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## Banco Bradesco S.A.

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# Banco Bradesco S.A.

<b>SACP</b>	<b>bbb-</b>		+	<b>Support</b>	<b>0</b>	+	<b>Additional Factors</b>	<b>-2</b>			
<b>Anchor</b>	<b>bb+</b>			<b>ALAC Support</b>	<b>0</b>		<table border="1"> <tr> <th colspan="2">Issuer Credit Rating</th> </tr> <tr> <td colspan="2" style="background-color: yellow; text-align: center;"><b>BB/Negative/B</b></td> </tr> </table>	Issuer Credit Rating		<b>BB/Negative/B</b>	
Issuer Credit Rating											
<b>BB/Negative/B</b>											
<b>Business Position</b>	<b>Very Strong</b>	<b>+2</b>		<b>GRE Support</b>	<b>0</b>						
<b>Capital and Earnings</b>	<b>Weak</b>	<b>-1</b>		<b>Group Support</b>	<b>0</b>						
<b>Risk Position</b>	<b>Adequate</b>	<b>0</b>		<b>Sovereign Support</b>	<b>0</b>						
<b>Funding</b>	<b>Average</b>	<b>0</b>									
<b>Liquidity</b>	<b>Adequate</b>										

## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• Very strong and diversified franchise in Brazil, with a market-leading banking franchise, diversified earnings, and good track record</li> <li>• Low-cost, diversified and stable funding base that supports the business during market distress</li> </ul>	<ul style="list-style-type: none"> <li>• Weak capitalization, although slower portfolio growth relieves pressure on risk-adjusted capital (RAC)</li> <li>• Challenging credit environment as across-the-board asset quality pressure jeopardizes returns and leads to more refinancing</li> <li>• High business concentration in Brazil, with limited international diversification.</li> </ul>

## Outlook : Negative

The negative outlook reflects our view that the ratings on Banco Bradesco S.A. should move in tandem with those on the sovereign. There is a greater than one-in-three likelihood that we could lower the ratings on Brazil again. Our outlook also incorporates potential further downgrades of S&P Global Ratings' Banking Industry Country Risk Assessment (BICRA) and the 'bb+' anchor for banks operating in Brazil, as well as potential further deterioration in the bank's capital because of increasing risk charges. We could also see some pressure on the bank's business position due to potential revenue instability compared with international peers.

### Downside scenario

Within the next year, a downgrade of Brazil and Bradesco could stem from potential key policy reversals given the fluid political dynamics, including lack of cohesion within the cabinet, inconsistent policy initiatives, and uncertainties following the impeachment process. A downgrade could also result from changes in Brazil's BICRA and risk charges (currently with a negative trend). In turn, that could lead to further capital pressure, risk position pressure due to asset quality deterioration, and business position pressure due to revenue instability (compared with international peers). We might ultimately see multiple score changes and a multiple notch drop in the bank's stand-alone credit profile (SACP) to levels below the sovereign rating.

### Upside scenario

We could revise our outlook on Bradesco to stable if policy execution were to consistently improve across all branches of Brazil's government, fiscal deterioration stopped, and prospects for GDP growth strengthened. Those developments could help Brazil recover more quickly from its recession, facilitate better fiscal performance, and provide room to maneuver in the face of economic shocks. Therefore the ratings on Bradesco could also stabilize. We then might change our negative trend on Brazil's BICRA to stable if asset quality improves materially and revenues stabilize.

## Rationale

The issuer credit ratings (ICR) on Bradesco are based on our assessment of its very strong business position, which continues to reflect the bank's prominent market share in almost all the lines in which it operates. We've revised the bank's capital and earnings assessment to weak from moderate, taking into account our forecasted risk-adjusted capital (RAC) ratio (4.1% for the next 24 months). The bank has felt pressure from both Brazil's BICRA and from recent sovereign downgrades, as these materially increased risk-weighted assets (RWAs) and the estimated goodwill from its HSBC Brasil acquisition. Increasing credit losses and asset quality pressure have brought our adequate risk position assessment under pressure. The ratings also incorporate our assessment of the bank's funding as average and its liquidity as adequate. We lowered the SACP to 'bbb-', from 'bbb' because of the change in its capital and earnings score. Nonetheless, the foreign currency rating on Brazil constrains the ratings on Bradesco due to its extensive exposure to the government in the bank's government bond portfolio. Therefore, Bradesco fails the stress test associated with a sovereign foreign currency default.

We have seen increasing capital pressure on all Brazilian banks due to the substantial increase in RWAs since the sovereign and BICRA downgrades of Brazil in the last three years. At the same time, Basel III capitalization ratios continue to have zero risk-weight for Brazilian government bonds, even though this asset risk has clearly increased in the last three years. Pressure on asset quality stemming from Brazil's recession will stress bank performance across the country for the next few years, in turn jeopardizing internal capital generation and putting a strain on capitalization. In Bradesco's case, additional pressures stem from our estimates of goodwill from the HSBC acquisition and our conservative approach toward insurance assets, which are fully deducted. For Bradesco, they're representative of the overall system because the bank controls the country's largest insurance company.

### Anchor: 'bb+' for a bank operating only in Brazil

Under our bank criteria, we use our Banking Industry Country Risk Assessment's (BICRA) 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 Brazil is 'bb+', based on the country's economic risk score of 7 and an industry risk score of 5.

Brazil's economic risk reflects the country's low GDP per capita levels and political and economic challenges, which remain considerable. In our view, credit risks in the economy have increased. We believe that Brazil's challenging economic conditions, high inflation, rising interest rates, and tighter credit conditions will weaken the corporate sector, which would result in higher non-performing loans and credit losses. Furthermore, we expect these conditions will place a greater burden on Brazil's already highly-indebted households as unemployment rises. We expect the banking sector's asset quality will continue deteriorating amid rising credit losses.

Our industry risk assessment for Brazil reflects the large presence of government-owned banks in the financial system, which has caused significant distortions over the past few years, weakening competitive dynamics. However, the pressure on banks' margins has eased over the past few months as reference rates have increased sharply. Domestic financial regulation has improved thanks to extensive coverage and alignment with international standards. The Brazilian banking system also has an adequate funding mix with a stable core customer deposit base and satisfactory access to domestic and international capital markets. In addition, banks' dependency on external funding is fairly low, accounting for 8.6% of the system's total liabilities in the past two years.

**Table 1**

Banco Bradesco S.A. Key Figures					
	--Year-ended Dec. 31--				
(Mil. R\$)	2015	2014	2013	2012	2011
Adjusted assets	845,948.8	859,739.1	755,590.0	732,597.3	642,814.9
Customer loans (gross)	366,567.4	346,643.6	323,061.2	290,960.3	268,667.9
Adjusted common equity	81,341.0	71,429.4	61,920.4	57,899.2	51,093.1
Operating revenues	86,065.9	79,997.6	68,933.1	67,838.3	65,783.1
Noninterest expenses	46,610.7	45,021.7	42,015.4	41,333.5	39,255.0
Core earnings	18,871.5	16,347.4	13,253.6	12,389.5	12,042.9

R\$--BRL-Brazilian real. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

### Business position: Strong pricing power and capacity to generate fee revenues

We continue to assess Bradesco's overall business position as very strong due to its diversified market presence, wide range of loans and services, and solid franchise, especially within the retail and insurance segments where its pricing power is evident. While the bank remains very representative of the country's financial system, we are starting to see less room to maneuver in the bank's pricing power and revenue stability in light of Brazil's severe recession. With total assets of R\$1.2 trillion as of March 31, 2016, Bradesco is the second-largest private bank in Latin America and controls the country's largest insurer, Bradesco Seguros. The acquisition of HSBC Bank Brasil, which was fully cleared by regulators for \$5.2 billion, enhances the bank's presence in its key retail and corporate markets, with a particular improvement of the bank's market share in the south of the country. Bradesco provides banking and insurance services to almost 34% of Brazil's total population (about 200 million), underscoring its exceptional market penetration. Despite Brazil's sluggish economy, the bank's revenues are stable, given its diversified business activities, stable fee revenues, and ongoing efficiency gains. Bradesco is primarily a domestic bank, with no major operations outside Brazil. But the bank has a nationwide footprint and management has many years of experience and a proven track record.

**Table 2**

Banco Bradesco S.A. Business Position					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Loan market share in country of domicile	9.8	10.2	10.8	11.3	12.0
Deposit market share in country of domicile	9.4	10.8	11.6	12.0	12.8
Total revenues from business line (currency in millions)	85,553.6	79,481.8	70,568.7	70,469.9	66,676.9
Commercial banking/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Retail banking/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Commercial & retail banking/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Trading and sales income/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Corporate finance/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Brokerage/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Insurance activities/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Agency services/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Payments and settlements/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Asset management/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Other revenues/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Investment banking/total revenues from business line	N/A	N/A	N/A	N/A	N/A
Return on equity	20.2	19.8	17.0	18.1	21.3

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

### Capital and earnings: Weak capital levels and pressured profitability

We revised Bradesco's capital and earnings score to weak from moderate. In addition to the capital pressure that we've seen in the last two years for all Brazilian banks due to sovereign and BICRA downgrades (which increase all RWAs used in our RAC model), we have also estimated goodwill from the fully-approved HSBC acquisition and introduced it into our RAC calculation. These combined factors led to a forecasted RAC of 4.1% for the next two years, which correspond to weak capital levels. In addition to incorporating HSBC and the aforementioned goodwill, we assumed

3% portfolio growth, increasing net interest margins, continued asset quality pressure, and overall lower results. The quality of capital has also decreased materially in the last few years, as deferred-tax assets (DTAs) grew substantially after the increase in credit provisions. DTAs now account for more than 50% of Bradesco's net worth, somewhat limiting its loss absorption capacity. Despite Brazil's recession in 2015, we believe Bradesco's profitability, although lower than last year, will continue to be the main contributor in terms of supporting current capitalization levels. This support will provide a solid buffer against the bank's credit risks, attesting to its resilience in such a difficult scenario.

**Table 3**

Banco Bradesco S.A. Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2015	2014	2013	2012	2011
Tier 1 capital ratio	12.7	12.9	12.3	11.0	12.4
S&P RAC ratio before diversification	5.5	5.5	N.M.	N.M.	N.M.
S&P RAC ratio after diversification	6.0	6.3	N.M.	N.M.	N.M.
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Double leverage	N.M.	N.M.	N.M.	N.M.	N.M.
Net interest income/operating revenues	65.2	58.9	53.1	67.2	59.8
Fee income/operating revenues	22.4	27.2	28.2	25.2	22.5
Market-sensitive income/operating revenues	N/A	N/A	N/A	N/A	N/A
Noninterest expenses/operating revenues	54.2	56.3	61.0	60.9	59.7
Preprovision operating income/average assets	3.8	3.6	3.0	3.2	3.8
Core earnings/average managed assets	1.8	1.7	1.5	1.5	1.7

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

### **Risk position: Asset quality pressure across the industry continues strong**

We view Bradesco's risk position as adequate based on its conservative growth, good track record in managing acquisitions, relatively simple business model for an institution of its size, national scope, and industry diversification in its loan portfolio. The bank's assets have grown at a slower pace than the domestic financial system in the past few years. NPLs ticked upwards to 4.9% in December 2015 from 4.0% in March 2014, pointing to potentially higher credit losses. We expect NPLs to grow in 2016, potentially surpassing 7% of the total portfolio depending on the bank's strategy toward renegotiations, especially among large corporate clients. Weaker asset quality, which we are observing in all banks operating in Brazil, should take a toll in Bradesco's results going forward and could potentially lead to a change in the bank's currently adequate risk position. The bank's diversification and low single-name concentration help it maintain adequate asset quality indicators. The recent indictment of Bradesco senior executives in a corruption investigation by the Brazilian Federal Police represents a risk not covered by its RAC framework. The scandal could harm the bank's ratings if it tarnishes Bradesco's reputation, reducing investor appetite for the bank and potentially affecting its funding and business stability. Nevertheless, we haven't yet seen any material impact from the recent indictments of several senior executives.

**Table 4**

<b>Banco Bradesco S.A. Risk Position</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Growth in customer loans	5.7	7.3	11.0	8.3	16.5
Total diversification adjustment / S&P RWA before diversification	(8.7)	(12.7)	N.M.	N.M.	N.M.
Total managed assets/adjusted common equity (x)	12.5	14.4	14.7	15.2	14.9
New loan loss provisions/average customer loans	5.8	4.3	4.4	5.0	4.8
Net charge-offs/average customer loans	2.9	2.7	3.2	3.3	2.4
Gross nonperforming assets/customer loans + other real estate owned	4.7	4.1	4.0	4.6	4.4
Loan loss reserves/gross nonperforming assets	171.7	161.2	168.3	158.9	163.5

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

### **Funding and liquidity: Competitive and diversified funding**

Bradesco has average funding and adequate liquidity, which are in line with those of its regional peers, in our view. The bank's extensive retail network results in a stable deposit base, and its widely known brand and resilience make it a safe harbor in times of stress. The bank's stable funding ratio was 93.83% as of December 2015, while its broad liquid assets to short-term funding ratio was 1.44x.

The long-term issuer credit rating on Bradesco is two notches lower than its SACP, and at the same level as the long-term foreign currency rating on Brazil. It's unlikely that we'd assign an issuer credit rating to a bank that's above the sovereign rating because the bank would have to demonstrate a capacity to maintain sufficient capital and liquidity to cover the significant stress that accompanies a sovereign default. Additionally, Bradesco has significant asset exposure to the sovereign because the bank's liquid assets are largely invested in sovereign bonds.

**Table 5**

<b>Banco Bradesco S.A. Funding And Liquidity</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Core deposits/funding base	46.2	40.2	42.1	41.5	46.5
Customer loans (net)/customer deposits	114.3	112.8	114.5	108.5	99.6
Long term funding ratio	66.3	57.6	60.0	60.2	66.3
Stable funding ratio	95.1	95.8	95.8	102.4	110.7
Short-term wholesale funding/funding base	38.1	46.9	44.1	44.1	36.8
Broad liquid assets/short-term wholesale funding (x)	1.4	1.2	1.2	1.3	1.5
Net broad liquid assets/short-term customer deposits	42.1	24.3	26.1	44.6	64.9
Short-term wholesale funding/total wholesale funding	70.8	78.5	76.2	75.4	68.9
Narrow liquid assets/3-month wholesale funding (x)	N/A	N/A	N/A	N/A	N/A

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

## Related Criteria And Research

### Related Criteria

- S&P Global Ratings' National And Regional Scale Mapping Tables, June 1, 2016
- Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Group Rating Methodology, Nov. 19, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 09, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov.09, 2011
- Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks, May 04, 2010
- Bank Capital Methodology And Assumptions, Dec. 06, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Commercial Paper I: Banks, March 23, 2004

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 October 11, 2016)

#### Banco Bradesco S.A.

Counterparty Credit Rating

BB/Negative/B

*Brazil National Scale*

brAA-/Negative/brA-1

Senior Unsecured

BB

#### Counterparty Credit Ratings History

17-Feb-2016 *Foreign Currency*

BB/Negative/B

10-Sep-2015

BB+/Negative/B

28-Jul-2015

BBB-/Negative/A-3

26-Mar-2014

BBB-/Stable/A-3

07-Jun-2013

BBB/Negative/A-2

## Ratings Detail (As Of October 11, 2016) (cont.)

11-Jul-2012		BBB/Stable/A-2
17-Feb-2016	<i>Local Currency</i>	BB/Negative/B
10-Sep-2015		BB+/Negative/B
28-Jul-2015		BBB-/Negative/A-3
26-Mar-2014		BBB-/Stable/A-3
07-Jun-2013		BBB/Negative/A-2
11-Jul-2012		BBB/Stable/A-2
17-Feb-2016	<i>Brazil National Scale</i>	brAA-/Negative/brA-1
10-Sep-2015		brAA+/Negative/brA-1
28-Jul-2015		brAAA/Negative/brA-1+
29-Sep-2014		brAAA/Stable/brA-1+
<b>Sovereign Rating</b>		
Brazil (Federative Republic of)		BB/Negative/B
<i>Brazil National Scale</i>		brAA-/Negative/--
<b>Related Entities</b>		
<b>Banco Bradesco Argentina S.A.</b>		
Issuer Credit Rating		
<i>Argentina National Scale</i>		raBBB/Stable/raA-2
<b>Bradesco Capitalizacao S.A.</b>		
Issuer Credit Rating		
<i>Brazil National Scale</i>		brAA-/Negative/--
<b>Bradesco Seguros S.A.</b>		
Financial Strength Rating		
<i>Brazil National Scale</i>		brAA-/Negative/--
Issuer Credit Rating		
<i>Brazil National Scale</i>		brAA-/Negative/--

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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