CreditSights

Euro Financial Movers: Hold On Tight

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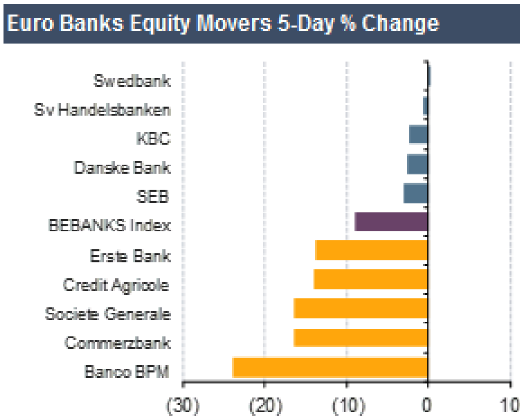
EXECUTIVE SUMMARY

- **Secondary markets remained volatile, while this year's vigorous primary market has stuttered to a halt in the wake of the spread of COVID-19.** We published our thoughts on European banks' exposure to the effects of the virus as well as how to position in the event of further escalation.
- **Banco BPM disclosed a new business plan with detailed FY20-23 financial targets.** Going forward, the bank sees only marginal revenue growth, but bondholders will be reassured by the projected asset de-risking.
- **The European Court of Justice gave its verdict on the potential mis-selling of mortgages linked to the IRPH loan reference index by Spanish banks.** Whilst it was not totally decisive, it rules out the worst-case scenario for Spanish banks.
- **The Retirement segment of L&G continues to be the growth engine of the group, with £11.3 bn of new business in FY19.**
- **Aviva reported unimpressive FY19 results that showed some progress towards its turnaround.**
- **With the $9 bn acquisition of Partner Re, Covéa is finally set to realise its ambition of being an international reinsurance and insurance group after its failed bid for Scor two years ago.**

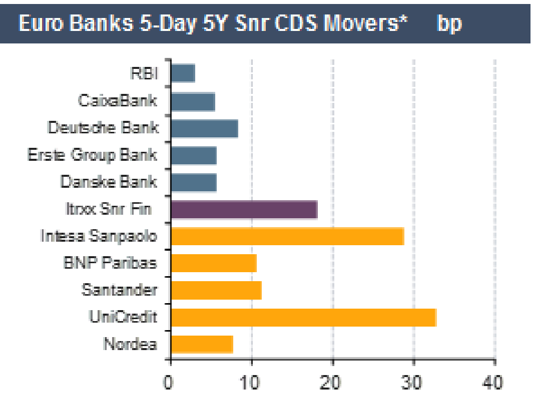
BANKS

COVID-19 fears continued to loom over European banks last week. The potential consequences are wide-ranging, from direct effects on primary markets and even disruption in the workplace to the potentially more significant indirect repercussions for revenue generation and asset quality as economic growth declines. We published our thoughts on the exposure of different European banks to the crisis as well as how to position in the event of further escalation (**European Banks & COVID-19: Dos and Don'ts**).

In the midst of this chaos, **Banco BPM** disclosed a new medium-term strategic plan, with detailed targets looking ahead to FY23 (**Banco BPM: Uninspiring, COVID-19 Unlikely To Help**). Unsurprisingly, the bank sees marginal revenue growth in the next three years as asset de-risking coupled with the adverse operating environment will continue to hinder top-line revenue growth. Return on tangible equity is expected to reach 7% by 2023, which is 40 bp higher than the FY19 underlying figure. The key positive feature of the plans for bondholders is the lower non-performing exposures projected for 2023. As the chart below shows, its share price fell steeply in response, and it was the worst performer of the week, while the traditional 'safe haven' banks in the Nordic region outperformed.



Source: Bloomberg



Source: Bloomberg
*Bars show bp change, ranked by percentage change.

Meanwhile, the European Court of Justice issued a verdict on the potential mis-selling of mortgages by **Spanish banks** linked to the mortgage loan reference index ("IRPH"). Whilst it was not totally decisive, it ruled out the worst-case scenario for Spanish banks and determined that local judges will make an assessment on a case-by-case basis that will potentially lead to the mortgage being cancelled or its terms and conditions being changed. It was not surprising to us that Spanish banks were not found liable (at least not straight away). As we argued most recently in **Bankia: 2019 Profitability Under Pressure**, we found the probability of an adverse ruling retroactively penalising the banks to be low in consideration of the fact that a) the methodology used to set the mortgage rate was clearly included in the contracts and communicated by the banks, and b) IRPH was acknowledged by the General Counsel to be one of six indices for pricing mortgages permitted by the regulators. We continue to believe that the risk that the banks will have to set aside large provisions for risks and charges remains low, and represents an immaterial potential driver for credit spread widening. The banks most exposed to IRPH are, according to the latest figures circulated in the press, **CaixaBank** (€6.1 bn, 3% of loans), **Santander** (€4.3 bn, 0.3% of loans), **BBVA** (€2.8 bn, 1% of loans), **Bankia** (€1.3 bn, 1% of loans), and **Banco Sabadell** (€800 mn, 1% of loans).

AIB Group, a laggard in the earnings calendar, reported a sharp decline in its FY19 operating and pre-tax profit (**AIB Group: FY19 Profits Under Pressure**). However, these results were broadly in line with **Bank of Ireland's,** and pre-tax profit was hit by a €300 mn tracker mortgage provision, included in non-core items and previously signalled.

EUR Outperformers				EUR Underperformers			
	OAS (bp)				OAS (bp)		
Security	05-Mar	27-Feb	Change	Security	05-Mar	27-Feb	Change
BBVASM € AT1 8.875 2021	493	530	-37	TPEIR € T2 9.75 2024	870	766	104
RABOBK € AT1 6.625 2021	280	311	-31	UBIIM € T2 5.875 2029	353	278	75
ISPIM € AT1 7.0 2021	433	450	-17	NOVBNC € T2 8.5 2023	602	537	65
LUMINO € PFD SEN 1.375 2022	108	116	-8	MONTE € T2 10.5 2029	857	792	65
BKIASM € AT1 6.0 2022	496	504	-8	MONTE € T2 5.375 2023	630	566	64
SOCGEN € AT1 6.75 2021	350	356	-6	CXGD € T2 5.75 2023	303	243	60
OBERBK € PFD SEN 0.75 2026	59	63	-4	BPEIM € T2 5.125 2022	365	306	59
DB € AT1 6.0 2022	454	458	-4	MONTE € T2 8.0 2025	731	677	54
HESLAN € NPS 1.56 2032	87	90	-3	CAJAMA € T2 7.75 2022	660	613	47

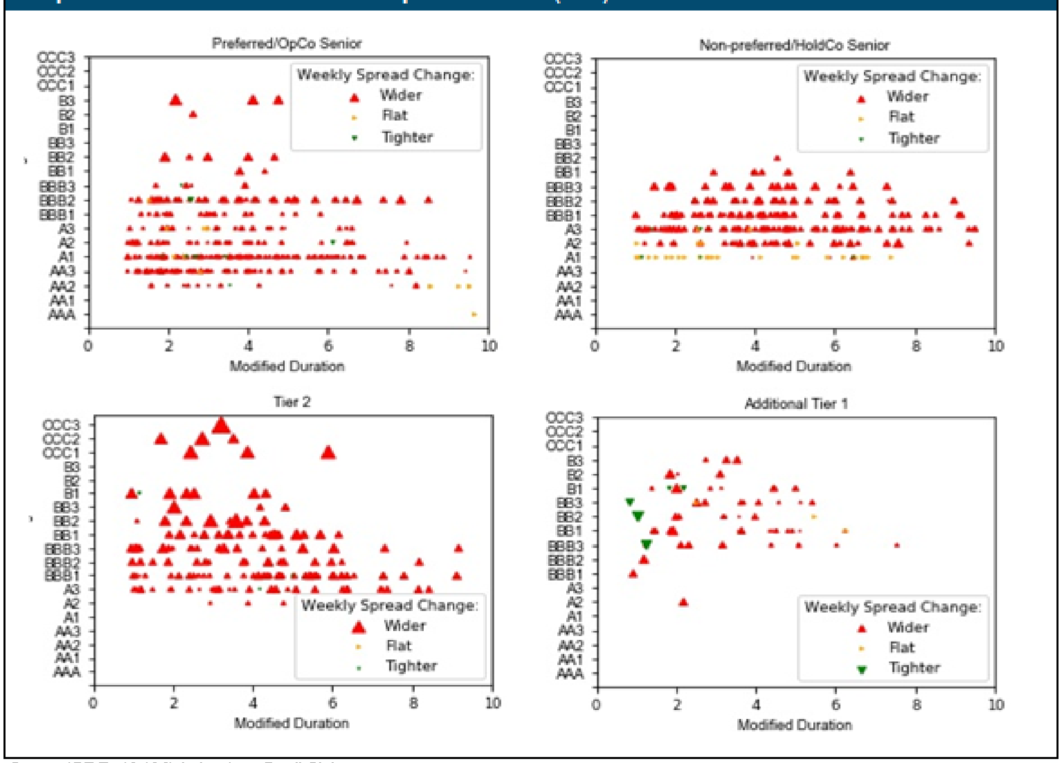
Source: ICE BofA / ML Index data, CreditSights

USD Outperformers				USD Underperformers			
	OAS (bp)				OAS (bp)		
Security	05-Mar	27-Feb	Change	Security	05-Mar	27-Feb	Change
BNP $ AT1 7.625 2021	407	437	-30	BACR $ AT1 7.625 2022	272	194	78
SEB $ PFD SEN 2.8 2022	34	52	-18	INTNED $ PFD SEN 2.75 2021	94	21	73
DNBNO $ PFD SEN 2.15 2022	39	55	-16	DB $ T2 4.5 2025	367	298	69
CS $ NPS 3.8 2023	90	98	-8	RBS $ AT1 8.625 2021	511	442	69
BPCEGP $ T2 4.875 2026	161	169	-8	RABOBK $ T2 3.75 2026	178	114	64
DANBNK $ NPS 3.001 2021	94	101	-7	UBS $ AT1 7.625 2022	198	137	61
BPCEGP $ T2 4.5 2025	158	165	-7	LLOYDS $ PFD SEN 12.0 2024	979	919	60
BPCEGP $ PFD SEN 4.0 2024	84	91	-7	DB $ NPS 3.375 2021	148	89	59
BPCEGP $ T2 4.625 2024	145	151	-6	BACR $ T2 10.179 2021	134	79	55

Source:ICE BofA / ML Index data, CreditSights

The primary tap remained firmly shut on account of the volatile market conditions surrounding the spread of COVID-19. Meanwhile, secondary markets witnessed another week of spread widening across the capital structure. The charts below highlight that once again, the sell-off was led by lower-rated securities further down the capital structure. AT1 outperformed Tier 2 which was probably helped by the equity bounce in the early part of the week, although this quickly evaporated after the Fed rate move. We have updated the excess return tracking tables on our website to the close of 5 March – see **Bond Tracker Performance Tables**. We show any MREL-eligible 'sub-senior' debt, including HoldCo senior and non-preferred senior issuance, in a separate table, and the performance tables include AT1 securities.

European Banks: Moves across the Capital Structure (EUR)



Source:ICE BofA / ML Index data, CreditSights

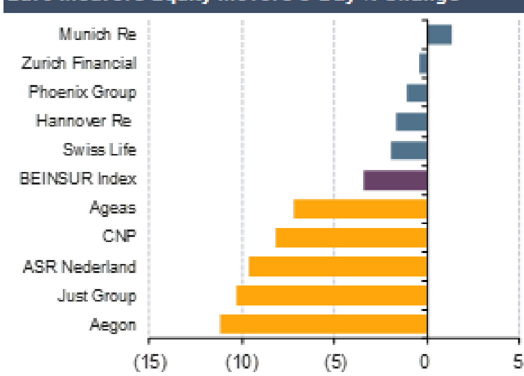
INSURERS

In a slight pause to the flow of earnings, the largest UK insurers took centre stage. **Legal & General** posted softer FY19 results, impacted by the expected reduction in reserve releases from a slowdown in UK longevity trends (see **Legal & General: FY19 Fueled by PRT Growth**). Operating profits dipped 2% to £2,286 mn with only £155 mn of longevity reserve releases compared with £433 mn in the previous year. In terms of underlying performance, the Retirement segment of L&G (LGR) continues to be engine behind the results. LGR had another strong year of Pension Risk Transfer (PRT) transactions as it wrote £11.3 bn of new business (+21% YoY) which included a £4.6 bn Bulk Annuity with the Rolls Royce UK Pension fund and £1.6 bn Bulk Annuity with the National Grid UK Pension scheme. LGR's international ambition also continues to gain momentum as premiums reached the £1 bn mark in 2019, +35% YoY and included LGR's first Canadian transaction through a partnership with Brookfields. In our view, the latter remains L&G's current competitive advantage over its peers like Rothesay Life and PIC.

While Aviva avoided same fate as L&G, with its operating profits up 6% YoY, we were still unimpressed with its FY19 performance. An improvement in the underwriting profitability of General Insurance helped compensate for the mixed results in Life. In our view, **Aviva** remains in its early days in its turnaround (see **Aviva: FY19 Early Days**). Of its 2022 targets, debt reduction stood at £210 mn of the target £1.5 bn following the expected redemption in 2019, whilst Aviva only achieved £72 mn of its target £300 mn of net expense savings. With regards to strategic review, questions remain over its operations in Hong Kong and Vietnam as Aviva finally confirmed its exit in Indonesia (see **Aviva: Update on Asia Strategic Review**). Aviva will sell its entire shareholding in the joint venture back to its partner, PT Astra International. The transaction is set to complete in 4Q20. Lastly, the long running saga on the sale of Friends Provident International (FPI), which was in agreed in July 2017, is set to finally close in 2Q20 according to management.

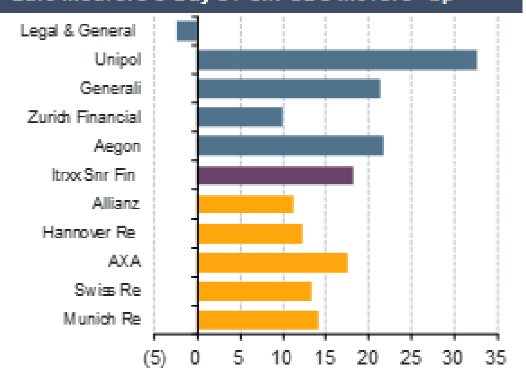
To break up another week of results, reports indicated that **Exor** had finally reached an agreement to sell its 100% stake in **Partner Re** to **Covéa** for $9 bn. We had always viewed Partner Re as the "last of the Mohicans" given it was the only mid-tier reinsurer not currently part of a larger insurance or reinsurance franchise. During the depths of the soft market for P&C reinsurance, most mid-tier reinsurers had sought the shelter of a larger franchise such as XL and Axa, as a means to protect itself and remain relevant in a shrinking market. Exor is expected to turn a tidy profit from the sale considering it acquired Partner Re for $6.7 bn in cash in 2016. Meanwhile, Covéa is finally set to realise its ambition of being an international reinsurance and insurance group after its failed bid for Scor in 2018 (see **Scor: Rejects Offer from Covéa**).

Euro Insurers Equity Movers 5-Day % Change



Source: Bloomberg

Euro Insurers 5-Day 5Y Snr CDS Movers* bp



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M/P Banco BPM	N/R Banco de Sabadell SA	M/P Banco Santander
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