Daiwa Capital Markets

European Banks – Credit Update

- Norwegian regulators indicate lower MREL subordination requirements for banks.
- ECB intends to widen climate stress tests to include trading operations of banks, while the EBA expects banks to build capital buffers in light of stricter climate-related regulatory demands.
- Primary markets seemingly shrugged off the Evergrande fallout, as markets rebounded quickly and issuance volumes among SSAs and FIGs were well within expectation.

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Norway clarifies SNP MREL requirement

At the end of 2020, the Norwegian financial supervisory authority (FSA) decided that the 14 largest Norwegian banks would be subject to MREL requirements that could be met with both regulatory capital and subordinated liabilities. For this purpose, the senior non-preferred (SNP) debt category was introduced under the EU Creditor Hierarchy Directive, clarifying for the first time on a statutory basis the use of this debt class in the country. So far, Norwegian banks have issued SNP debt on a contractual basis. Despite Norway not being part of the European Union but rather the European Economic Area (EEA) relevant EU rules are adopted but incorporation into the EEA Agreement may occur with some delay. For instance, the second iteration of the Bank Recovery and Resolution Directive (BRRD2) will likely be introduced sometime later in 2021 or 2022, while national transposition in the EU was due by end-2020. BRRD2 changes the method for calculating the sum of loss absorption and recapitalisation amounts of MREL. It is calculated according to a risk-weighted and leverage based method, both of which are to be met at all times. Crucially it also introduces absolute minimum requirements, meaning MREL must generally be at least 13.5% of RWAs and at least 5% of leverage exposure amounts. The share of MREL that must be subordinate to senior liabilities is also determined as at least 8% of a bank's overall balance sheet, at least 5% of leverage exposure amounts and at least 13.5% plus all buffer requirements for RWAs. The starting point of the linear phase-in will be set at the minimum subordination requirement of 13.5% (on top of the minimum Pillar 1 and Pillar 2 requirements) as of 1 January 2022.

Norwegian financial institutions sought clarification from the Ministry of Finance on its interpretation of the framework set by BRRD2 regarding what portion of MREL shall be met by liabilities subordinated to senior creditors. The Ministry's interpretation is similar to that of the Single Resolution Board (SRB) in the Euro area, the Danish FSA and the Swedish National Debt office, meaning no change to MREL for domestic banks. However, it is of the opinion that subordinated liabilities are not exclusively required to meet full MREL demands, instead MREL is to be met with subordinated liabilities capped at 2 x (Pillar 1 + Pillar 2) + the combined buffer requirement (CBR), excluding the countercyclical buffer. This effectively lowers the required volume of SNP debt, allowing banks to use some eligible senior debt to comply with MREL, thus providing less protection to senior creditors. Moody's estimates that the lowered subordination requirement would likely reduce the volume of SNP debt that banks need by 30-50% compared to current funding plans. As the final implementation of BRRD2 in Norway is only likely to occur in 2022 and the Norwegian FSA usually communicates individual MREL in December of each year, we may not see the effects of BRRD2 in Norway until end-2022.

MREL requirements for Norwegian banks

		Total Assets (NOKbn)	MREL Requirement (%)*
1	DNB	3,080.1	35.54%
2	SpareBank 1 SR-Bank	299.9	34.40%
3	Sparebanken Vest	224.1	34.40%
4	SpareBank 1 SMN	200.4	34.80%
5	SpareBank 1 Ostlandet	155.2	34.60%
6	Sparebanken Sor	140.4	32.00%
7	SpareBank 1 Nord-Norge	124.0	34.00%
8	Sbanken	101.5	31.00%
9	Sparebanken More	82.8	31.40%
10	SpareBank 1 BV	73.8	31.80%
11	Sparebanken Sogn og Fjordane	65.7	31.40%
12	Norwegian Finans Holding	58.4	39.02%
13	OBOS Finans Holding**	50.6	32.80%
14	Sparebanken Ost	48.9	31.60%

**As of FY20 and based on adjusted RWA; **FY20 figures*

ECB and EBA expect climate-related disclosures and capital buffers to increase

The ECB will likely scrutinize the trading operations of banks as part of its next climate stress test in 2022, according to a Bloomberg report. The decision was reached after the central bank concluded that looking at the loan books of banks did not provide enough insight into the downside effects of climate change. The ECB would thus be able to see what might happen to traded exposures if they're exposed to shocks such as losses in sectors strongly affected by climate change. This in turn could place pressure on the prices of carbon intensive businesses as banks may reposition themselves in order to avoid regulatory consequences. The ECB is reportedly also asking banks for data on emissions associated with the revenue they generate, an approach the Bank of England opted against for its climate tests this year because of a lack of available data.

Separately, senior representatives from the EBA have stated that they expect banks to build capital buffers in light of stricter regulatory demands triggered by climate change. New and amended EU legislation will see a host of sustainability and ESG-related disclosure requirements affect all participants in European capital markets, some of which are already in place such as the Sustainable Finance Disclosure Regulation (SFDR). However, there is no clear timeline

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for climate-related capital requirements yet. It is likely that once banks are in a position to give investors and regulators a better sense of their sustainable credentials, through the publication of their Green Asset Ratio (GAR) or estimated emissions tied to the revenues generated across net interest income, fee and commission income, and trading income, capital allocations could be made more easily. The EBA also believes that in light of upcoming disclosure regulation and an increasing focus on climate change within stress testing, banks will pre-emptively build the aforementioned capital buffers to appeal to regulators, stakeholders and rating agencies in hopes of seeing those benefits result in lower funding costs.

Primary and secondary markets

European **primary market** issuance volumes for SSAs stood at EUR19.9bn over the course of last week, above market expectations of EUR14bn-18.5bn. FIG supply of EUR9.5bn was in line with the weekly forecast amount of EUR8bn-13bn. The total 2021 year-to-date FIG volume of EUR350bn is 15.2% ahead of last year's issuance volume. SSA volumes however, remain behind last year's level but closed the gap. They are down 1% at EUR633bn. For the week ahead, survey data suggest SSA volumes will range between EUR10bn-14.5bn and FIGs are expected to issue EUR6bn-10.5bn.

Weekly **SSA** supply in the primaries was slightly above market expectations, boosted by the **UK DMO**'s inaugural green Gilt. The Treasury came to market with a GBP10bn transaction, the largest ever green bond issued, attracting the largest ever order book of GBP100bn. The massive interest in the deal caused the 12-year bond to settle at G + 7.5bps, helping it price through the conventional curve by ~2.5bps. A second green Gilt is due to follow in mid-October, which will coincide with the planned timing for the EU's inaugural green NGEU issuance. The next issuance by the UK Treasury should be smaller at GBP5bn, as per guidance that the DMO is looking to issue a total of GBP15bn this year. More themed Sterling supply came from **KfW** with two transactions over the course of last week. The German development bank tapped its existing 5-year green senior unsecured for GBP500m and GBP750m, bringing to total outstanding to GBP1.9bn.

FIGs landed well within the expected range of issuance over the course of last week. In terms of senior debt, **ING Group** launched a EUR1.5bn Sr. HoldCo deal for 7NC6 at MS + 70bps (-15/20bps from IPT). Including this transaction the Dutch lender issued a total EUR5.8bn in senior debt this year which is now within the target range of EUR5bn-7bn based on their 2021 funding plan. There is currently also no pressure from a regulatory perspective to issue more MREL eligible debt as ING already meets its 2024 requirements of 27.87% comfortably (+110bps buffer). In the subordinated debt space, **La Banque Postale** came to market with a EUR750m AT1. Strong demand saw book orders push the coupon level down to 3%, the lowest for a Euro denominated AT1. It was 10bps inside the previous low AT1 coupon that was issued by Rabobank in April. **Commerzbank** issued a Tier 2 bond with a maturity of 10NC5 at MS + 173bps. The EUR500m WNG deal landed amidst news that the profitability at the bank should be better than expected. Commerzbank, that is in the midst of a EUR2bn restructuring process, stated that the bank is making good progress and the effects of cost cuts will come through strongly in 2023 and 2024 after another transition year in 2022. Customer attrition caused by negative interest rates charged on deposit accounts was also less pronounced than initially feared as most rivals have followed suit. Lastly, a host of USD supply reach primaries as **Nordea** and **DNB Bank** issued one SP and two SNP deals amongst themselves with **Bank of Ireland** also in the market with a senior unsecured USD deal. Further issuance from NatWest brings the total USD FIG issuance to USD5.8bn.

(Table 1) Key Transactions

Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
SSA						
UK DMO	Sr. Unsecured (Green)	GBP10bn	12Y	G + 7.5	G + 7.5/8.5	>GBP100bn
KfW	Sr. Unsecured (Tap)	GBP750m	5Y	G + 23	G + 25	>GBP1bn
KfW	Sr. Unsecured (Tap)	GBP500m	5Y	G + 23	G + 25	>n.a.
Deutsche Bahn	Sr. Unsecured	EUR750m	10Y	MS + 32	MS + 55/60	>EUR2.15bn
Nederlanske Waterschappen	Sr. Unsecured (Social)	EUR1bn	25Y	MS + 9	MS + 11	>EUR1.8bn
AFD	Sr. Unsecured (Sustainable)	EUR2bn	10Y	OAT + 18	OAT + 21	>EUR8.2bn
FIG (Senior)						
ING Group	Sr. HoldCo	EUR1.5bn	7NC6	MS + 70	MS + 85/90	>EUR2.9bn
Nordea	SNP	USD1.5bn	5Y	T + 60	T + 80	n.a.
DNB Bank	SP	USD1.25bn	4NC3	T + 33	T + 50/55	n.a.
DNB Bank	SNP	USD750m	6.5NC5.5	T + 68	T + 90	n.a.
Bank of Ireland	Sr. Unsecured	USD1bn	6NC5	T + 110	T + 125/130	n.a.
NatWest	Sr. Unsecured	USD1bn	5Y	T + 65	T + 85	n.a.
NatWest	Sr. Unsecured (FRN)	USD300m	5Y	SOFR + 76	SOFR + 76	n.a.
FIG (Subordinated)						
La Banque Postale	AT1	EUR750m	PNC7.5	3.00%	3.375%	>EUR1.1bn
Commerzbank	Tier 2	EUR500m	10NC5	MS + 173	MS + 200	>EUR1.3bn

Source BondRadar, Bloomberg.

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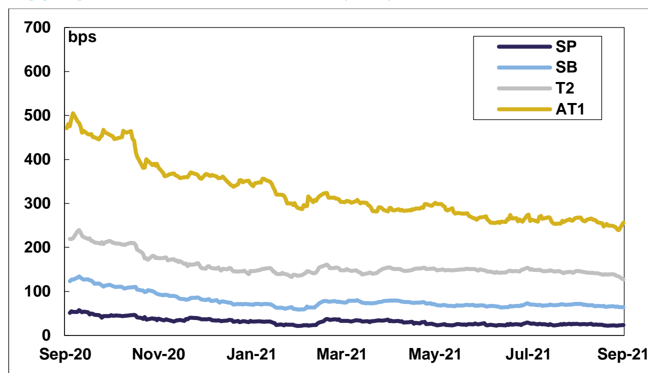
Secondary markets remained stable in EUR and USD as risk perceptions improved, following some volatility caused by the Evergrande fallout. CDS price indices on European senior (55bps) and subordinated financials (107bps), as measured by iTraxx benchmarks, priced 4bps and 7bps tighter against last week's levels.

Early last week we observed some volatility in the market caused by the potential fall-out from Evergrande, the highly leveraged Chinese real estate developer. However, the recovery was swift and within days volatility had subsided with seemingly little impact on issuance volumes. Exposure of European banks to that section of the Chinese markets appears limited with HSBC and Standard Chartered the most exposed, albeit with nominally manageable amounts. In the second half of the week, sovereign yields jumped following more hawkish commentary from the Fed and Bank of England (BoE), as well as a rate hike from Norges Bank. Indeed, the Fed signalled that tapering would start imminently and might well be concluded by mid-2022, while half of FOMC expected a first rate hike by end-2022. And while the BoE's Monetary Policy Committee (MPC) left all of its monetary policy settings unchanged, it indicated that the case had strengthened for some modest tightening of monetary policy over the forecast period. The market responded by bringing forward expectations for BoE rate hikes, with 15bps of tightening priced in by March and a further 25bps hike in Bank Rate to 0.5% priced in by September 2022, from November 2022 previously. Bank spreads remained relatively stable despite the yield movements among sovereigns, as trading volumes were somewhat restrained. The slowdown in new issues compared to previous weeks and the abundance of cash and liquidity in the market suggests that spreads will continue to remain tight in the near-term.

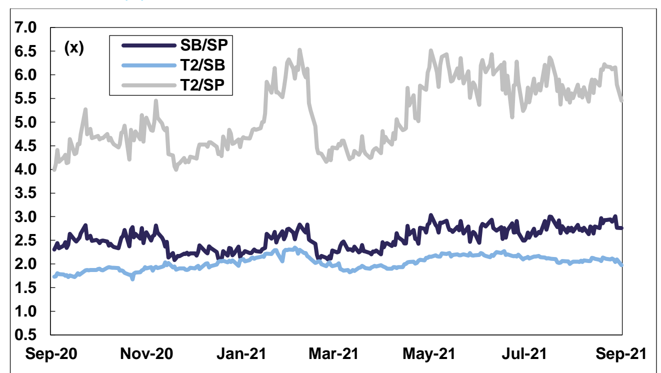
Weekly average EUR spreads were generally stable across payment ranks with SP (-0.2bps), SNP (+/- 0bps) and Tier 2 (+0.6bps). USD average weekly spreads tightened week on week with SP (-0.3bps), SNP (-1.5bps) and Tier 2 (-4.4bps). Based on data collected from Bloomberg, 12% of FIG tranches issued in September and only 4% of SSAs tranche quoted wider than launch.

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.

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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	2.5	0.7	14.1	-0.1	-23.6	3.7	1.5	63.1	-3.3	-22.6	5.7	2.6	133.6	-6.3	-41.9
BFCM	1.8	0.5	18.4	-0.2	-15.8	3.7	1.5	63.1	-3.3	-22.6	5.7	2.6	133.6	-6.3	-41.9
BNPP	1.4	0.3	8.8	1.6	-6.3	5.3	1.8	75.4	-1.5	-15.1	4.9	2.2	109.0	-3.5	-7.9
BPCE	4.5	1.4	42.5	-2.2	-17.9	4.7	1.9	71.7	-0.3	-11.7	2.6	1.4	72.3	-3.2	-17.5
Credit Ag.	2.4	0.7	19.5	3.4	-1.1	3.6	1.4	56.9	-2.6	-15.0	6.4	2.6	123.3	-2.0	-14.7
Credit Sui.	2.1	0.5	22.0	-0.6	0.8	3.8	1.7	71.1	-0.9	-2.9	1.9	1.6	111.7	12.7	-15.6
Danske	3.0	1.0	35.7	-3.0	-8.5	2.2	1.1	58.6	1.1	-28.2	1.9	1.6	111.7	12.7	-15.6
Deutsche	4.8	1.6	50.4	-2.4		3.0	1.3	69.6	-3.2	-44.9	4.2	2.7	174.9	-13.6	-98.9
HSBC	3.0	0.9	75.7	23.9	-6.6	4.3	1.7	69.8	-0.5	-12.6	10.2	3.3	154.3	-6.4	-12.8
ING	3.0	0.9	75.7	23.9	-6.6	4.3	1.6	57.5	-1.6	-16.6	1.7	1.3	98.3	0.9	-18.6
Intesa	2.6	1.2	78.2	-2.4	-25.4	4.3	1.6	57.5	-1.6	-16.6	3.8	3.3	205.4	-12.2	-61.2
Lloyds	6.5	2.1	88.6	-4.0	-30.9	2.9	1.3	49.8	-1.2	-13.9	4.1	2.5	113.8	-3.4	-37.3
Nordea	2.6	0.7	11.5	-1.9	-14.6	3.3	1.1	17.8	-0.1	-22.3	4.1	2.5	113.8	-3.4	-37.3
Rabobank	3.4	1.0	14.0	0.0	-15.2	3.6	1.4	45.9	-1.1	-7.6	4.0	1.6	59.2	-3.2	-14.7
RBS	3.4	1.0	14.0	0.0	-15.2	3.6	1.4	45.9	-1.1	-7.6	4.0	1.6	59.2	-3.2	-14.7
Santander	2.6	0.8	27.9	-3.9	-25.6	4.8	1.9	73.3	-3.8	-25.5	5.9	2.3	109.0	-4.0	-22.4
San UK	2.4	0.7	19.1	0.5	-19.5	3.4	1.6	68.4	-0.9	-9.2	3.7			-2.8	-90.4
SocGen	3.7	1.3	47.0	-0.3	-3.7	4.0	1.9	85.2	-2.6	-22.0	3.8	2.1	113.6	-3.4	-34.1
StanChart	0.7	0.2	4.7	3.7	-50.1	3.2	1.5	68.3	-0.3	-20.9	4.9	2.5	144.7	-1.6	-31.2
UBS	2.6	0.6	22.8	-0.1	-10.8	4.2	1.6	58.5	-1.3	-6.5	4.9	2.5	144.7	-1.6	-31.2
UniCredit	4.9	2.2	114.4	-8.6	-55.5	3.8	1.8	103.3	-2.5	-43.1	5.8	4.0	259.0	-8.0	-72.5

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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4) On 30 May 2019, Daiwa Securities Group Inc. formalized an equity/business alliance with Samty, and as of 14 June 2019 it owned 16.95% of shares outstanding in Samty along with convertible bonds with a par value of Y10bn. Conversion of all of said convertible bonds into common shares would bring the stake of Daiwa Securities Group Inc. in Samty to 27.28%.

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- For derivative and margin transactions etc., our company may require collateral or margin requirements in accordance with an agreement made beforehand with you. Ordinarily in such cases, the amount of the transaction will be in excess of the required collateral or margin requirements**.
- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
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* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
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