

Environmental, Social, And Governance Evaluation

Algonquin Power & Utilities Corp.

Summary

Algonquin Power & Utilities Corp. (APUC) is a diversified generation, transmission, and distribution utility with assets in the U.S., Canada, Chile, and Bermuda. APUC organizes operations into two units. The Regulated Services Group primarily owns and operates electric, natural gas, and waste and wastewater regulated utility systems throughout the U.S., Canada, Chile, and Bermuda, serving approximately one million customer connections. The Renewable Energy Group generates and sells electrical energy produced by its portfolio of renewable power generation and clean power generation facilities primarily in the U.S. and Canada. APUC's electricity generation capacity in 2019 consisted of natural gas (51%), wind (37%), solar (8%), and hydroelectric (4%) with a combined gross generating capacity of approximately 3.0 GW. APUC generates about \$1.6 billion in revenue (85% distribution and 15% generation) and has \$11 billion in asset book value.

APUC's ESG Evaluation of 79 reflects a deep commitment to sustainability, a robust governance structure, and strong preparedness for disruptions from the energy transition. The environmental profile of 75 reflects APUC's comprehensive plan to expand its renewables footprint leading to better than industry average GHG emissions and lower waste generation. APUC's social profile of 63 benefits from above-average customer engagement and proactive safety management. Governance standards in Canada are high, bolstering APUC's governance profile of 74, which also reflects its improving transparency and reporting framework and clear code of conduct.

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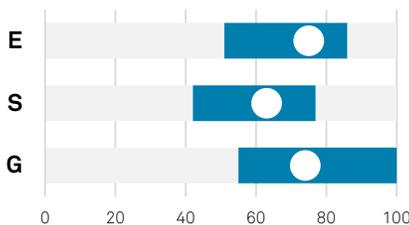
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ESG Profile Score

71 / 100



Company-specific attainable and actual scores

Preparedness Opinion (Scoring Impact)

Strong (+ 8)

ESG Evaluation



A higher score indicates better sustainability

Component Scores

Environmental Profile			Social Profile			Governance Profile		
Sector/Region Score	36/50		Sector/Region Score	27/50		Sector/Region Score	35/35	
 Greenhouse gas emissions	Strong		 Workforce and diversity	Good		 Structure and oversight	Good	
 Waste and pollution	Strong		 Safety management	Strong		 Code and values	Good	
 Water use	Good		 Customer engagement	Strong		 Transparency and reporting	Good	
 Land use and biodiversity	Strong		 Communities	Good		 Financial and operational risks	Neutral	
 General factors (optional)	None		 General factors (optional)	None		 General factors (optional)	None	
Entity-Specific Score	39/50		Entity-Specific Score	36/50		Entity-Specific Score	39/65	
E-Profile (30%)	75/100		S-Profile (30%)	63/100		G-Profile (40%)	74/100	

ESG Profile (including any adjustments)

71/100

This figure is subject to rounding

Preparedness Summary

APUC's strong preparedness reflects its successful decarbonization strategy, including the expansion of its renewable footprint through acquisitions. Its senior leadership anticipated the energy transition ahead of some U.S. peers, which enabled the company to take advantage of strategic opportunities to acquire new renewable assets. We believe APUC continues to demonstrate excellent awareness of disruptive trends, including climate change, technology risk, and changing customer demands, effectively prioritizes the materiality of risks, and has a resilient strategy linked to sustainability objectives.

Capabilities

Awareness	Excellent
Assessment	Good
Action plan	Excellent

Embeddedness

Culture	Good
Decision-making	Good

Preparedness Opinion (Scoring Impact)

Strong (+ 8)

ESG Evaluation

79/100

Environmental Profile

75/100

Sector/Region Score (36/50)

APUC operates in the electric grid (50% of revenue), gas utility (25%), power generation (15%), and water utility (10%) sectors. The most material environmental risk for these sectors is the low-carbon energy transition, given tightening environmental regulations globally. The physical impacts of climate change, including extreme weather events, can also have material effects. In addition, the sectors are exposed to waste from construction and impacts to land and biodiversity from distribution and transmission corridors expansion and gas networks.

Entity-Specific Score (39/50)

				
Greenhouse gas emissions	Waste and pollution	Water use	Land use and biodiversity	General factors
Strong	Strong	Good	Strong	None

APUC is more advanced than global peers in the energy transition based on its lower-than-average GHG emissions profile and ambitious renewable expansion plans. APUC has a target to grow its renewable generation to 75% of total generation by 2023, which we view as aggressive but achievable given its current mix already includes 52% of renewables generation and it has 1,600 MW of incremental renewable capacity under construction. Furthermore, in 2019 the company retired its final coal-fired generation plant, earlier than anticipated, reducing its GHG emissions by approximately one million metric tons of CO₂e from 2017 levels. These actions have resulted in Scope 1 and 2 GHG intensity that falls below the sector median and we anticipate this performance will continue given its renewable growth strategy. Offsetting these strengths are APUC's fugitive methane emissions, which are above the average of its peer group, but we expect emissions will continue to decline (following a 23% decline in 2019) from its investments in replacing cast iron and unprotected steel mains at a rate of at least 6.5% per year. APUC is also exploring opportunities for renewable natural gas and green hydrogen, which is more advanced than many peers, but remains in early stages.

APUC has demonstrated measurable improvement in waste generation with air emissions levels that are lower than the industry average (including -20% SO₂ and -15% NO_x). The company also demonstrates strong coal ash and solid waste management practices including an annual coal ash ponds integrity assessment, fugitive dust mitigation plan, and a comprehensive strategy for recycling solid waste associated with construction.

APUC's approach to land management is more advanced than peers, given proactive steps to protect species and wildlife as it grows its renewables footprint. APUC employs Integrated Vegetation Management practices, which go beyond regulatory requirements and the company leverages its geographic scope, with operations spanning across 12 states to boost the health of pollinators. As of 2019, APUC had 25 acres of land dedicated toward pollinating species.

APUC's water consumption is lower than the sector median although its water recycling rate still lags many global peers. We expect the company's renewable transition strategy will help reduce water dependency, but APUC doesn't have a comprehensive water management policy or target. However, APUC is committed to deploying new technologies to reduce demand of freshwater resources. For example, it operates two aquifer projects in Arizona that should help replenish the declining water table in the area.

Social Profile

63/100

Sector/Region Score (27/50)

The most material social risks for the utility and power generation sectors involve maintaining reliable, affordable, and accessible networks for customers. Safety is generally well managed, but low probability, high impact events can be material. Strikes from largely unionized workforces, aging talent, and skills shortages related to the energy transition also pose risks to the sector. We adjust the score for social standards risk in the U.S.

Entity-Specific Score (36/50)



Workforce and diversity

Good



Safety management

Strong



Customer engagement

Strong



Communities

Good



General factors

None

APUC maintains reliable and affordable networks, with a track record of 100% distribution reliability and customer bills below other utilities within the states they operate in. APUC is investing about \$1 billion in infrastructure technology over the next five years, including behind-the-meter storage, microgrids, batteries, and smart meters, which we expect will help it achieve a lower cost and higher quality of service for its customers. Due to its renewable expansion strategy, the company is expected to generate customer savings of \$300 million over 30 years. APUC recently rolled out its Customer First Initiative, a multi-year project to improve the customer experience through enhanced online functionality and service capabilities. We believe these initiatives will help the company maintain its strong customer service rankings.

APUC demonstrates a safety track record well above peers. The company conducts regular safety training for all staff, including contractors, and in 2019 completed development of a new Safety and Training Center which enhanced its real-world training for employees. In our view, these initiatives have proven effective given the company's recordable incident is below the sector median and down significantly from 2018 levels. We believe safety metrics will continue to improve toward the company's zero-injury target as APUC expands its renewable footprint (given renewables generally have safer working conditions than fossil-fuel based generation) and continues to enhance its safety training programs.

APUC's inclusion and talent management efforts have translated into a well-diversified workforce, but investment in training still lags peers. APUC has cultivated a diverse workforce by gender and age group. Women comprise 32% of total employees and management, which is well above peers. However, while training and employee integration are key focus areas, average training hours and training spend per employee lag the industry average. We will continue to evaluate APUC's track record of successfully upskilling and integrating a diverse employee base across its operations as it continues to expand its renewables footprint through acquisitions.

APUC's relations with local communities are generally positive given its effective planning mechanisms to minimize infrastructure disruptions. APUC evaluates design plans for new renewable infrastructure up-front and consults with line owners, landowners, and local community members to avoid infrastructure disruptions and mitigate future upgrade and maintenance plans. Whenever infrastructure buildout is unavoidable, APUC engages directly with asset owners to set the limit of impact which we view as standard industry practice.

Governance Profile

74/100

Sector/Region Score (35/35)

We base the governance profile sector/region score on APUC's headquarters in Canada, which we believe has relatively high governance standards characterized by a stable political system, strong rule of law, and respect for human rights.

Entity-Specific Score (39/65)

				
Structure and oversight	Code and values	Transparency and reporting	Financial and operational risks	General factors
Good	Good	Good	Neutral	None

APUC's board composition features strong gender and experience diversity, but independence among members is lower than regional peers. Strong characteristics of its nine-person board structure include split chairman and CEO roles, a high level of engagement (approximately 99% average meeting attendance in 2019), and solid gender diversity (33% women). It also has a well-diversified skill mix, with most members having utility expertise and others with significant acquisition experience, which we believe support overseeing APUC's strategic priorities. However, currently four out of nine directors, including the chair, are not considered independent because of long tenures (18-23 years). One of these directors will retire this year and a second one next year, given the company's board retirement policy, which we believe will enhance board independence and structure in the near term.

APUC has a well-defined and embedded set of values across its operations and value chain, although risk and compliance mechanisms are still under development. Its values framework highlights environmental and social responsibility, together with diversity and safety. Governance policies outlined in APUC's code of conduct are in line with many publicly listed companies, addressing anti-corruption, bribery, whistleblowing. Similar to other companies in the region, the company provides an annual Code of Business Conduct and Ethics training to all employees and has a separate Supplier Code of Conduct, indicating a good level of commitment to applying its code and values across its value chain. APUC is still updating its compliance framework, which we believe is key to building a robust code and values framework. As part of this effort, APUC appointed new members to its Compliance and Risk Office and also launched a new compliance policies page on its website in 2019. In our opinion, executive compensation is balanced with about 40% fixed and 60% share-based and ESG-related metrics (safety, employee engagement, sustainability plan targets, and customer satisfaction) are included in variable compensation. These features ensure executives prioritize these ESG objectives and have a vested interest in the company's long-term performance.

APUC's disclosure and reporting practices have improved but are similar to other publicly traded companies in Canada. APUC made substantial improvements in its sustainability reporting practices in 2020. It published its second sustainability report, which integrated elements of the Global Report Initiative (GRI) and Sustainability Accounting Standards Board (SASB) frameworks as well as a separate TCFD disclosure report, which included comprehensive climate-related scenario analysis. However, APUC's track record of sustainability reporting still remains relatively short compared with peers with more comprehensive disclosure practices, which in our view inhibits historical analysis on material performance indicators.

Preparedness Opinion

Strong
(+ 8)

Preparedness	Low	Emerging	Adequate	Strong	Best in class
Awareness	Developing	Good		Excellent	
Assessment	Developing	Good		Excellent	
Action	Developing	Good		Excellent	
Culture	Developing	Good		Excellent	
Decision-making	Developing	Good		Excellent	

Summary

APUC’s strong preparedness reflects a strategy rooted in sustainability, involving the transition to an expansion of renewable generation from thermal power, largely through acquisitions, with a goal to be 75% renewable over the next few years. Its senior management has anticipated secular trends in the industry ahead of many U.S. peers. The board emphasizes key strategic risks and opportunities from decarbonization, technology risk, and changing customer preferences and consumption patterns and has successfully translated these strategic risks into business opportunities. However, its ability to navigate challenges with respect to natural gas (which still comprise a large proportion of its generation mix) poses a residual risk given the rapidly progressing decarbonization agenda, although we believe natural gas will continue to have a prominent role in North American power generation during the next decade.

APUC’s main strategic objectives include decarbonizing its asset portfolio and expanding its renewable energy footprint, to support the energy transition. The company has translated this goal into three strategic pillars: growth (through strategic acquisitions and developing renewable assets), operational excellence (by greening its generation fleet), and sustainability leadership (partnering with commercial and industrial customers to decarbonize their operations, and ultimately have an impact on reducing cumulative GHG emissions globally). In our view, the company has made progress against its strategic objectives by focusing on innovation at all levels of the organization and implementing a more active stakeholder engagement strategy. These factors contribute to a resilient strategy in light of advancing decarbonization goals disrupting the energy industry.

Awareness	Developing	Good	Excellent
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APUC’s board members and senior management team have excellent awareness of potential disruptions and long-term growth opportunities that could have a material impact on the company’s operations and strategy. These include physical climate risks, low-carbon transition risks, changing customer preferences and consumption patterns (including a shift to electric home heating, which could lower the demand for natural gas), and energy storage innovation (including microgrids and batteries). Identification of these risks have led APUC’s transformation into a more renewable-focused energy and utility company, with a growing portfolio of wind, solar, and hydroelectric facilities replacing legacy thermal generation assets. The company has also

embraced the shift to more innovative energy technologies including microgrids and battery storage, recognizing that they will become an essential part of its service mix in the future. APUC's track record of anticipating emerging trends reflects the deep awareness and long-term thinking of its board and senior management. The composition and skillset of the management team (including newly hired CEO Arun Banskota who has extensive expertise in renewable energy technologies) has evolved to reflect future strategic trends.

Assessment

Developing

Good

Excellent

APUC's senior leadership has the appropriate processes and tools in place to assess the impact of potential disruptions on APUC's strategy. APUC utilizes a risk assessment matrix to help the company identify and ensure mitigation plans are present for risks that are the most likely to affect the company's operations. The company leveraged internal and external expertise to conduct a company-wide materiality assessment in 2019, which is a standard practice. In 2021, APUC will carry out a materiality assessment refresh while engaging with a wider group of stakeholders. APUC recognizes that the emerging risks and opportunities associated with climate change (including physical and transition risks) are essential to creating long-term value for its business. As a result of a recent qualitative climate scenario analysis, the company concluded it is well positioned to capitalize on transformations in the sector. This includes higher use of electricity, a shift to lower-carbon power grids, and the increased importance of reliability. Reliability is important as physical risks accelerate because of its renewable energy generation base and the need to expand or adjust service offerings as needed over time. In addition, its assets are diverse in terms of geography and commodity, which should help mitigate some of these emerging risks and lay the groundwork for the company to capitalize on transition-related opportunities. We believe management and the board will incorporate the outcomes of these scenarios more succinctly into the business strategy over the coming year, including its risk mitigation plans and approach to innovation.

Action Plan

Developing

Good

Excellent

We believe APUC's action planning is excellent because the company anticipated the energy transition ahead of many U.S. peers and has established a track record of successful tuck-in and large acquisitions of renewable energy. The company also continues to invest in pilot initiatives, which we believe is proactive and supports its renewable integration strategy. Since 2018, APUC has been rapidly expanding its renewables portfolio through strategic acquisitions across a variety of regulatory jurisdictions. APUC plans to invest \$300 million in renewable generation in Bermuda. As such, it acquired the Bermuda Electric Co. in June 2019, and Ascendant, a Bermuda-based electric utility in November 2020. In our opinion, the company's strategy to grow its renewables footprint in supportive regulatory environments responds to an expectation of increased regulation over time and is in line with climate change mitigation goals. APUC's strategy to build additional renewable generation capacity also allows it to meet increasing demands from commercial and industrial customers for greener energy in their own operations. The company has also expanded its customer base by leveraging established relationships with commercial and industrial customers (Chevron, General Mills, Starbucks, Amazon, etc.) and helping support these customers' own emissions reduction goals. In addition, senior leaders at the company have put risk mitigation action plans in place for other strategic risks such as physical climate-change risks. These include storm response plans, business continuity planning, and deployment of technology (including wind, radiance, and hydrology resources) to increase asset productivity and availability. We believe the successful development of risk scenarios and resulting action plans have effectively facilitated change management in the face of risks and opportunities. In our view, the company's ability to navigate emerging risks with a higher degree of uncertainty, including the

transition away from natural gas as a leading energy source and the penetration of hydrogen, poses a residual risk given the rapidly changing fossil fuel landscape.

Culture

Developing

Good

Excellent

We assess APUC's culture as good because we believe APUC's key stakeholders understand its strategic objectives and these objectives are embedded across the organization. However, maintaining a consistent culture remains a challenge given the company's acquisitive nature. APUC's culture features a deep focus on safety, customer-focus and reliability, employee accountability, and inclusivity. We believe innovative thinking is embedded in APUC's and forward-looking mindset. For example, in 2019, the company implemented a recommendation from its employees to establish a more developed sustainability framework so that business practices maximized alignment with the organization's commitment to sustainability. This encouraged APUC to establish its Office of Sustainability, hold its first Sustainability Day, and introduce local and regional sustainability committees across the organization. The company also developed a cross-regional innovation team, the goal of which is to develop solutions that are forward-thinking and cost effective for customers. The team has been heavily involved in various microgrid and behind-the-meter pilot projects and has also provided renewable energy designs for company-owned facilities. In addition, APUC conducts regular culture and engagement surveys to assess employee values and has actively incorporated employee feedback into strategic decision making.

Given its highly acquisitive nature, APUC has strategies in place to incorporate newly acquired employees into its employee engagement process (for example, through informal discussions with management and inclusion in leadership and safety symposiums) as soon as the acquisition is announced. We believe recent integrations have been implemented well due to a clear company culture and integration strategy, but completely integrating the culture of a newly acquired entity into the organization is challenging.

Decision-Making

Developing

Good

Excellent

APUC's senior management has demonstrated an involvement and commitment to the company's purpose of "sustaining water and energy for life." Decision makers at APUC are incentivized to focus on tactical decisions consistent with long-term strategy and sustainability-related objectives. Executive remuneration is linked to ESG targets, including safety, employee engagement, system reliability, customer satisfaction, and growth in renewable energy capacity, ensuring these areas are prioritized. APUC has also so far launched two green bond offerings, which we believe exemplifies its commitment to advancing sustainability objectives.

APUC considers investment criteria, which are financial and qualitative in nature, in its pursuit of its highly acquisitive growth strategy. Financial metrics include ROI and accretion in relation to APUC's existing operations while qualitative factors include alignment with APUC's strategy, environmental exposures, sustainability considerations, and growth opportunities. APUC's five-year capital plan includes a \$3.1 billion investment in renewable energy development and more investments in energy storage and renewable natural gas. APUC has also engaged in pilot projects to increase its expertise with new and emerging technologies such as microgrids and battery storage. There is limited clarity of its capital spending beyond the five-year plan and there are limited examples of choices made by the management team to improve preparedness for emerging disruptions such as the transition away from natural gas toward lower-carbon fuel sources.

Sector And Region Risk

Primary sector(s)	Utility Networks
Primary operating region(s)	U.S. Canada

Sector Risk Summary

Environmental exposure

The regulated utility network sector's exposure to environmental risks stems from its infrastructure assets and exposure to the environmental characteristics of entities across value chains. These networks are generally viewed as highly responsible for ensuring clean water and air and helping to transition to a lower carbon economy. While electric, gas, and water networks each have unique environmental risk drivers, the most material environmental risks facing these subsectors are the physical effects of climate change and mitigation policies. Each subsector also faces some land-use risk; as they grow they risk encroaching on habitable or undeveloped lands that are more exposed to biodiversity issues in some parts of the world. Electric and gas utilities are exposed to significant energy transition risks, indirectly, through their upstream partners. These risks to networks are moderated, at least financially, by the regulatory support they enjoy and their ability to absorb costs through rate increases. However, less direct reputational effects can be significant given utilities' strong brand recognition. For electric transmission and distribution networks, the physical effects of climate change, including more frequent and severe wildfires, storms, hurricanes, and tornadoes, have the potential to disrupt the functioning of critical equipment and processes. Battery storage has its own set of environmental risks, stemming from mining and end-of-life disposals of materials used in battery units. For natural gas networks, we focus on gas explosions and leaks that emit highly potent greenhouse gases and may adversely affect local biodiversity, leading to costly penalties and reputational damage. For water networks, environmental risks are mainly water quality and availability, sometimes because of inefficient and aging infrastructure. Climate-related factors, including droughts and floods, can impair water quality and availability, which are essential for this sector.

Social exposure

The regulated utility network sector plays a crucial community role by providing essential services that must remain affordable and reliable to ensure conciliatory regulatory and customer relationships. This is the essence of utilities' social license to operate. However, as infrastructure ages, utilities must also ensure safety as leaks, explosions and fires can yield very material financial and reputational consequences. Water utilities may also face public health risks if they are unable to avoid drinking water contamination or stop wastewater from polluting supplies. Governments and regulators focusing increasingly on affordability, which we believe could create barriers to regulated networks' cost recovery. This is especially so in areas facing upward cost pressures from ongoing high investments in renewables and grid strengthening. Longer term, increased costs and improved solar and battery technology could result in some downstream residential, commercial, and industrial customers partially defecting from electric utilities. Utilities also face significant workforce issues. Amid an unrelenting energy transition, electric utilities, specifically, must develop employee bases with appropriate skills to operate the grid of the future, as well as retain employees. Given the sector's high unionization, companies have to focus on labor-relations management to avoid labor disruptions and related costs. Given that

utilities are local in nature, they play a prominent role in communities and have large numbers of local employees. This can often result in regulatory support, but also carries a responsibility to contribute to the community and support low income customers, as well as tactfully mitigating disputes around land use as they expand. Finally, given the social responsibility of providing continuous electricity, gas, and water, preventing any risk that could lead to a power blackout or water shortage is an important consideration. Cyber attacks are therefore bigger threats for the sector, more so than in many other sectors.

Regional Risk Summary

Canada

The rule of law and respect for human rights are both very strong. Unlike other advanced countries, there has been no rise in populist political parties or social movements that question the mainstream consensus on economic, social, or immigration policies. Canadian governments at all levels have actively pursued environmental and social regulations. While there's no federal regulatory agency, the Ontario Securities Commission (which oversees the Toronto Stock Exchange) carries significant weight regarding corporate governance recommendations. Canada follows a "principles-based" approach to corporate governance. Overall, governance standards are good and improving. Companies usually have smaller boards, meet more often, and have fewer joint CEO/chair positions, but board renewal and over-boarding are issues. However, boards can lack adequate independence, and remuneration or nomination committees are less common than in other jurisdictions. Amendments to the Canada Business Corporation Act (CBCA) came into effect on Jan. 1, 2020, requiring new diversity disclosures for all companies incorporated under the CBCA. The amendments also broaden the definition of diversity including aboriginal persons, visible minorities, and persons with disabilities. Local institutional investors have been active on ESG and stewardship amid growing regulatory momentum to improve companies' ESG disclosures led by the Canadian Securities Administrator.

Related Research

- Environmental, Social, And Governance Evaluation: Analytical Approach, Dec. 15, 2020
- The ESG Risk Atlas: Sector And Regional Rationales And Scores, July 22, 2020
- Our Updated ESG Risk Atlas And Key Sustainability Factors: A Companion Guide, July 22, 2020
- How We Apply Our ESG Evaluation Analytical Approach: Part 2, June 17, 2020

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