Daiwa Capital Markets

European Banks – Update on the senior unsecured primary market

- In line with expectations, senior bond issuance is running below last year's total despite largely supportive conditions.
- As MREL/TLAC needs have been largely met, partly due to lower requirements, we expect funding needs to be driven increasingly by balance sheet dynamics rather than regulation.

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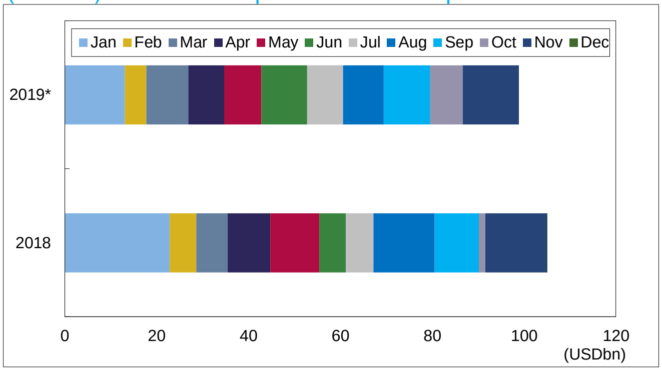
Market Update

In line with our expectations, the supply of senior unsecured debt has fallen slightly so far this year in both preferred and bail-in-able formats. Public placements of senior preferred debt (Senior Preferred/Senior OpCo) have totaled the equivalent of $99bn YTD, vs $105bn issued throughout 2018, whilst Senior Bail-in debt (Senior Non-Preferred/Senior HoldCo) amounted to the equivalent of $141bn YTD, vs $150bn in 2018. *While a reversal of the declining Y/Y trend is still feasible, the December issuance window tends to be limited given generally low levels of activity in financial markets and as investors close their books for the year.*

In 2019, issuers were strongly supported by the sharp drop in yields and spreads in both USD and EUR on the back of Fed and ECB monetary policy easing. In that context, banks have been able to comfortably fulfil their funding needs for the year, whilst some have already started pre-funding for 2020. The sharp drop in rates has also solidified the hunt for yield, enabling tier 2 and tier 3 names to venture to the markets, and allowing comfortable issuance of lower ranked paper.

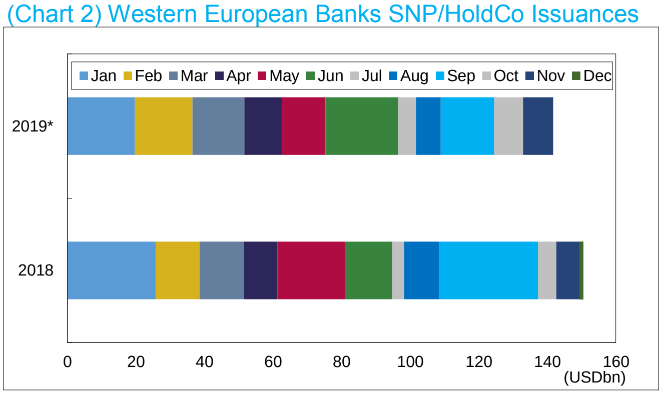
The drop in yields was more substantial in the Euro market, as a result of further monetary easing by the ECB, a weak economic environment and the new round of TLTROs. This led to an increased preference for EUR placements vs USD, bringing even some non-recurrent American issuers to the EUR market. These favourable conditions for EUR placements also impacted the supply volume of JPY issuance by European banks, which was also hit by new risk weighting rules for TLAC holdings in Japan, in place from April. The latter was particularly evident in the reduced size of JPY transactions issued by G-SIBs, although the actual number of transactions was in line with figures observed last year as issuers continue to value funding diversification.

(Chart 1) Western European Banks SP/OpCo Issuances



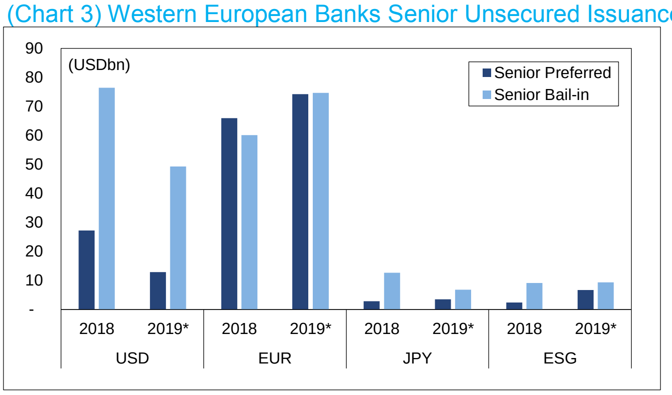
**YTD. Source: BondRadar, Daiwa Capital Markets Europe. Data as of 22/11/2019. Figures include public placements only.*

(Chart 2) Western European Banks SNP/HoldCo Issuances



**YTD. Source: BondRadar, Daiwa Capital Markets Europe. Data as of 22/11/2019. Figures include public placements only.*

(Chart 3) Western European Banks Senior Unsecured Issuance



**YTD. Source: BondRadar, Daiwa Capital Markets Europe. Data as of 22/11/2019. Figures include public placements only.*

Investor Sensitivity

Geopolitics had an increased impact on the timing of issuance this year, as investors were sensitive to US-China trade tensions, Brexit and Italian politics. We expect similar sensitivity in 2020, when we'll also have the US Presidential election to contend with. In addition, despite the hunt for yields, investors have become increasingly selective on pricing, with an elevated number of deals being pulled from the market in Europe this year. Note, however, that the failure of these deals was driven by issuer- and transaction-specific issues rather than a sign of weakness in the market. The majority of these transactions are deemed to have failed on pricing and misjudgement as regards liquidity and demand.

Environmental, Social and Governance Bonds

Seen as a tangible commitment to the UN's Sustainable Development Goals, the issuance of **ESG bonds** by European banks continued to gain traction in 2019, backed also by increasing investor demand for ESG products. European banks have so far in 2019 issued a total of $16bn of ESG bonds in senior unsecured format, up from $13.5bn issued in 2018.

This is still a modest 6.7% of total senior unsecured issuance by European banks, albeit up from 4.5% from last year. There is no clear evidence yet that ESG bonds provide a cheaper source of funding for issuers than non-ESG paper. Indeed, if the only difference between two bonds was the ESG label, and one provided a higher return than the other, with the same level of risk, an arbitrage opportunity would arise. Therefore, we believe ESG bonds should trade with minimal, if any difference in pricing to their non-ESG equivalents. That said, ESG paper placed by European banks to date has largely been met with strong demand, which may occasionally push up prices in the primary market.

2020 Outlook

A clearer picture of the likely funding plans of European banks for 2020 should arise with the year-end results to be published in February and March. That said, we expect the supply volume of senior unsecured debt to be largely flat Y/Y on aggregate, both in senior preferred and in senior bail-in format. As observed in the table below, most banks already meet (or are close to) their regulatory requirements. Thereby, we expect a shift from regulatory funding needs to issuer-specific funding needs, with banks looking at their own balance sheet and liquidity needs rather than regulatory requirements.

The largest issuers in the **UK** and **Switzerland** continue to have comfortable levels of bail-in-able paper, with limited additional needs for regulatory compliance, so that net supply should largely be flat. In the UK, it will be interesting to observe whether the BoE will renew its Term Funding Scheme (TFS), the funding facility created for UK banks in the aftermath of the Brexit vote. There is currently £112bn of outstanding funds to banks from the TFS, with first drawings set to mature in September 2020; the non-renewal of the TFS could create liquidity issues for some of the smaller names in the UK, which has led to expectations that the BoE will renew the scheme. In **France**, local banks have been supported by more accommodative MREL requirements, which will allow them partly to use senior preferred debt for compliance. We remain against this approach, and believe the use of senior preferred debt for MREL compliance undermines the MREL framework. Lower MREL requirements, to be met purely with bail-in-able debt, would be a preferred approach as it would bring some much needed clarity to the rules. That being said, some French issuers aim eventually to comply with MREL requirements utilizing bail-in-able debt only, which should maintain the elevated level levels of SNP debt placements.

Similar to what we observed this year, we are likely to a see a wider range of issuers tapping the markets for SNP debt in 2020. In **Sweden**, local banks have refrained from issuing significant volumes of SNP debt until further clarity on debt subordination is given by the local regulator, which is expected to happen in December. That said, investor appetite for Swedish names might be hindered by the ongoing investigations on anti-money laundering failures. In **Norway**, the local regulator is also expected to provide further clarity on requirement this December, with inaugural Norwegian SNP expected for 2020. **In Italy**, the very low yields should improve market access to tier 2 and tier 3 names, widening the population of SNP issuers in the country, where even Intesa is yet to issue Senior Non-Preferred paper.

Senior Bail-in Debt 2019 Issuance

Selected euro area issuers (end-3Q19 data)

Euro Area	Shortfall[1]	Outstanding[2]	YTD Issuance	Senior Bail-In Debt Issuance Plans
Nordea	TBC	€2.7bn	0	€10bn SNP until 2022, including the €2.7bn issued in 2018. SNP issuance plan to be reviewed in line with SRB updates on MREL rules.
Crédit Agricole	0	€17.8bn	€4.5bn	€5-6bn in Tier 2 or SNP in 2019; €4.5bn in SNP and €1.8bn in T2 already issued YTD.
BPCE	0	€16.8bn	€5.0bn	€3-4bn in SNP format for 2019. Already started pre-funding for 2020.
BFCM[2]	0	€1.0bn	€1.0bn	€2-2.5bn of SNP and Tier 2 per annum
BNP Paribas	€1bn	€39.9bn	€13.4bn	€14bn of SNP debt in 2019. Annual running rate is €14-15bn.
SocGen	0	€20.5bn	€8.2bn	€6-7bn of SNP debt in 2019, completed.
Commerzbank	0	€8.8bn	€1.2bn	Issuance strategy to be consistent with the MREL requirement.
Deutsche Bank	0	€57.0bn	€6bn	Amid its ongoing restructuring, Deutsche reduced its total SNP debt issuance plan for 2019 from €9-11bn to €6bn, already completed.
Intesa Sanpaolo	TBC	0	0	Intesa is yet to disclose its MREL requirement and SNP issuance plan.
UniCredit	0	€8.8bn	€3.2bn	SNP issuance plan of €3.2bn for 2019, completed.
Rabobank	€0.1n	€6.8bn	€4.6bn	€3-5bn per annum, subject to regulatory and peer group developments and taking into account expected Basel IV impact.
Banco Santander S.A.	0	€17.1n	0.0	Banco Santander S.A. has no plan to issue SNP papers in 2019. The group follows the Multiple Point of Entry (MPE) resolution approach, with several resolution entities within the group issuing TLAC/MREL debt separately.
BBVA S.A.	0	€7.3bn	€3.0bn	SNP debt of €2.5-3.5bn for the European resolution perimeter.

Source: Banks' statements, Bloomberg, BondRadar. [1]Estimate [2]Figures as at end-3Q19 unless otherwise stated.

Senior Bail-in Debt 2019 Issuance

(Cont.) Selected Swiss, UK and Nordic Issuers (end-3Q19 data)

Switzerland	Net shortfall[1]	Outstanding[2]	YTD Issuance	Senior Bail-In Debt Issuance Plans
UBS	0	\$37.5bn	\$1.9bn	UBS will focus on further optimizing its funding structure and on refinancing maturing HoldCo debt.
Credit Suisse	0	CHF40.3bn	CHF6.6bn	CHF5-7bn of HoldCo notes in 2019.
UK	Net shortall[1]	Outstanding[2]	YTD Issuance	Senior Bail-In Debt Issuance Plans
Nationwide	0	£8.7bn	£1.7bn	The bank is already comfortably above its minimum MREL requirement, additional placements are likely to be opportunistic and for funding structure optimisation.
Lloyds Group	0	£13.3bn	£2.6bn[2]	MREL steady state issuance of c.£5bn p.a. on average from 2019.
HSBC Group	0	\$77.3bn[4]	\$10.4bn	Low/mid-teens USDbn per year, another \$2bn of senior HoldCo to be issued in 4Q.
RBS Group	£3.6bn by 2022	£19.3bn	£3bn	£3-5bn issuance target for 2019.
Standard Chartered	0	\$14.6bn	\$6.0bn[3]	Focus on funding structure optimization and refinancing of maturing HoldCo debt.
Barclays	£2.5bn by 2022	£34.5bn	£3.5bn	Barclays issuance plan until 2022 has been calibrated to meet MREL requirements and allow for an MREL management buffer. Initial plan was for c.£8bn of MREL issuance for 2019 across Senior HoldCo, Tier 2 and AT1. £8.2bn has been issued YTD. Further pre-funding opportunities will be considered.
Santander UK	£3.7bn by 2022	£9.4bn[3]	0	Santander UK has not disclosed its funding plans for 2019, yet, aligned with the parent, it has not issued senior bail-in debt so far in 2019.
Nordics	Net Shortfall[1]	Outstanding[2]	YTD Issuance	Senior Bail-In Debt Issuance Plans
Danske	DKK41bn	DKK85bn	DKK58bn	Initial plan was for DKK35-45bn of SNP debt to be issued in 2019, but the issued amount was significantly higher as a result of an increase in the bank's MREL requirement. 2020 plan will be in line with the initial plan for 2019.
DNB	NOK150bn	0	0	Regulatory clarification to be provided in Dec'19. Inaugural SNP no earlier than 2020.
SpareBank 1 SR-Bank	NOK20bn	0	0	Regulatory clarification to be provided in Dec'19.
Swedbank	SEK64bn	SEK8bn	SEK8bn	Issuance timing dependent on market conditions. Further clarification on MREL needs will be disclosed by the Swedish regulator in Dec'19.
SEB	SEK81bn	SEK11bn[4]	SEK11bn	Upcoming senior unsecured maturities are a good indication of new issuance. Further clarification on MREL needs will be disclosed by the Swedish regulator in Dec'19.

Source: Banks' statements, Bloomberg, BondRadar. [1]Estimate [2]Figures as at end-3Q19 unless otherwise stated. [3]as at end-1H19. [4]as of 20 Nov'19.

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