

Rating Report

Concentra Bank

DBRS Morningstar

October 7, 2020

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Sohail Ahmer, CFA
 Vice President, Global FIG
 +1 416 597-7409
 sohail.ahmer@dbrsmorningstar.com

Michael Driscoll
 Managing Director, Head of NA FIG
 +1 212 806-3234
 michael.driscoll@dbrsmorningstar.com

Ratings

Issuer	Obligation	Rating	Rating Action	Trend
Concentra Bank	Long-Term Issuer Rating	A (low)	Trend Change April 2020	Negative
Concentra Bank	Short-Term Issuer Rating	R-1 (low)	Trend Change April 2020	Negative

Rating Drivers

Factors with Positive Rating Implications

- Given the Negative trend, an upgrade is unlikely at this time.
- DBRS Morningstar could change the trend back to Stable if the Canadian economy is able to reopen and the Province's economic potential approaches pre-crisis levels.

Factors with Negative Rating Implications

- Conversely, a reduction in SaskCentral's ratings resulting from the adverse impact of the Coronavirus Disease (COVID-19) and lower oil prices could negatively affect Concentra's ratings.
- Furthermore, a sustained deterioration in liquidity or an inability to source funding through existing sources, including credit unions, could lead to a negative rating action.
- A decrease in DBRS Morningstar's assessment of the willingness and ability of SaskCentral to support Concentra could also lead to negative rating pressure.

Rating Considerations

Franchise Strength

- Concentra Bank (Concentra or the Bank) derives its franchise strength through its partnership with the credit union systems in Canada (excluding Québec), which includes 239 credit unions across Canada with \$246 billion in assets. The Bank remains an important provider of wholesale banking, capital markets, and trust services to the majority of credit unions in Canada.

Earnings Power

- Although Concentra has historically generated relatively stable earnings, a combination of low interest rates and rising provisions for credit losses (PCL) is pressuring earnings in the current environment.

Risk Profile

- Concentra has generally good asset quality with a low history of loan losses on its residential mortgage portfolio; however, the Bank's risk appetite has been progressively increasing, exposing it to potentially higher loan losses given the current economic environment.

Funding and Liquidity

- Funding is largely generated through wholesale sources and overnight deposits and is, thus, less stable in DBRS Morningstar's opinion. However, wholesale maturities are staggered, which enables Concentra to appropriately manage its interest-rate risk and liquidity.

Capitalization

- Concentra's capitalization strengthened significantly in 2019 which DBRS Morningstar view positively. Furthermore, internal equity generation was healthy in 2019 and the Bank's capital cushion is sufficient to absorb normal levels of losses.

Financial Information

	For the Year Ended December 31 (IFRS)				
	2019	2018	2017	2016	2015
Return on Average Equity (%)	6.13	8.66	7.55	6.72	7.04
Efficiency Ratio (%)	59.00	57.85	56.32	48.93	59.70
Net Interest Margin (%)	1.05	0.98	0.91	0.92	0.95
Common Equity Tier 1 Ratio (%)	13.30	11.80	13.10	10.20	11.60
Net Impaired Loans / Total Net Loans (%)	0.54	0.33	0.11	0.18	0.23
Loan Loss Provision/Average Net Loans (%)	0.09	-0.10	0.01	0.20	0.04
Income before Provisions & Taxes (CAD millions)	50	48	47	53	37
Net Income (CAD millions)	30	41	34	29	25
Total Equity (CAD millions)	502	479	457	434	425
Total Assets (CAD millions)	8,945	9,679	9,127	9,437	7,800

Source: DBRS Morningstar and company reports.

Issuer Description

Concentra provides wholesale financial, capital markets, and trust services to credit unions in Canada (except Québec). The Bank is indirectly owned by credit unions through their centrals. SaskCentral holds the majority (84%) economic and voting interest in Concentra while the remaining 16% is divided between credit union central organizations and credit unions across Canada.

Rating Rationale

On April 6, 2020, DBRS Limited (DBRS Morningstar) confirmed Concentra Bank's (Concentra or the Bank) long-term ratings at A (low) and short-term ratings at R-1 (low). The trend on all ratings was revised to Negative from Stable. Concentra's Support Assessment of SA1 reflects the willingness and ability of Credit Union Central of Saskatchewan's (SaskCentral; rated R-1 (low) with a Stable trend by DBRS Morningstar) to support Concentra. SaskCentral owns 84% of Concentra and is instrumental in driving business activity and strategy at Concentra. As such, DBRS Morningstar views Concentra as a supported subsidiary of SaskCentral.

Franchise Strength

DBRS Morningstar views Concentra's interconnectedness to the credit union system in Canada (excluding Québec) as a key driver in determining the Bank's franchise strength. As an important provider of wholesale financial (including capital markets) and trust services to the majority of credit unions in Canada, Concentra has developed significant expertise in these areas. These services particularly benefit small to mid-sized credit unions that lack scale to access wholesale and capital markets or are unsure of solutions that best meet their needs. Additionally, the Bank acts as a counterparty in plain-vanilla interest rate swaps that allow credit unions to hedge interest rate risk. Also, by purchasing, selling, and syndicating loans from and to credit unions, Concentra offers credit unions investment opportunities outside their franchise areas, providing them with some yield pickup and asset diversification. These activities are core to Concentra's partnership with credit unions; however, DBRS Morningstar notes that excessive reliance on stand-alone activities, which could be viewed as relatively unrelated to the credit union system, could have a negative impact on DBRS Morningstar's assessment of Concentra's franchise strength.

The Bank is indirectly owned by credit unions through their Centrals. Since January 1, 2017, SaskCentral has held the majority (84%) economic and voting interest in Concentra while the majority of the remaining 16% is divided between credit unions (through their Central organizations) across Canada. While the Bank aims to be owned by credit unions and operate on cooperative principles, a significant change in ownership at Concentra could alter the existing incentive structure and would require DBRS Morningstar to reevaluate the Bank's franchise strength and risk appetites with potential implications for its ratings.

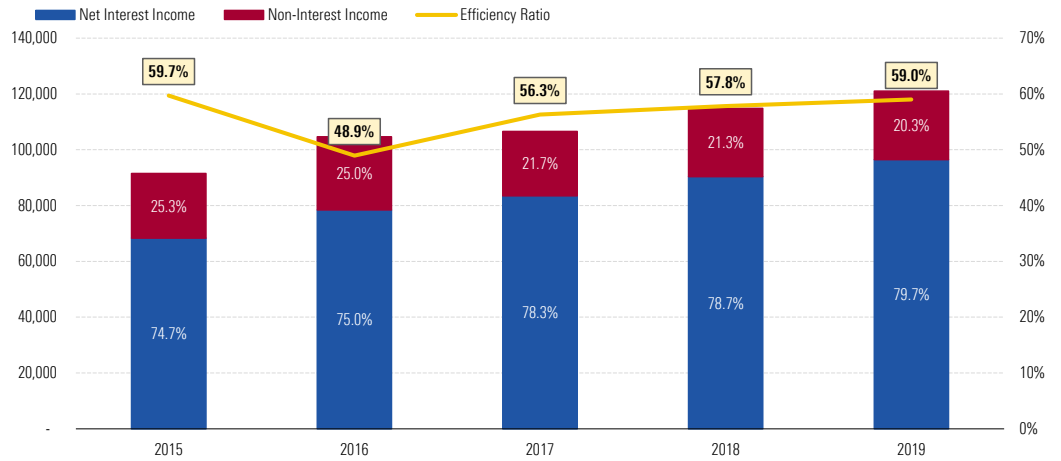
Credit unions' oversight of Concentra's activities is crucial because a capital shortfall at the Bank would need to be funded directly by SaskCentral as a majority owner and indirectly by credit unions in Saskatchewan through their 100% ownership of SaskCentral; therefore, excessive risk on Concentra's balance sheet implies contingent risk for the System. The Bank maintains a robust corporate governance structure that maintains good oversight of its activities. Consequently, Concentra's risk appetite is ultimately dictated by its Board of Directors, most of whom are associated with the cooperative sector or have prior experience in it. The majority of Concentra's Board members are independent of its executive management team.

Earnings Power

Concentra has generated relatively stable recurring earnings, largely driven by spread income. However, earnings have been under pressure since the onset of the coronavirus pandemic as a result of a decline in credit spreads and an increase in PCL.

In DBRS Morningstar's assessment, since obtaining a banking license, Concentra has become more focused on profit maximization and growth. The Bank's strategy and objectives are nevertheless driven by its Board and are within the confines of cooperative principles, which DBRS Morningstar expects to restrict excessive risk-taking by Concentra. Furthermore, successful implementation of the Bank's Trust strategy, while continuing to provide fee-based services to credit unions, could enhance Concentra's capacity to generate non-interest income, which would be viewed positively by DBRS Morningstar.

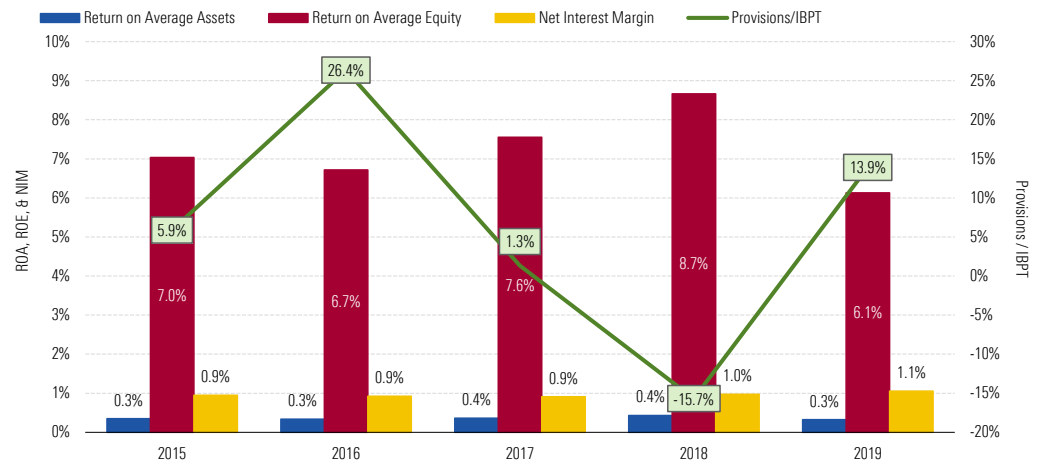
Exhibit 1 Revenue Mix versus Efficiency



Sources: DBRS Morningstar and company reports

Concentra generated net income of \$30.1 million in F2019, 25.8% lower than the prior year, mainly because of a normalization in PCL to \$6.9 million compared with a reversal of \$7.6 million in the prior year. Income before provisions and taxes (IBPT) improved marginally by 2.4% year over year (YOY) to \$49.6 million. Although net interest margins (NIM) improved to 1.05% in F2019 from 0.98% in the prior year, average interest earning assets declined marginally by 1.1%, primarily led by a contraction in the residential mortgage loans book. The improvement in NIM was driven by an increase in the size of the consumer lending portfolio. Given that Concentra is primarily wholesale funded, its interest spread is lower than that of its peers. Operating efficiency deteriorated marginally in F2019 as Concentra continued to spend on initiatives to support a direct-to-customer strategy and talent acquisitions.

Exhibit 2 Profitability Metrics



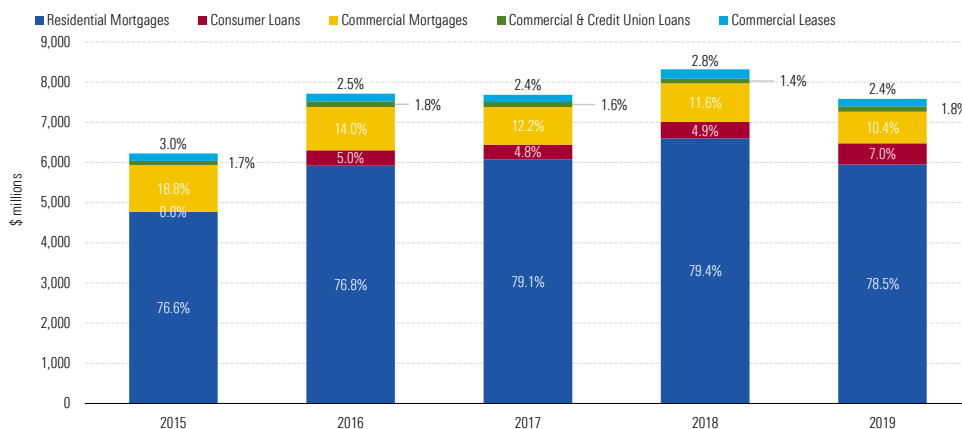
Sources: DBRS Morningstar and company reports

In 2020, Concentra's earnings have come under considerable pressure. Net income for Q2 2020 was \$1.7 million, a significant reduction from \$9.0 million Concentra earned in Q2 2019, mainly because of a compression in credit spreads and higher PCL. In DBRS Morningstar’s assessment, although Concentra has generated sufficient income before provisions and taxes (IBPT) to cover PCLs under normal operating conditions, should the current weak operating environment persist into 2021, PCL could increase substantially, particularly given the geographic concentration of the Bank's loan portfolio in Alberta and, to a lesser extent, in Saskatchewan. Economies in these provinces have been under considerable pressure from the twin impacts of low oil prices and economic lockdowns driven by the coronavirus pandemic.

Risk Profile

Concentra is predominately exposed to residential mortgage lending, most of which represents insured exposures. Although DBRS Morningstar remains cautious of excessive growth in the Bank’s exposure to uninsured Alt-A residential mortgages, commercial mortgages and unsecured consumer loans in recent years, year to date, commercial loans and consumer loans balances have been trending lower. DBRS Morningstar also notes that, as Concentra branches out into other types of lending, it could be exposed to less familiar structures and elements of operational risks. Increased appetite for riskier lending, particularly that which is unrelated to the credit union industry, would be viewed negatively by DBRS Morningstar.

Exhibit 3 Loan Portfolio Composition

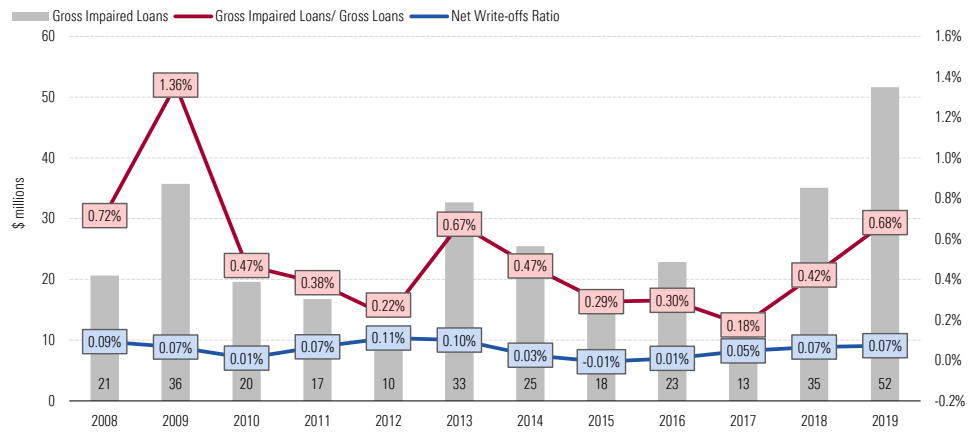


Sources: DBRS Morningstar and company reports

While Concentra’s asset quality remains solid, the Bank experienced an uptick in delinquencies from a small number of large commercial accounts in both 2018 and 2019, resulting in the gross impaired loans-to-gross loans ratio increasing to 0.68% at the end of F2019 from 0.42% in F2018, and 0.18% in 2017. Positively, net write-offs remain low and at manageable levels. An important risk facing Concentra is the geographic concentration of its loans in the Prairies (Alberta, Saskatchewan and Manitoba) as well as large single-party exposures within the commercial-lending portfolio. Particularly in Alberta, and to some extent also in Saskatchewan, low oil prices have contributed to damping economic activity. In addition

to which, the coronavirus pandemic has added to the negative impact resulting in financial institutions offering their clients the option of deferring loan payments for a period of up to six months. Consequently, about 3.6% of Concentra's residential mortgage loans, 62.7% of which represent insured mortgages, and 10.9% of the combined commercial and equipment finance loans have been placed on a payment deferral program. In DBRS Morningstar's assessment, in the event that provincial economies fail to recover over the intermediate term, a proportion of the loans that were placed under a payments deferral program, could become delinquent, particularly in the commercial loan book, potentially resulting in significant loan losses for Concentra.

Exhibit 4 Evolution of Credit Quality



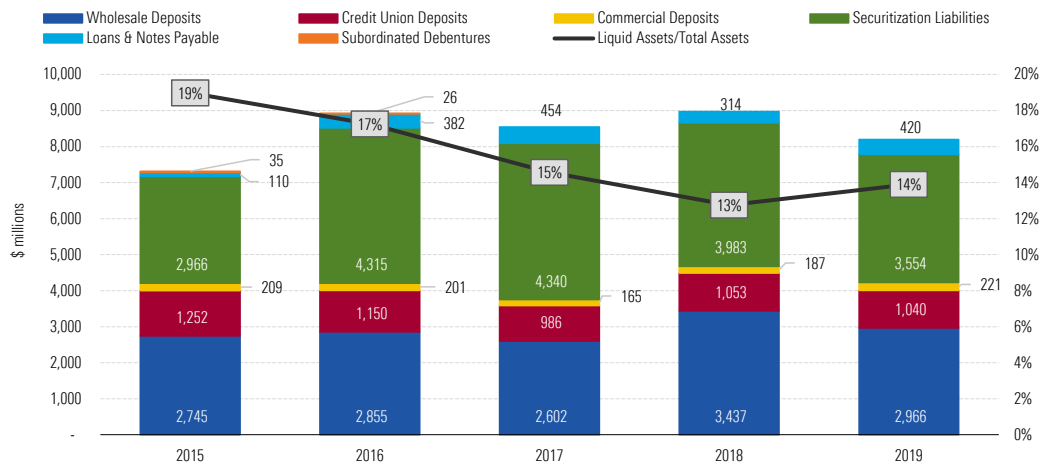
Sources: DBRS Morningstar and company reports

Through its limited capital markets operations, Concentra is exposed to some market risk. The Bank provides credit unions with the capital markets expertise they lack, including foreign-exchange contracts and plain-vanilla interest-rate swaps for asset-liability management purposes entered into with major financial institutions.

Funding and Liquidity

DBRS Morningstar views Concentra’s funding position to be well managed, but remains cautious about the Bank’s reliance on wholesale deposits. Positively, DBRS Morningstar notes that asset-liability duration mismatch is limited while the liquidity buffer is acceptable.

Exhibit 5 Funding & Liquidity Profile



Sources: DBRS Morningstar and company reports.

Concentra sources the majority of its funding from market-based sources, mainly by securitizing insured residential mortgages. These mortgages are acquired from third parties and placed in pools of mortgage-backed securities. Although this has been a relatively secure source of funding for Concentra, declining spreads on securitizations are resulting in contraction in this business. The Bank’s next major source of funding are nominee deposits from Canada’s large banks. These represent bank client deposits that are placed with other financial institutions, such as Concentra, and tend to be higher-yielding term deposits. Credit union deposits are also a significant source of funding, 39% of which constituted overnight deposits at F2019, against which Concentra is required to hold liquid assets to meet its Liquidity Coverage Ratio (LCR) requirements. Although Concentra maintains good access to market funding and interest-rate risk remains manageable, excessive reliance on wholesale funding is viewed negatively by DBRS Morningstar. Positively, Concentra has maintained a stable funding position since the onset of the coronavirus pandemic given that it does not rely on redeemable high interest savings accounts, which are subject to flight risk, and also because the term deposits it holds are laddered up to five years such that they match the duration of the Bank’s loan assets.

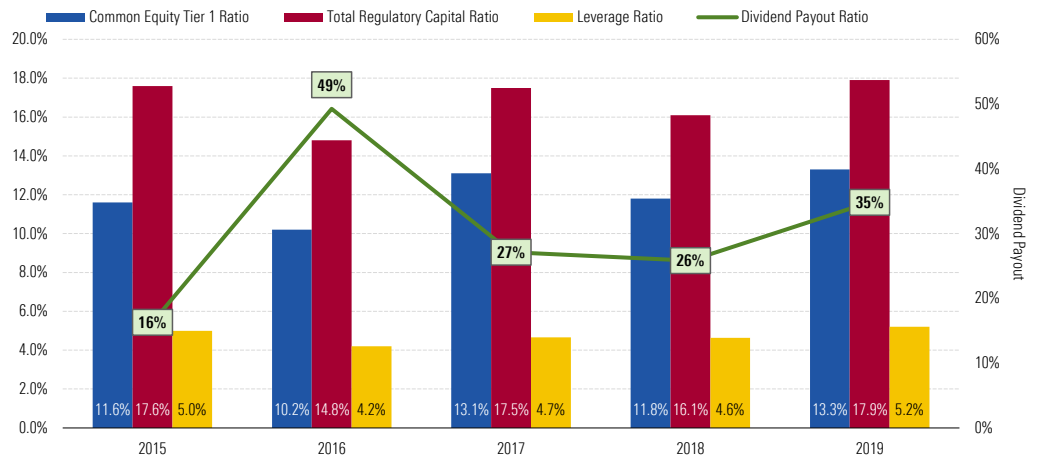
The liquid assets-to-total assets ratio improved in F2019 and has been trended up in each Q1 and Q2 of 2020 as credit unions parked their excess liquidity with Concentra. Although traditionally credit union have opted to place overnight deposits with Concentra, the increase in credit union deposits in 2020 have mainly been in the form of term deposits. Furthermore, the Bank maintains an LCR that is

significantly higher than regulatory requirements. DBRS Morningstar notes that Concentra monitors and manages its liquidity using OSFI guidelines, which are Basel III compliant. To bolster its liquidity position, Concentra maintains short-term funding programs (bearer deposit notes and repos) in addition to lines of credit with SaskCentral and a banking syndicate for cash management and emergency liquidity purposes. Concentra has access to Bank of Canada's Standing Term Lending Facility and the Contingent Term Repo Facility through which it can draw on liquidity if needed. The Bank does not yet have access to Bank of Canada's Emergency Lending Assistance facility, although it is in the process of gaining access. In DBRS Morningstar's opinion, Concentra maintains a sufficient liquidity buffer that should allow it to cover short-term drawdowns in deposits.

Capitalization

Concentra maintains good levels of capital with reasonable levels of internal equity generation. DBRS Morningstar views the Bank's capital cushion as sufficient to absorb normal levels of losses.

Exhibit 6 Capitalization Trends



Sources: DBRS Morningstar and company reports.

Concentra's capital ratios improved in 2019 with a Total Capital Ratio of 17.9%, which remains significantly ahead of regulatory minimum requirements of 10.5%. Although internal equity generation was healthy at 4.0% in 2019, the reduction in risk exposures associated with commercial loans/leases and uninsured mortgage loans was primarily responsible for the improvement in capital ratios. As at Q2 2020, the TCR declined to 16.7% thanks to growth in residential mortgage lending while the leverage ratio improved to 4.8%. DBRS Morningstar notes that capital management is based on an OSFI-prescribed Basel III-compliant approach and capital ratios are calculated on an all-in basis.

The quality of Concentra's capital is solid with 74% representing CET1 capital. The remaining AT1 capital is non-viability contingent capital compliant and would be written down to nil if a trigger event is deemed to have occurred. Given the current structure of balance-sheet risk, DBRS Morningstar concludes that Concentra holds sufficient capital cushion to absorb potential losses under normal operating conditions.

Concentra Bank Financial Information

	For the Year Ended December 31 (IFRS)				
	2019	2018	2017	2016	2015
Balance Sheet (CAD millions)					
Cash	403	174	425	194	54
Securities	842	1,060	905	1,434	1,426
Loans Receivable	7,559	8,299	7,678	7,697	6,224
Total Assets	8,945	9,679	9,127	9,437	7,800
Deposits	4,377	4,827	3,753	4,207	4,205
Securitization Liabilities	3,554	3,983	4,340	4,315	2,966
Total Liabilities	8,443	9,200	8,670	9,003	7,375
Total Equity	502	479	457	434	425
Income Statement (CAD millions)					
Net Interest Income	96	90	83	78	68
Non-Interest Income	25	24	23	26	23
Total Revenue	121	115	107	105	91
Operating Expenses	71	66	60	51	55
Income before Income Taxes	43	56	46	39	35
Income Tax Expense	13	15	12	10	9
Net Income	30	41	34	29	25
Profitability (%)					
Net Interest Margin	1.05	0.98	0.91	0.92	0.95
Net Interest Income/ Operating Revenue	79.70	78.70	78.32	74.99	74.68
Efficiency Ratio	59.00	57.85	56.32	48.93	59.70
Provisions/IBPT	13.90	-15.69	1.33	26.36	5.89
Operating Leverage	-2.10	-2.93	-15.37	20.63	-8.16
Return on Average Equity	6.13	8.66	7.55	6.72	7.04
Return on Average Assets	0.32	0.43	0.36	0.33	0.35
Risk Profile (%)					
Loan Loss Provision/Average Net Loans	0.09	-0.10	0.01	0.20	0.04
Net Write-offs/Average Net Loans	0.07	0.07	0.05	0.01	-0.01
Gross Impaired Loans/ Gross Loans	0.68	0.42	0.18	0.30	0.29
GILs/Common Equity + Reserves	12.37	9.00	3.67	6.51	5.49
Loan Loss Allowances / GILs	51.77	61.55	163.54	125.65	90.61
Funding & Liquidity (%)					
Gross Loans/Total Deposits	173.30	172.37	204.85	183.34	148.12
Demand Deposits/Total Deposits	14.35	12.37	18.94	20.16	20.03
Liquid Assets/Short Term Debt & Deposits	28.42	25.58	35.44	38.71	35.20
Capitalization (%)					
Common Equity Tier 1 Ratio	13.30	11.80	13.10	10.20	11.60
Tier 1 Capital Ratio	17.30	15.60	17.50	13.90	16.20
Total Regulatory Capital Ratio	17.90	16.10	17.50	14.80	17.60
Leverage Ratio	5.20	4.63	4.66	4.20	5.00
Tangible Common Equity/ Risk Weighted Assets	13.45	11.92	13.16	10.39	11.87
Total Risk Weighted Assets/Total Assets	30.90	30.24	27.20	31.00	31.82
Adjusted Internal Equity Growth	4.00	6.43	5.50	3.41	5.89

Peer Group Comparison - FY 2019

	Concentra Bank	Median	Canadian Western Bank	Laurentian Bank of Canada	Bank of China (Canada)	HSBC Canada
Long-Term Issuer Rating:	A (low)		A (low)	A (low)	A (low)	A (high)
Short-Term Issuer Rating:	R-1 (low)		R-1 (low)	R-1 (low)	R-1 (low)	R-1 (middle)
Trend:	Negative		Negative	Negative	Negative	Negative
Period Ended:	12/31/2019		10/31/2019	10/31/2019	12/31/2019	12/31/2019

Income Statement Data (CAD millions)

Net Interest Income	96	686	786	686	72	1,268
Non-Interest Income	25	76	76	282	16	917
Operating Expenses	71	405	405	726	30	1,291
Income before Provisions and Taxes (IBPT)	50	241	448	241	57	738
Loan Loss Provisions	7	44	58	44	(4)	78
Net Income	30	173	288	173	46	595

Income Statement Ratios (%)

Return on Average Assets	0.32	0.38	0.95	0.38	1.18	0.57
Return on Average Equity	6.13	6.82	10.36	6.82	7.54	10.18
Return on Average Common Equity	6.58	6.98	10.95	6.98	7.54	11.39
Non-Interest Income/Total Revenue	20.30	20.30	8.82	29.13	17.90	41.97
Net Interest Margin	1.05	1.57	2.60	1.57	1.88	1.40
Efficiency Ratio	59.00	59.00	47.06	75.01	34.61	59.08
IBPT/ Avg. Risk-Weighted Assets	1.79	1.79	1.84	1.18	2.17	1.80
Provisions/IBPT	13.90	13.90	12.88	18.46	-7.68	10.57

Balance Sheet Data (CAD millions)

Total Assets	8,945	31,424	31,424	44,353	3,883	106,571
Deposits	4,377	25,351	25,351	25,653	2,939	63,925
Net Loans	7,559	28,366	28,366	33,566	2,662	63,091
Total Common Equity	391	2,324	2,556	2,324	630	5,009
Total Equity	502	2,568	2,948	2,568	630	6,109
Tangible Common Equity	483	1,816	2,687	1,816	630	4,854

Balance Sheet Ratios (%)

Risk-Weighted Assets/Total Assets	30.90	46.01	80.20	46.01	67.93	39.49
Net Loans/Total Assets	84.51	84.51	90.27	75.68	68.55	59.20
Total Common Equity/Total Assets	4.37	5.24	8.13	5.24	16.23	4.70

Risk Profile Ratios (%)

Loan Loss Provisions/Avg. Net Loans	0.09	0.13	0.21	0.13	-0.16	0.13
Net Write-offs/Avg. Net Loans	0.07	0.12	0.23	0.12	0.00	0.06
Gross Impaired Loans/Gross Loans	0.68	0.52	0.52	0.52	0.05	0.53
Loan Loss Reserves/Gross Loans	0.00	0.30	0.39	0.30	0.36	0.38
Loan Loss Reserves/Gross Impaired Loans	0.00	57.35	74.76	57.35	0.00	72.46

Funding & Liquidity Ratios (%)

Net Customer Loans/Deposits	172.69	130.85	111.89	130.85	90.55	98.70
Net Customer Loans/Total Funding	90.51	95.26	102.17	95.26	89.33	75.96
Liquid Assets/Total Assets	13.91	13.91	7.75	20.86	30.54	22.24

Capitalization Ratios (%)

Common Equity Tier 1 Ratio (Basel III)	13.30	9.10	9.10	9.02	23.89	11.30
Tier 1 Ratio (Basel III)	17.30	10.70	10.70	10.22	23.89	13.90
Leverage Ratio	5.20	5.20	8.30	4.60	14.48	4.90
Capital Cushion (CAD millions)	174	413	529	413	445	1,809
Tangible Common Equity / Risk Weighted Assets	13.45	10.66	10.66	8.90	23.89	11.54
Total Dividend Payout	34.82	39.90	39.90	71.62	0.00	78.99

The applicable methodology is the *Global Methodology for Rating Banks and Banking Organisations* (June 8, 2020), which can be found on DBRS Morningstar's website under Methodologies & Criteria.

Ratings

Issuer	Obligation	Rating Action	Rating	Trend
Concentra Bank	Long-Term Issuer Rating	Trend Change	A (low)	Negative
Concentra Bank	Long-Term Senior Debt	Trend Change	A (low)	Negative
Concentra Bank	Long-Term Deposits	Trend Change	A (low)	Negative
Concentra Bank	Short-Term Issuer Rating	Trend Change	R-1 (low)	Negative
Concentra Bank	Short-Term Instruments	Trend Change	R-1 (low)	Negative

Source: DBRS Morningstar.

Ratings History

Issuer	Obligation	Current	2019	2018	2017
Concentra Bank	Long-Term Issuer Rating	A (low)	A (low)	A (low)	A (low)
Concentra Bank	Long-Term Senior Debt	A (low)	A (low)	A (low)	NR
Concentra Bank	Long-Term Deposits	A (low)	A (low)	A (low)	A (low)
Concentra Bank	Short-Term Issuer Rating	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (low)
Concentra Bank	Short-Term Instruments	R-1 (low)	R-1 (low)	R-1 (low)	R-1 (low)

Source: DBRS Morningstar.

Previous Actions

- [DBRS Morningstar Confirms Concentra Bank's Long Term Ratings at A \(low\), Trend Revised to Negative, April 6, 2020.](#)
- [DBRS Assigns a Long-Term Senior Debt Rating of A \(low\) with a Stable Trend to Concentra Bank, November 1, 2018.](#)
- [DBRS Confirms Concentra Bank at A \(low\)/R-1 \(low\), Stable Trends, September 27, 2018.](#)

Related Research

- [Navigating Bank Ratings During a Global Pandemic, March 27, 2020.](#)
- [Canada's Federal Agencies Coordinate Efforts to Support the Financial System Amid the Coronavirus Disease \(COVID-19\) Pandemic, March 24, 2020.](#)
- [DBRS Morningstar's Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings, March 10, 2020.](#)

Previous Reports

- Concentra Bank: [Rating Report](#), October 7, 2019.
- Concentra Bank: [Rating Report](#), October 11, 2018.
- Concentra Bank: [Rating Report](#), November 27, 2017.

Note: All figures are in Canadian dollars unless otherwise noted.

About DBRS Morningstar

DBRS Morningstar is a global credit ratings business with approximately 700 employees in eight offices globally.

On July 2, 2019, Morningstar, Inc. completed its acquisition of DBRS. Combining DBRS' strong market presence in Canada, Europe, and the U.S. with Morningstar Credit Ratings' U.S. footprint has expanded global asset class coverage and provided investors with an enhanced platform featuring thought leadership, analysis, and research. DBRS and Morningstar Credit Ratings are committed to empowering investor success, serving the market through leading-edge technology and raising the bar for the industry.

Together as DBRS Morningstar, we are the world's fourth largest credit ratings agency and a market leader in Canada, the U.S., and Europe in multiple asset classes. We rate more than 2,600 issuers and 54,000 securities worldwide and are driven to bring more clarity, diversity, and responsiveness to the ratings process. Our approach and size provide the agility to respond to customers' needs, while being large enough to provide the necessary expertise and resources.



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