Daiwa Capital Markets

European Banks – Credit Update

- Redemptions of legacy AT1 instruments and upcoming call dates for high coupon yielding AT1s will likely see issuance volumes of the same paper increase over the course of 2021.
- January primary market volumes see SSAs outpace last year's performance while FIGs lag.
- Spread widening in the secondary as initial vaccine euphoria makes way for sober outlook on the operating environment of European FIGs.

William Hahn
Credit Analyst
+44 20 7597 8355
William.Hahn@uk.daiwacm.com

Increased AT1 redemptions expected for 2021

Over the course of 2021, we expect to see the number of AT1 redemptions rise compared to previous years for several reasons. Some of these outstanding capital instruments supporting Tier 1 ratios are considered grandfathered as eligible regulatory capital until end-2021 under the EU's Capital Requirements Regulation (CRR). After this date, they will no longer be permitted to be considered for MREL purposes. This issue moved into the focus of issuers and investors after the EBA issued in October 2020 an opinion addressing so-called possible 'infection risk' stemming from legacy instruments whose ineligibility can also affect the eligibility of other capital instruments.

The ECB opinion highlighted the risk that the integrity of other layers of own funds or eligible liabilities could be disqualified. This is because some AT1 bonds contain contractual terms establishing their position in the capital structure, which may conflict with the ranking provisions set out under CRR as well as distribution payments. These legacy debt instruments may contain dividend pushers and stoppers, which influence whether a bank can make payments on other capital instruments. AT1 instruments that are pushed down the capital structure into Tier 2 could restrict distributions of Tier 2 or lower-tier instruments, which in turn would disqualify higher layers of regulatory capital under the CRR, even if the lower-tier instrument might otherwise have been eligible.

For the above reasons, the EBA would prefer banks to either call, redeem or repurchase legacy instruments to avoid infection risk. Banks are technically permitted to keep these legacy instruments on their balance sheets. However, we believe that this is unlikely as they are excluded from regulatory MREL and would carry a high funding cost. Several banks have already announced that they will redeem their legacy AT1 debt. DZ will retire eight bonds that were issued between 2003 and 2007 for a nominal value of EUR1.41bn and BNP announced that it will call its USD600m legacy note in March this year. The EBA is expected to monitor how Eurozone banks will manage their grandfathered liability structures while the Prudential Regulation Authority (PRA) in the UK has stated that it shares the EBA's stance on infection risk and requires banks to submit plans to address this issue by end-March 2021.

2021 European Banks High Coupon AT1 Call Dates

Issuer	Issue Amount	Coupon (%)	First Call Date
Intesa	€1.25bn	7.0	19-Jan-2021
Svenska Handelsbanken	$1.2bn	5.25	01-Mar-2021
UBS	$1.5bn	6.875	22-Mar-2021
BNP Paribas	$1.5bn	7.625	30-Mar-2021
SocGen	€1bn	6.75	07-Apr-2021
BBVA	€1bn	8.875	14-Apr-2021
Bankinter	€200m	8.625	10-May-2021
HSBC	$2bn	6.875	01-Jun-2021
Credit Agricole	€1bn	6.5	23-Jun-2021
Rabobank	€1.25bn	6.625	29-Jun-2021
UBS	$1.1bn	7.125	10-Aug-2021
Natwest	$2.65bn	8.625	15-Aug-2021
UniCredit	€1bn	6.75	10-Sep-2021
Santander	€1.5bn	6.25	11-Sep-2021
Nordea	$550m	5.25	13-Sep-2021
SocGen	$1.5bn	7.375	13-Sep-2021
Erste Group	€500m	8.88	15-Oct-2021
Virgin Money UK	£288m	8.75	10-Nov-2021

Source: Bloomberg, compiled by DCME

We further anticipate that the majority of issuers with high-coupon yielding, callable AT1 notes will elect to redeem them when there is a chance this year. Financing conditions remained favourable and supply dynamics remain supportive of AT1 valuations. Investor appetite for higher-yielding instruments remained high as seen in Abanca's EUR375m AT1 which was highly subscribed (6x) earlier this year. We have already seen the likes of Intesa and Svenska Handelsbanken opting to call old deals and replace them with cheaper ones, though many AT1 bonds have already been refinanced during 2020. The upcoming call dates are evenly spread across the year with the majority expected between March and September. Generally, the call record of European banks is good with only two benchmark-sized AT1s outstanding that weren't called (Deutsche Bank and Lloyds). Investor fears over non-call risk was sparked in March 2019 when Santander decided not to call a euro AT1 bond. Market participants worried that the first non-call of an AT1 could do lasting damage to the asset class. However, these concerns were disbursed as AT1 prices held up and investors were willing to pick up the outstanding Spanish instrument, even if its handling proved contentious at the time. There have been a number of issuers that followed Santander's example since then, yet it has failed to cause disruption to the market.

Primary and secondary markets

Data collected from Bloomberg on European **primary market** issuance volumes shows that SSAs issued EUR31.1bn over the course of last week exceeding market expectation of EUR22.5bn-26.6bn. Sovereign issuers as well as CADESs and the European Union contributed to the strong deal flow which far outstripped FIG supply of EUR6.2bn that lagged survey data of EUR7-11.5bn for the week. January 2021 FIG volumes of EU52.4bn closed 44% behind last year's issuance while SSAs were up 32.8% at EUR135.5bn compared to last year. The EU tapped its social bond programme (SURE) for EUR4bn which was the most subscribed bond of the week with 12.25x orders over deal size. The EUR10bn second leg over 7-years was 8.6x oversubscribed. Market participants expect SSA issuances to carry forward their momentum into February leading the way for a fifth week in a row. Survey data suggests SSA volumes will range between EUR16bn-21bn and FIGs to issue EUR4.5bn-9bn over the course of this week.

For FIGs, Australia and New Zealand Banking Group (ANZ) issued the most subscribed FIG deal of the week with book orders 3.07x over deal size. ANZ issued a 10-year, Tier 2 sustainability bond linked to the UN's sustainable development goals (SDG). The EUR750m transaction was offered at IPT MS + 135/140bps and eventually tightened 28bps helped by its order book. It was the first sustainable bond issuance by the bank since the merger of their SDG and green bond frameworks last year. ANZ aims to raise a further USD0.65bn-1.65bn Tier 2 debt during 2021 in line with other Australian banks that need to meet their TLAC requirements with subordinated debt by 2024. The Australian Prudential Regulation Authority (APRA) mandated in July 2019 that systemically important banks need to meet the equivalent of 3% of their RWA with Tier 2 to satisfy TLAC requirements. This will likely prompt more capital trades throughout the year from ANZ, Commonwealth Bank of Australia, NAB and Westpac. The estimated shortfall of the four systemically relevant institutions is around USD38bn.

(Table 1) Key Transactions

Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
JP Morgan	Senior Unsecured	USD3bn	11NC10	T + 90	T + 105/110	n.a.
JP Morgan	Senior Unsecured	USD2bn	6YNC5	T + 62	T + 75/80	n.a.
La Banque Postale	Tier 2	EUR500m	11.5NC6.5	MS + 123	MS + 145	>EUR1.3bn
ANZ Bank	Tier 2 (Sustainable)	EUR750m	10.25NC5.25	MS + 112	MS + 135/140	>EUR2.3bn
European Union	Senior Unsecured	EUR4bn	30Y TAP	MS + 5	MS + 7	>EUR49bn
European Union	Senior Unsecured	EUR10bn	7Y	MS - 16	MS -13	>EUR83bn
Cades	Unsecured (Social)	EUR4bn	10Y	OAT + 16	OAT + 18	>EUR9.3bn

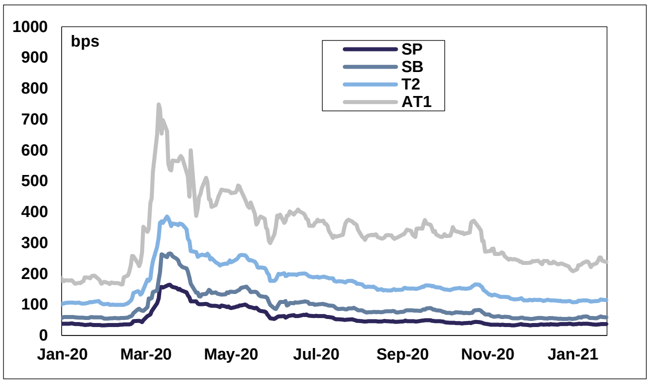
Source BondRadar, Bloomberg.

Secondary market spreads widened modestly across EUR and USD, reflecting market risk perceptions. CDS price indices on European senior (63bps) and subordinated financials (118bps) as measured by iTraxx benchmarks also priced higher against the prior week's levels by 1bps each. Volatility was slightly frontloaded during the week as Italy's Prime Minister resigned on Tuesday, a step anticipated by the market, and the spat between Astra Zeneca and the EU over vaccine contingencies fuelled negative sentiment over slow vaccine rollouts on the continent. The initial vaccine euphoria, which raised hopes for a 2H21 recovery, has given way to a more sober outlook for the rest of the year given the evident challenges in rolling out enough doses across Europe. The Fed's acknowledgment that the US recovery had stalled and needed progress on vaccines underscored this broad based softening of sentiment in the market and ultimately led to some widening in the secondary market.

The lack of FIG deal flow during the European banks' earnings season arguably shifted investor focus towards the uncertainty surrounding bank operating environments, adversely impacting spreads. This was exemplified by Goldman's recently launched EUR1.75bn senior unsecured that traded wide of its reoffer level, despite stellar fundamentals reported by the bank. Based on data collected from Bloomberg 35% of FIG tranches issued this year quoted wider than launch (SSA only 21%) which has worsened against last week when 27.4% of FIG deals traded wider (SSA: 24.5%). Weekly average EUR spreads across geographies for SP (0.6bps), SNP (2.4bps) and Tier 2 (6.2bps) closed wider on general economic uncertainty. A stronger outlook in the US somewhat limited the widening among USD spreads over the past week with USD SP (0.7bps), SNP (1.3bps) and Tier 2 (5.4bps).

Western European Banks EUR Spreads and Yields

Aggregate EUR Z-spread LTM (bps)



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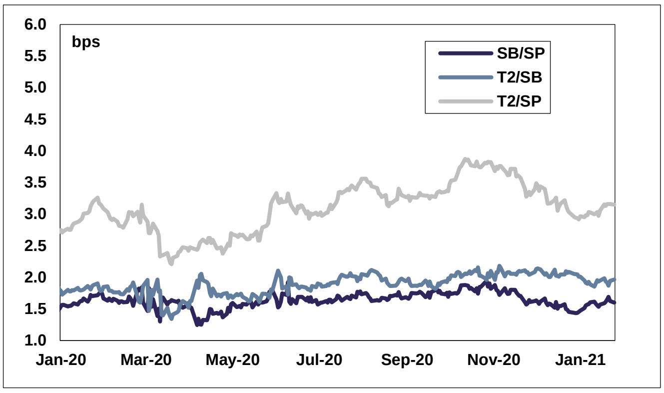

Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCo; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

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	50.3	0.8	-3.6	3.8	0.3	73.5	2.4	-0.1	4.6	1.8	216.3	10.5	3.6
Barclays	3.2	0.2	61.0	2.5	2.4	2.8	0.0	52.3	1.8	8.9	1.9	0.9	139.6	8.6	1.4
BBVA	5.0	0.0	43.3	0.6	4.4	3.9	0.1	54.1	0.7	2.8	5.4	0.8	125.7	6.0	1.4
BFCM	4.4	-0.1	32.1	1.5	1.3	8.7	0.5	67.4	2.0	5.9	4.8	0.5	87.3	5.0	4.3
BNPP	2.3	-0.3	21.1	0.6	-1.2	5.0	0.2	61.2	1.5	1.6	4.6	0.6	98.8	5.3	-0.1
BPCE	3.4	-0.2	30.3	0.6	0.2	4.5	0.2	60.0	2.3	5.9	2.3	0.2	64.8	2.8	3.6
Credit Ag.	3.2	-0.1	31.8	1.2	-0.6	5.6	0.2	59.2	2.6	5.9	4.6	0.8	118.6	5.9	2.3
Credit Sui.	5.4	0.1	50.3	0.8	-3.6	5.2	0.3	70.2	-1.7	5.3	5.6	1.3	161.2	6.4	8.0
Danske	2.3	-0.2	31.0	1.6	0.4	2.3	0.0	49.8	-0.4	-2.9	3.6	0.8	125.6	3.4	-7.4
Deutsche	2.5	0.0	43.4	1.1	-3.8	3.9	0.7	114.2	3.9	1.6	4.4	1.9	227.6	8.2	-7.3
DNB	2.8	-0.2	24.1	1.3	-1.3	3.6	0.0	47.0	2.5	-5.3	1.6	0.0	50.0	2.7	3.1
HSBC	3.3	0.0	34.3	1.6	1.8	3.2	-0.1	46.9	2.1	6.4	5.4	0.5	82.3	7.4	3.8
ING	1.1	-0.4	8.0	1.1	-1.2	4.7	0.1	49.5	1.0	3.4	3.5	0.7	108.0	4.6	2.8
Intesa	4.5	0.2	63.5	-1.9	6.5						5.1	1.7	204.8	7.9	6.2
Lloyds	2.7	-0.2	21.5	2.3	2.1	3.6	0.1	55.6	3.3	4.3	2.5	0.6	108.2	6.1	1.5
Nordea	3.9	-0.2	23.4	0.7	-3.6	2.4	-0.2	28.7	2.3	1.8	0.6	0.2	60.0	0.7	-7.7
Rabobank	3.2	-0.3	19.3	-0.2	-5.6	5.7	0.0	39.0	1.4	2.3	1.6	0.0	42.2	0.5	-0.7
RBS	3.1	0.0	39.4	1.0	-2.0	5.7	0.0	39.0	1.4	2.3	1.6	0.0	42.2	0.5	-0.7
Santander	3.4	-0.1	35.1	0.0	1.8	4.8	0.3	62.5	0.1	4.2	5.5	0.8	115.2	6.9	2.5
San UK	4.0	0.0	38.5	2.8	2.1	2.4	0.0	58.9	3.4	5.1	5.5	0.8	115.2	6.9	2.5
SocGen	1.8	-0.3	21.5	1.0	-2.6	6.2	0.4	78.0	2.0	1.7	3.0	0.5	94.8	3.7	-2.3
StanChart	3.6	-0.1	36.9	1.3	-2.5	5.4	0.3	69.2	3.6	18.1	3.1	0.6	106.6	4.1	-1.1
Swedbank	4.2	-0.1	36.4	0.9	-1.4	5.3	0.2	54.7	1.7	-0.1	4.9	0.4	88.8	-2.8	-10.8
UBS	2.0	-0.3	22.0	1.8	-2.2	3.1	0.0	54.0	2.9	6.2	0.3	1.0	76.0	1.5	-30.1
UniCredit	4.1	0.4	84.6	-2.3	10.1	4.4	0.9	130.4	-2.2	7.0	2.8	1.9	228.5	11.4	5.4

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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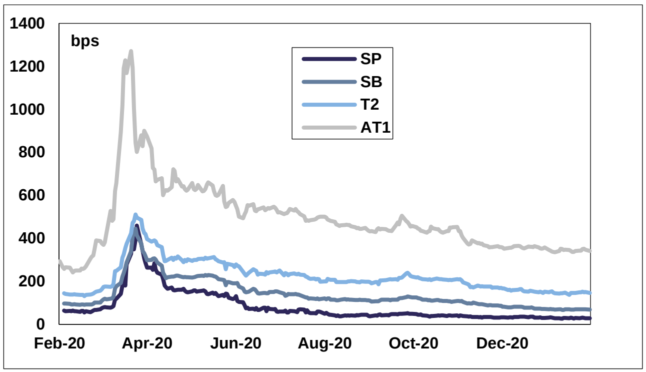

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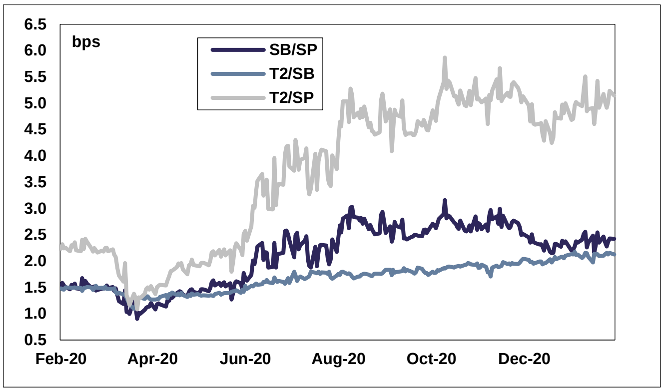

Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCo; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

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	2.1	0.4	19.2	-4.0	-8.7	4.0	1.3	84.4	1.3	2.7	5.5	2.2	147.6	5.0	-3.5
BFCM	2.4	0.5	31.1	1.1	-2.3	4.0	1.3	84.4	1.3	2.7	5.5	2.2	147.6	5.0	-3.5
BNPP	2.0	0.3	7.9	-4.0	-7.3	4.1	1.3	64.2	0.9	-2.7	5.4	1.8	107.8	1.7	3.7
BPCE	3.9	0.8	45.8	-0.4	-4.3	4.5	1.2	50.3	0.0	-3.1	3.2	1.2	81.6	1.5	-2.8
Credit Ag.	2.5	0.6	31.6	0.8	-2.2	4.4	1.2	50.6	-2.4	-3.1	7.0	2.4	134.0	4.2	1.0
Credit Sui.	3.0	0.4	24.6	-1.3	2.2	4.1	1.2	67.9	1.1	-1.3	2.4	2.0	159.4	12.5	27.9
Danske	1.8	0.6	39.3	-0.3	4.5	2.6	1.0	74.3	-0.2	-6.7	2.4	2.0	159.4	12.5	27.9
Deutsche						3.3	1.3	69.1	-2.2	-7.2	7.6	3.5	279.0	8.5	15.5
HSBC	3.5	1.1	84.6	3.6	2.3	4.7	1.3	71.5	0.7	0.8	10.7	3.1	170.5	5.6	-1.0
ING	3.5	1.1	84.6	3.6	2.3	4.4	1.1	62.1	1.9	-2.3	2.2	1.2	85.5	-3.6	-9.4
Intesa	3.2	1.4	106.0	0.2	4.1	4.4	1.1	62.1	1.9	-2.3	3.7	2.6	208.2	21.3	6.8
Lloyds	4.0	1.0	59.4	-0.7	-3.3	3.5	1.0	62.7	0.8	3.2	4.6	1.7	110.8	0.9	-7.0
Nordea	3.4	0.6	24.5	0.5	0.0	2.4	0.6	33.3	-0.2	-7.4	1.6			17.0	3.3
Rabobank	3.0	0.5	21.6	0.1	0.3	3.8	0.8	39.9	2.2	-2.0	4.5	1.3	70.1	1.2	-0.9
RBS	3.0	0.5	21.6	0.1	0.3	3.8	0.8	39.9	2.2	-2.0	4.5	1.3	70.1	1.2	-0.9
Santander	5.4	1.3	67.7	2.1	-4.7	4.8	1.4	81.8	-1.2	-5.2	6.5	2.1	130.5	3.4	2.3
San UK	2.9	0.6	34.1	0.6	-6.3	2.6	0.9	58.9	2.0	-6.4	4.1			-12.1	-41.8
SocGen	4.3	1.0	54.8	4.5	4.2	4.2	1.4	86.0	0.0	-3.4	4.1	1.8	131.6	0.9	-13.9
StanChart	0.3	0.6	43.6	7.8	-11.1	3.8	1.2	76.6	1.3	-7.5	5.4	2.3	187.2	5.3	-7.9
UBS	9.4	1.5	60.3	0.8	0.8	4.2	1.2	62.0	-0.3	-0.9	5.4	2.3	187.2	5.3	-7.9
UniCredit	1.8	1.4	118.7	2.7	-4.7	4.3	1.9	148.7	2.6	0.6	5.8	4.5	343.5	10.3	5.7

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.

Credit Research

Key contacts

London		
Head of Research	*Chris Scicluna*	+44 20 7597 8326
Financials, Supras/Sovereigns & Agencies	*William Hahn*	+44 20 7597 8355
Research Assistant	*Katherine Ludlow*	+44 20 7597 8318
Tokyo		
Domestic Credit		
Chief Credit Analyst	*Toshiyasu Ohashi*	+81 3 5555 8753
Electronics, Automobiles, Non-Banks, Real Estate, REIT	*Takao Matsuzaka*	+81 3 5555 8763
Chemicals, Iron & Steel	*Kazuaki Fujita*	+81 3 5555 8765
International Credit		
Non-Japanese/Samurai, European Sovereigns	*Hiroaki Fujioka*	+81 3 5555 8761
Non-Japanese/Samurai	*Fumio Taki*	+81 3 5555 8787
Non-Japanese	*Jiang Jiang*	+81 3 5555 8755
London Translation		
Head of Translation, Economic and Credit	*Mariko Humphris*	+44 20 7597 8327

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[Moody's]

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[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.

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