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JSC SB Alfa-Bank

Primary Credit Analyst:

Annette Ess, CFA, Frankfurt (49) 69-33-999-157; annette.ess@standardandpoors.com

Secondary Contact:

Ekaterina Marushkevich, CFA, Moscow (7) 495-783-4135;
ekaterina.marushkevich@standardandpoors.com

Table Of Contents

Major Rating Factors

Outlook

Rationale

Related Criteria And Research

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JANUARY 27, 2015 1

1380877 | 300132818

JSC SB Alfa-Bank

SACP	b	+	Support	+1	+	Additional Factors	0				
Anchor	bb-		GRE Support	0	<table border="1"> <tr> <th colspan="2">Issuer Credit Rating</th> </tr> <tr> <td colspan="2" style="text-align: center;">B+ / Stable / B</td> </tr> </table>			Issuer Credit Rating		B+ / Stable / B	
Issuer Credit Rating											
B+ / Stable / B											
Business Position	Moderate	-1	Group Support	+1							
Capital and Earnings	Moderate	0	Sovereign Support	0							
Risk Position	Moderate	-1									
Funding	Average	0									
Liquidity	Adequate										

Major Rating Factors

Strengths:

- Support from parent Alfa Group.
- Consistently sound profitability compared with local peers over the past five years.
- Ample liquidity cushion.
- Little lending to construction and real estate.

Weaknesses:

- Small domestic customer franchise concentrated in corporate banking.
- Aggressive loan growth strategy that is untested through the cycle.
- Deterioration in asset quality in 2014.
- High individual concentrations in the lending portfolio.

Outlook: Stable

The stable outlook on Kazakhstan-based JSC SB Alfa-Bank (ABK) reflects Standard & Poor's Ratings Services' view that the bank will be able to adequately manage the rapid growth of its franchise and maintain capital and asset quality, which weakened in the first nine months of 2014, at current levels over the next 12 months.

We could lower the ratings if we observed increased execution risks of ABK's rapid growth strategy. This would lead to a material increase in credit losses, which would push our projected risk-adjusted capital (RAC) ratio to below 5% or materially erode liquidity. We may also take a negative rating action if we see a weakening of the bank's links with and support from Alfa Group.

We consider an upgrade to be unlikely within our 12-month outlook horizon. Nevertheless, we could consider an upgrade if the bank moderates its asset growth, keeps its conservative risk appetite, and demonstrates a successful track record of developing its retail strategy, while maintaining the percentage of its nonperforming loans (NPLs; loans more than 90 days overdue) in single digits. An upgrade would be more likely if, in addition to the factors above, capitalization does not weaken as much as we currently expect.

Rationale

Our ratings on ABK reflect its anchor of 'bb-' for a commercial bank operating in Kazakhstan, as well as its "moderate" business position, "moderate" capital and earnings, "moderate" risk position, "average" funding, and "adequate" liquidity, as our criteria define these terms. The stand-alone credit profile (SACP) is 'b'. The long-term counterparty credit rating factors in one notch of uplift above the SACP to reflect our view of ABK's "moderately strategic" importance to its ultimate parent ABH Holdings SA and the associated possibility for some support from immediate Russian parent Alfa-Bank OJSC (BB+/Watch Neg/B).

Anchor: 'bb-' for a commercial bank operating in Kazakhstan

Under our bank criteria, we use our Banking Industry Country Risk Assessment economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Kazakhstan is 'bb-'.

Economic risks in Kazakhstan remain very high in a global context. Kazakhstan's economy depends heavily on the hydrocarbons sector. Although we expect GDP growth to slow to 4.5%-5.0% in 2014-2016, sustained balanced fiscal and current accounts continue to support economic growth. We expect the banking assets to increase at a similar rate of about 15% in 2014-2015 as in 2011-2014. Uncertainty regarding highly centralized policymaking and implementation as well as concerns about smooth presidential succession poses high political risk. In our opinion, the Kazakh economy has been in a "correction" phase since 2011, during which banks' nonperforming and restructured loans remained the highest among peers. Also, these loans have not reduced while credit losses have increased. Our view of extremely high credit risk in Kazakhstan takes into account the banks' history of aggressive underwriting standards and the country's weak payment culture and rule of law.

The banking industry risks are also very high in Kazakhstan. We believe Kazakh banking regulators lack independence and can be subject to political interference. Their corrective actions to prevent the system from overheating before the

recent crisis and to clean the banking system of the very high level of problem loans after the crisis proved inadequate. In our view, Kazakh banks' risk appetites remain aggressive, reflected in opportunistic growth pursued by some medium and small Kazakh banks and continued interest by banks in financing the inherently risky real estate and construction sectors. The banking system's risk-adjusted profitability is low because income generation significantly lags balance sheet expansion at rapidly growing banks, due to margin pressure, or due to poor asset quality at a few mid- and large-sized banks. Positively, since the crisis, Kazakh banks have predominantly financed themselves with customer deposits, an important proportion of which is from government and government-related companies, which we consider to be more stable than corporate or retail deposits.

Table 1

JSC SB Alfa-Bank Key Figures					
	--Year-ended Dec. 31--				
(Mil. KZT)	2014*	2013	2012	2011	2010
Adjusted assets	235,179.0	167,511.9	130,813.6	98,786.1	76,380.3
Customer loans (gross)	138,556.8	124,802.5	87,959.3	51,255.5	31,439.4
Adjusted common equity	28,017.8	23,456.6	19,551.3	12,224.0	9,895.7
Operating revenues	14,972.3	11,209.0	8,212.8	5,243.2	3,480.5
Noninterest expenses	4,490.5	4,340.6	3,049.7	2,188.7	1,757.7
Core earnings	5,637.7	4,639.0	2,952.7	2,791.0	2,111.9

*Data as of Sept. 30. KZT--Kazakhstani tenge.

Business position: A rapidly growing small corporate bank with retail ambitions

Our assessment of ABK's business position as "moderate" reflects our view that it has a small domestic franchise concentrated in corporate banking. We also see meaningful execution risk related to its ambitious growth strategy. Nevertheless, we recognize that ABK benefits from the operational, managerial, product, and funding support it receives from its parent OJSC Alfa-Bank and from its ultimate parent ABH Holdings SA, as well as the strong "Alfa Bank" brand name. With a market share of about 1.3% by assets totaling Kazakhstani tenge (KZT) 235 billion (\$1.3 billion) as of Nov. 1, 2014, ABK is the 17th largest bank among 38 commercial banks operating in Kazakhstan.

Historically, ABK has been a corporate bank with a limited customer base. In 2013 it started to actively develop consumer lending, capitalizing on Alfa-Bank's retail experience, which we view positively for its risk diversification and wider margins. However, the growth of ABK's retail banking activity has crawled behind original targets. Despite recent expansion, ABK's distribution network of full service branches or smaller offices and its 1,300 points of service in 14 cities and towns in Kazakhstan still lags medium-sized Kazakh banks. The share of retail loans in total increased to 13% of total loans as of Sept. 30, 2014 from only 4% a year earlier. ABK plans to maintain it at least at 15%.

We believe that Alfa-Bank's expertise could help ABK augment retail business sustainably, but we see associated risks. Many Kazakh banks have targeted the consumer finance segment, which has been the fastest-growing lending segment in Kazakhstan over the past four years. To address the expanding bubble, started Jan 1, 2014, the Kazakh banking regulator capped growth in unsecured consumer lending in Kazakhstan to maximum 30% per year for any bank from year-end 2013. This curtailed ABK's growth ambitions and the bank started to more actively offer consumer loans secured by real estate. As a late entrant in the consumer lending segment, we see a risk that ABK could target

higher-risk customers with lower incomes and nonexistent or short credit histories, which would weaken its asset quality in a down cycle.

Overall, we view with caution the bank's aggressive loan growth over the past five years. That said, in 2014 the bank increased its loan growth below its budget due to low growth in the corporate segment, restriction on growth of unsecured consumer lending, as well as lower-than-expected GDP growth in Kazakhstan. ABK plans to attract new corporate clients offering transactional banking, trade finance and factoring.

Table 2

JSC SB Alfa-Bank Business Position					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
Total revenues from business line (mil. KZT)	14,972.3	11,209.0	8,212.8	5,243.2	3,480.5
Return on equity	27.6	20.3	17.6	23.7	21.8

*Data as of Sept. 30. KZT--Kazakstani tenge.

Capital and earnings: Weakening capitalization due to the postponement of a planned capital increase

We revised our assessment of ABK's capital and earnings to "moderate" from "adequate" to reflect our opinion that the bank's capitalization measured under our risk-adjusted capital (RAC) framework has weakened. This assessment is a neutral rating factor because ABK has a "bb-" anchor, as per our methodology.

We project that ABK's RAC ratio will weaken to about 5.5-6.0% by year-end 2015 from 7.1% at year-end 2013. This is contrary to our previous expectation that the RAC ratio would stay above 7%. ABK is set to perform below our expectations because the \$40 million shareholder capital increase that we anticipated for 2014 has been put on hold. ABK needs capital injections to maintain its RAC ratio because its asset base is currently growing faster than its internal capital generation.

Our RAC projection for 2014-2015 includes the following assumptions:

- Loan growth of about 25%-30% per year;
- No shareholder capital injections;
- Dividends paid to the group of less than 15%;
- Annual net profits between KZT6 billion and KZT7 billion; and
- A jump in the cost of risk to 3.5%-4.0%.

The bank currently meets all regulatory requirements for capital adequacy and reported a BIS Tier 1 ratio of 11.8% and total capital adequacy ratio of 14.0% on Nov 1, 2014.

The bank's profitability compares well to peers with return on assets of 3.2% and return on equity of 27.6% in the first nine months 2014. Over that period, the bank's net interest margin of 5.4% was in line with peers. Nevertheless, despite an increasing share of high-margin retail lending in its loan portfolio, we expect the sector-wide pressure on margin to continue, mostly on the funding side. The cost-to-income ratio has improved to 30% in the first nine months 2014, despite continued investments in the distribution network, and we expect it to stay at broadly the same level in 2015.

Table 3

JSC SB Alfa-Bank Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
S&P RAC ratio before diversification	N.M.	7.1	8.2	8.7	7.9
S&P RAC ratio after diversification	N.M.	5.0	5.3	5.8	5.1
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	50.4	72.1	71.7	66.3	60.5
Fee income/operating revenues	14.2	19.7	22.5	27.1	30.1
Market-sensitive income/operating revenues	26.6	6.0	5.8	5.7	8.9
Noninterest expenses/operating revenues	30.0	38.7	37.1	41.7	50.5
Preprovision operating income/average assets	6.9	4.6	4.5	3.5	2.8
Core earnings/average managed assets	3.7	3.1	2.6	3.2	3.5

*Data as of Sept. 30. RAC--Risk-adjusted capital. N.M.--Not meaningful.

Table 4

JSC SB Alfa-Bank Risk-Adjusted Capital Framework Data						
(Mil. KZT)	Exposure*	Basel II RWA	Average Basel II RW (%)	Standard & Poor's RWA	Average Standard & Poor's RW (%)	
Credit risk						
Government and central banks	23,844	0	0	5,547	23	
Institutions	11,249	0	0	4,455	40	
Corporate	163,042	0	0	276,311	169	
Retail	10,177	0	0	15,576	153	
Of which mortgage	618	0	0	464	75	
Securitization	0	0	0	0	0	
Other assets	3,391	0	0	8,477	250	
Total credit risk	211,703	0	0	310,366	147	
Market risk						
Equity in the banking book§	0	0	0	0	0	
Trading book market risk	--	0	--	0	--	
Total market risk	--	0	--	0	--	
Insurance risk						
Total insurance risk	--	--	--	0	--	
Operational risk						
Total operational risk	--	0	--	21,017	--	
(Mil. KZT)		Basel II RWA		Standard & Poor's RWA	% of Standard & Poor's RWA	
Diversification adjustments						
RWA before diversification	--	0	--	331,383	100	
Total adjustments to RWA	--	--	--	137,168	41	
RWA after diversification	--	0	--	468,551	141	

Table 4

JSC SB Alfa-Bank Risk-Adjusted Capital Framework Data (cont.)					
(Mil. KZT)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	Standard & Poor's RAC ratio (%)
Capital ratio					
Capital ratio before adjustments	--	17,231	0.0	23,457	7.1
Capital ratio after adjustments†	--	17,231	0.0	23,457	5.0

*Exposure at default. Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. §Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. †Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. KZT--Kazakhstan tenge. Sources: Company data as of Dec. 31, 2013, Standard & Poor's.

Risk position: Execution risk of high growth strategy supported by the parent

Our "moderate" assessment of ABK's risk position reflects execution risk related to its high growth strategy with targeted development of retail business and a notable deterioration of its asset quality in 2014.

We view ABK's risk-management capacity as better than other midsize Kazakh banks. The bank's enterprise risk management was developed with the expertise of OJSC Alfa-Bank. In our view, senior management knows the bank's customers well and is aware of the risks facing the bank. Positively, the bank emphasizes quality over quantity in new loans disbursement and has a lower acceptance rate in consumer loans than competitors.

Nevertheless, asset quality deteriorated notably in 2014. NPLs increased to 7.4% at Sept. 30, 2014, from 0.5% a year earlier due to deterioration of four large loans. Provisions covered NPLs by only 84% at Sept. 30, 2014, which is insufficient in our view. We expect the bank will increase provision coverage in line with its more conservative practices in the past. That said, asset quality in the consumer lending portfolio remains good with NPLs of only 1.7% as of Sept. 30, 2014. We expect to see a moderate increase of NPLs in the next 24 months as the retail loan portfolio seasons.

We expect some further manageable deterioration of asset quality of some borrowers with loans in foreign currencies (23% of total loans at mid-2014) in the next 12 months due to the devaluation of the tenge in February 2014. A mitigating factor is that the majority of corporate borrowers with loans in foreign currencies are exporters who would partially benefit from tenge devaluation.

The bank's 3.5% share of lending to the risky construction and real estate sector as of Sept. 30, 2014 is significantly lower than the system average of 24%, which we view as positive. Lending to wholesale trade dominates corporate lending accounting for 43% of total loans as of Sept. 30, 2014, a level higher than peers. The bank has high single-name and geographic loan concentrations: The top 20 loans accounted for about 60% of total loans and 3.3x total adjusted capital, which is in line with regional peers but high in a global comparison. These concentrations reflect the bank's limited customer base. We expect some reduction in lending concentrations in the following years due to development of retail lending.

Table 5

JSC SB Alfa-Bank Risk Position					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
Growth in customer loans	14.7	41.9	71.6	63.0	80.9
Total diversification adjustment / S&P RWA before diversification	N.M.	41.4	53.7	49.9	53.8
Total managed assets/adjusted common equity (x)	8.4	7.2	6.7	8.1	7.7
New loan loss provisions/average customer loans	4.1	1.2	2.3	(0.3)	(3.2)
Net charge-offs/average customer loans	(1.7)	(2.0)	(1.4)	(4.0)	N.M.
Gross nonperforming assets/customer loans + other real estate owned	7.4	1.2	0.6	1.5	N/A
Loan loss reserves/gross nonperforming assets	84.4	311.5	786.1	316.7	N/A

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

Funding and liquidity: Funding mainly by customer deposits, with a solid base of liquid assets

We consider ABK's funding profile to be "average" as in our view it does not differ materially from local peers. We assess its liquidity as "adequate," reflecting a solid base of liquid assets.

Customer deposits accounted for 91% of total funding as of Sept. 30, 2014. The bank's deposit concentrations are lower than domestic peers, with the top-20 depositors accounting for only 30% of total deposits as of Sept. 30, 2014. The share of retail deposits in total deposits was 19% at the same date, down from 24% at year-end 2013. This was somewhat lower than our expectations because we had expected retail deposits to rise following the increase in the bank's distribution network and growth of consumer lending. The loan-to-deposit ratio of 69.3% at Sept. 30, 2014, compares favorably with peers. The bank's stable funding ratio of 119%-134% over the past four years supports this assessment.

The liquidity coverage ratio of broad liquid assets-to-short-term wholesale funding of 6.7x at year-end 2013, which is in line with peers, reflects ABK's ratio, as well as other midsized Kazakh banks' limited wholesale funding. Broad liquid assets accounted for 31% of total assets at Sept. 30, 2014. We expect the bank to start issuing domestic bonds in the next few years to diversify its funding profile.

Table 6

JSC SB Alfa-Bank Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2014*	2013	2012	2011	2010
Core deposits/funding base	92.0	91.9	84.3	78.8	77.4
Customer loans (net)/customer deposits	69.3	92.4	91.5	73.2	57.1
Long-term funding ratio	97.3	96.7	91.2	86.9	80.5
Stable funding ratio	133.7	119.0	122.6	130.5	N/A
Short-term wholesale funding/funding base	3.1	3.9	10.5	15.1	22.7
Broad liquid assets/short-term wholesale funding (x)	11.4	6.7	3.3	2.8	N/A
Net broad liquid assets/short-term customer deposits	46.9	32.5	34.4	38.7	N/A
Short-term wholesale funding/total wholesale funding	38.6	47.6	66.4	71.1	100.1
Narrow liquid assets/3-month wholesale funding (x)	203.7	121.7	3.4	2.8	N/A

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

External support: "Moderately strategic" importance to its parent Alfa Group

ABK's ultimate parent is ABH Holdings —the Luxembourg holding company of the Alfa Group banking arm. The ratings on ABK reflect our view of its "moderately strategic" importance to ABH Holdings and the possibility that ABK could receive financial support in case of need. Although ABH Holdings is the ultimate owner, we expect such extraordinary support would come through the bank's immediate parent Alfa-Bank, the group's principal operating company.

Our assessment of support is influenced by ABH Holdings's mixed track record of supporting its financial subsidiaries during the 2008-2009 financial crisis. We note, however, that while ABK makes a fairly small contribution to group earnings, in 2012 it benefitted from a capital increase and a buyout of NPLs. It also has substantial managerial, operational, and risk management links with Alfa-Bank.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria And Research

- National and Regional Scale Ratings, Sept. 22, 2014
- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of January 27, 2015)**JSC SB Alfa-Bank**

Counterparty Credit Rating

Kazakhstan National Scale

B+/Stable/B

kzBBB/--/--

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1380877 | 300132818

Ratings Detail (As Of January 27, 2015) (cont.)**Counterparty Credit Ratings History**

03-May-2013		B+/Stable/B
23-Jan-2012	<i>Kazakhstan National Scale</i>	kzBBB/--/--

Sovereign Rating

Kazakhstan (Republic of)	BBB+/Negative/A-2
<i>Kazakhstan National Scale</i>	kzAAA/--/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:

Financial Institutions Ratings Europe; FIG_Europe@standardandpoors.com

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JANUARY 27, 2015 10

1380877 | 300132818

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JANUARY 27, 2015 11

1380877 | 300132818