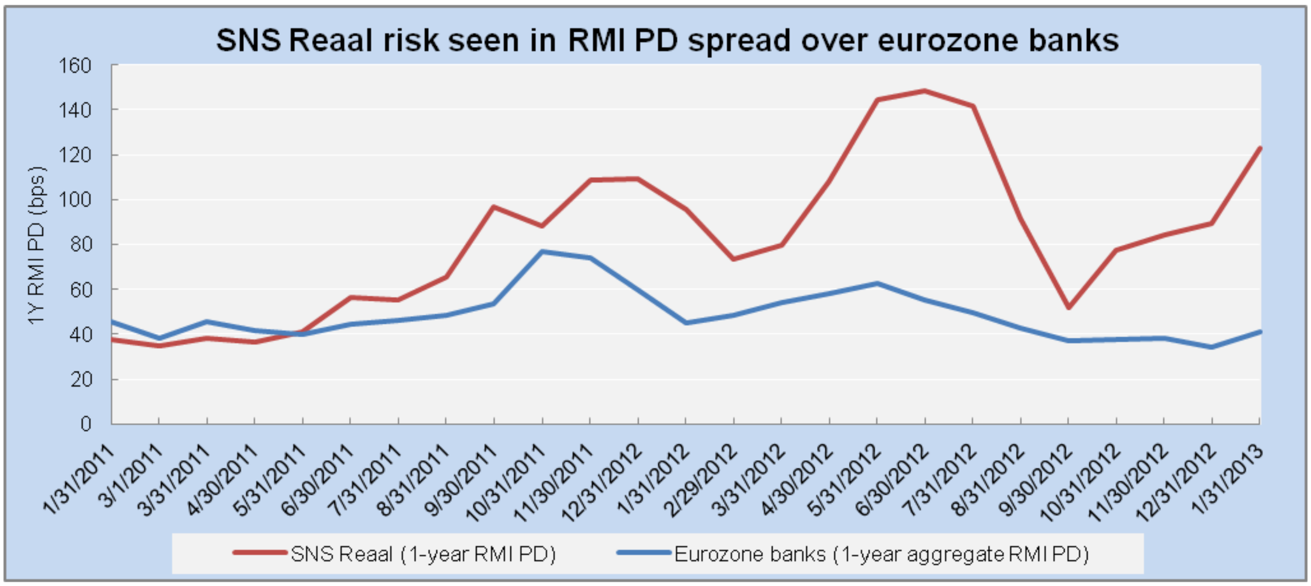
Weekly Credit Brief
Jan 29 - Feb 04 2013

Story of the Week

SNS Reaal credit risk reflected in RMI PDs, nationalization likely to speed up bail-in laws
By James Weston

The 1-year RMI probability of default (PD) for struggling Netherlands-based lender and insurance company SNS Reaal NV remained significantly higher than the aggregate RMI PD for banks within the eurozone last week, as the Dutch government nationalized the company on February 1. Moreover, the company's RMI PD has remained well above the eurozone aggregate since May 2011. Concerns about a possible debt restructuring and the collapse of negotiations with private investors caused a heavy outflow of deposits in the last fortnight, pushing SNS Reaal close to collapse and necessitating government support.



The company is the fourth-largest lender in the Netherlands, and was deemed systemically important to the health of the Dutch banking system. The government will inject EUR 2.2bn of capital into the company, and write off EUR 800bn from an earlier bailout. Existing shareholders and subordinated debt holders will be wiped out under the terms of the nationalization. Dutch Finance Minister Jeroen Dijsselbloam said protecting senior bondholders was necessary in order to prevent a large increase in funding costs for SNS Reaal and other Dutch lenders.

The government will also write down the value of the lender's property portfolio by EUR 700mn. Losses at the banks real estate lending unit, which made loans to real estate projects in the US, Spain and the Netherlands, had increased concerns the bank would face large loan write downs. This helped fuel a large drop in the company's share price in the last quarter of 2012 and January 2013, which contributed to an increase in the company's RMI PD.

A majority of the Dutch banking system is now either owned by the government or dependent on government aid. The government now owns two of the country's largest lenders, as ABN Amro Bank NV was nationalized in 2008. The largest bank by assets, ING Groep NV, is still yet to repay EUR 3bn of a EUR 10bn government bailout provided in 2008. ING, ABN Amro and privately owned Rabobank will have to pay a combined EUR 1bn to the government next year to help pay for the SNS Reaal nationalization.

Incoming eurozone bail-in laws: The nationalization of SNS Reaal is likely to speed up EU plans to force losses on senior bondholders of failing banks, so-called 'bail-ins.' Leaders in Finland, Germany and the Netherlands called for the rules to be introduced as soon as 2015, instead of the currently proposed introduction in 2018. The ECB has said that implementation in 2018 is "far too far away."

Under the EU proposal, European regulators would have the power to impose losses on holders of senior unsecured debt and derivatives counterparties, if losses wipe out a lender's capital and subordinated debt. In addition, regulators could convert senior debt into equity, to create new capital. Regulators would take such steps before using taxpayer money to stabilize a failing bank.

This should reduce the potential scale of taxpayer rescues. Senior bank bondholders within the EU have largely avoided losses since the sovereign debt crisis began in 2010, while European governments and the IMF have provided EUR 486bn in aid to struggling eurozone member states. A large part of this aid was then used to shore up lenders in Greece, Ireland, Portugal and Spain who experienced large losses on government bond holdings and property portfolios.

Sources:
Dutch Ministry of Finance decree: Nationalization of SNS Reaal NV (Ministry of Finance)
Dutch State Nationalizes SNS Reaal (WSJ)
German push to accelerate bank bail-ins joined by Dutch, Finns (Bloomberg)

In the News

Hong Kong debt adds to home risks as cooling steps eyed

Feb 04. The Chief Executive of the Hong Kong Monetary Authority Norman Chan hinted at the possibility of further cooling measures to curb the property market as heightened household debt adds to risks from property-price gains over the past four years. Mr Chan warned that debt is "near historic high levels," citing debt to GDP ratios of 58% to 59% in the third and fourth quarters, respectively; and that overheating in Hong Kong's property market remains the biggest risk to the city's financial and economic stability. Household debt in Hong Kong almost doubled to HKD 1.2tr last year from HKD 662.8bn in 1997, when a housing bubble in the city burst, according to the Hong Kong Monetary Authority. (Bloomberg, HKMA)

Croatia cut to junk by Moody's on fiscal, external risks

Feb 01. Moody's cut Croatia's government bond rating from Baa3 to Ba1, citing the country's poor growth prospects, a lack of budget discipline and vulnerability to external shocks. Moody's also changed Croatia's outlook to stable from negative, suggesting that "the risk that the government's fiscal position and debt will materially deteriorate any further is limited". (Bloomberg, Moody's)

Peugeot leads drop in junk debt as Seat Pagine extends decline

Jan 30. PSA Peugeot Citroen's 20-year 6% bond registered its worst weekly performance since December 2008, following an order from a French appeals court to suspend the company's restructuring plans while car workers strike over job losses. Credit-default swaps hedging against Peugeot's default risk for five years rose 41bps this week to 723, the highest since November 30. Elsewhere in eurozone credit markets, bonds of Seat Pagine Gialle SpA (PG), Italy's largest directory publisher, fell after the company suspended a coupon disbursement due January 31. (Bloomberg, The New York Times, WSJ)

Bank bonds poised to recapture pre-crisis yield eminence

Jan 29. The spread between yields on bonds issued by US banks and yields on bonds issued by US industrial companies have tightened to levels not seen since the 2008 financial crisis. US Banks could overtake industrial companies as the safest corporate bond issuers in the US as earnings have improved for most of the reporting banks in Q4 2012. New capital requirement rules from the Dodd Frank Act and Basel Committee have compelled lenders to hold a higher proportion of quality assets on their balance sheets. Moving forward, analysts expect bank credit spreads to tighten further as the Federal Reserve embarks on the third round of quantitative easing. (Bloomberg)