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Weekly Credit Brief

August 19 - August 25

## Credit profile of Taiwanese lenders improve on stellar earnings

By Victor Liu

Taiwanese lenders are enjoying stellar earnings from strong growth in private sector loan demand outside the island. The top 3 banks are seeing high percentage growth in their net incomes with Cathay Financial reporting a 71% jump in their Q1 2014 profits. Fubon Financial and CTBC saw a 37.3% and a 21% increase respectively for the same period. Their recently announced Q2 results show an even better growth rate in Table 1.

Net Income change (Year-on-Year)		
	Q1 2014	Q2 2014
Cathay Financial	71.1%	126.8%
Fubon Financial	37.3%	74.8%
CTBC Financial	21.0%	201.7%

Table 1: Net income growth rate of top 3 financial institutions in Taiwan. Source: Bloomberg

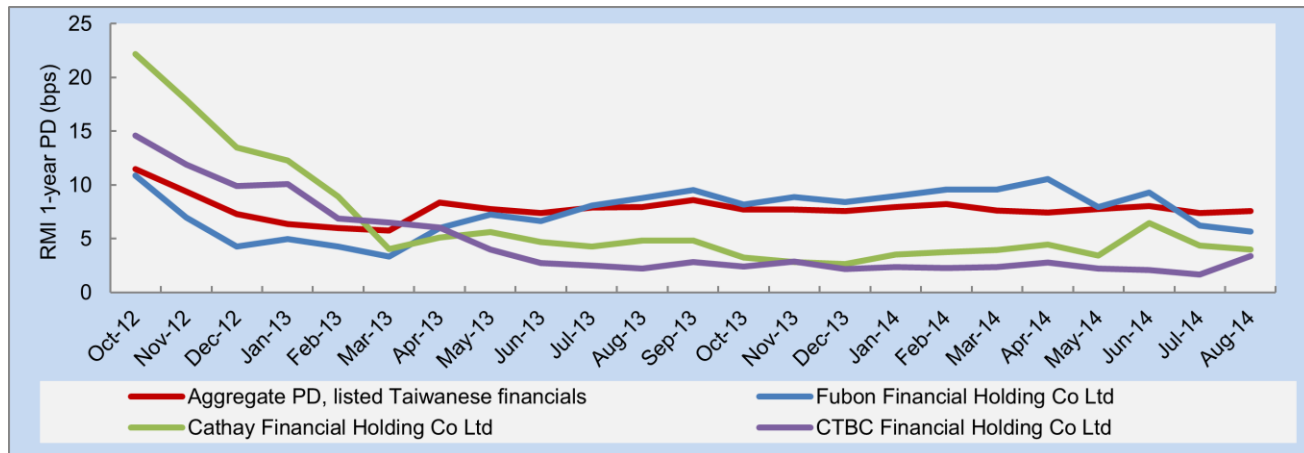


Chart 1: RMI 1-year PD for Taiwanese lenders. Source: Risk Management Institute, Bloomberg

The RMI 1-year probabilities of default (PD) for the 3 lenders have been on a downward trend since October 2012 from 22bps (Cathay Financial), 14 bps (CTCB) and 11 bps (Fubon) to their current lows of below 6 bps. To gain a perspective, the industry average PD of Taiwanese banks currently stands at 7bps. The improvement in PDs was due to increase in profit margins as lenders moved offshore away from the saturated home market. On the other hand, the more stringent capital requirements implemented by the Taiwanese regulators and the international BASEL III accord have helped Taiwanese lenders to improve their credit profiles. The island regulators have [already implemented](#) a minimum common Tier 1 ratio of 7%, minimum Tier 1 capital at 8.5% and a minimum total capital adequacy ratio of 10.5% imposed on all Taiwanese banks, a far stricter requirement than Basel III and its regional peers like Singapore, thus the island's lenders have the [best buffers in Asia](#). Taiwanese lenders are also the largest players of syndicated loans in Asia to generate revenues. They were strong supporters of loans for private Chinese companies, which borrowed USD 26.7bn in Hong Kong in 2013, and accounted for [a third of Hong Kong's total volume](#).

Recent events like the default of Shanghai Chaori Solar Energy Science & Technology's onshore bonds and the slump in China's property sector, have made Taiwanese lenders more cautious about lending to private Chinese companies. In addition, Taiwanese banks are shutting off lending to mainland firms. Offshore loans to mainland firms in the first quarter were just 15% of the sums lent in the previous quarter according to [Thomson Reuters Loan Pricing Corp](#). Taiwanese lenders are flushed with US dollar, which they get from major exporting firms (Acer, Asus, Hon Hai, TSMC, UMC) that need to swap their sales proceeds into local new Taiwan dollar. The increase in liquidity of Taiwanese lenders helped to boost their credit profiles as well.

The recent announcement that Taiwan will ease regulations for its financial sector to make acquisition in Asia will further provide a stimulus to improve the banks' earnings in the midst of a slowdown in lending to Chinese private corporations. [Regulators will raise the limits on merger and acquisition](#) in the banking sector from 40% of a company's authorized capital to 40% of a company's net worth. These acquisitions can be a force to be reckoned with in terms of strategic tie-up and enhancement, pricing and competitive edge. The big 3 lenders have already established their offshore presence in Hong Kong and China and further inroads to expanding economies will help them to sustain the earnings momentum that they enjoyed now.

## Credit News

### Chongqing bank shares face sell-off

**Aug 19.** Shares of Chongqing Rural Commercial Bank fell 6% after bad loans jumped substantially by 16.6% YoY in the first half of this year, now standing at CNY 1.92bn (HKD 2.42bn). The non-performing loan ratio rose to 0.85%, up from 0.8% at the end of 2013. The bank has been highly exposed to delinquent local government debt which accounted for 11% of its loans as compared to the average ratio of 6.24% at the nine largest banks in Mainland China. Besides, the manufacturing sector has been a more significant contributing factor in the rise in Chongqing Rural's bad loans. ([SCMP](#))

### Different recovery paths for banks in Ireland, Italy, Portugal and Spain

**Aug 19.** According to Moody's, the bank solvency ratios of Ireland, Italy, Portugal and Spain will stay weak. The recovery trajectories of these four banking systems are different in credit fundamentals including efficiency, asset quality, capital, liquidity and net profits. Ireland and Spain deteriorated in the aspect of asset quality and have to be recapitalized using taxpayer funds and the bail-in of junior creditors. Portugal's recapitalization followed the EBA's stress test and was funded using public-sector funds and private resources. ([Moody's](#))

### Rosneft hit by western sanction as USD 2bn Vitol deal scrapped

**Aug 21.** A failure of the USD 2bn Rosneft-Vitol deal could limit the ability of Rosneft to raise long-term capital from investors, following Western sanctions imposed on the Russian state oil company. Rosneft spent USD 55bn acquiring TNK-BP last year and requires financing of RUB 1.1tn by the end of next year. The company's ambition to expand including a project to develop energy resources in the Arctic may be kept on hold without the access to Western financing and technology. ([FT](#))

### Bank of America and DOJ reach USD 17bn settlement over mortgage securities

**Aug 21.** After reaching a settlement agreement with the Justice Department, Bank of America will pay a record USD 17bn for misleading investors and selling faulty mortgage securities. Questions have arisen as to how much money would be given to investors who bought the securities, but there is not yet any specific carve-out to compensate most investors except for the public pension fund investors who suffered tremendously during financial crisis. ([The Washington Post](#))

### Europe fears banks lack cash cushion to cover bad loans

**Aug 21.** An increasing number of analysts believe that Eurozone banks would require additional cash after the stress tests. In the last three months, the Texas ratio, a popular analytical tool used to identify banks on the brink of failure, has exceeded 10. 11 banks in Southern Europe were highlighted with nonperforming loans after being tested by Texas ratio. Out of the 11 banks, 3 banks stood out with ratios of 150 or above. However, the Texas ratio is not infallible and that it may underscore the increasing gap that separates European banks from their American counterparts, as the European banks have suffered from a fundamental capital deficit for more than 2 years. ([NY Times](#))

**Burger King in talks to buy Tim Hortons** ([Reuters](#))

**Roche to buy InterMune for USD 8.3bn** ([FT](#))

**Regulatory Updates****Asset-backed bonds facing tougher SEC Disclosure rules**

**Aug 25.** The US Securities and Exchange Commission (SEC) is considering a more extensive disclosure rule for asset-backed bonds. If the rule is passed on August 27, sellers of bonds backed by loans for houses, autos and commercial real estate will have to disclose details including the borrowers' income and credit scores to investors. However, the rules are not applicable to issuers of government-backed mortgage bonds such as Fannie Mae and Freddie Mac, or bonds backed by student loans or business inventory purchases. ([Bloomberg](#))

**US bank liquidity rule said to exclude municipal bonds**

**Aug 26.** Regulators are set to approve a final liquidity rule on September 3, which will exclude municipal bonds from the group of high-quality assets that may help sustain a bank through a 30-day squeeze. The new regulations could weigh on prices in the municipal bond market worth USD 3.7tn by giving banks less incentive to buy bonds from municipal issuers, which will weaken the country's ability to raise money. ([Bloomberg](#))

**Goldman Sachs to pay USD 3.15bn to settle mortgage case** ([Channel News Asia](#))

**Carney urged to help end masking of swap counterparties** ([Risk.net](#))

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