European Banks – Credit Update

- EU banks well placed to deal with capital impact from full implementation of Basel III regulation.
- September was the busiest month of the year in the primaries with combined FIG and SSA volumes above EUR150bn despite a noticeable slowdown in issuance over the past week.
- Secondary market spreads hold firm as pressure from primary market glut resides. Expected restraint in issuance volumes leading up to 3Q21 reporting season should further support this development.

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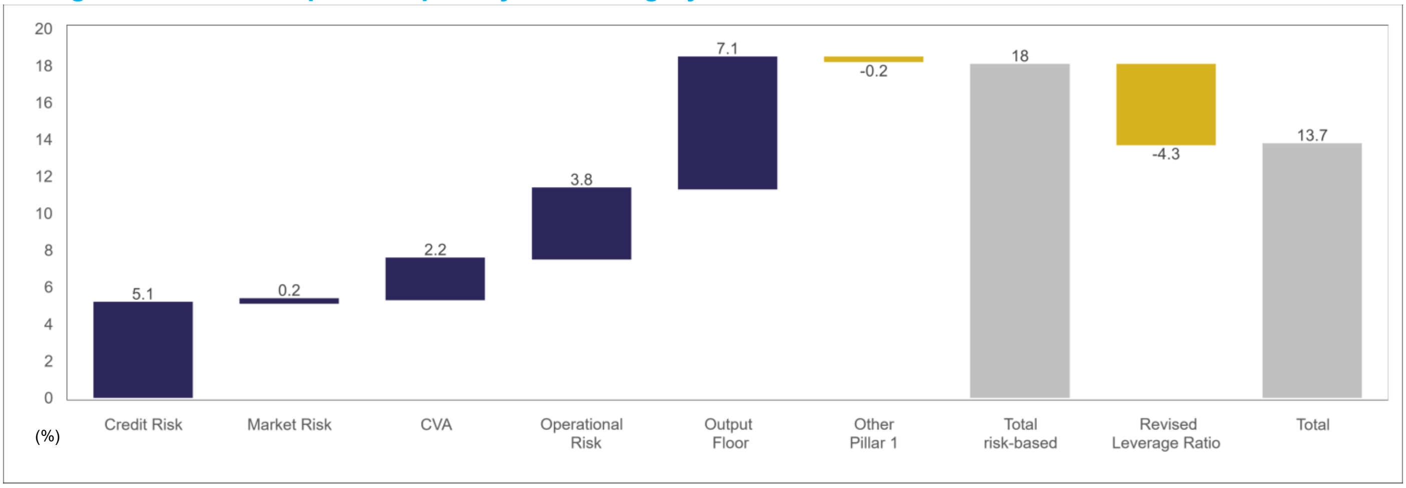
European Banks appear well equipped for full Basel III implementation

The EBA regularly publishes a monitoring report on the full implementation of the Basel III regulation and how well European banks are adapting to its requirements. The ruleset was developed by the Basel Committee on Banking Supervision (BCBS) in response to the financial crisis with the aim of improving risk management and governance as well as strengthen banks' transparency and disclosures. Moreover, the reform package includes the Committee's efforts to strengthen the resolution of systemically significant cross-border banks. Key components such as the risk-based capital standards and the Liquidity Coverage Ratio (LCR) are already enforced by all member jurisdictions. Most member jurisdictions also have final rules in place for other Basel III standards, including those relating to the Net Stable Funding Ratio (NSFR), the leverage ratio, the standardised approach for measuring counterparty credit risk (SA-CCR) and the supervisory framework for measuring and controlling large exposures (LEX). However, final rules for some standards have not yet come into force in some jurisdictions, and many jurisdictions have faced delays in implementing some standards based on the agreed timelines. The final elements of the package include the following components:

- a revised standardised approach for credit risk;
- revisions to the internal ratings-based (IRB) approach for credit risk;
- revisions to the credit valuation adjustment (CVA) framework;
- a revised standardised approach for operational risk;
- revisions to the measurement of the leverage ratio and a leverage ratio buffer for G-SIBs; and
- an aggregate output floor, which will ensure that banks' risk-weighted assets (RWA) generated by internal models are no lower than 72.5% of RWA as calculated by the Basel III Framework's standardised approaches. Banks will also be required to disclose their RWA based on these standardised approaches.

Change in Minimum Required Capital by Risk Category

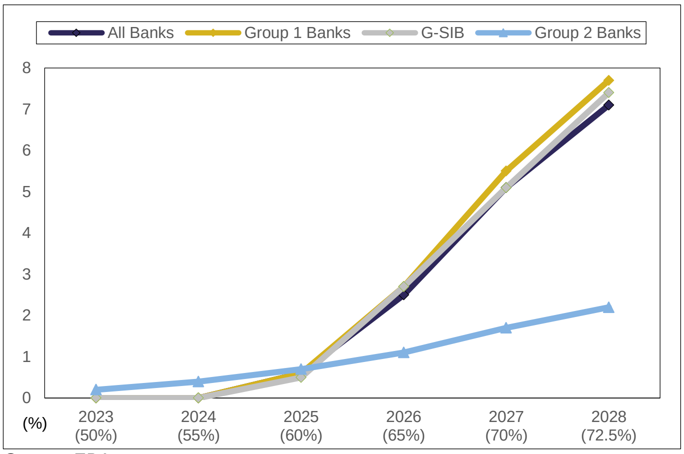


Source: EBA

The standards were due to take effect in January 2022, with the output floor to be phased in over five years. However, due to concerns over the adverse effects of the pandemic on the global banking system, implementation was delayed by one year. Nevertheless, the EBA regularly publishes its monitoring report on the full implementation of the above measures and its most recent assessment was carried out based on end-2020 bank data. For this the EBA looked at a sample of 99 banks, 40 large and internationally operating banks with Tier 1 capital in excess of EUR3bn (Group 1) and the remaining 59 banks (Group 2). The results show an average increase of 13.7% on the current minimum Tier 1 capital requirement across the sample group, 14.4% for Group 1 and 8.1% for Group 2. Globally systemic banks (G-SIB's) experienced the largest increase in requirements, +22.7%. Although these figures may appear high, the EBA stated that in nominal terms banks need to raise an estimated EUR3.1bn in Tier 1 capital by 2028.

Given the long implementation period we deem this to be more than manageable as it also presents a strong improvement over the average EUR9.6bn capital shortfall published one year ago. The figures underscore how well EU banks are currently capitalised in preparation for the reforms. In this context, they have indirectly benefitted from pandemic-related dividend pay-out and share buyback restrictions imposed by the ECB resulting in stronger capital positions. However, as the ECB has lifted its restrictions, EU banks are expected to return at least EUR22bn in capital to shareholders during the next quarter, which may slow Basel III related preparedness. Looking ahead, the EU Commission is due to hold an oral procedure this week to discuss the legislative initiatives on EU bank capital requirements, suggesting it may complete the proposal for a new Capital Requirements Regulation (CRR) - the EU's implementation of Basel standards - in the foreseeable future. Up until now there has been strong opposition to some reform elements, most notably the plans for an output floor that would prevent larger banks from using internal ratings to risk weight assets at anything below 72.5% of the result that would have been produced by using standardised models. The outcome of the proposal will thus likely be keenly anticipated.

Output floor impact on Minimum Required Capital



Source: EBA

Primary and secondary markets

European **primary market** issuance volumes for SSAs stood at EUR4.5bn over the course of last week, below market expectations of EUR10bn-14.5bn. FIG supply of EUR12.4bn was above the weekly forecast amount of EUR6bn-10.5bn. The total 2021 year-to-date FIG volume of EUR365.7bn is 18% ahead of last year's issuance volume. SSA volumes however, remain behind last year's level, down 1.5% at EUR640.6bn. For the week ahead, survey data suggest SSA volumes will range between EUR10bn-15bn and FIGs are expected to issue EUR5bn-9.5bn.

Weekly **SSA** volumes in the primaries were subdued with a handful of issues, most notably from Spain's rail operator **(ADIF).** The government owned company issued a 10-year, green senior unsecured note under its green bond framework. The issuer planned to place a EUR500m note but on the back of strong demand (5.8x subscribed) decided to upsize slightly to EUR600m, setting the spread at SPGB+17bps. France's social housing service **(ALS)** issued a senior unsecured EUR1bn sustainability bond. The 10-year note priced at OAT+29bps (-3bps from guidance) and was only the third bond placed by the issuer following deals in 2019 and July 2021 that were ESG themed. Supported by its track record thus far, ALS claims to be the first and only issuer to issue under an entirely sustainable EMTN programme. Lastly, the **Asian Development Bank (ADB)** placed a short dated 3-year senior deal in the market. The reception for the USD3bn bond was solid with book orders more than twice that (2.2x). Spreads were priced off SOFR MS+13bps making ADB only the fifth issuer to price fixed rate USD against SOFR mid-swaps rather than LIBOR mid-swaps.

FIG volumes also slowed down noticeably ahead of the 3Q21 reporting season. Despite the reduction compared to prior weeks we still saw some core European names in the market. **Banco Santander** added to the recent glut of Sterling transactions with a GBP850m Tier 2 bond. The 11NC6 tightened 20bps from IPT, settling at G+165bps, suggesting the Spanish giants left a 5-10bps new issue premium on the table. Prior to this deal, Santander didn't have any outstanding Sterling bonds in the sub-debt space. **Credit Agricole Assurance** added to the subordinated debt supply with its own EUR1bn Tier 2. The 10-year deal priced MS +145bps (-10/15bps tighter) on the back of 1.6x demand. It also paid a new issue premium of some 10bps. Senior supply came from **Banco Comercial Portugues (BCP)**, which issued its debut themed senior preferred deal. The social bond was issued under BCP's recently formulated green, social and sustainability framework. BCP is currently rated Ba1/BB/BB by Moody's, S&P and Fitch and proceeds will go towards SME's affected by the adverse economic effects of Covid-19. The bond will also likely help build the issuer's MREL base which it has not disclosed to date.

(Table 1) Key Transactions

Bank	Rank	Amount	Maturity	Final Spread (bps)	IPT (bps)	Book Orders
SSA						
ADIF	Sr. Unsecured (Green)	EUR600m	10Y	SPGB + 17	SPGB + 21	>EUR2.9bn
ALS	Sr. Unsecured (Sustainable)	EUR1bn	10Y	OAT + 29	OAT + 32	>EUR4.7bn
ADB	Sr. Unsecured	USD3bn	3Y	SOFR MS+13	SOFR MS+15	>USD6.6bn
Kommunekredit	Sr. Unsecured (Tap)	EUR500m	12.5Y	MS + 5	MS + 8	>EUR1.15bn
KfW	Sr. Unsecured (Tap)	GBP700m	2Y	G + 20	G + 21	>GBP775m
FIG (Senior)						
BCP	SP (Social)	EUR500m	6.5NC5.5	MS + 200	MS + 215/220	>EUR725m
OP Corporate Bank	SNP	GBP400m	5Y	MS + 85	MS + 95/100	>GBP525m
BFCM	SP	USD800m	5Y	T + 60	T + 80	n.a.
BFCM	SP (FRN)	USD700m	3Y	SOFR + 41	SOFR + 41	n.a.
BFCM	SP	USD500m	3Y	T + 45	T + 65	n.a.
FIG (Subordinated)						
Credit Agricole Assurance	Tier 2	EUR1bn	10Y	MS + 145	MS + 160/165	>EUR1.6bn
Belfius	Tier 2	EUR500m	12.5NC7.5	MS + 130	MS + 145	>EUR725m
Banco Santander	Tier 2	GBP850m	11NC6	G + 165	G + 185	>GBP1.3bn

Source BondRadar, Bloomberg.

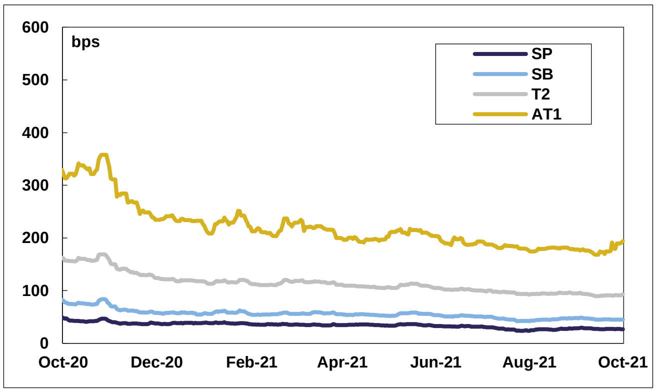
Secondary markets remained broadly stable in EUR and slightly wider in USD while risk indicators pointed upwards amidst some movements in rates and equity markets. CDS price indices on European senior (58.5bps) and subordinated financials (114bps), as measured by iTraxx benchmarks, priced 3.5bps and 3bps wider against last week's levels.

Markets continued to experience choppy conditions as rates and equities moved up and down throughout the week. Senior spreads weathered the conditions, the best even going somewhat tighter among EUR issuance, while subordinated spreads experienced some widening. Towards the end of last week, Wall Street and other markets rebounded amidst lower bond yields but holidays in some Asian markets may just temporarily delay more news on China's Evergrande situation that may add to volatility. Following the recent glut in primary markets which exerted some pressure on secondary spreads we do expect to see continued restraint in issuance volumes in the run up to the 3Q21 FIG reporting season.

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 widened week on week with SP (+1.4bps), SNP (+2.1bps) and Tier 2 (+4.8bps). 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 EUR Spreads and Yields

Aggregate EUR Z-spread LTM (bps)



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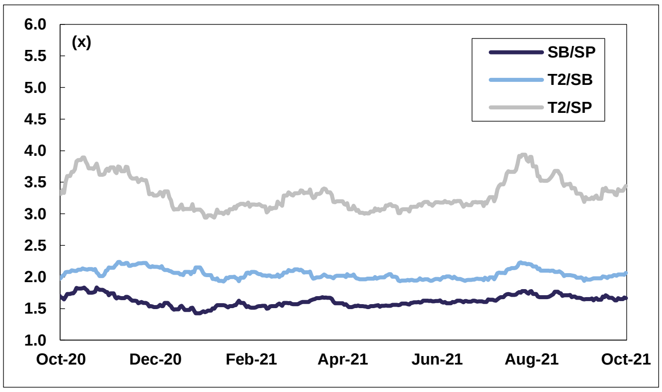


Source: Bloomberg, Daiwa Capital Markets Europe. SP = Senior Preferred/Senior OpCo; SB = Senior Non- Preferred/ Senior HoldCo; T2= Tier 2; AT1 = Additional Tier 1. All figures based on Z to worst spread of public benchmark issuances.

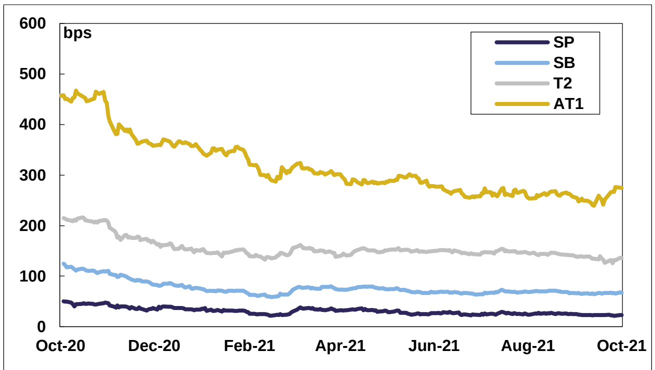
Selected Names

	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	4.3	0.1	35.9	-0.3	-15.5	3.4	0.2	44.7	-0.2	-20.5	4.1	1.3	144.4	2.3	-75.8
Barclays	2.6	-0.1	22.2	-0.1	-35.7	2.7	0.1	44.2	0.0	-16.7	2.8	0.6	94.7	1.3	-51.7
BBVA	4.7	0.1	28.9	0.1	-13.0	3.5	0.0	32.1	0.8	-14.5	3.2	0.6	73.6	1.8	-52.5
BFCM	4.4	0.0	23.5	-0.3	-10.2	7.5	0.6	58.9	0.4	-4.5	4.3	0.4	57.5	0.8	-25.8
BNPP	1.9	-0.3	6.3	0.1	-16.6	4.6	0.2	44.0	-0.1	-14.4	4.4	0.5	62.9	1.3	-37.8
BPCE	3.0	-0.2	14.6	-0.2	-12.7	4.3	0.2	44.5	0.2	-11.6	3.0	0.0	43.1	0.8	-24.4
Credit Ag.	3.6	-0.1	19.7	-0.3	-9.2	5.6	0.3	46.7	-0.2	-8.1	4.1	0.8	89.6	0.4	-30.3
Credit Sui.	4.3	0.1	35.9	-0.3	-15.5	4.6	0.5	74.3	0.5	6.0					
Danske	1.6	-0.3	15.6	-0.2	-19.0	2.4	-0.1	34.2	-0.1	-22.2	3.3	0.7	105.3	0.7	-34.2
Deutsche	1.9	-0.1	26.3	-0.6	-20.4	4.0	0.5	71.3	0.6	-41.6	3.9	1.0	122.9	1.4	-107.7
DNB	2.1	-0.4	5.0	-1.2	-20.8	7.0	0.5	54.0	-0.1	-1.7	0.9	0.0	42.2	0.1	-4.3
HSBC	4.3	0.0	21.0	0.3	-12.3	4.2	0.1	49.5	0.2	-1.3	4.9	0.4	59.9	0.4	-22.0
Intesa	4.3	0.1	30.2	-0.5	-25.6	3.4	0.3	61.0	-0.1	-54.0	4.6	1.2	138.2	0.5	-92.7
Lloyds	3.2	-0.1	18.3	-0.6	-3.8	2.9	-0.1	27.2	-0.1	-25.5	1.9	0.0	44.2	0.2	-62.0
Nordea	4.6	-0.1	11.4	-0.5	-17.5	5.5	0.1	25.5	-0.2	-15.7	5.8	0.6	79.4	0.4	-17.1
Rabobank	3.6	-0.2	7.1	-0.4	-21.3	5.0	0.1	24.8	0.1	-12.6	1.8	-0.2	22.6	-0.2	-22.2
RBS	3.3	0.0	26.0	0.0	-15.6	5.0	0.1	24.8	0.1	-12.6	1.8	-0.2	22.6	-0.2	-22.2
Santander	3.8	0.0	25.2	0.6	-10.2	4.8	0.4	53.3	0.2	-14.3	4.9	0.6	77.1	2.2	-36.0
San UK	3.4	-0.2	11.9	-0.6	-24.2	1.9	-0.2	38.1	0.3	-10.7	4.9	0.6	77.1	2.2	-36.0
SocGen	5.1	0.2	33.9	0.0	-8.2	5.8	0.6	70.6	0.0	-9.1	2.4	0.5	87.7	0.9	-40.7
StanChart	4.7	0.1	29.0	0.0	-11.9	4.7	0.3	50.4	0.1	-0.9	3.6	0.9	121.3	3.3	-34.4
Swedbank	3.5	-0.1	19.0	-1.0	-18.4	4.7	0.2	47.2	0.1	-9.3	1.1	0.0	47.2	2.7	-54.6
UBS	4.5	0.0	22.3	-0.4	-9.1	3.3	0.1	37.9	-0.1	-12.4	8.4	2.0	195.2	10.0	-8.5
UniCredit	3.5	0.2	57.4	-0.4	-22.3	3.2	0.5	78.7	0.3	-38.6	2.2	1.2	152.6	6.2	-82.7

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.

Western European Banks USD Spreads and Yields

Aggregate USD Z-spread LTM (bps)



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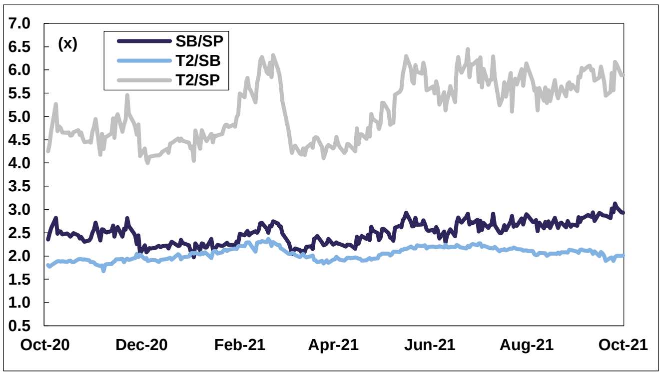

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Selected Names

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Barclays	2.5	0.7	13.1	0.6	-24.6	3.6	1.5	64.6	3.6	-18.4	5.7	2.6	136.8	4.6	-38.1
BFCM	2.7	0.6	22.5	-1.9	-15.2	3.6	1.5	64.6	3.6	-18.4	5.7	2.6	136.8	4.6	-38.1
BNPP	1.4	0.3	8.0	5.1	-7.1	5.3	1.8	75.6	2.9	-12.9	4.9	2.2	111.2	3.3	-4.1
BPCE	4.5	1.4	44.2	2.5	-15.1	4.7	1.9	72.9	3.1	-9.6	2.6	1.3	71.2	2.1	-17.4
Credit Ag.	2.4	0.7	22.0	3.5	-2.8	3.5	1.4	58.0	0.6	-15.9	6.4	2.6	127.4	5.8	-14.4
Credit Sui.	2.1	0.4	23.2	2.9	0.4	3.8	1.7	74.5	4.3	2.2	1.8	1.6	117.3	3.9	-10.3
Danske	3.0	1.0	37.8	0.6	-5.6	2.1	1.1	57.1	-0.3	-29.1	1.8	1.6	117.3	3.9	-10.3
Deutsche	4.8	1.6	60.7	8.4		2.9	1.2	66.6	3.9	-46.6	4.3	2.7	176.3	1.4	-105.3
HSBC	3.0	0.9	63.4	3.4	-19.0	4.2	1.7	72.4	4.8	-6.9	10.2	3.3	160.4	5.9	-6.4
ING	3.0	0.9	63.4	3.4	-19.0	4.3	1.6	58.1	4.5	-16.1	1.6	1.3	98.6	3.3	-14.8
Intesa	2.7	1.2	74.2	-1.5	-26.3	4.3	1.6	58.1	4.5	-16.1	3.8	3.3	211.2	11.5	-52.3
Lloyds	6.5	2.1	91.9	1.7	-27.6	2.9	1.3	51.3	2.0	-10.9	4.1	2.5	116.5	5.6	-35.8
Nordea	2.6	0.7	11.8	1.4	-11.6	3.3	1.1	33.8	2.2	-21.6	4.1	2.5	116.5	5.6	-35.8
Rabobank	3.4	1.0	22.4	2.0	-14.4	3.6	1.4	47.9	3.1	-6.1	4.0	1.6	61.2	4.3	-9.1
RBS	3.4	1.0	22.4	2.0	-14.4	3.6	1.4	47.9	3.1	-6.1	4.0	1.6	61.2	4.3	-9.1
Santander	2.6	0.8	28.4	2.5	-20.3	4.8	1.9	77.1	5.1	-19.3	5.9	2.3	111.2	3.6	-18.4
San UK	2.3	0.7	19.6	2.0	-19.0	3.4	1.6	71.3	2.3	-15.7	3.6			1.8	-86.7
SocGen	3.7	1.3	50.1	1.5	-0.5	4.0	1.9	88.2	4.2	-18.0	3.7	2.1	113.8	3.2	-33.9
StanChart	0.7	0.2	1.7	-0.1	-53.0	3.2	1.5	70.0	3.4	-16.4	4.8	2.5	148.1	4.1	-25.9
UBS	2.6	0.6	22.0	1.6	-2.3	4.1	1.6	59.4	2.6	-8.0	4.8	2.5	148.1	4.1	-25.9
UniCredit	4.9	2.3	119.2	5.5	-50.7	3.8	1.7	103.2	1.2	-37.2	5.9	4.1	266.3	11.3	-63.5

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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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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- 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