Daiwa Capital Markets

European Banks – Credit Update

- The publication of a climate transition-finance handbook by ICMA in December and subsequent benchmark transition bond issuance by the Bank of China gives traction to this ESG sub-segment
- New Year European primary market activity saw SSA's pick up where they left off in terms of healthy volume growth while FIG issuance is down 30% and limited to Sr/HoldCo, Tier 2 and AT1
- Spreads in EUR and USD secondary market remain tight on back of supportive ECB and Fed policy

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Transition bonds expected to gain relevance

The ESG landscape is continually maturing and as the market evolves from familiar labels such as 'green', 'social' and 'sustainable' (GSS) we are likely to see more so-called 'transition' bonds in 2021 following the publication of the International Capital Market Association's (ICMA) climate transition handbook in early December 2020. Transition bonds are considered a relatively new segment among ESG securities, targeting high carbon-emitting industries that otherwise do not qualify for green finance, allowing them to raise needed capital to transition from 'brown' or polluting business activities to more environmentally friendly, green business activities. For this purpose and to meet the objectives enshrined in the Paris Agreement on Climate Change, ICMA published its Transition Finance Handbook that seeks to provide clear guidance and common expectations to capital markets participants on the practices, actions and disclosures to be made available when raising funds in debt markets for climate transition-related purposes. Similar to the EU Taxonomy, ICMA's handbook encourages market participants that are raising climate transition-related funds to reference its recommendations in their reporting. This should provide some comfort and guidance to investors that are reluctant to invest in something other than GSS. Volumes of GSS bonds reached record levels in 2020 according to data from the Climate Bond Initiative, which states that issuance volumes will have reached USD425bn, approximately 30% more than last year. Transition bonds in comparison are still considered niche with just over 11 deals finalised since 2017, notably by Italian energy infrastructure firm SNAM in late 2020 and the European Bank for Reconstruction and Development (EBRD) with their inaugural transition bond issued in October 2019.

Transition financing faces difficulties that green bonds arguably did not when they were first launched as agreeing on what constitutes green financing is objectively easier than gauging what constitutes a gradual transition away from a 'brown' industry. However, the ICMA handbook provides investors and issuers with a guiding framework that formulates its recommendations across four key pillars. Notably, the handbook points to 'science-based targets and pathways' and 'implementation transparency', referencing the Taxonomy alongside other sources of verification. With guidelines in place, the format received a huge endorsement when the Bank of China (BoC) sold its debut transition bond last week. The senior unsecured transaction was split into an USD500m, 3-year tranche and a CNY1.8bn (USD280m equivalent) 2-year tranche. It was listed in Hong Kong and issued under BoC's USD40bn MTN Programme and has identified several projects eligible for funding under the transition framework that will support China's drive for carbon neutrality by 2060. Both tranches received sizeable orders including from the joint leads. BoC is at the forefront of green and sustainable finance in many new issues either on the Asian continent or globally. It is one of China's big four banks and the first Asian issuer to sell a USD denominated transition bond worldwide. In September 2020 it sold Asia's first blue bond which benefits ocean-related projects. It was also the first bank to sell a Covid-linked bond, the first bond under the Belt and Road initiative, and the first social bond offshore from China. Undoubtedly there are risks attached to being an early adopter, especially in trying times like these. However, with clarity provided to investors with ICMA's transition finance handbook, this example could embolden other Asian issuers to help their economies transition to a more sustainable path.

BoC Transition Bonds	USD500m	CNY1.8bn (~USD280m)
Tenor	3-years	2-years
Coupon	0.875%	2.80%
Yield	0.933%	-
Spread	T + 72bps	-
Book Orders	>USD1.76bn*	>CNY9.8bn**
Number of Investors:	68	89
Investor Geography:		
Asia	64%	94%
EMEA	36%	6%
Investor Type:		
Banks	48%	-
Central Banks/ Official institutions	31%	-
Fund Managers/Others	21%	-
ALM	-	47%
Asset Managers	-	36%
Private Banks	-	14%
Hedge Funds	-	3%

*Source: Bloomberg; *incl $330m JLM; **incl. CNY2.6bn JLM*

Primary and secondary markets

The first week of 2021's European **primary** market activity told two different stories when comparing SSA and FIG volumes. Based on data compiled from Bondradar, European SSA's closed the week strong with combined issuance of some EUR42bn, which was up 3% against the same period last year. In contrast, FIG activity was muted at just EUR15.8bn, down 30% on last year. As one of the few major European sovereigns not in negative yield territory, Italy's government had the most subscribed bond of the week with order books 10.5x over the EUR10bn deal size. Spreads of the 16-year bond tightened by 5bps on the back of sizeable book orders pricing at BTP + 8bps. Other SSA issuers attracted similarly high book orders with the EIB (9.76x), Republic of Slovenia (8x) and Republic of Ireland (7.3x) seemingly shrugging off news surrounding rising infection numbers, tighter lockdown measures and political unrest across the pond. Germany's KfW was the first major development agency to access EUR MTN for its 2021 funding plan of EUR70-80bn, launching a EUR5bn note with a 10-year maturity. Order books of 3.9x saw the issue tighten by 2bps to MS-9bps but also exceeded demand for KfW's inaugural 2020 EUR5bn offering by EUR4.5bn. This suggests continued appetite from SSA investors for core European titles despite the expectation of continued negative yields, which was reinforced by the enhancement of the ECB's policy stimulus in December last year.

FIG supply so far has been below levels seen in previous years and extends the trend observed throughout 2020 as central bank policies drove spreads significantly tighter while also crucially reducing banks' reliance on capital market funding, a trend which we expect to continue in 2021. Limited Euro supply of EUR6.8bn was predominantly provided in Sr/HoldCo format as issuers looked towards strengthening their TLAC/MREL positions rather than issuing debt for purely funding purposes. SocGen (8NC7) and Swedbank (7NC6) both issued longer-dated SNP to avoid going into negative yield territory. Narrowing spreads between SNP and SP paper means that for a few basis points more issuers gain regulatory benefits at little additional cost. That explains why BPCE has been the only SP issuer so far, with its EUR2bn dual-tranche transaction leaving overall issuance of the senior format down by quite a margin on the 2020 level of EUR12.5bn. New virus strains and stricter lockdown measurers haven't dampened funding conditions further down the seniority waterfall which prompted some issuers to offer more junior paper. Spain's Abanca and Banco de Sabadell took advantage of this and issued half of the EUR3.1bn AT1 and Tier 2 notes that went to market this week.

For Spain's fourth largest bank Sabadell, the EUR500m Tier 2 was the first bond issued since merger talks with BBVA fell through in November of last year. Nevertheless, investor interest was undeterred as the Tier 2 was 3.6x oversubscribed note pushing spreads down by 35bps to MS + 295bps. Appetite for yield and reduced coupon risk from large existing capital buffers over MDA saw Abanca's EUR375m AT1 attract book orders 6x over offering. This was the highest subscribed FIG transaction of the week. At least four more European high coupon AT1s will be callable during 1Q21, which we expect will add to the issuance pipeline at cheaper levels as spreads have almost recovered to pre-Covid levels. European banks were able to source large volumes and diversify from EUR during the first week of 2021 as USD volumes of USD9.5bn outpaced the same period last year (USD7.7bn; +23% yoy). USD issuance was led by Standard Chartered Bank which came to market with two Sr/HoldCo and one AT1 for a combined volume of USD4.25bn.

(Table 1) Key Transactions

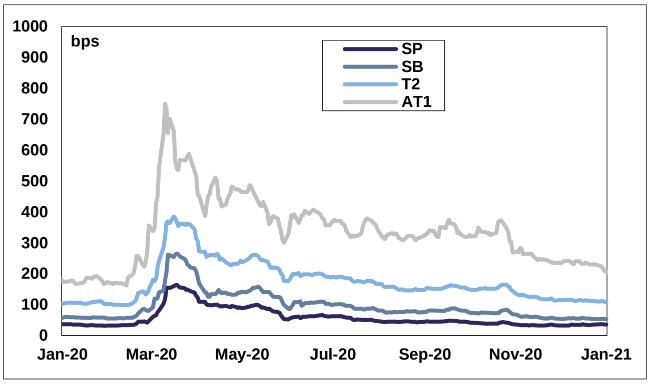
Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
Banco de Sabadell	Tier 2	EUR500m	10.25NC5.25	MS + 295	MS + 330	>EUR1.8bn
KBC	Sr/HoldCo	EUR750m	8NC7	MS + 60	MS + 80	>EUR1.2bn
Abanca	AT1	EUR375	PNC5.5	-	~6%	>EUR2.1bn
SocGen	SNP	EUR1,000m	8NC7	MS + 95	MS + 115/120	>EUR2.4bn
Swedbank	SNP	EUR750m	7Y	MS + 63	MS + 80	>EUR1.1bn
KfW	Senior Unsecured	EUR5,000m	10Y	MS - 9	MS - 7	>EUR16bn
KfW	Senior Unsecured	GBP1,000	5Y	G + 22	G + 23	>GBP2.1bn
Italy Government	Senior Unsecured	EUR10,000m	15Y	BTP + 8bps	BTP + 13	>EUR105bn
BPCE	SP	EUR1,250	10Y	MS + 60	MS + 75	>EUR1.6bn
BPCE	SP	EUR750m	6Y	MS + 48	MS + 60/65	>EUR1.1bn
Standard Chartered	AT1	USD1,250m	PNC10	-	5.50%	>USD8.4bn
EIB	EARN	EUR5,000m	10Y	MS - 11	MS - 9	>EUR48.8bn
BNP Paribas	SNP	GBP1,000m	10Y	G + 105	G + 120/125	>GBP1.9bn
Banco de Sabadell	Tier 2	EUR500m	10.25NC5.25	MS + 295	MS + 330	>EUR1.8bn

Source BondRadar, Bloomberg.

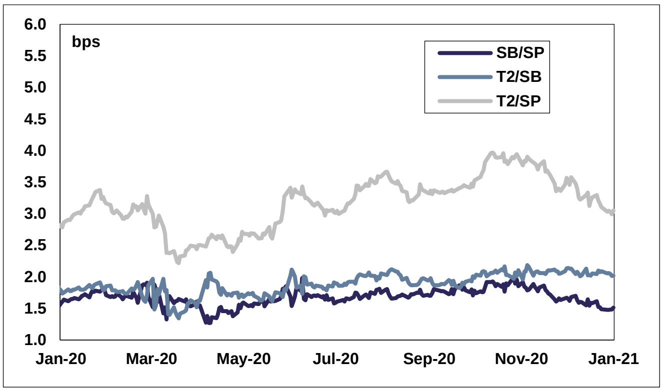
Secondary market spreads tightened on the whole across EUR and USD. CDS price indices on European senior (58.2bps) and subordinated financials (109.1bps) as measured by iTraxx benchmarks continued closing in on pre-Covid levels coming within 7bps and 2bps respectively, signalling continued benign funding conditions. News of political unrest in the USA and stricter lockdown measures in Europe that are diminishing the likelihood of a V-shaped recovery did not hamper demand. Excess liquidity driven by ECB policies have kept spreads tight as average weekly EUR spreads across geographies for SP (-1bps), SNP (-0.2bps) and Tier 2 (-8bps) closed at narrower levels. Given the expected lower SP issuance volumes in the near term and higher supply of SNP we may see the delta between both classes widen again. Strong funding conditions were even more pronounced in the USD market with USD SP tighter by 2bps while SNP and Tier 2 were down by 5bps and 8bps respectively. Bloomberg data shows that 22 of 27 monitored deals across SSA and FIG have tightened in the secondary market since being launched last week. We expect near-term conditions to remain stable until we enter the reporting period for US banks later this week.

Western European Banks EUR Spreads and Yields

Aggregate EUR Z-spread LTM (bps)



Multiples (x)



Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCo; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

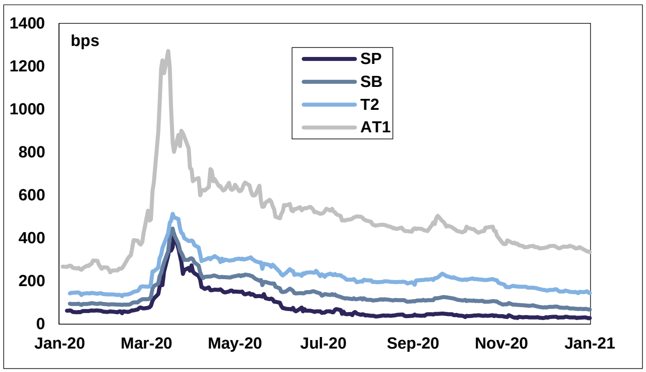
Selected Names

	Sr Preferred/Sr OpCo					Sr Non-Preferred/Sr HoldCo					Tier 2				
	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD
Commerz	5.4	0.1	52.2	-1.3	-1.3	3.9	0.3	70.1	-2.8	-2.8	4.7	1.6	197.5	-16.1	-16.1
Barclays	3.3	0.2	60.2	1.7	1.7	2.8	0.0	49.1	4.8	4.8	2.0	0.8	127.9	-10.2	-10.2
BBVA	4.3	-0.1	34.1	0.8	0.8	4.0	0.1	49.9	1.3	1.3	5.5	0.7	119.0	-10.2	-10.2
BFCM	4.2	-0.2	30.4	0.8	0.8	8.8	0.4	61.9	0.1	0.1	4.9	0.4	77.8	-3.8	-3.8
BNPP	2.1	-0.3	21.8	1.6	1.6	4.7	0.2	56.3	-1.2	-1.2	4.6	0.6	95.8	-5.0	-5.0
BPCE	3.5	-0.2	31.4	2.2	2.2	4.6	0.1	54.7	1.6	1.6	2.4	0.2	69.3	0.0	0.0
Credit Ag.	3.1	-0.1	30.8	0.0	0.0	5.7	0.1	52.1	0.9	0.9	4.7	0.8	116.0	-5.8	-5.8
Credit Sui.	5.4	0.1	52.2	-1.3	-1.3	5.3	0.2	60.7	0.4	0.4	5.6	1.1	145.4	-8.2	-8.2
Danske	2.4	-0.2	30.7	0.1	0.1	2.3	0.1	56.8	1.6	1.6	3.6	0.8	126.5	-6.1	-6.1
Deutsche	2.6	0.0	44.0	-2.9	-2.9	3.8	0.6	104.4	-3.0	-3.0	4.4	1.8	218.4	-20.3	-20.3
DNB	2.8	-0.2	26.4	1.0	1.0	3.7	0.1	50.6	-1.4	-1.4	1.6	0.0	47.2	0.7	0.7
HSBC	3.3	-0.1	33.5	2.4	2.4	3.2	-0.1	38.9	2.6	2.6	5.4	0.4	75.2	-2.8	-2.8
ING	1.2	-0.4	8.7	-0.2	-0.2	4.8	0.1	46.1	0.7	0.7	3.6	0.6	100.2	-4.1	-4.1
Intesa	4.2	0.1	54.5	0.5	0.5						5.1	1.6	197.6	-4.3	-4.3
Lloyds	2.8	-0.2	20.1	0.9	0.9	3.6	0.0	49.2	-2.5	-2.5	2.6	0.6	104.0	-2.0	-2.0
Nordea	4.0	-0.2	24.8	-0.7	-0.7	2.4	-0.2	27.9	1.2	1.2	0.7	0.2	58.3	-8.3	-8.3
Rabobank	2.3	-0.3	17.7	-1.0	-1.0	5.8	-0.1	36.6	-1.7	-1.7	1.6	0.0	40.5	-2.0	-2.0
RBS	3.2	0.0	41.5	0.1	0.1	5.8	-0.1	36.6	-1.7	-1.7	1.6	0.0	40.5	-2.0	-2.0
Santander	3.4	-0.1	36.1	3.3	3.3	4.9	0.2	57.6	-0.7	-0.7	5.5	0.7	104.9	-6.0	-6.0
San UK	2.5	-0.2	22.8	-0.9	-0.9	2.4	0.0	53.7	0.2	0.2	5.5	0.7	104.9	-6.0	-6.0
SocGen	1.5	-0.3	23.5	-0.2	-0.2	6.2	0.3	71.9	-1.8	-1.8	3.1	0.5	91.1	-4.8	-4.8
StanChart	3.7	-0.1	39.6	0.3	0.3	5.4	0.1	50.7	3.4	3.4	3.1	0.6	100.3	-7.0	-7.0
Swedbank	4.2	-0.1	38.3	0.7	0.7	5.3	0.1	53.6	-0.5	-0.5	5.3	0.5	93.6	-5.3	-5.3
UBS	1.9	-0.3	22.3	-0.7	-0.7	3.1	0.0	47.0	0.7	0.7	0.3	0.7	54.1	-52.3	-52.3
UniCredit	3.6	0.3	65.1	-1.1	-1.1	4.0	0.8	123.8	-0.7	-0.7	2.8	1.7	210.7	-14.0	-14.0

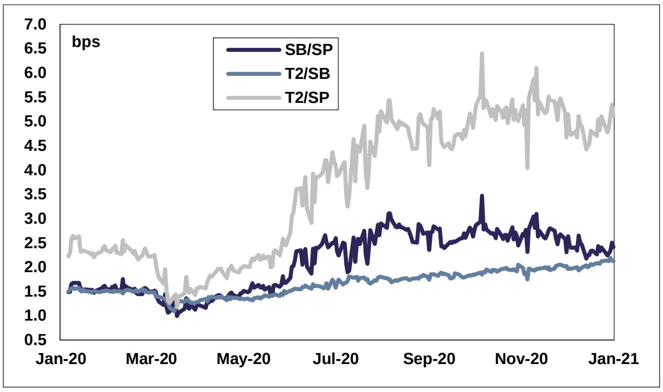
Source: Bloomberg, Daiwa Capital Markets Europe. Dur.= Duration. Yield= Yield to worst (%). Z = Z-Spread to Worst (bps). Z 5DΔ = last 5 days Z-spread net change (bps). Z YTD = year to date Z-Spread net change (bps). Blank cells represent lack of statistically significant data. Figures may not be representative of the whole market.

Western European Banks USD Spreads and Yields

Aggregate USD Z-spread LTM (bps)



Multiples (x)



Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCo; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

Selected Names

	Sr Preferred/Sr OpCo					Sr Non-Preferred/Sr HoldCo					Tier 2				
	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD
Barclays	2.2	0.5	21.3	-6.5	-6.5	4.1	1.3	77.6	0.2	0.2	5.6	2.2	143.8	-8.8	-8.8
BFCM	2.4	0.5	27.4	-2.2	-2.2	4.1	1.3	77.6	0.2	0.2	5.6	2.2	143.8	-8.8	-8.8
BNPP	2.1	0.3	10.8	-4.3	-4.3	4.2	1.2	60.8	-5.7	-5.7	5.1	1.7	101.7	-2.6	-2.6
BPCE	2.5	0.6	35.9	-2.0	-2.0	4.2	1.1	50.9	-1.9	-1.9	3.3	1.3	89.0	-2.5	-2.5
Credit Ag.	2.6	0.6	32.8	4.8	4.8	2.8	0.9	36.6	-3.1	-3.1	7.0	2.3	129.2	-1.4	-1.4
Credit Sui.	2.3	0.4	22.0	0.6	0.6	4.0	1.3	68.1	1.2	1.2	2.4	1.7	125.4	2.1	2.1
Danske	1.9	0.6	36.3	1.5	1.5	2.5	1.0	67.0	-6.3	-6.3	2.4	1.7	125.4	2.1	2.1
Deutsche						3.4	1.4	76.0	-2.9	-2.9	6.3	3.0	258.8	-20.0	-20.0
HSBC	3.6	1.0	71.2	-11.2	-11.2	4.6	1.3	70.0	-0.4	-0.4	10.8	3.1	156.7	-6.9	-6.9
ING	3.6	1.0	71.2	-11.2	-11.2	4.4	1.2	59.8	-2.4	-2.4	2.3	1.1	83.5	-4.6	-4.6
Intesa	3.3	1.4	101.3	-2.8	-2.8	4.4	1.2	59.8	-2.4	-2.4	3.8	2.6	203.8	-10.1	-10.1
Lloyds	4.0	1.1	61.1	0.3	0.3	3.3	1.0	59.9	1.5	1.5	4.6	1.7	109.9	-5.0	-5.0
Nordea	3.5	0.6	25.9	1.4	1.4	2.5	0.6	28.1	-4.2	-4.2	1.6	0.8	43.7	-0.4	-0.4
Rabobank	2.0	0.4	14.7	-1.0	-1.0	3.8	0.9	39.9	-3.1	-3.1	4.6	1.4	74.7	-4.1	-4.1
RBS	2.0	0.4	14.7	-1.0	-1.0	3.8	0.9	39.9	-3.1	-3.1	4.6	1.4	74.7	-4.1	-4.1
Santander	5.4	1.4	72.4	0.0	0.0	4.8	1.5	86.1	-3.4	-3.4	6.5	2.1	124.1	-5.1	-5.1
San UK	3.0	0.6	34.4	-9.6	-9.6	2.7	0.9	54.6	-6.3	-6.3	4.2	2.2	164.3	-28.4	-28.4
SocGen	4.4	1.0	49.1	-1.5	-1.5	3.8	1.3	80.5	-4.6	-4.6	4.1	1.9	128.9	-9.0	-9.0
StanChart	0.4	0.6	38.3	-16.5	-16.5	3.6	1.2	73.4	-6.7	-6.7	5.1	2.3	168.2	-6.2	-6.2
UBS	9.5	1.5	60.4	0.9	0.9	4.3	1.2	57.7	-0.8	-0.8	5.1	2.3	168.2	-6.2	-6.2
UniCredit	1.8	1.4	119.0	-4.3	-4.3	3.5	1.5	114.3	-8.8	-8.8	5.8	4.2	314.0	-20.4	-20.4

Source: Bloomberg, Daiwa Capital Markets Europe. Dur.= Duration. Yield= Yield to worst (%). Z = Z-Spread to Worst (bps). Z 5DΔ = last 5 days Z-spread net change (bps). Z YTD = year to date Z-Spread net change (bps). Blank cells represent lack of statistically significant data. Figures may not be representative of the whole market.

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[Standard & Poor's]

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[Moody's]

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The name and registration number of the Registered Credit Rating Agency in the group: Moody's Japan K.K. (FSA commissioner (Rating) No.2)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Unregistered Rating explanation" in the section on "The use of Ratings of Unregistered Agencies" on the website of Moody's Japan K.K. (The website can be viewed after clicking on "Credit Rating Business" on the Japanese version of Moody's website (https://www.moodys.com/pages/default_ja.aspx)

Assumptions, Significance and Limitations of Credit Ratings

Credit ratings are Moody's Investors Service's ("MIS") current opinions of the relative future credit risk of entities, credit commitments, or debt or debt-like securities. MIS defines credit risk as the risk that an entity may not meet its contractual, financial obligations as they come due and any estimated financial loss in the event of default. Credit ratings do not address any other risk, including but not limited to: liquidity risk, market value risk, or price volatility. Credit ratings do not constitute investment or financial advice, and credit ratings are not recommendations to purchase, sell, or hold particular securities. No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information, is given or made by MIS in any form or manner whatsoever.

Based on the information received from issuers or from public sources, the credit risks of the issuers or obligations are assessed. MIS adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MIS considers to be reliable. However, MIS is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of April 16th, 2018, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Moody's Japan K.K. (https://www.moodys.com/pages/default_ja.aspx)

[Fitch]

The Name of the Credit Rating Agencies group, etc

The name of the Credit Rating Agencies group: Fitch Ratings ("Fitch")
The name and registration number of the Registered Credit Rating Agency in the group: Fitch Ratings Japan Limited (FSA commissioner (Rating) No.7)

How to acquire information related to an outline of the rating policies and methods adopted by the person who determines Credit Ratings

The information is posted under "Outline of Rating Policies" in the section of "Regulatory Affairs" on the website of Fitch Ratings Japan Limited (https://www.fitchratings.com/site/japan)

Assumptions, Significance and Limitations of Credit Ratings

Ratings assigned by Fitch are opinions based on established criteria and methodologies. Ratings are not facts, and therefore cannot be described as being "accurate" or "inaccurate". Credit ratings do not directly address any risk other than credit risk. Credit ratings do not comment on the adequacy of market price or market liquidity for rated instruments. Ratings are relative measures of risk; as a result, the assignment of ratings in the same category to entities and obligations may not fully reflect small differences in the degrees of risk. Credit ratings, as opinions on relative ranking of vulnerability to default, do not imply or convey a specific statistical probability of default.

In issuing and maintaining its ratings, Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The assignment of a rating to any issuer or any security should not be viewed as a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating or the results obtained from the use of such information. If any such information should turn out to contain misrepresentations or to be otherwise misleading, the rating associated with that information may not be appropriate. Despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

For the details of assumption, purpose and restriction of credit ratings, please refer to "Definitions of ratings and other forms of opinion" on the website of Fitch Rating Japan Limited.

This information is based on information Daiwa Securities Co. Ltd. has received from sources it believes to be reliable as of September 27th, 2019, but it does not guarantee accuracy or completeness of this information. For details, please refer to the website of Fitch Rating Japan Limited (https://www.fitchratings.com/site/japan)

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