European Banks – Credit Update

- According to EBA data, FIG issuers still have MREL shortfalls to contend with. Paired with volatile market conditions and spread widening, this may impact issuance strategies over coming quarters
- Primary market issuers mostly stayed away from markets over the past week as they digested monetary policy decisions by the ECB, Fed, SNB and BoE
- Secondary market spreads and CDS price indicators continued to go wider across EUR and USD

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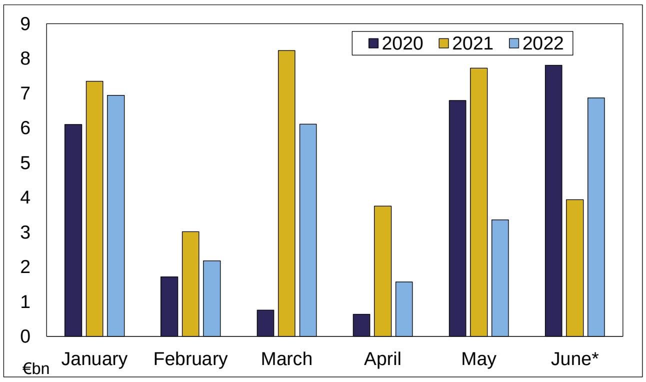
Spread widening and residual MREL shortfalls could affect sub-debt structures

Persistent market volatility has made it tricky for European banks to find opportune funding windows to place their bonds. This is especially true for subordinated debt, in part earmarked for MREL purposes. Year-to-date Tier 2 and AT1 issuance is down 20.5% and 44.8% respectively against the same period last year, reflecting the worsened funding conditions. Against this unfavourable backdrop, the European Banking Authority's (EBA) annual report from April highlights a MREL shortfall of EUR67.6bn across 110 of the 260 resolution groups. The average MREL ratio across all resolution groups was 22.9%, while the shortfall amount represents 0.8%. The deficit is skewed towards O-SSI (69% of total), followed by other banks (25%) and G-SII (6%). However, the data shows that the overall shortfall amount has fallen from EUR115bn reported in the EBA's previous annual report. Larger institutions reduced their shortfall amounts by a proportionally higher amount compared to smaller lenders, suggesting that those lenders have higher barriers to access capital markets, especially in a stressed market environment.

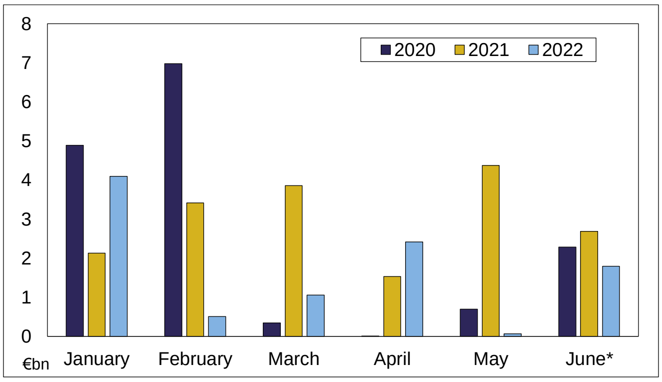
Furthermore, the EBA notes that in several jurisdictions, smaller banks were only given their MREL decisions in 2018 or 2019, which could explain the apparently slower progress in closing the shortfall. The EBA also believes that, were this trend to continue as final MREL requirements come into effect in 2024, resolution authorities may need to take concrete actions to ensure compliance. While banks can issue MREL eligible senior preferred, senior non-preferred and subordinated debt, it is the latter that has been noticeably lagging YTD. Inflationary pressure and market volatility have contributed to rising spreads and kept issuance volumes low so far. Based on Bloomberg data, we calculate average spread widening for newly placed Tier 2 and AT1 notes by European banks during the first half of the year at 64bps and 103bps respectively. In an attempt to reduce funding costs for sub-debt, issuers may consider amendments to issuance structures or labelling. Dutch lender DeVolksbank tested the latter, perhaps hoping to take advantage of the perceived greenium when it launched its recent EUR denominated green AT1. This made them Europe's second bank to issue a green AT1 after BBVA had already done so back in June of 2020. Despite the rarity of the label, pricing remained unchanged from guidance.

On the other hand, Tier 2 issuers may consider launching their bonds with bullet structures as opposed to call options. According to ING research, the average spread differential between the two formats in Europe is about 60bps at issue, which captures the extension risk stemming from the call option. Banks tend to prefer issuing callable Tier 2 bonds, as they are more efficient from a regulatory capital perspective. During the last five years to maturity, an amortisation factor of 20% per year is applied on a linear basis that reduces their value from a regulatory capital perspective, as stipulated in the Basel regulation. To provide issuers with more flexibility in choosing conducive funding windows, three month call periods have become increasingly common place. However, we believe these have their greatest use when market conditions are broadly stable. The current changeable conditions may prompt some issuers to consider bullet structures as they likely provide them with greater execution certainty at a lower cost. Issuers would not have to consider reset spreads when approaching call dates and this would remove extension risk altogether. The minimum five-year tenor of a Tier 2 bonds means that those with bullet structures would see their regulatory eligibly amortise shortly after issuance. Therefore, we believe that issuers would likely opt for Tier 2 bullet bonds at longer maturities as to take advantage of the regulatory capital benefit for longer.

European Banks Tier 2 issuance volume



European Banks AT1 issuance volume



*Source: Bloomberg; Daiwa Capital Markets Europe; *June data until 16th of the month in all instances*

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Primary and secondary markets

European **primary market** issuance for SSAs stood at EUR2bn over the course of last week, well below market expectations of EUR10bn-14bn. FIG supply of EUR0.75bn was also below the weekly forecast amount of EUR7.5bn-12bn. The total 2022 year-to-date FIG volume of EUR305bn is 29% ahead of last year's issuance volume. SSA volumes, however, remain behind last year's level, down 28.5% at EUR327bn. For the current week, survey data suggest SSA volumes will range between EUR11bn-15.5bn and FIGs are expected to issue EUR6.5bn-11bn.

Last week's market conditions deteriorated on the back of the prior week's ECB's Governing Council meeting that set out plans for monetary policy normalisation, as well as a further increase in US inflation to a 40-year high. Only few **SSAs** entered the market given this backdrop and the **European Financial Stability Facility (EFSF)** was one of them. Despite the challenging market conditions, the issuer may have been emboldened by a recent credit upgrade from Moody's that lifted the issuer's rating to 'Aaa' from 'Aa1'. However, the EUR2bn, 10-year note only priced flat to offering at MS+1bps as order book reached just EUR2.7bn. Compared to previous subscription levels for EFSF bonds this is considered low. The EFSF's previous bond issued in March managed to tighten pricing by 2bps from IPT. **Rentenbank** issued the only other SSA bond last week with its NZD300m Kauri offering also pricing flat to guidance. No information on book building was shared however, the bond size was eventually set at double the NZD150m minimum stipulated by the issuer.

(Table 1) Key Transactions

Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
SSA						
EFSF	Sr. Unsecured	EUR2bn	10Y	MS + 1	MS + 1	>EUR2.7bn
Rentenbank	Sr. Unsecured	NZD300m	7Y	MS + 39	MS + 39	n.a.
FIG (Subordinated)						
Credit Suisse	AT1	USD1.65bn	PNC5	9.75%	9.75%	n.a.

Source BondRadar; Bloomberg;

Last Monday's market sell-off and mid-week monetary policy meetings by the Fed and the BoE meant that **FIG** issuers perceivably had few opportune funding windows. Only **Credit Suisse** braved conditions and accessed markets for a USD1.65bn AT1. The PNC5 note was issued to replace its existing USD1.5bn AT1 that has an end-July call date. Guidance on the new bonds coupon was 9.75%, which was above the 7.125% on the bond that it was intended to replace and well above the 4.5% Credit Suisse paid back in late 2020 when it last issued a USD denominated AT1. Credit Suisse's concession on the deal is thought to be around 75bps and the issuer will likely be pleased to have completed the transaction given the difficult market conditions as well as the negative news flow surrounding the issuer. Other recent USD AT1's by European lenders landed considerably tighter. Julius Baer priced its USD400m, PNC5.5 AT1 at 6.875% while SEB's USD500m note priced at 6.873%.

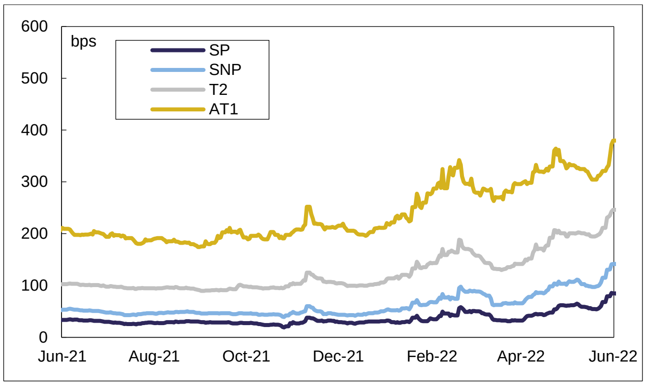
Secondary markets remained volatile and went wider for EUR and USD. CDS indices on European senior (119bps) and subordinated financials (224bps), as measured by iTraxx benchmarks, priced +/-0bps and +15bps against the previous week's levels, close to one-year highs.

In the US, the Federal Open Market Committee (FOMC) ratified the market expectation of a 75bps rate hike to a range of 1.50-1.75% and suggested that additional increases would be implemented in the months ahead. Chair Powell noted in his press conference that a change of 50bps or 75bps is likely in July. Meanwhile, in the UK the BoE's Monetary Policy Committee (MPC) raised the benchmark rate by 25bps for the fifth consecutive time to 1.25%. The BoE noted that it would act forcefully if needed to prevent high inflation becoming more persistent. Looking ahead, in France the recent parliamentary election results in which President Macron's group lost its majority had only a modest impact on OATs while Christine Lagarde's speech today to the European Parliament today will be closely monitored for any signals on potential rate hikes as well as the ECB's plans for an anti-fragmentation tool in the EU.

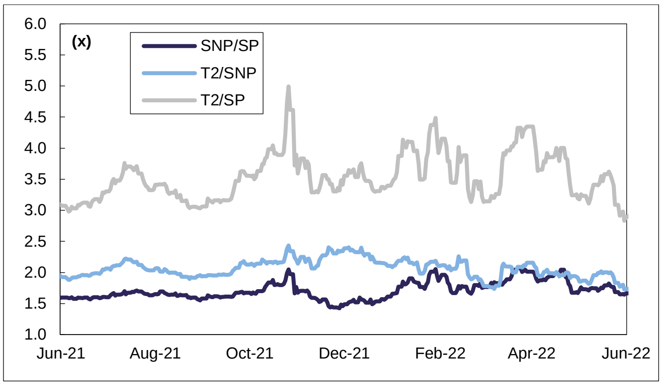
Weekly average EUR spreads were wider once more across payment ranks with SP (+8.4bps), SNP (+11.3bps) and Tier 2 (+19.6bps). USD average spreads were also tighter week-on-week, with SP (+1.6bps), SNP (+2.3bps) and Tier 2 (+11bps). Based on Bloomberg data, 73% of FIG tranches and 22% of SSA tranches issued in June quoted wider than launch.

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.

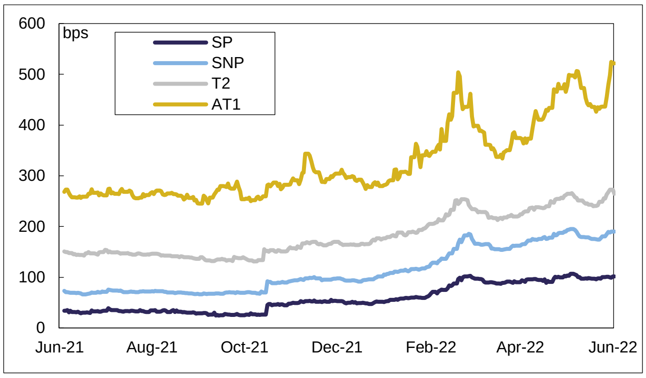
Selected Names

	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	3.6	3.1	96.8	6.9	65.5	3.4	3.6	155.8	13.7	99.9	3.5	4.9	273.6	17.4	115.1
Barclays	1.9	2.1	26.7	-0.3	1.7	3.5	3.3	159.8	13.1	112.9	6.5	4.4	306.5	19.0	207.5
BBVA	3.8	3.0	88.4	8.1	47.7	3.4	3.0	92.6	8.6	56.3	4.5	4.5	255.6	19.8	158.5
BFCM	3.7	2.9	80.3	5.8	51.4	6.7	3.9	150.0	9.9	97.1	5.3	4.4	215.2	14.0	119.3
BNPP	2.4	2.7	60.2	2.7	18.8	4.7	3.6	142.9	10.3	92.1	3.9	4.2	203.9	15.6	135.0
BPCE	3.5	2.8	74.8	7.3	44.3	5.1	3.7	147.0	12.8	81.2	3.8	3.8	166.1	5.5	72.4
Credit Ag.	3.8	2.3	29.4	5.6	3.9	5.4	3.6	139.7	9.2	89.5	3.6	4.1	194.8	22.6	113.0
Credit Sui.	5.3	4.7	240.5	5.0	137.5	4.7	4.5	239.2	19.5	160.0					
Danske	2.6	2.4	66.2	11.8	39.1	3.8	3.4	140.0	13.1	78.8	6.9	4.8	278.8	18.4	177.6
Deutsche	2.0	2.2	53.4	11.0	25.7	4.3	4.5	228.8	15.7	135.3	3.5	5.3	270.4	12.8	111.5
DNB	3.8	2.8	78.1	8.0	22.2	6.5	3.7	137.5	8.3	87.2	5.3	2.8	199.2	27.8	143.6
HSBC	5.1	3.1	83.8	2.5	53.9	4.3	3.6	159.7	9.4	109.8	4.1	3.9	175.0	11.5	117.7
ING	1.4	3.6	163.2	19.8	-1.4	4.9	3.6	138.1	10.0	97.9	6.5	4.5	247.8	22.7	167.3
Intesa	3.8	2.8	95.7	10.6	62.5	3.2	4.0	194.1	9.8	123.1	3.8	4.6	239.6	13.4	76.7
Lloyds	2.5	2.4	43.4	7.3	38.3	2.3	2.8	120.6	15.0	94.0	5.6	4.0	265.4	31.2	217.9
Nordea	4.3	2.8	66.3	7.5	57.8	6.2	3.6	114.4	6.5	56.2	8.0	4.3			40.9
Rabobank	3.7	2.4	30.7	3.9	24.5	5.5	3.4	112.0	8.2	70.7	1.1	1.6	32.7	18.6	26.3
RBS	2.7	3.8	166.6	6.6	133.9	5.5	3.4	112.0	8.2	70.7	1.1	1.6	32.7	18.6	26.3
Santander	3.4	2.7	82.7	6.7	55.5	4.6	3.6	147.3	10.4	91.9	4.2	4.4	216.2	15.6	125.7
San UK	2.7	2.5	49.4	1.5	47.0	1.9	2.5	120.7	12.2	88.4	4.2	4.4	216.2	15.6	125.7
SocGen	4.6	3.1	96.1	3.9	58.4	5.3	3.9	161.1	10.8	100.8	6.4	4.6	310.7	34.1	216.9
StanChart	4.3	2.9	73.7	5.6	42.6	4.9	3.9	172.9	8.8	117.7	5.6	4.9	283.7	21.0	165.9
Swedbank	4.3	3.0	80.2	7.5	38.7	4.6	3.5	129.7	10.6	72.0	4.6	2.1	174.7	9.6	114.8
UBS	4.0	3.0	82.4	4.5	60.8	4.3	3.5	135.8	10.3	90.4	2.6	3.8	266.3	47.5	187.0
UniCredit	3.8	4.0	195.6	10.7	134.0	4.0	4.6	250.9	14.1	155.5	6.3	5.9	394.1	22.2	212.3

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)



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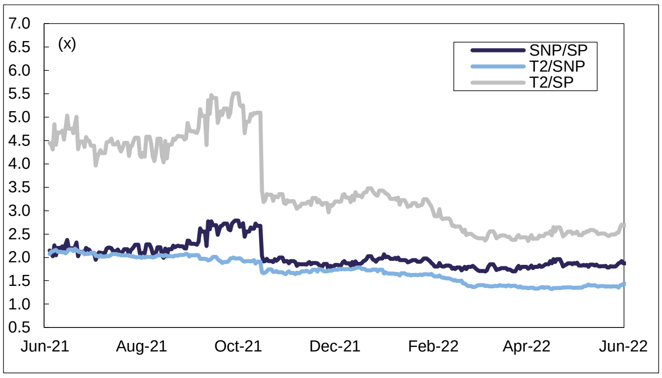

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	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD	Dur.	Yield	Z	Z 5DΔ	Z YTD
Barclays	1.8					4.7	5.3	210.3	5.7	81.6	5.2	5.8	269.2	4.2	96.0
BFCM	3.7	2.9	80.3	5.8	51.4	4.7	5.3	210.3	5.7	81.6	5.2	5.8	269.2	4.2	96.0
BNPP	2.4	2.7	60.2	2.7	18.8	4.9	5.2	197.4	2.5	89.9	4.1	5.4	212.0	4.8	80.4
BPCE	3.5	2.8	74.8	7.3	44.3	4.7	5.4	209.2	5.8	79.6	2.9	5.7	246.9	6.7	70.6
Credit Ag.	3.8	2.3	29.4	5.6	3.9	3.8	5.1	176.9	2.8	91.0	7.3	5.7	255.2	11.5	97.6
Credit Sui.	2.3	4.7	124.1	10.5	51.8	3.4	5.5	242.9	4.0	120.4	1.2	5.2	165.1	36.2	94.8
Danske	2.6	2.4	66.2	11.8	39.1	2.4	4.9	167.5	0.0	67.9	1.2	5.2	165.1	36.2	94.8
Deutsche	2.0	2.2	53.4	11.0	25.7	3.2	5.8	231.4	3.8	112.1	7.4	7.7	446.2	20.4	245.5
HSBC	5.1	3.1	83.8	2.5	53.9	3.7	5.0	187.4	5.3	82.8	8.6	5.9	283.4	6.5	75.0
ING	1.4	3.6	163.2	19.8	-1.4	4.2	5.0	182.7	2.8	59.1	2.3	4.7	247.7	-6.4	83.1
Intesa	3.8	2.8	95.7	10.6	62.5	4.2	5.0	182.7	2.8	59.1	3.1	7.7	449.3	12.4	225.4
Lloyds	2.7					2.6	4.9	160.1	5.5	69.6	8.1	5.5	248.2	8.4	97.8
Nordea	4.3	2.8	66.3	7.5	57.8	2.6	4.2	171.0	0.2	61.0	7.3	5.8	288.2	0.0	-13.7
Rabobank	3.7	2.4	30.7	3.9	24.5	4.2	4.9	157.8	7.0	58.0	3.7	5.4	213.3	7.4	63.1
RBS	2.7	3.8	166.6	6.6	133.9	4.2	4.9	157.8	7.0	58.0	3.7	5.4	213.3	7.4	63.1
Santander	3.4	2.7	82.7	6.7	55.5	4.8	5.4	218.5	5.4	89.1	7.2	5.9	278.9	7.5	110.2
San UK	1.8	3.4	52.7	0.0	9.5	4.3	5.3	193.4	3.9	90.2	2.9	5.5	208.1	-1.4	31.0
SocGen	4.6	3.1	96.2	3.9	58.4	4.1	5.6	221.3	3.7	94.9	3.7	5.5	225.5	1.9	81.2
StanChart	4.3	2.9	73.7	5.6	42.6	2.9	5.1	171.4	1.6	82.3	8.2	6.2	303.4	7.0	92.2
UBS	2.5	4.3	86.3	0.0	42.9	4.3	5.1	198.8	2.3	79.2	8.2	6.2	303.4	7.0	92.2
UniCredit	3.8	4.0	195.6	10.7	134.0	3.8	5.5	190.4	-5.1	96.5	7.2	8.0	487.3	24.4	207.1

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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Other Disclosures Concerning Individual Issues:
1) As of 26 April 2016, Daiwa Securities Co. Ltd., its parent company Daiwa Securities Group Inc., GMO Financial Holdings, Inc., and its subsidiary GMO CLICK Securities, Inc. concluded a basic agreement for the establishment of a business alliance between the four companies.
As of end-December 2017, Daiwa Securities Group Inc. owned shares in GMO Financial Holdings, Inc. equivalent to approximately 9.3% of the latter's outstanding shares. Given future developments in and benefits from the prospective business alliance, Daiwa Securities Group Inc. could boost its stake in GMO Financial Holdings, Inc. to up to 20% of outstanding shares.

2) Daiwa Real Estate Asset Management is a subsidiary of Daiwa Securities Group Inc. and serves as the asset management company for the following J-REITS: Daiwa Office Investment Corporation (8976), Daiwa Securities Living Investment Corporation (8986).

3) Samty Residential Investment became a consolidated subsidiary of Daiwa Securities Group Inc. effective 10 September 2019.

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%.

5) Daiwa Securities Group Inc. and Credit Saison Co., Ltd. entered into a capital and business alliance, effective 5 September 2019. In line with this alliance, Daiwa Securities Group Inc. is to acquire up to 5.01% of Credit Saison's total common shares outstanding (excl. treasury shares; as of 31 Jul 2019).

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If you decide to enter into a business arrangement with our company based on the information described in this report, we ask you to pay close attention to the following items.

- In addition to the purchase price of a financial instrument, our company will collect a trading commission* for each transaction as agreed beforehand with you. Since commissions may be included in the purchase price or may not be charged for certain transactions, we recommend that you confirm the commission for each transaction. In some cases, our company also may charge a maximum of ¥2 million per year as a standing proxy fee for our deposit of your securities, if you are a non-resident.
- 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.
- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* 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.
** The ratio of margin requirements etc. to the amount of the transaction 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.

When making an actual transaction, please be sure to carefully read the materials presented to you prior to the execution of agreement, and to take responsibility for your own decisions regarding the signing of the agreement with our company.

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