European Banks – Credit Update

- Bank of England comments on UK banking sector resilience, finds UK banks well capitalised and liquid. Elevated CRE exposures mainly found at HSBC due to large Asia lending volumes
- Major French banks investigated for potential fiscal fraud following dividend-stripping cases
- Primary market activity concentrated among SSAs and some covered bonds. DCME supports FMO in kick-starting USD market back to life. Secondary market spreads tightened in EUR and to a lesser degree in USD as markets digested recent banking fallout

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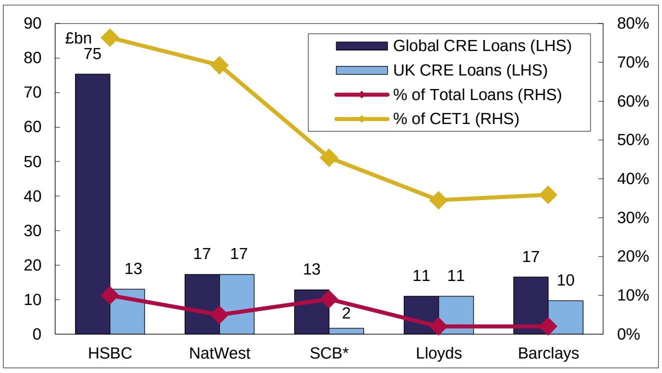
BoE Financial Policy Committee (FPC) comments on UK banking sector resilience

On 29th March, the Bank of England published its financial policy summary and record, which identifies risks to stability in the UK financial system and agreed policy action aimed at safeguarding the sector's resilience. The publication is timely as it takes into consideration recent overseas bank failures that have not only increased investor caution but also caused significant volatility to global financial systems. The FPC also notes that the banking sector is grappling with financial pressure on UK households and business from tighter credit conditions brought on by higher borrowing costs and prices. However, a fall in energy prices, extra government support, and an improvement in the outlook for UK unemployment means fewer people are expected to struggle with mortgage payments than previously thought. Nevertheless, commercial real estate (CRE) exposures are considered a potential vulnerability globally as higher interest rates and falling property values amplify concerns around borrowers' abilities to service debt. Additionally, the FPC made several recommendations to The Pensions Regulator (TPR) to improve resilience among non-bank financial institutions following the severe stresses observed among liability-driven investment funds (LDI) in autumn 2022. The vulnerabilities in UK pension schemes resulted in collateral calls and forced gilt sales that risked further market dysfunction and a material risk to UK financial stability. The FPC's recommendations should make LDI funds resilient to yield shocks of around 250bps, at a minimum, in addition to the resilience required to manage other risks and day-to-day movements in yields.

UK banks well capitalised and highly liquid

Bank exposures to commercial real estate loans have become a focal point following recent bank collapses in the U.S. and Switzerland as they highlight the sensitivity of highly-leveraged sector exposures to rising interest rates. Of all UK banks, HSBC by far has the highest nominal CRE exposure, which is predominantly geared towards Asia (71% of total), Europe (23%) and North America (2.5%). Within Europe, the UK accounts for the majority (73%) while exposures to Hong Kong make up 75% of all Asian CRE loans. HSBC's capital encumbrance is the highest among its peer group at 76% of CET1. A large portion of HSBC's CRE portfolio (40%) also has a short maturity profile and either requires refinancing or matures within one year, which may be a concern considering elevated rates and generally tighter credit conditions.

UK banks CRE exposures at FY22



*Source: Company reports; Bloomberg;*References Europe& Americas; % calculated against Global CRE Loans*

Generally, however, the FPC judged that the UK banking system was well capitalised with the aggregate CET1 ratio for major UK banks and building societies up at 14.6% in 4Q22. This reflects underlying profitability, which had increased in 2022 due to higher NII contributions, while the outlook suggested that major UK banks could absorb further increases in expected credit losses without adversely impacting their capital positions. From a liquidity perspective, major entities had large asset buffers (GBP1.4tr), more than six times larger than the total size of major UK banks' securities held at amortised costs in the banking book. Around two-thirds of these liquidity buffers are currently either in the form of cash or central bank reserves (GBP908bn). The aggregate LCR and NSFR ratios of 149% and 136% respectively provide some resilience to deposit outflows while the FPC found that smaller UK firms typically run larger liquidity surpluses over regulatory standards than major firms.

In conclusion, the FPC considered the UK banking system to be resilient to the current economic outlook with the capacity to support the economy in a period of higher interest rates even if economic conditions are worse than forecast. Challenges to UK economic conditions may emerge from possible future strains from banks outside the UK that could have a lasting impact on bank funding costs, with the potential for that to increase the cost of borrowing for UK households and businesses. Lastly, should there be further volatility and/or sharp moves in asset prices, there are risks this could crystallise previously identified vulnerabilities in market-based finance, amplifying any tightening in credit conditions.

Major French banks investigated for potential fiscal fraud

Last week, French authorities raided the offices of five major French banks on the suspicion of tax fraud and money laundering involving dividend arbitrage strategies, also known as 'cum-cum'. The banks in question are BNP Paribas and its Exane unit, Société Générale, Natixis, and HSBC Holdings. The national financial prosecutors' office (PNF) stated that it linked the investigation to so-called 'cum-ex' dividend stripping cases, carried out in other European countries, most notably Germany. The estimated cost resulting from the 'cum-ex' cases are thought to have cost German taxpayers around EUR10bn. The 'cum-cum' practise is thought to be far less profitable but could still result in significant fines for French banks and be credit negative for their earnings outlook. The French banking association, Fédération Bancaire Française (FBF), responded to the prosecutor's allegations by seeking clarification from France's highest administrative court on what dividend arbitrage strategies required tax payments as it argues that there currently is no clear tax guidance in place by fiscal authorities. While it will be difficult to exact a figure on the scale of the alleged fraud at this point, initial estimates expect the targeted banks to face total fines, back taxes and late interest payments of more than EUR1bn.

Primary and secondary markets

European **primary market** issuance volumes for SSAs stood at EUR14bn over the course of last week, above market expectations of EUR8-12.5bn. FIG supply of EUR9.9bn was also above the weekly forecast amount of EUR5-9bn. The total 2023 year-to-date FIG volume of EUR217bn is 11.1% ahead of last year's issuance volume. SSA volumes are also ahead of last year's level, up 11.7% at EUR248bn. For the current week, survey data suggest SSA volumes will range between EUR5-9bn and FIGs are expected to issue EUR4.5-9bn.

Primary market activity from **SSAs** was kick-started by the sizeable EUR6bn green tap from the European Union. The deal was more than 12x subscribed, showcasing investor demand for high-quality paper. Last Thursday, Dutch agency **Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO)** reopened the USD SSA market by issuing a USD500mn 2-year bond at MS+24bps. Daiwa Capital Markets Europe (DCME) acted as joint-lead manager on the transaction that benefitted from being the only name in the market at the time, attracting many high-quality investors. The spread was tightened by 3bps during execution and final books were in excess of USD1.1bn (excl. JLMs). The final new issue premium was negligible. This was the first USD SSA trade from a typical issuer name since NIB's USD1.5bn 5-year and AfDB's USD2bn 5-yr on the 7th March. More green bond supply came from **Société du Grand Paris (SDGP)** that raised EUR1bn from a new 3.7% May-2053 note. This transaction brings SDGPs 2023 total funding to EUR2bn, meaning it has now raised half of its EUR4bn funding mandate for 2023. They were last in the market in January with a May-2043 line. With books at EUR1.8bn, the deal managed to tighten 1bp from IPT, thus pricing with a new issue premium of 2-3bps when compared to its existing lines.

Unsecured **FIG** markets remained dormant, as spread levels remained elevated compared to early March, despite average weekly double-digit tightening in secondary markets. The relative calm observed in markets towards the end of last week could pave the way for a return of senior unsecured issuers. Early movers will however likely face elevated pricing points and new issue concessions, which we expect to be mitigated by shorter deal tenors and high-quality issuers making the first moves.

(Table 1) Key Transactions

Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
SSA						
European Union	Sr. Unsecured (Green Tap)	EUR6bn	Feb-2048	MS + 68	MS + 70	>EUR73bn
Land Berlin	Sr. Unsecured	EUR1bn	6Y	MS - 7	MS - 7	>EUR1.2bn
Flemish Community	Sr. Unsecured	EUR1.25bn	10Y	OLO + 41	OLO + 45	>EUR3.5bn
KfW	Sr. Unsecured (Tap)	GBP300m	Jul-2027	G + 58	G + 58	>EUR200m
FMO	Sr. Unsecured	USD500m	2Y	SOFR MS + 24	SOFR MS + 27	>USD1.1bn
Rentenbank	Sr. Unsecured (Tap)	EUR500m	Sep-2030	MS - 9	MS - 9	>EUR500m
SDGP	Sr. Unsecured (Green)	EUR1bn	30Y	OAT + 52	OAT + 53	>EUR1.8bn
NRW Bank	Sr. Unsecured (Social)	EUR1bn	10Y	MS + 3	MS + 3	>EUR1.25bn
Greece	Sr. Unsecured	EUR2.5bn	5Y	MS + 90	MS + 95	>EUR19.1bn

Source BondRadar, Bloomberg;

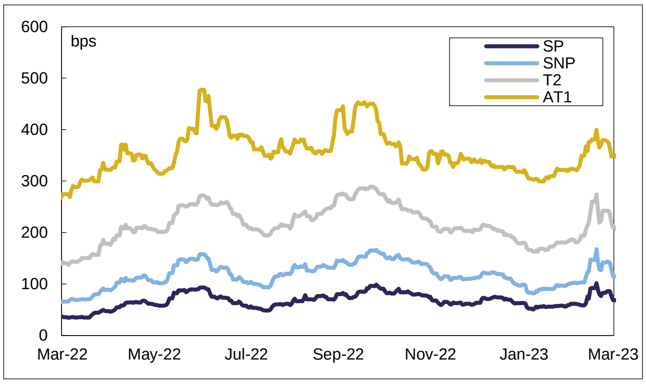
Secondary market spreads were mostly tighter last week for EUR and USD, while CDS indices on European senior (98bps) and subordinated financials (180bps) as measured by iTraxx benchmarks priced -18bps and -40bps against the previous week's levels.

Secondary market spread performance was encouraging last week as spreads mostly tightened after what had otherwise been a volatile month. Nevertheless, heading into April spreads remained significantly wider compared to early March. Despite double-digit tightening across all payment ranks, markets are still 15-55bps wider than one month ago.

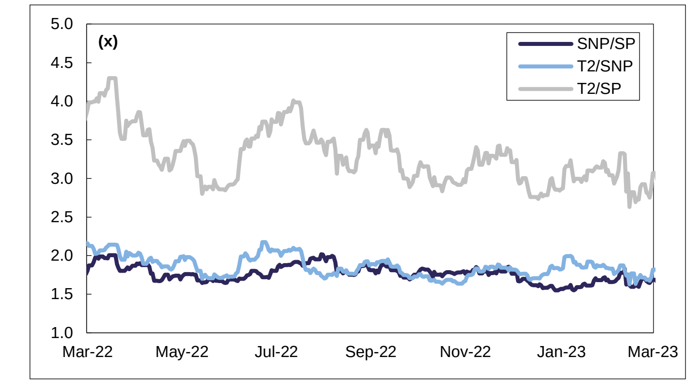
Weekly average EUR spreads were tighter with SP (-13.8bps), SNP (-24.5bps) and Tier 2 (-35.6bps). USD average spreads were wider for SP (+3bps), but tighter for SNP (-14.2bps) and Tier 2 (-25.7bps). Based on Bloomberg data, 53% of FIG tranches and 48% of SSA tranches issued in March quoted wider than 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.

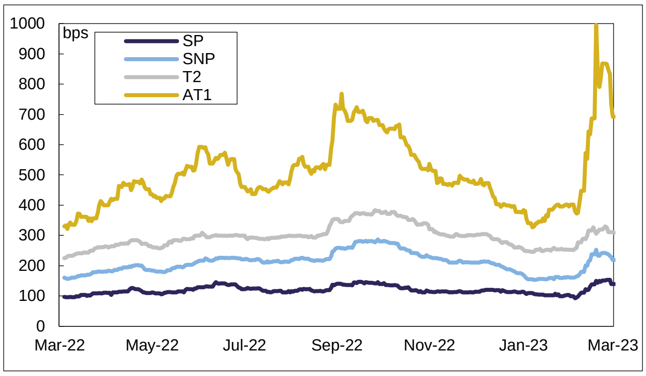
Selected Names

	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	3.2	4.0	75.5	-24.4	33.3	3.3	4.9	163.3	-38.4	5.7	2.8	5.1	171.9	-97.7	26.8
Barclays	1.2	3.8	5.8	-8.8	31.2	2.8	4.7	157.2	-35.3	-15.0	7.2	6.3	291.7	-72.1	-11.5
BBVA	3.7	3.7	46.8	-27.9	-15.1	3.4	3.9	62.6	-27.8	4.8	3.6	5.5	170.4	-46.8	13.6
BFCM	4.2	3.8	53.4	-19.9	-1.1	5.9	4.2	111.3	-32.3	6.6	3.7	4.6	154.4	-44.4	18.9
BNPP	3.8	3.8	54.3	-10.3	6.8	4.3	4.2	107.2	-27.8	-6.4	3.4	4.6	135.8	-44.3	14.3
BPCE	3.8	3.8	63.9	-17.6	10.1	4.6	4.2	112.7	-29.1	-0.5	8.1	5.4	160.8	-44.2	3.6
Credit Ag.	3.7	3.7	53.8	-23.3	0.3	4.6	4.0	94.5	-29.2	-4.6	2.6	4.3	96.7	-15.8	-12.9
Credit Sui.	4.6	4.4	112.1	-8.8	-76.3	4.1	5.8	246.7	-79.7	-226.6					
Danske	2.3	4.0	59.0	-12.1	-20.5	3.7	4.5	124.3	-15.1	-5.7	6.2	5.7	214.6	-37.2	-28.8
Deutsche	2.1	4.4	108.5	-44.4	24.3	4.1	5.8	248.7	-63.6	66.1	2.7	7.1	356.0	-177.5	115.9
DNB	3.2	3.7	45.2	-7.0	-11.9	4.6	4.0	83.3	-11.7	5.4	4.3	4.8			
HSBC	4.3	3.6	30.0	-9.5	9.1	3.4	4.1	107.4	-32.4	-9.5	4.0	4.6	149.9	-35.0	-7.0
ING	2.4	7.4	386.9	-25.0	81.0	4.8	4.3	98.6	-36.1	3.9	5.2	5.5	206.7	-48.0	-9.2
Intesa	3.4	4.0	56.7	-18.0	-9.1	3.9	4.7	156.8	-27.5	10.2	3.8	5.0	153.1	-26.0	17.1
Lloyds	1.7	3.8	25.5	-18.4	6.9	3.1	4.0	62.7	-32.3	-10.4	4.8	6.4	225.9	-68.2	-237.3
Nordea	3.5	3.6	40.2	-14.9	29.7	5.4	3.9	78.3	-13.9	18.3	6.5	5.0			
Rabobank	2.9	3.5	21.4	-17.6	17.0	5.2	3.9	86.7	-29.1	-10.4	5.2	5.0	180.8	-46.4	6.1
RBS	3.4	5.1	187.3	-14.6	9.5	5.2	3.9	86.7	-29.1	-10.4	5.2	5.0	180.8	-46.4	6.1
Santander	2.6	3.9	40.6	-25.0	-9.5	3.8	4.0	91.0	-30.9	3.6	3.5	4.3	103.9	-52.8	8.4
San UK	1.9	3.9	34.6	-1.8	26.3	4.3	5.0	179.9	-28.2	-10.6	3.5	4.3	103.9	-52.8	8.4
SocGen	4.1	3.9	70.5	-13.3	-0.7	4.5	4.5	133.9	-21.2	4.2	6.9	6.0	254.1	-42.6	18.5
StanChart	3.5	4.0	79.8	-5.0	-18.8	4.4	4.6	137.3	-28.3	-13.6	4.9	5.7	228.6	-42.1	-60.0
Swedbank	3.0	3.9	60.1	-13.5	10.1	4.0	4.3	121.5	-21.9	9.3	7.5	5.5	233.1	-32.9	2.8
UBS	3.2	4.0	69.7	-14.6	7.1	4.4	4.7	141.7	-23.7	28.1	2.4	216.5			-106.4
UniCredit	3.2	4.3	106.3	-20.0	-28.2	3.2	5.1	184.5	-36.0	-14.7	5.6	7.2	371.9	-53.7	0.5

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.

Western European Banks USD Spreads and Yields

Aggregate USD Z-spread LTM (bps)



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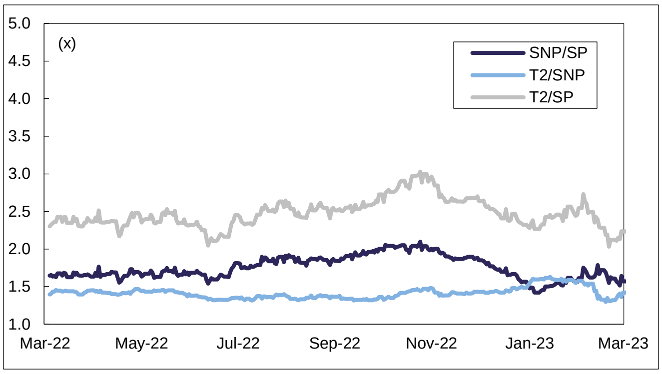

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Selected Names

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Barclays	1.1					3.8	6.1	228.5	-23.2	-1.1	4.6	6.6	313.7	-37.2	1.1
BFCM	4.2	3.8	53.4	-19.9	-1.1	3.0	6.1	221.2	-32.5	26.7	4.6	6.6	313.7	-37.2	1.1
BNPP	3.8	3.8	54.3	-10.3	6.8	4.4	5.8	213.5	-16.1	23.9	3.5	6.4	253.8	-24.2	9.0
BPCE	3.8	3.8	63.9	-17.6	10.1	4.1	6.1	224.3	-12.1	10.0	2.7	6.9	346.9	-21.4	-8.6
Credit Ag.	3.7	3.7	53.8	-23.3	0.3	3.2	5.7	169.5	-15.2	18.3	6.8	6.3	280.7	-19.2	-20.7
Credit Sui.	1.8	10.0	425.2	0.0	-1.0	3.6	7.9	341.3	-40.0	-111.6	2.3	8.8	475.5	-113.7	-76.1
Danske	2.3	4.0	59.0	-12.1	-20.5	2.9	6.4	195.6	10.2	3.4	2.3	8.8	475.5	-113.7	-76.1
Deutsche	2.1	4.4	108.5	-44.4	24.3	2.9	7.5	342.6	-60.4	51.7	7.1	8.8	489.6	-90.0	64.3
HSBC	4.3	3.6	30.0	-9.5	9.1	3.8	5.8	202.0	-27.0	-15.3	8.6	6.3	278.5	-18.0	-9.2
ING	2.4	7.4	386.9	-25.0	81.0	3.6	5.6	187.6	-12.3	1.5	8.6	6.3	278.5	-18.0	-9.2
Intesa	3.4	4.0	56.7	-18.0	-9.1	6.8	7.4	403.3	-56.2	-24.5	4.7	8.9	554.0	-72.1	62.2
Lloyds	2.0				0.0	3.6	5.9	198.3	-28.6	9.0	6.6	6.5	299.9	-20.5	3.9
Nordea	3.5	3.6	40.2	-14.9	29.7	3.6	5.4	161.8	-22.8	16.1	6.7	6.0			
Rabobank	2.9	3.5	21.4	-17.6	17.0	3.9	5.5	170.3	-7.3	3.7	7.4	5.8	183.7	-6.9	9.2
RBS	3.4	5.1	187.3	-14.6	9.5	3.9	5.5	170.3	-7.3	3.7	7.4	5.8	183.7	-6.9	9.2
Santander	2.6	3.9	40.6	-25.0	-9.5	3.8	5.8	215.0	-18.4	9.0	6.5	6.5	308.7	-19.7	16.0
San UK	1.2					3.9	6.3	239.5	-7.1	-9.9	2.3				
SocGen	4.1	3.9	70.5	-13.3	-0.7	3.9	6.4	277.4	-8.9	20.9	7.2	7.4	385.8	-20.2	52.4
StanChart	3.5	4.0	79.8	-5.0	-18.8	2.5	6.1	206.0	-6.7	-5.6	8.8	6.6	320.6	-23.2	0.7
UBS	2.3	5.9	130.3	-28.1	52.6	3.9	6.1	236.3	-20.5	50.2	8.8	6.6	320.6	-23.2	0.7
UniCredit	3.2	4.3	106.3	-20.0	-28.2	3.2	7.0	287.6	69.4	80.3	7.0	9.0	547.2	-47.6	9.5

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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Daiwa Securities Co. Ltd. and Daiwa Securities Group Inc.: Daiwa Securities Co. Ltd. is a subsidiary of Daiwa Securities Group Inc.

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).

Notification items pursuant to Article 37 of the Financial Instruments and Exchange Law
(This Notification is only applicable to where report is distributed by Daiwa Securities Co. Ltd.)
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.

Corporate Name: Daiwa Securities Co. Ltd.
Registered: Financial Instruments Business Operator, Chief of Kanto Local Finance Bureau (Kin-sho) No.108
Memberships: Japan Securities Dealers Association, The Financial Futures Association of Japan, Japan Investment Advisers Association, Type II Financial Instruments Firms Association