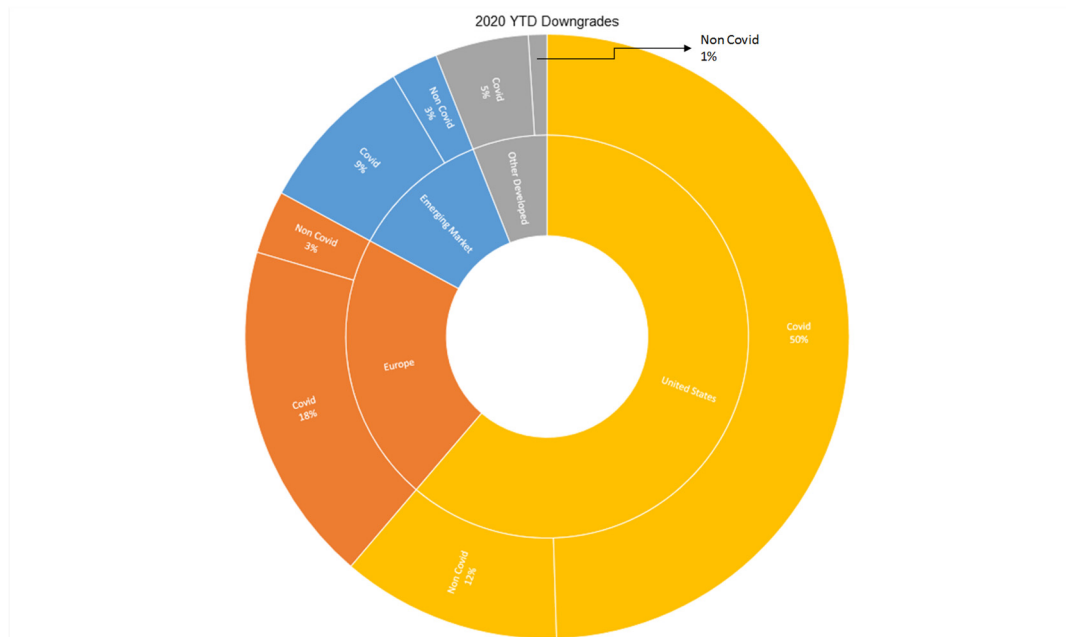
Global financial crisis (2008) regional rating distribution for nonfinancials rated 'B-' and below



Source: S&P Global Ratings

Chart 23

2020 YTD (as of April 30) downgrades by region



Source: S&P Global Ratings

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