DBS Live more, Bank less

European Banks

Credit fundamentals remain supportive to invest for carry

What are fixed rate capital securities for banks and insurers?

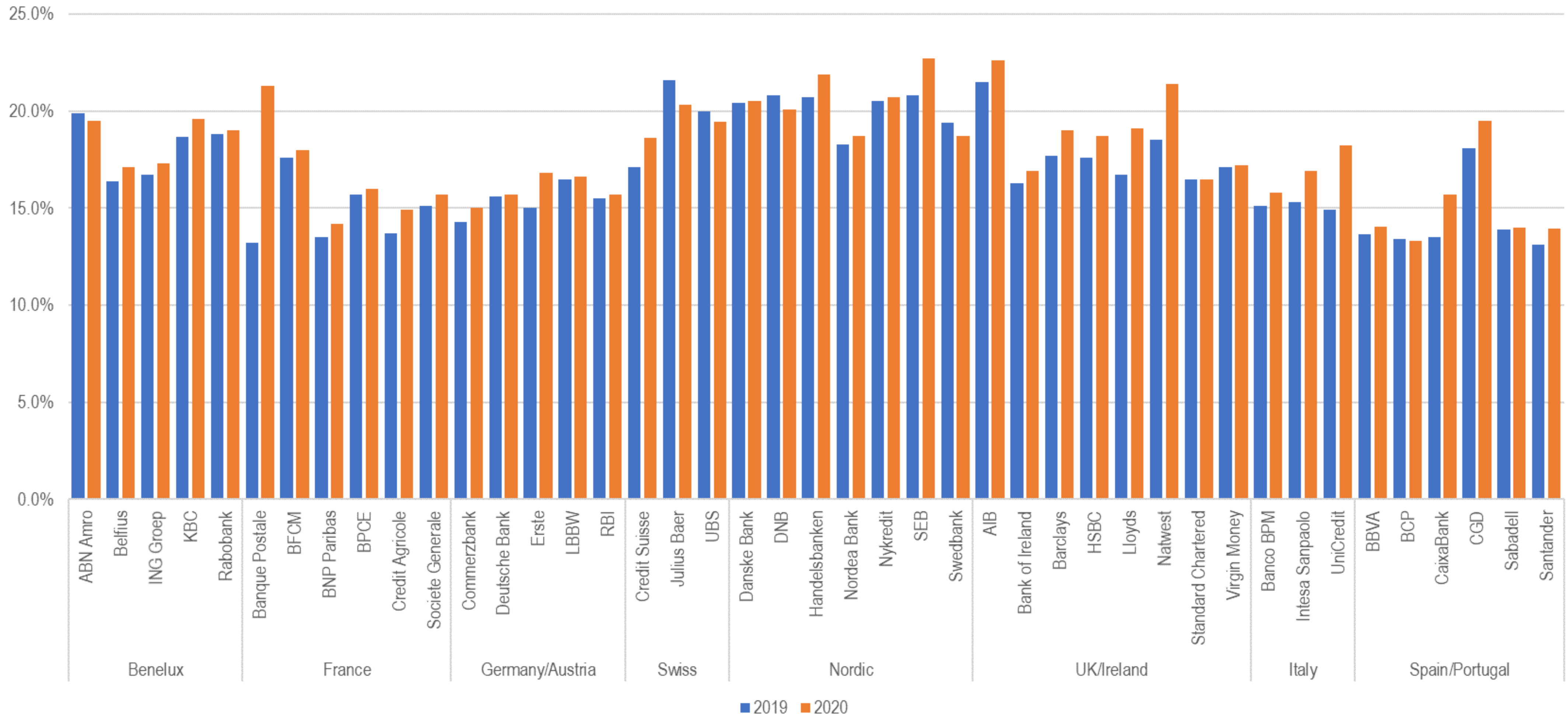
- Junior subordinated debt that qualify as capital under current European banking regulations
  - Additional Tier 1: perpetuals with a minimum five-year non-call, non-cumulative optional coupons, and a contractual trigger to principal write-down or equity conversion
  - Tier 2: dated with at least five (usually ten) years maturity, cumulative optional coupons, and no contractual trigger

- Risks for investors are:
  - Loss of principal investment (via write-down or equity conversion)
  - Coupon non-payment and/or deferral (for AT1s)
  - Extension (non-call)

Type of Instrument	Maturity	Coupons	Write-down / conversion	Coupon step-up after first call date
Insurance Restricted Tier 1	Perpetual, minimum 5 year non-call	Fully discretionary, non-cumulative	Contractual trigger level (usually 75% of requirements or lower than 100% for three months)	No
Insurance Tier 2	At least 10 years, deferrable	Optional Deferral, cumulative	N/A	Yes, usually 100bps
Bank Additional Tier 1	Perpetual, minimum 5 year non-call	Fully discretionary, non-cumulative	Contractual trigger level (5.125 or 7%) or point of non-viability (PONV)	No
Bank Tier 2	At least 5 years	Mandatory	N/A	No

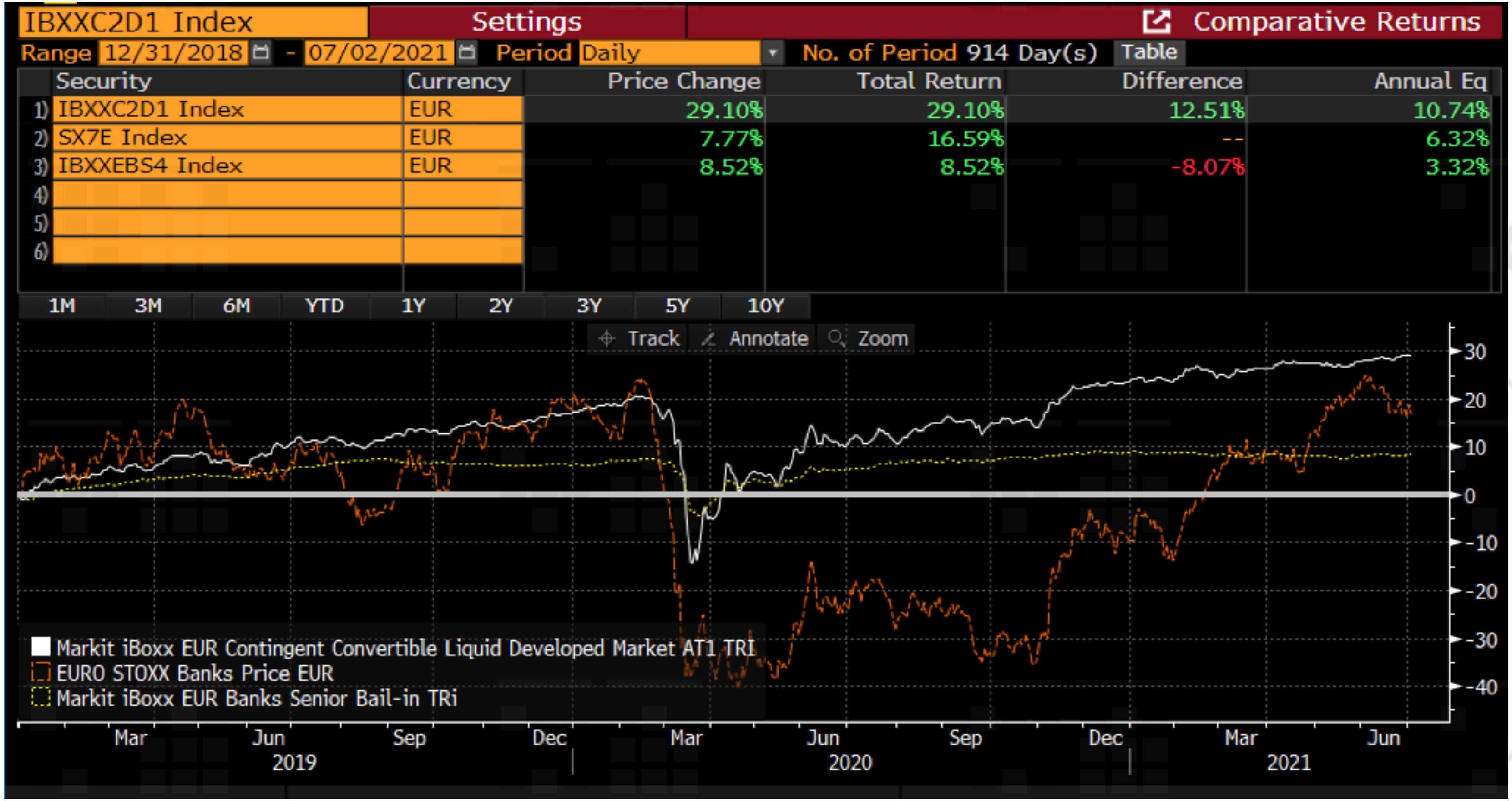
Source: DBS

Tier 1 ratios improved during global lockdown



Source: Bloomberg

AT1s recovered last year while equities recovered this year



Source: Bloomberg

Investment Overview

- Valuations are attractive for AT1s
  - Buy tactical calls on dollar, euro, pound, Singapore dollar, and Australian dollar-denominated securities
  - Supply outlook supportive of pricing as issuance expected to be mostly for re-financing of existing instruments (even legacy)

- Prefer the larger European banks given global backdrop, which enjoy significant capital buffers
  - High capital buffers (highest since after GFC) will decline as capital is returned
  - Prefer investing in the weaker banks (German) through Tier 2 instruments

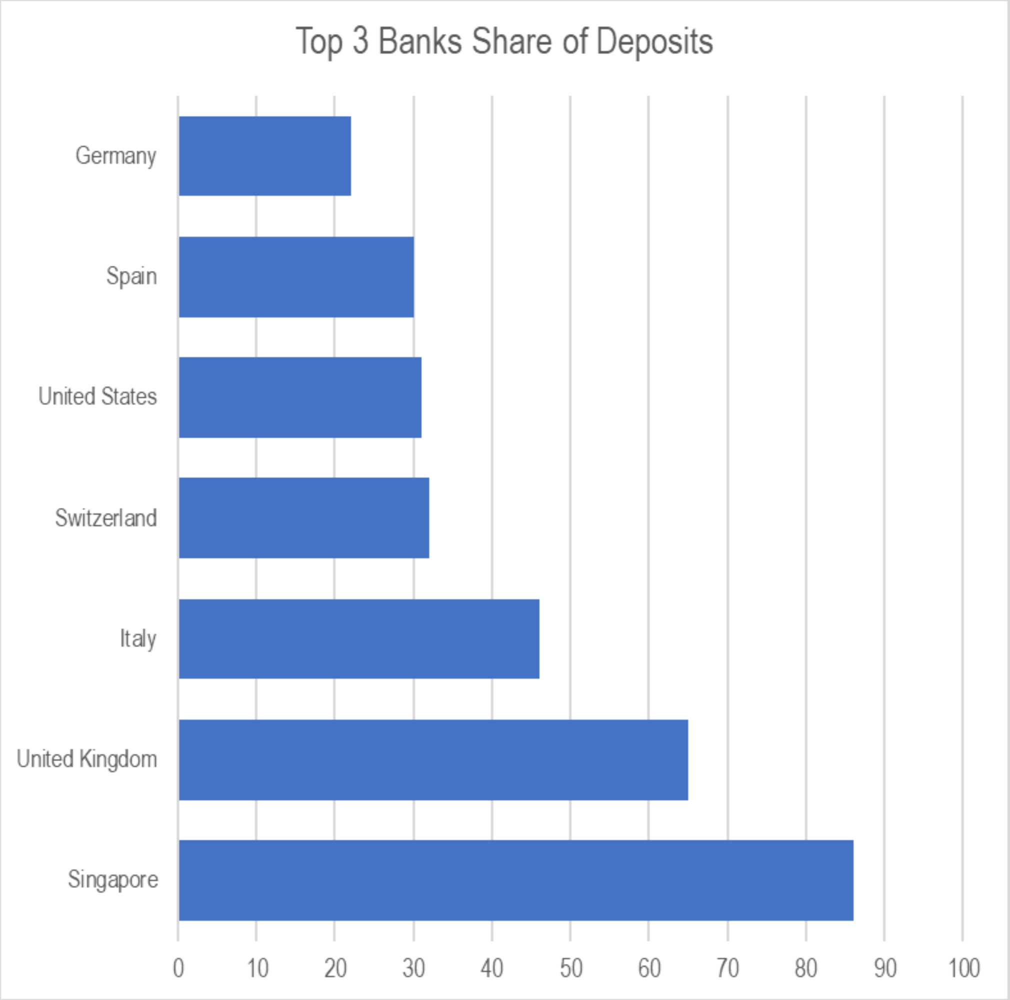
- Conversion/write-off, extension, and coupon-deferral risks are low, in our view
  - Calls expected to be made for reputational factors even if modestly uneconomical to call

- Credit fundamentals should be stable from expected recoveries in economies
  - Steady performance for AT1 (and Tier 2) instruments in 2021 after recovery during prior year
  - Coronavirus an "earnings" impact rather than a "capital" issue – dividends and buybacks will resume in 4Q
  - Credit risks peaked? Guidance from management is that loan loss provisions hit their high in mid-2020
  - Retail and corporate banking hardest hit, but market and investment banking revenues elevated
  - Consolidation within countries, could see pan-European tie-ups

- Recent outlook change to stable (from negative) for European Banks by Standard & Poor's in late June
  - Action by rating agency for banks in Belgium, Britain, France, Italy, Netherlands, and Spain

Consolidation in Europe

- Italy: **Intesa Sanpaolo** and **UBI Banca**, first not due to financial distress in many years in Europe. Speculation on **UniCredit** and **Banca MPS** or **Banco BPM**
- Spain: **CaixaBank** and **Bankia**, becomes largest domestic bank. Possible tie-up between **BBVA** and **Sabadell**
- Ireland: Consolidation as exit from the market of both **NatWest** and **KBC**
- Switzerland: Rumored **UBS** and **Credit Suisse**
- Germany: Rumored **Deutsche Bank** and **Commerzbank**
- Pan-Europe: **UBS** and **BNP Paribas** or **Deutsche Bank**. Other previously discussed between **ING** and **Commerzbank**



Source: Bain & Co.

European Banks: Fixed Income Capital Securities

European Banks													
Issuer Name	ISIN	Coupon	Maturity	Callable Date	Currency	Yield to Worst (YTW)	Composite Credit Rating	MSCI ESG Rating	Total Return YTD	Risk Rating (RR)	Indic. LV	Reset Index	Reset margin (bps)
Banco Santander	XS1951093894	7.500%	Perp	08 Feb 2024	USD	2.93%	BB+	BBB	2.89%	5	45%	5-Year Swap Rate	498.9
BNP Paribas	USF1R15XK938	6.625%	Perp	25 Mar 2024	USD	2.80%	BBB-	AA	3.33%	5	45%	5-Year Swap Rate	414.9
Barclays	US06738EBA29	7.750%	Perp	15 Sep 2023	USD	2.90%	BB	A	6.38%	5	30%	5-Year Swap Rate	484.2
Danske Bank	XS1825417535	7.000%	Perp	26 Jun 2025	USD	3.45%	BB+	BB	4.1%	5	45%	USD 7Y Treasury Yield	413.0
Deutsche Bank	US251526BN89	4.875%	1 Dec 2032	01 Dec 2027	USD	3.35%	BB	A	4.68%	5	45%	5-Year Swap Rate	255.3
HSBC	US404280BN80	6.250%	Perp	23 Mar 2023	USD	2.29%	BBB-	AA	4.17%	5	65%	5-Year Swap Rate	345.3
NatWest	US780099CK11	8.000%	Perp	10 Aug 2025	USD	3.06%	BB	AA	4.58%	5	30%	5-Year Swap Rate	572.0
SEB	XS2076169668	5.125%	Perp	13 May 2025	USD	3.06%	BBB-	AA	4.34%	5	0%	USD 5Y Treasury Yield	346.3
Standard Chartered	USG84228EH74	6.000%	Perp	26 Jul 2025	USD	3.21%	BB	AA	5.45%	5	45%	USD 5Y Treasury Yield	566.1
UBS Group	USH4209UAT37	7.000%	Perp	31 Jan 2024	USD	2.62%	BB+	AA	3.79%	5	45%	USD 5Y Swap Rate	434.4

Source: Bloomberg, Factset, MSCI

A comprehensive list and research reports of covered bonds in the Financial Services sector is available upon request

European Banks: Fixed Income Capital Securities

Banco Santander

Santander is a universal bank with a high focus on retail financial services. We regard the global bank as possessing a stead y, well-managed business model with adequate (risk-adjusted) capitalization – Santander does not have large investment banking operations and is instead a large global lender.

BNP Paribas

BNP Paribas is one of the world's largest banks, which services 30 million customers in retail services across France, Belgiu m, Italy, and Luxembourg. The French bank's capital position remains solid. BNP Paribas' profitability has been impacted from the global virus lockdown but remains in the black. We remain positive on t he bank's capital securities that are denominated in several currencies.

Barclays

Barclays is a global financial services provider. In 2Q 2020, Barclays reported a net profit of £296 million. Revenues decreased 4%, driven by interest income decreasing 20%, despite capital markets revenues increasing 49%. Operating costs decreased 5%. However, credit impairments more than tripled to £1.6 billion. Managem ent maintained the target of reducing the cost-to-income ratio to below 60% over time.

Danske Bank

Danske Bank was founded in 1871 and is headquartered in Copenhagen, Denmark. The AML issues are essentially past for Danske B ank and we anticipate the bank to now focus on cost reductions, similar to many of its peers in the Nordic and wider European region.

Deutsche Bank

Deutsche Bank is a universal bank with a strong presence in the retail markets of Europe. We prefer to invest in the German b ank's higher rated and ranked T2 notes rather than its AT1 securities given the higher potential for a credit event for the latter and attractive relative valuation of the former to similar issue s from European peers.

HSBC Holdings

HSBC is one of the world's largest and Europe's largest diversified financial services group. While the bank's profitability remains subpar, with a return on tangible equity of 8.9% in 2018 and 4.2% in 2019, a large restructuring initiative is underway over the medium term. We continue to see value in the AT1 note complex of HSBC in dollars, euros, and pounds.

NatWest

NatWest (formerly The Royal Bank of Scotland Group plc) is a partially state-owned British banking and insurance provider headquartered in Edinburgh. We continue to regard the valuation of NatWest's fixed rate capital securities as attractive relative to European peers and remain comfortable with its solid credit profile.

SEB Bank

SEB is a large financial services group in the Nordic region with headquarters in Stockholm, Sweden. We take comfort from the quality of the loan portfolio of SEB and capital buffers remain very solid with a CET1 ratio of 17.8 at the end of the last quarter. The bank should be viewed as a safe haven credit and any valu ation pullback should be viewed as an investment opportunity.

Standard Chartered

Standard Chartered operates predominately in Asia, Africa, and the Middle East. We regard the wide credit spreads of the sub-debt notes from the British emerging markets-focused bank as excessive when compared to other like-rated peers globally. We view Standard Chartered's geographic diversity as an advantage with exposure to the high-growth economies of the Asia-Pacific, Middle East, and Africa.

UBS Group

UBS is a leading retail bank in Switzerland and a world leading private bank and asset manager. We remain positive towards th e Swiss bank's AT1 issues. The capital buffers of UBS are high with a CET1 ratio of 13.3% and a total capital ratio of 21.3%. The bank has also ceased dividend payments for common equity to prese rve capital similar to other European banks.

Desk Commentaries

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