

Credit Outlook

13 July 2020

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Main Street Lending Program offers new liquidity backstop for eligible issuers

Originally [published](#) on 09 July 2020

On 6 July, the Federal Reserve Bank of Boston announced that the \$600 billion Main Street Lending Program (MSLP) program is now fully operational, offering credit relief for eligible issuers that can use the funding facility as a liquidity backstop if necessary. The launch of the MSLP, the latest support program for businesses that monetary and fiscal authorities have rolled out since the beginning of the pandemic, is credit positive for eligible companies, though we expect relatively few to take advantage of it.

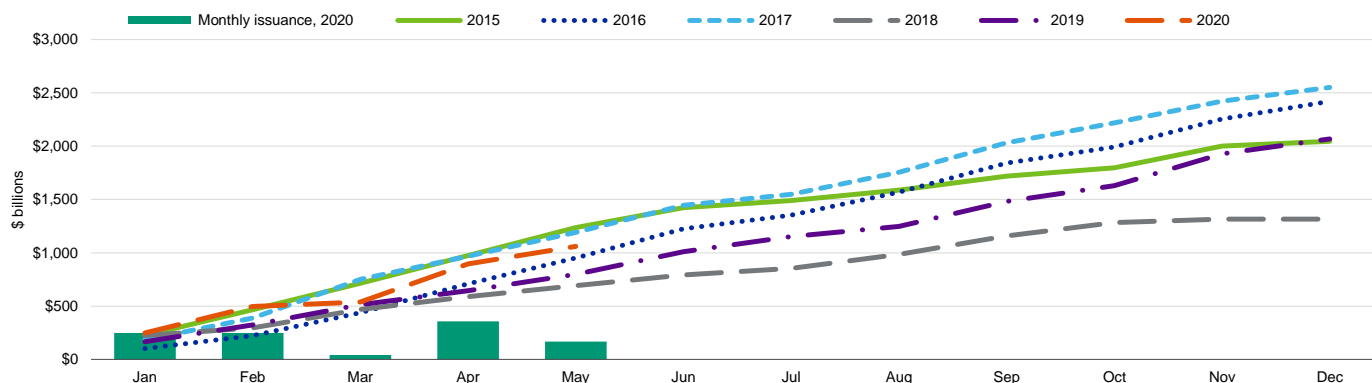
The facility is designed to support the flow of credit to small and medium-size businesses by purchasing loans originated by participating financial institutions. The program will help buttress investor confidence and provide a potentially valuable liquidity backstop for eligible businesses in the event of renewed market dislocation.

We expect that few rated issuers will apply for loans under the program, however, because of its restrictive eligibility criteria and onerous terms relative to market lending. Many rated midsize companies will be ineligible given their high leverage and private-equity ownership. US corporate issuers that are eligible are unlikely to need the MSLP as long as traditional funding sources remain open, including bank and institutional term-loan markets¹. Indeed, high-yield corporate issuance slowed in March 2020 at the start of the pandemic but quickly resumed in April, supported by the Federal Reserve's corporate bond purchase program (see Exhibit 1).

Exhibit 1

High-yield corporate issuance in line with prior years, after March dip

Monthly and cumulative high-yield corporate debt issuance



Lines indicate cumulative issuance for each year; columns indicate monthly issuance for 2020

Source: Dealogic

Businesses eligible for the MSLP include US-based companies with less than \$5 billion in annual revenue or fewer than 15,000 employees, with leverage between 4.0x and 6.0x, and that were financially sound before the onset of the pandemic. Under the program, businesses can apply for new loans (Main Street New Loans or Priority Loans) or can apply to increase the size of an existing loan (Main Street Expanded Loans) with a participating lender (see Exhibit 2).

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Exhibit 2

Small and medium-size US businesses would have different loan options under MSLP

	Main Street New Loans	Main Street Priority Loans	Main Street Expanded Loans
Min. loan size	\$250,000	\$250,000	\$10 million
Max. loan size	Lesser of \$35 million or 4x 2019 adjusted EBITDA	Lesser of \$50 million or 6x 2019 adjusted EBITDA	Lesser of \$300 million or 6x 2019 adjusted EBITDA
Term	5 years	5 years	5 years
Lender risk retention	5%	5%	5%
Payment	Deferral of interest payment for one year and principal payments for two years Years 3-5: 15%, 15%, 70%	Deferral of interest payment for one year and principal payments for two years Years 3-5: 15%, 15%, 70%	Deferral of interest payment for one year and principal payments for two years Years 3-5: 15%, 15%, 70%
Rate	Libor + 300 bps	Libor + 300 bps	Libor + 300 bps
Borrower origination fee	Up to 100 bps	Up to 100 bps	Up to 75 bps
Lender transaction fee (may be paid by borrower)	100 bps	100 bps	75 bps

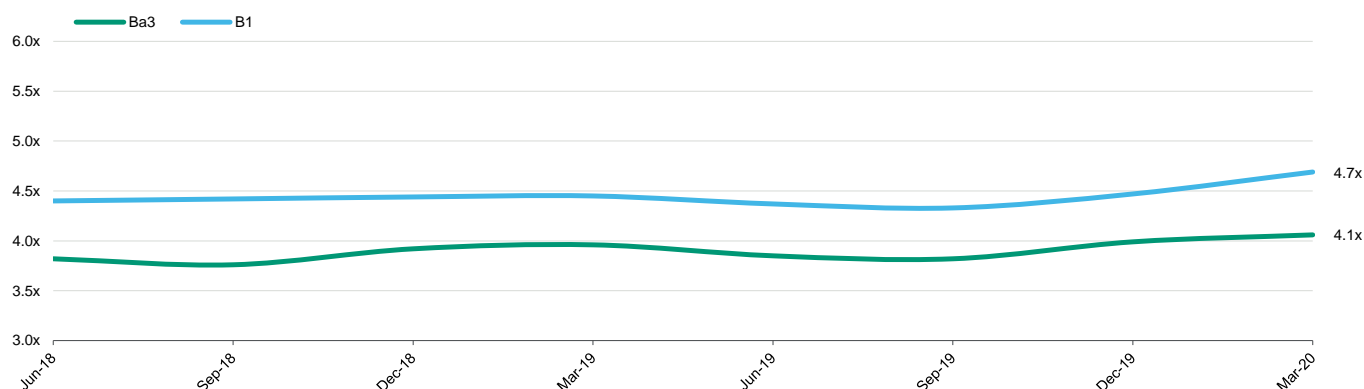
Source: US Federal Reserve

We expect that only a small share of rated non-financial companies will be able to participate in the program, based on these size and leverage criteria. We estimate that businesses targeted by the program roughly correspond to US non-financial corporate issuers with corporate family ratings (CFRs) of Ba3 and B1 (see Exhibit 3). The terms of the MSLP exclude weaker speculative-grade issuers—particularly those with high financial leverage backed by private-equity firms, which will remain vulnerable to material and enduring credit deterioration.

Exhibit 3

Issuers with CFRs of Ba3 and B1 most likely to meet the MSLP's leverage test

Median Moody's adjusted debt/EBITDA ratios



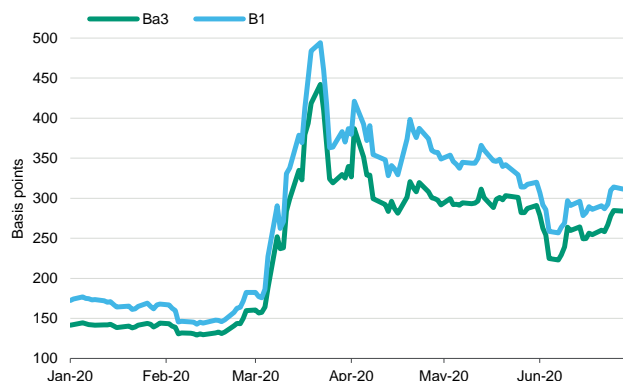
Moody's leverage does not count available revolving commitments, among other important differences to the MSLP leverage definition. US corporate issuers; excludes GRIs, investment holding companies, captive finance companies, homebuilders, E&P companies, REITs, regulated utility and power companies, project finance, airports, and toll roads.

Source: Moody's Financial Metrics™

Eligible issuers are likely to view the MSLP as a funding option to be tapped only if existing sources dry up, because the program terms may be onerous under current market conditions. The terms of the MSLP include an interest rate of 300 basis points above Libor, which appears to be generally lower than prevailing market rates for rated eligible borrowers (see Exhibits 4-5). However, other terms of the program make the loan program significantly less attractive than traditional funding sources, including: a short five-year final maturity; significant annual amortization; high upfront fees; and restrictions on executive compensation, stock repurchases and capital distributions that remain in place for 12 months after the loan has been repaid.

Exhibit 4

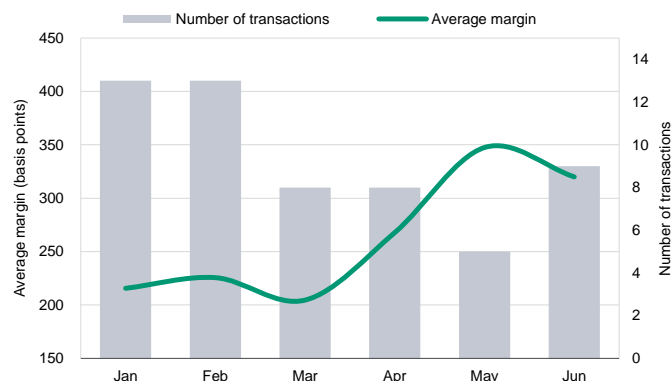
MSLP 300 basis-point margin appears competitive 1-year CDS spreads for issuers with CFRs at Ba3 and B1



Source: Moody's Analytics

Exhibit 5

Pricing for new loans have risen sharply since March Pricing for US marketed loans by issuers with Ba3 CFRs



Source: Dealogic

The MSLP could provide more significant support for unrated businesses, which would be positive for overall US economic activity and employment. Unrated companies are less likely than rated issuers to have existing relationships with capital-market investors and may be more likely to take advantage of the program. But it remains to be seen whether US banks will be keen to grant credit to these types of businesses, given that they can only retain 5% of loan balances under the program. Federal Reserve Chair Jay Powell said last week that about 300 lenders had registered to participate in the MSLP program so far. In contrast, more than 5,000 lenders have participated in the Paycheck Protection Program (PPP), a program which provides forgivable loans to small businesses.

The MSLP aims to fill a gap among other existing support programs for businesses that monetary and fiscal authorities have rolled out since the beginning of the pandemic. Businesses targeted by the MSLP are generally too large to qualify for PPP loans for small businesses launched in early April, but also too small to benefit directly from the Federal Reserve's corporate bond-buying programs announced in late March.

According to the Census Bureau, as of 2017 there were about 19,000 businesses with more than 500 employees, generally considered a small business, but less than the 15,000-employee maximum for the program. Taken together, these midsize businesses employ more than 30 million people or nearly 25% of private non-farm payroll.

Endnotes

- 1 Borrowers under the program must certify that the amount, price, or terms of credit available from other sources are inadequate for their needs

Rebecca Karnovitz, *VP-Senior Analyst/CSR*

Moody's Investors Service
rebecca.karnovitz@moodys.com
+1.212.553.1054

Christina Padgett, *Associate Managing Director*

Moody's Investors Service
christina.padgett@moodys.com
+1.212.553.4164

Edmond DeForest, *VP-Sr Credit Officer*

Moody's Investors Service
edmond.deforest@moodys.com
+1.212.553.3661

Robard Williams, *Senior Vice President/CSR*

Moody's Investors Service
robard.williams@moodys.com
+1.212.553.0592

US deems Philip Morris IQOS tobacco heating system as modified risk tobacco product, a credit positive

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On 7 July, the US Food and Drug Administration (FDA) authorised the marketing of [Philip Morris International Inc.'s](#) (PMI, A2 stable) IQOS Tobacco Heating System as a modified risk tobacco product (MRTP). The authorisation permits PMI to market IQOS in the US as exposing users to lower amounts of harmful substances than traditional combustible tobacco products like cigarettes and cigars.

This is credit positive for the tobacco sector because it paves the way for the recognition of other alternative products as less "exposure". It also sets a precedent we expect regulators in other countries will follow. This will ensure the viability of these businesses as a replacement for combustible cigarettes, the sales of which are in structural decline.

For PMI, the authorisation will help sustain revenue and profit by offsetting the decline in traditional cigarette sales. IQOS products generated \$5.6 billion net revenues in 2019, or around 18.7% of group total. East Asia and Australia accounted for 48% of PMI net reduced risk product net revenues, the European union for 31%, Eastern Europe for 15% and other 6%. PMI has established a strategic framework (i.e. licensing agreement) with [Altria Group Inc.](#) (A3 stable) to commercialize two of its reduced risk products in the US. In September 2019, Altria's subsidiary, Philip Morris USA Inc., began commercialization of a version of these products in the US but the lockdown measures taken by US states have delayed the campaign. There are around 34 million smokers in the US compared with around 20 million in Japan. In Japan, the overall heated tobacco category in first-quarter 2020 was over 24% of the total tobacco share, with PMI's IQOS being by far the dominant brand.¹

Although market acceptance of heated tobacco in the US remains to be seen, the FDA noted in its PMTA authorization back in 2019 that "IQOS delivers nicotine in levels close to combustible cigarettes suggesting a likelihood that IQOS users may be able to completely transition away from combustible cigarettes and use IQOS exclusively." The jury is clearly still out on the fortunes of the category in the US but if we assume just 10% of US smokers switch, over time the size of the US heated tobacco market would be similar to the size of today's Japanese market, generating similar net revenue of around \$3-\$4 billion, in our view.²

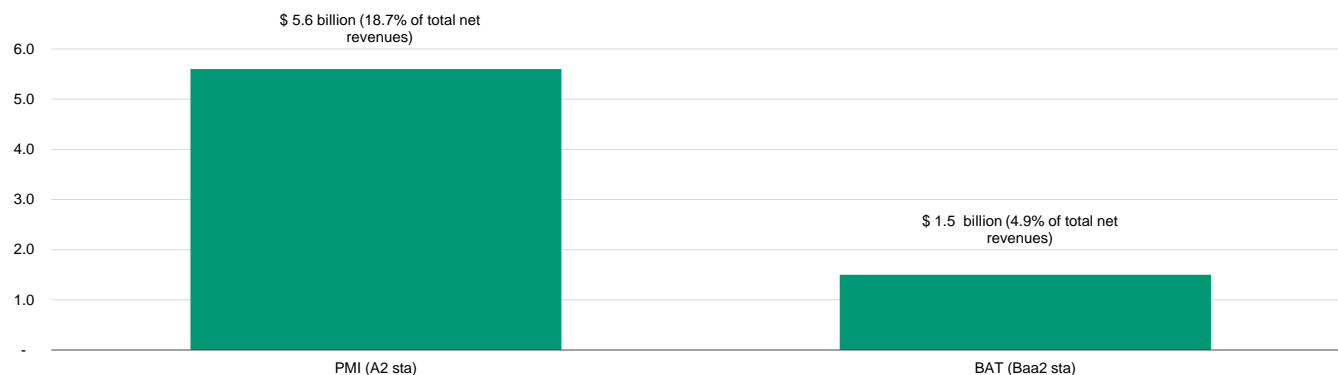
PMI does not disclose its IQOS gross profit margin but we estimate it at around 40%-50%. Because the costs of the IQOS product platform are largely fixed, we estimate the potential contribution from the US heated tobacco operations to PMI's EBITDA would range between \$1 billion-\$2 billion over time. This would be about 10%-20% of PMI's group Moody's adjusted EBITDA of \$12.7 billion for the 12 months to 31 March 2020. We do not expect much change to PMI's credit ratios because its heated tobacco operations in the US are within a strategic framework with Altria, as described above. However the EBITDA generation potential of the US heated tobacco market, if fully attributed to PMI, could lower its Moody's adjusted debt to EBITDA leverage ratio by about 0.3x-0.5x. In March this ratio stood at 2.7x. We expect PMI's leverage to increase to around 3x this year as a result of the negative impact of the lockdown measures.

The FDA authorisation will also give PMI a competitive advantage in the US market. Although [Swedish Match AB](#) (Baa2 stable) has MRTP approval for eight products in its General Snus brand in the US, IQOS is the first tobacco product to receive "exposure modification" orders.³ This allows PMI to market IQOS as containing or presenting a reduced exposure to harmful substances.⁴

[British American Tobacco plc](#) (BAT, Baa2 stable), [Japan Tobacco Inc.](#) (A1 stable) and [Imperial Brands PLC](#) (Baa3 stable) also have heat-not-burn products in their portfolios. However the contributions to net revenue are much lower than for PMI. Also none of the other companies has applied for MRTP for their products in the US yet.⁵ No company has submitted vaping products to the process, so the entire vaping category is falling behind heated tobacco in terms of regulatory recognition. PMI recently launched its vaping products on the UK market but generates no meaningful revenue from the category. BAT generated £401 million net revenue from vaping products and £728 million from heated tobacco in 2019 globally, but its overall alternative products revenue remains much lower than PMI's (see exhibit).

PMI's new product revenue is much higher than BAT's

Net revenue from new product categories in 2019 (\$ billion)



Sources: Company information, Moody's Investors Service

The FDA has not ruled IQOS or Swedish Match's snus products as safe, but simply as lower "exposure" than combustible products. In the case of PMI, the FDA's exposure modification order does not allow PMI to make any other modified risk claims or suggest that the FDA views these products as safe. The FDA says it will monitor PMI data to make sure its marketing is appropriate, assessing the potential for increased use among youth. The FDA's premarket tobacco authorisation (PMTA) already places stringent restrictions on how the products are marketed, particularly online, to make sure young people are not targeted.⁶ PMI's authorisation is valid for four years and it will have to resubmit a MRTP request when the order expires.

Wider regulatory acceptance of alternative tobacco products like heat-not-burn and vaping will help ensure the industry's long term future. Combustible tobacco's role as a major cause of preventable illness and premature death is the main driver of [high social credit risk](#) in the sector and cigarette smoking is in structural decline. The World Health Organization (WHO) forecasts the number of people aged over 15 globally who smoke will fall to 18.9% in 2025 from an estimated 22.1% in 2010. Companies continue to offset sales volume declines with price increases, but have also ramped up investment in alternative products in the past decade.

Endnotes

- ¹ In early 2019, IQOS was estimated to have a 71.8% share of Japan's heated tobacco market, according to Reuters. We believe that its market share has not significantly changed since then.
- ² We may significantly underestimate the market potential of the category in the US because net revenue in the US is significantly higher than in Japan based upon current pricing/tax conditions.
- ³ See [FDA grants first-ever modified risk orders to eight smokeless tobacco products](#), 22 October 2019, US Food and Drug Administration
- ⁴ And therefore "appropriate to promote the public health and is expected to benefit the health of the population as a whole taking into account both users of tobacco products and persons who currently do not use tobacco products."
- ⁵ BAT has received Premarket Tobacco Product Application authorisations for its vaping "Vuse" ranges.
- ⁶ Under the PMTA process the FDA authorises companies to market products, but without any reduced risk claims.

Roberto Pozzi, *Senior Vice President*
Moody's Investors Service
roberto.pozzi@moodys.com
+44.20.7772.1030

Richard Etheridge, *Associate Managing Director*
Moody's Investors Service
richard.etheridge@moodys.com
+44.20.7772.1035

Provisional new law offers financial relief to Brazil's pandemic-hit airline sector

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On 7 July, Brazil's lower house of congress approved a provisional measure offering financial relief to the country's beleaguered airlines sector and delaying their obligation to refund travelers who cancel flights because of the coronavirus pandemic. The bill's approval is credit positive for the carriers, reducing the airlines' liquidity risk amid the pandemic.

The provisional measure, known as MP925, is already effective, but will expire unless it receives senate approval by 16 July. It will also not by itself resolve the problems facing the industry, which will not return to its pre-pandemic footing until 2023, and we anticipate that the sector will need further relief from the Brazilian government and regulators.

As passed, the legislation would offer certain relief measures to airlines that operate in Brazil, including [Azul](#) (Caa1 negative), [Gol Linhas Aereas Inteligentes](#) (Caa1 negative) and LATAM Airlines, which are reeling as travel has plunged amid coronavirus-related lockdowns and health concerns. The approved measures include the following:

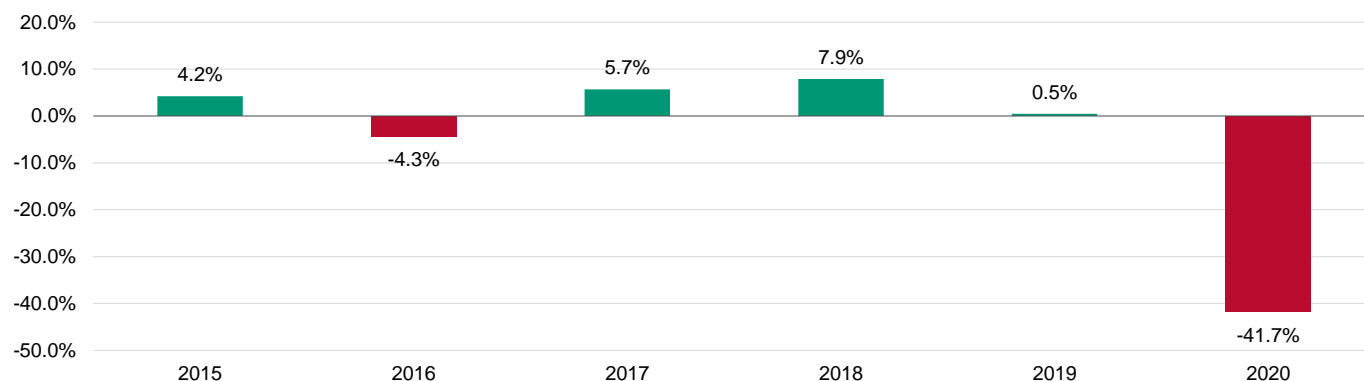
- » giving airlines the right to reimburse passengers within 12 months for flights canceled during March-December 2020 as a consequence of the coronavirus;
- » shifting the cost of connection fees to the passengers, away from the airlines;
- » ending the existing additional \$18 fee for international departures; and
- » making airlines eligible for loans if they can prove they have incurred losses from the pandemic.

Under the bill, the airlines would be eligible for loans funded with the resources from FNAC, the national fund for civil aviation, to be withdrawn by the end of 2020. The FNAC loans will have attractive costs, at a minimum rate determined by the TLP, Brazil's long-term interest rate, which was 4.94% as of the bill's passage. Borrowers would have a 36-month grace period, with final maturity in December 2031. FNAC will also be able to guarantee loans up to BRL3.0 billion (\$559 million) starting in January 2021, but not in 2020. The bill will bring some liquidity relief, but the amounts are still modest compared to the industry's cash needs.

Although the measures benefit the Brazilian airlines sector, reducing their liquidity risks from the pandemic, their situation remains delicate. Air travel in Brazil for the first several months of 2020 was down more than 40% for January-May 2020 from a year earlier (see exhibit), and we believe demand will remain severely depressed in 2021, with no substantial recovery before 2023. So far during the pandemic three big Latin American airlines have filed for Chapter 11, including Chile's LATAM Airlines, a major carrier in the Brazilian domestic and international markets.

Brazilian air travel plummeted in early 2020

Annual change in revenue per passenger kilometers



The 2020 data compare January-May data with year-earlier data.
Source: ANAC

Health concerns, changes in corporate travel policies, potential restrictions on international arrivals, and lower discretionary spending amid weaker GDP and higher unemployment will constrain air passenger demand into 2022. By 2023, demand might approach the levels of 2019, but that will depend on how soon the coronavirus recedes permanently, and additional health screening and the risk of being denied boarding will affect air travel beyond the pandemic. We anticipate that more lucrative corporate travel will likely remain impaired into 2023.

We expect that the airline industry will require further support from regulators, national government and labor representatives to alleviate stress on slot allocations, provide indirect or direct financial support, and help airlines managing their cost bases. The Brazilian government announced at the beginning of the pandemic that it is considering additional support to airlines operating in Brazil with a long-term credit line from the [Banco Nacional de Desenvolvimento Economico e Social - BNDES](#) (Ba2 stable, Ba2¹) but the state development bank has yet to established that line of credit.

Endnotes

¹ The ratings shown are BNDES' desposit rating and Baseline Credit Assessment.

Marcos Schmidt, *VP-Sr Credit Officer*
Moody's Investors Service
marcos.schmidt@moodys.com
+55.11.3043.7310

Marianna Waltz, *CFA, MD-Corporate Finance*
Moody's Investors Service
marianna.waltz@moodys.com
+55.11.3043.7309

MTR Corp.'s profit warning for first half 2020 results is credit negative

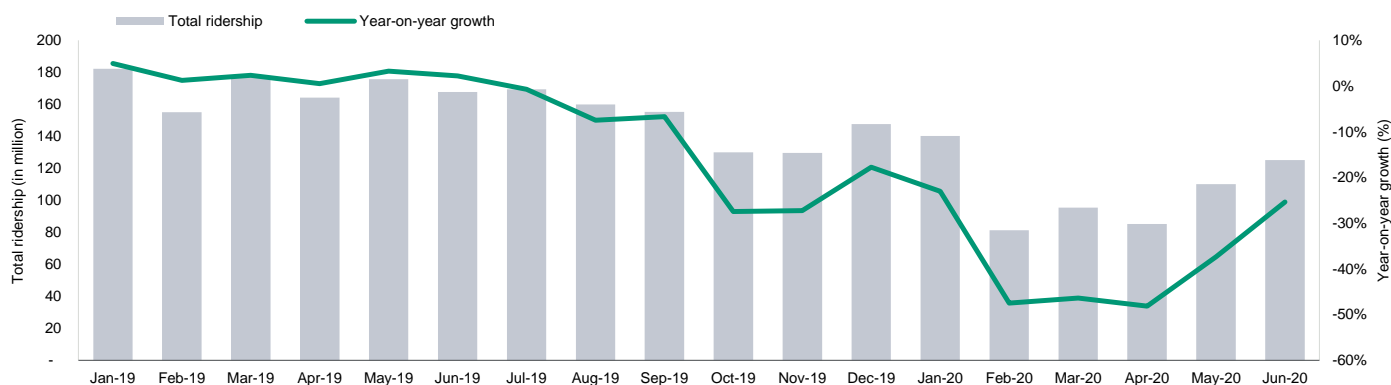
Originally [published](#) on 09 July 2020

On 7 July, [MTR Corporation Limited](#) (MTRC, Aa3 stable), which runs [Hong Kong SAR's](#) (Aa3 stable) mass transit railway, announced a profit warning for its first half 2020 results. The results are credit negative because of the significant reduction in estimated earnings as a result of coronavirus-related disruptions on its transport business and revaluation losses in its investment property portfolio caused by a weakened economy.

The company has estimated a total net loss of HKD400 million for the first six months of 2020, compared with a net profit of HKD5.5 billion over the same period in 2019. This significant fall is partly attributable to a HKD2.2 billion drop in its recurrent business during the first half of the year because of coronavirus containment measures in Hong Kong, including the closure of border crossings with mainland [China](#) (A1 stable), travel restrictions and social distancing rules. Losses are also attributable to rental abatements for station retail outlets and shopping mall tenants. Tenants had been adversely affected by fewer customers because of the coronavirus outbreak.

Ridership in the MTRC's Hong Kong operations dropped significantly by a total 38% for the first half of the 2020 (see exhibit). We expect that the monthly ridership for the remainder of 2020 will be lower than that of the same period last year, but monthly declines will narrow as disruptions from coronavirus outbreak lessen.

MTRC's ridership dropped by between 23% and 48% a month during the first six months of 2020



Sources: Company website and Moody's Investors Service

The adverse impact caused by the coronavirus outbreak has led to poor economic performance in Hong Kong. The MTRC expects to report a non-cash investment property revaluation loss of around HKD6 billion during the first six months in 2020, a drop of HKD8.1 billion compared with the first six months of 2019. This non-cash item is not likely to affect the MTRC's credit metrics but it indicates the reduced cash flow generation ability of its investment properties.

Although the MTRC expects a profit of HKD5.2 billion from its property development business in Hong Kong in the first half of 2020, this amount is not sufficient to counter the losses from recurrent business and property valuations.

While we have captured the negative credit impact of coronavirus in the MTRC's Aa3 issuer rating and a2 Baseline Credit Assessment (BCA), the big drop in profit in the first half of 2020 indicates that its credit metrics will weaken, which in turn will weaken its BCA.

Overall, we expect a debt/EBITDA of 4.5x-5.0x in 2020, which is broadly consistent with its current BCA. This is also supported by the controlled debt management of the company in the next 12-18 months. We expect that debt/EBITDA will improve to 3.5x-4.0x in 2021 as ridership normalizes, assuming lessening disruptions caused by the coronavirus outbreak over time.

We expect the company's cash position to remain strong, supported by its strong operating cash flow generation especially from the property development segment and prudent financial management.

Ralph Ng, AVP-Analyst

Moody's Investors Service
ralph.ng2@moodys.com
+852.3758.1530

Ning Loh, Associate Managing Director

Moody's Investors Service
ning.loh@moodys.com
+852.3758.1668

Justin Tse, Associate Analyst

Moody's Investors Service
justin.tse@moodys.com
+852.3758.1596

Terry Fanous, MD-Public Proj & Infstr Fin

Moody's Investors Service
terry.fanous@moodys.com
+65.6398.8307

ITOCHU's tender offer for FamilyMart is credit negative

On 8 July, Japanese trading company [ITOCHU Corporation](#) (A3 stable) announced a tender offer for convenience store chain FamilyMart Co., Ltd shares at ¥2,300 per share, a 31% premium over the closing price of ¥1,754 on 8 July. If the offer for 44.6% of FamilyMart shares is successful, it will amount to about ¥519 billion (\$4.8 billion). The tender offer to take FamilyMart private is credit negative because it will increase ITOCHU's leverage.

ITOCHU already owns a 50.1% of FamilyMart, one of the top three convenience store chains in Japan with about 16,500 stores. ITOCHU intends to acquire up to 44.6% of the remaining publicly traded shares, with Tokyo Century Corporation, an affiliate of ITOCHU, acquiring a 0.4% stake. The National Federation of Agricultural Cooperative Associations and [Norinchukin Bank](#) (A1/A1 stable, a3¹) together plan to acquire up to 4.9% from ITOCHU once FamilyMart is private.

The company has an ample financial buffer to absorb additional debt. For the fiscal year that ended March 2020 (fiscal 2019), its funds from operations (FFO)/debt ratio was 19.3% and debt/book capitalization was 51.5%, compared with our earlier expectation of FFO/debt of 12%-15% and a debt/book capitalization of 45%-55%.

As stated, the acquisition of 44.6% of FamilyMart will equate to about ¥519 billion for ITOCHU. At the same time, the company has provided guidance that its net income will decrease by about ¥100 billion in fiscal 2020 compared with the previous fiscal year.

Assuming that all ¥519 billion is funded with debt and a decrease in funds from operations of ¥100 billion, FFO/debt pro forma for the transaction will decrease to about 15.0% from 19.3% and debt/book capitalization will increase to about 52% from 51.5%, which still would be within our range of our expectations for ITOCHU's A3 rating. However, we expect that the company will finance a portion of the transaction with cash on hand or cash flow, which will mitigate a weakening in credit metrics.

The tender offer ends on 24 August. It is unclear what the company's plans are for the FamilyMart chain following the buyout, other than capitalizing on ITOCHU's supply chain, digital footprint and global partnerships to expand the convenience store franchise overseas.

Outside of Japan, Taiwan and China are the largest markets with about 3,000 stores each as of February 2020, according to FamilyMart. We expect that long-term growth prospects will drive ITOCHU to seek expansion in these areas. Euromonitor's March report projected convenience store sales will increase by 54% in China and 20% in Taiwan over 2019-24.

Endnotes

¹ The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

Mariko Semetko, *VP-Sr Credit Officer*
Moody's Japan K.K.
mariko.semetko@moodys.com
+81.3.5408.4209

Mihoko Manabe, *CFA, Associate Managing Director*
Moody's Japan K.K.
mihoko.manabe@moodys.com
+81.3.5408.4033

Dominion will sell around \$10 billion of natural gas assets and cancels Atlantic Coast Pipeline, a credit positive

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On 5 July, [Dominion Energy Inc.](#) (Baa2 stable) announced that it will sell its natural gas transportation, storage (T&S) and some gathering assets to [Berkshire Hathaway Energy Company](#) (BHE, A3 stable) for approximately \$10 billion, which includes approximately \$5.7 billion of assumed debt. Dominion will also cut its dividend, with the new dividend level re-based from lower pro forma earnings and incorporating a 65% payout ratio, down from around 85%, on average, since 2015. Dominion also announced the cancellation of the Atlantic Coast Pipeline (ACP) project because of ongoing delays and increasing construction cost uncertainty. Dominion was a 53% owner of ACP and made the announcement along with its partner, [Duke Energy Corporation](#) (Baa1 stable).

The plans are credit positive for Dominion because they refocus the company on its core, lower-risk utility businesses, keep key cash flow to debt ratios steady and materially reduce carbon and methane emissions risk.

Dominion expects to complete the transaction and refocus on its core utility businesses by year-end. The utility businesses will constitute roughly 85% of pro forma cash flow from operations (CFO), 70% from vertically integrated electric operations and about 15% from local gas distribution companies (LDCs). The remaining 15% of CFO will be from unregulated businesses that are mostly contracted. Currently, regulated utilities account for about 70% of CFO, the T&S business is about 20% and unregulated businesses are around 10%.

Dominion guarantees roughly \$1 billion of debt associated with the canceled pipeline, which will remain its obligation despite writing off ACP's equity value. The asset sale will reduce Dominion's consolidated CFO by around \$925 million, which largely offsets the benefit of transferring around \$5.7 billion of debt to BHE, keeping Dominion's consolidated ratio of cash flow before changes in working capital (CFO pre-WC) to debt at about 14%.

We estimate that Dominion's pro forma dividend will be around \$2 billion, down from approximately \$3 billion paid through the 12 months to 31 March 2020. The reduced dividend will improve the ratio of CFO pre-WC less dividends to debt to about 9% from roughly 8% through the 12 months to 31 March 2020. The dividend cut will also ease future free cash flow deficits and incremental debt needs, a credit positive.

The sale helps Dominion's carbon transition, since it will eliminate ownership of roughly 21 billion cubic feet per day (bcf/d) of natural gas transportation capacity and nearly 900 billion cubic feet of underground storage capacity that the company was responsible for in 2019. It will immediately reduce the company's carbon and methane exposure, while reducing higher-risk midstream business activities, which environmental concerns over the industry's emissions profile increasingly pressure.

The cancellation of ACP reflects the legal and execution risks for the midstream sector from environmental opposition. Over the past six years, ACP has had numerous legal challenges that have halted construction, nearly doubled the original cost estimates (i.e., to at least \$8.0 billion from \$4.5-\$5.0 billion) and delayed completion by more than three years (i.e., it was originally expected to be in service in 2018). Discontinuing the project removes the credit overhang of uncertain costs to complete, limits the debt incurred by Dominion for ACP to about \$1.0 billion and foregoes increased carbon and methane emissions associated with a 1.5 bcf/d of pipeline capacity over the next 50 years of the asset's useful life.

Ryan Wobbrock, VP-Sr Credit Officer

Moody's Investors Service

ryan.wobbrock@moodys.com

+1.212.553.7104

Michael G. Haggarty, Associate Managing Director

Moody's Investors Service

michael.haggarty@moodys.com

+1.212.553.7172

Poonam Thakur, Associate Analyst

Moody's Investors Service

poonam.thakur@moodys.com

+1.212.553.4635

Jim Hempstead, MD-Utilities

Moody's Investors Service

james.hempstead@moodys.com

+1.212.553.4318

CPFL Energia prepays higher-cost loans with BRL2.4 billion loan from parent, a credit positive

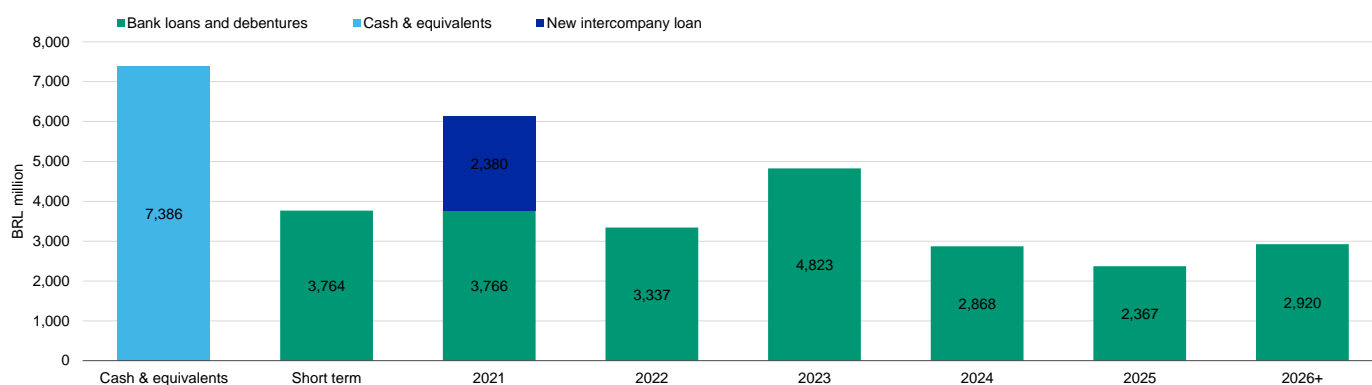
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On 7 July, [CPFL Energia S.A.](#) (Ba1/Aaa.br stable) used BRL2.4 billion of a loan from its controlling shareholder State Grid Brazil Power Participações S.A. (SGBP) to prepay other long-term secured loans with relatively higher interest rates, a credit positive.

The new loan from SGBP, which is ultimately controlled by [State Grid International Development Limited](#) (SGID, A2 stable), equates to 9.5% of CPFL Energia's consolidated debt. The parent's strong financial support provides CPFL Energia the financial flexibility to execute its long-term business strategy amid the current volatile market conditions worsened by COVID-19.

Of the total intercompany loans, BRL2.0 billion was contracted by its power generation subsidiary CPFL Energias Renováveis S.A.; the remaining BRL380 million was contracted by the energy trading subsidiary CPFL Comercialização Brasil S.A. The loans will be primarily used to prepay other outstanding loans from the BNDES and BNB that are relatively more expensive, with an average effective cost of 5.43% per year (as of March 2020). Despite shorter tenor (intercompany loans due in December 2021), the overall financial cost is attractive, based on the interbank deposit rate (DI) plus 1.1% per year, leading to an effective rate of 3.35% per year (see exhibit).

CPFL Energia's debt amortization schedule



As of 31 March, pro forma considering new debt issuances announced in April and new intercompany loan.

Sources: CPFL Energia and Moody's Investors Service

The release of company's shares pledged to the existing debt will also facilitate an ongoing business reorganization. In June 2020, SGBP concluded the tender offer for the acquisition of CPFL Energias Renováveis' remaining common shares and its delisting process. Following this event, we expect a partial or total merger of CPFL Energias Renováveis within the CPFL group, in order to extract operating synergies and fiscal benefits from the acquisition.

CPFL Energia's consolidated leverage, as measured by the net debt/EBITDA ratio of 2.21x as of March 2020, will not be affected by this transaction because we consider the new intercompany loan a debt-like instrument. We expect the company to refinance these loans upon maturity with a combination of bank loans and capital market issuances, or eventually extend the terms with the parent if market conditions worsen or become unfavorable.

Headquartered in Campinas, Brazil, CPFL Energia is a non-operational holding company with controlling and non-controlling interests in companies operating in the electricity distribution, generation, transmission and commercialization sectors in Brazil, and its related services. CPFL Energia is among the country's largest private energy companies, serving approximately 9.8 million clients in 687 municipalities in the distribution segment in the states of [São Paulo](#) (Ba2 stable), Rio Grande do Sul, [Paraná](#) (Ba2 stable) and [Minas](#)

[Gerais](#) (B2 stable). CPFL Energia is also the third largest private generator in the country, with 4,304 MW of installed capacity and operations in hydro, wind, thermal and biomass sources.

CPFL Energia is controlled by the Chinese SGID, which indirectly holds 83.71% of the company's total shares. The remaining 16.29% shares are in free float. In the 12 months that ended 31 March 2020, CPFL Energia reported net operating revenue (excluding construction revenue) of BRL27.9 billion and net income of BRL3.0 billion.

Cristiane Spercel, VP-Senior Analyst

Moody's Investors Service
cristiane.spercel@moodys.com
+55.11.3043.7333

Julia Ponte, Associate Analyst

Moody's Investors Service
julia.ponte@moodys.com
+55.11.3043.7339

Alejandro Olivo, Associate Managing Director

Moody's Investors Service
alejandro.olivo@moodys.com
+1.212.553.3837

US withdraws ability-to-pay underwriting requirements, a credit positive for payday lenders

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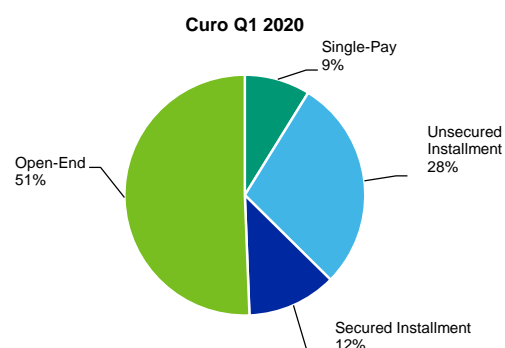
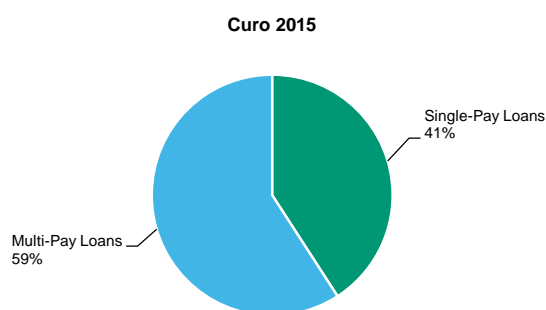
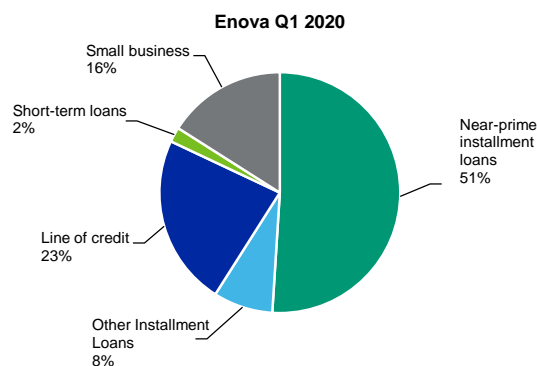
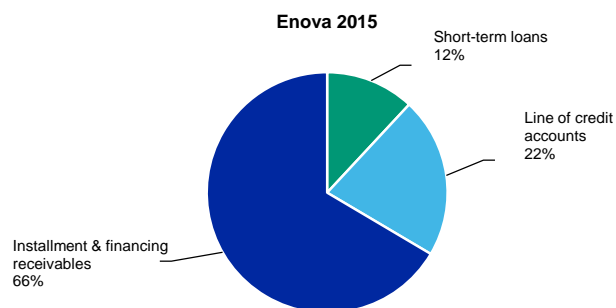
On 7 July, the US Consumer Financial Protection Bureau (CFPB) announced that it will revoke the ability-to-pay underwriting requirements of the 2017 final rule for small-dollar lending (2017 Final Rule). The change is credit positive for certain subprime consumer lenders that originate either payday or vehicle title loans, including [Enova International, Inc.](#) (B2 stable), [Curo Group Holdings Corp.](#) (B3 stable), [CNG Holdings Inc.](#) (B3 stable), [TMX Finance LLC](#) (B3 stable), [Populus Financial Group, Inc.](#) (B3 stable) and [CCF Holdings LLC](#) (Caa3 negative). The ability-to-pay underwriting provisions included in the original rule would have limited the lenders' ability to continue underwriting certain payday and vehicle title loans in their current form and would have reduced their profitability.

The underwriting provisions of the original rule applied to payday, vehicle title and longer-term balloon payment loans. The original rule required lenders to establish a borrower's ability to meet the loan's financial obligations after accounting for their net income and other expenses. The requirements would have negatively affected the profitability of these products, which are high-cost in nature and whose costs to borrowers often exceed the requirements established by the original ability-to-pay requirements.

The CFPB left other protections for consumers in place: lenders are now required for most products they offer to provide written notice before withdrawing a payment from a borrower's account and are prohibited from withdrawing payments from a borrower's account if two such attempts have failed, unless the borrower consents.

Since publication of the 2017 Final Rule, many subprime consumer lenders have pivoted away from the loans covered by the final rule and shifted to high-cost installment loans and other products. The exhibit shows the product mix of two publicly traded subprime consumer lenders, Enova and Curo. Both have shifted to a more diversified product offering from a high reliance on short-term single-pay loans (or, payday loans).

Some lenders have shifted from loans that would have been affected by ability-to-pay underwriting requirements
Enova's and Curo's loan Mix, year-end 2015 versus first-quarter 2020



Sources: Company filings and Moody's Investors Service

Notwithstanding the announcement, the subprime consumer lenders still face a high degree of regulatory risk and scrutiny because of the high cost of the loans they make to consumers. Many US states restrict an array of products or cap interest rates that subprime consumer lenders offer, negatively affecting their profitability.

Bruno Baretta, Analyst
 Moody's Investors Service
 bruno.baretta@moodys.com
 +1.212.553.6032

Andrea Usai, Associate Managing Director
 Moody's Investors Service
 andrea.usai@moodys.com
 +1.212.553.7857

James Benbrook, Associate Analyst
 Moody's Investors Service
 james.benbrook@moodys.com
 +1.212.553.4476

Ana Arsov, MD-Financial Institutions
 Moody's Investors Service
 ana.arsov@moodys.com
 +1.212.553.3763

Introduction of cashback services would be positive for Brazilian banks and payment acquirers

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On 8 July, Brazil's central bank announced that its instant payments system, PIX, which is due to launch in November, will enable cashback services for consumers. Card payment institutions are also preparing to offer cashback services through point-of-sale equipment this year. Cashback services allow cardholders to withdraw cash at commercial stores while purchasing goods or services with debit or credit cards, and they are not currently available in Brazil.

Cashback services would allow banks to save costs by rationalizing their ATM networks and would generate a credit-positive new fee stream for card payment acquirers, a portion of which would go to stores. Cashback services allow shops to reduce the amount of money they hold on site, and reduce the costs of money transport and related security measures.

Stores effectively reuse cash received for other purchases to provide the cashback service. Providing cash withdrawals through stores as opposed to ATMs would be a potential source of cost savings for banks because it reduces the need for a broad ATM network and related security costs for money transfers, supporting banks' efforts to rationalize branch networks.

The cashback services' new fee stream would also be credit positive for payment acquirers, particularly amid competitive pressure that has significantly reduced merchant discount rates (MDRs) in recent years. The gross MDR that stores currently pay for a customer's debit or credit card payment for goods or services is divided between the payment acquirer, which receives a net MDR, and the card issuer, which receives an interchange fee. We estimate that net MDRs fell by 45% in the three years to the first quarter of 2020 due to a spate of competition between acquirers. In a cashback transaction, the card issuer would pay a reverse interchange fee to payment acquirers, with a portion going to the store. Vertically integrated institutions that are both card issuers and acquirers, mainly banks, will pay this fee in-house from their card-issuing division to their acquiring unit.

PIX will incorporate both consumer-to-consumer and business-to-business payments. As of June, almost 1,000 financial institutions were preparing to participate in the new system, including large banks, acquirers and financial technology firms. Once the system launches, a shift toward instant payments, as opposed to debit card payments and cash transfers, will negatively pressure card payment volumes, a trend that the introduction of cashback services using Quick Response (QR) codes could exacerbate.

The introduction of cashback services reflects the increasing digitization of bank services in Brazil, which is increasingly relevant during the coronavirus pandemic. Banking services on digital platforms have surged since the pandemic began. Nevertheless, 60% of Brazilians still use cash, according to central bank data, and the volume of cash withdrawals is high because of the domestic economy's informality and low levels of financial inclusion.

Farooq Khan, AVP-Analyst

Moody's Investors Service

farooq.khan@moody.com

+55.11.3043.6087

Chile's direct support measures for households mitigate systemwide asset risks

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On 5 July, the [Government of Chile](#) (A1 stable) announced a \$1.5 billion [middle-class protection plan](#) to support households as COVID-19-related confinement has lingered for more than 110 days in certain areas of the country. The plan brings total support to around 10% of GDP, including a [\\$12 billion](#) support package announced on 14 June and a [\\$11.75 billion](#) package announced on 19 March.

The new support package will mitigate banks' asset quality deterioration related to the coronavirus pandemic by increasing individuals' capacity to repay loans despite a decline in disposable income. The plan includes state guarantees on deferred installments for certain mortgages, rent subsidies and cheap loans to middle-class families with a one-year grace period for amounts equal to the decline in their income during the pandemic. The plan will also mitigate the risks related to the new rounds of payment deferrals that banks face as stay-at-home measures extend.

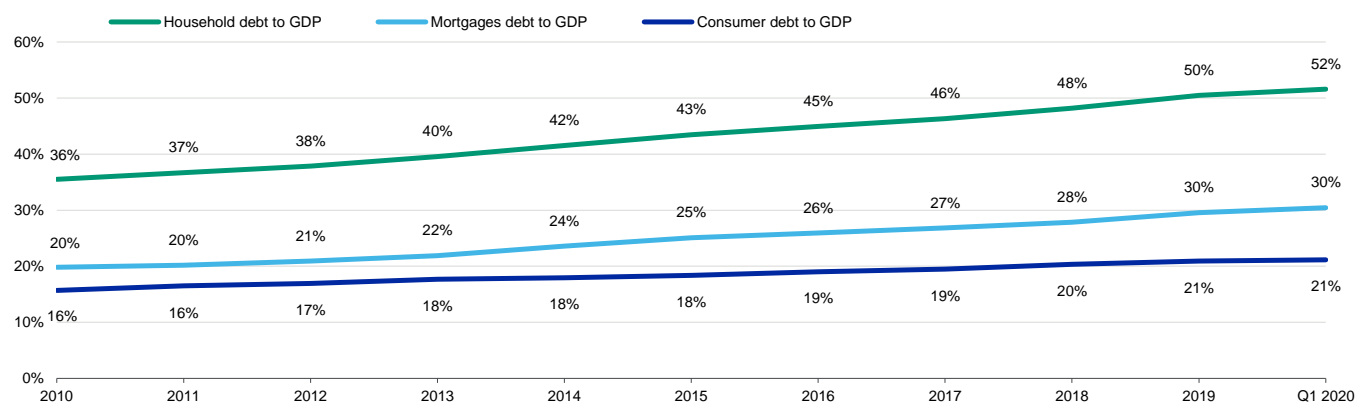
The plan supports the asset quality of large Chilean banks that have recently incorporated retailers' consumer finance books, which include loans to individuals more exposed to economic cycles. These banks include [Banco de Crédito e Inversiones](#) (A2/A2 stable, baa1¹), Scotiabank Chile, Banco Falabella, and [Banco Santander-Chile](#) (A1/A1 negative, baa1), which recently consolidated its ownership of Santander Consumer Finance S.A., a car lender.

Individuals' increased repayment capacity will be especially helpful for the asset quality of less diversified finance companies that focus almost exclusively on consumer financing for lower-income and underbanked individuals, such as Forum Servicios Financieros S.A. and Tanner Servicios Financieros S.A., as well as *cajas de compensación y asignación familiar* (CCAFs) such as Caja Los Andes. CCAFs are social-benefit-paying agents that also provide consumer financing to low-income borrowers in Chile, but which by law benefit from a certain seniority of repayment over other lenders.

State guarantees on deferred mortgage payments and incentives for banks to defer loans because of changes in provisioning requirements will lower the immediate monthly debt service burden on household income, which was a relatively moderate 24% as of first-quarter 2020, according to the Central Bank of Chile's [First Half 2020 Financial Stability Report](#).

The measures would increase total household debt to GDP, in line with the credit-negative long-term trend since 2010 (see exhibit). If the entire \$1.5 billion package were directed toward new loans, it would add around 1% to Chilean households' debt, which was 52% of GDP as of first-quarter 2020. Households' long-term increase in debt suggests increased asset risk, higher nonperforming loans and provisioning costs that would pressure Chilean banks' financial fundamentals.

Chilean household indebtedness continues to increase, a long-term credit negative



Source: Central Bank of Chile's First Half 2020 Financial Stability Report

A more systemwide database of household debt to limit information asymmetries among borrowers would limit the risks related to this increase. Chile's household debt to GDP is approaching the Organization for Economic Co-operation and Development average of 60.5%, according to International Monetary Fund data as of 2018. The database of household debt would include information on banks' and cooperative banks' retail loans, mutual funds' mortgage loans, unregulated cooperatives' consumer loans, retailers' credit card financing, CCAFs' payroll-linked loans and finance companies' car loans. Regulators are also evaluating possible restrictions on borrowers' debt-to-income levels.

Endnotes

¹ The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

Felipe Carvallo, *VP-Sr Credit Officer*
 Moody's Investors Service
 felipe.carvallo@moodys.com
 +52.55.1253.5738

Anna Chabanenko, *Associate Analyst*
 Moody's Investors Service
 anna.chabanenko@moodys.com
 +52.55.1555.5323

Dutch banks will create a common platform to combat money laundering, a credit positive

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On 9 July, the Dutch banking association Nederlandse Vereniging van Banken (NVB), [announced](#) that [ABN AMRO Bank N.V.](#) (A1/A1 stable, baa1¹), [ING Bank N.V.](#) (Aa3/Aa3 stable, baa1), [Rabobank](#) (Aa3/Aa3 stable, a3), Triodos Bank and [de Volksbank N.V.](#) (A3/A3 stable, baa1) agreed to create a shared transaction-monitoring company to fulfil their obligations for anti-money laundering and counterterrorist financing (AML-CFT).

The initiative is credit positive for Dutch banks because it will allow the five banks to more efficiently and effectively identify fraudulent transactions at lower cost for each bank and reduce the risk of litigation. The soon-to-be-created Transaction Monitoring Netherlands (TMNL) will provide a platform to detect suspicious transaction patterns, which are difficult to identify at a single bank but easier to discern by pooling several banks' data.

At present, each bank monitors the transactions going through its systems without the benefit of other banks' findings. Consequently, a transaction that is deemed suspicious and blocked by one Dutch bank may not be blocked by another because the latter's system is less efficient or it simply does not classify the transaction as being suspicious.

Under the auspices of the Dutch banking association, large Dutch banks have considered the feasibility of a joint monitoring tool and concluded that it could prove valuable in addressing AML-CFT risks. The tool will be developed in phases and other banks should ultimately have access to the resource.

AML-CFT is high on the Dutch authorities' agenda. Around €16 billion² (2% of Dutch GDP) from criminal activities is laundered in the Netherlands each year, making the country the eighth most attractive to money launderers globally. Failing to fight these activities adequately exposes banks to high litigation risks and costly remediation programmes. The Dutch central bank De Nederlandsche Bank (DNB) fined ING €775 million in 2018 because it failed to prevent money laundering transactions between 2010 and 2016. An investigation is ongoing at ABN AMRO for the same reason. The bank put in place a vast remediation programme, involving 2,800 full-time employees and operating expenses of €400 million in 2019.

The role of artificial intelligence in AML-CFT will also be key. Algorithms can be developed that spot suspicious activities in a much more efficient and cost-effective way. Thus, this joint initiative could also serve as a platform for banks to pool their resources and share the risks of developing such IT solutions, which can prove costly for banks working on their own. Currently, 8,000 bank employees (one in 10) in the Netherlands are working on AML-CFT-related issues. Developing solutions that are less labour-intensive would allow banks to reduce their cost base and support their profitability.

Endnotes

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² Estimate from the Utrecht University School of Economics.

Victor Henimann, Associate Analyst

Moody's Investors Service
victor.henimann@moodys.com
+33.1.5330.3352

Alain Laurin, Associate Managing Director

Moody's Investors Service
alain.laurin@moodys.com
+33.1.5330.1059

Guillaume Lucien-Baugas, VP-Senior Analyst

Moody's Investors Service
guillaume.lucien-baugas@moodys.com
+33.1.5330.3350

Nick Hill, MD-Banking

Moody's Investors Service
nick.hill@moodys.com
+33.1.5330.1029

Increase in transactions suggests a rebound in Russia's economy, a credit positive for banks

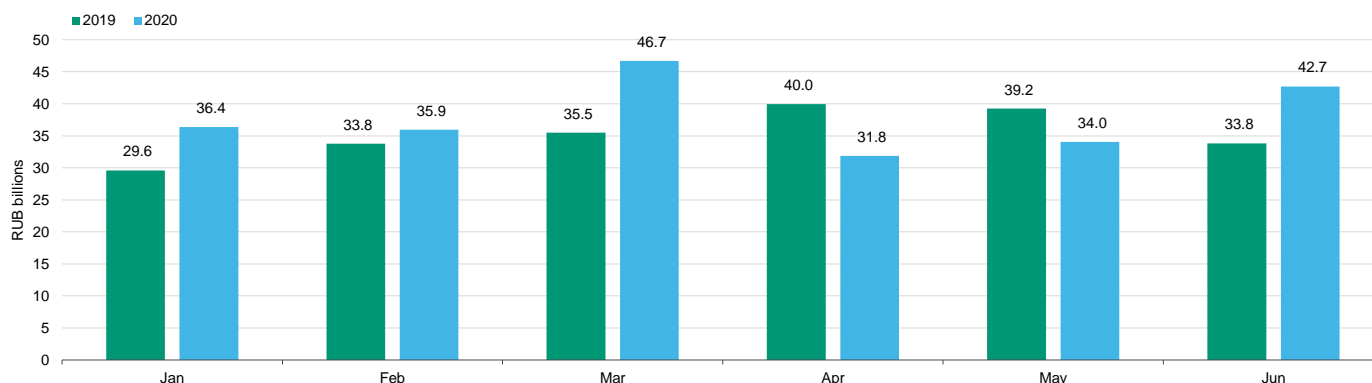
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On 8 July, [Sberbank](#) (Baa3 stable, ba1¹), Russia's largest bank, disclosed its [financial statements for the first six months of 2020 prepared under local GAAP](#), which showed that the bank's net fee-and-commission income had increased 25% in June 2020 from the previous month because of a rise in transactional business. Sberbank's strong recovery of fee and commission income is credit positive and an early sign of a rebound in Russia's economic activity that, if sustained, will strengthen banks' earning amid the coronavirus-driven recession.

Sberbank accounts for approximately 30% of Russia's banking sector total assets and has a diverse fee-and-commission income structure. In June 2020, the volume of the bank's net fee-and-commission income again exceeded year-ago levels after lagging year-ago levels in April and May 2020 (see Exhibit 1). Russia's widespread lockdowns because of the pandemic, and the ensuing economic slump, were behind the declines in April and May.

Exhibit 1

Sberbank's monthly net fee-and-commission income, 2019 versus 2020



According to Sberbank, the exhibit presents fairly the general trends, although the monthly volumes of net fee-and-commission income are not perfectly comparable with the prior-year numbers due to (a) the introduction of a new p2p settlements pricing model in June 2020 and (b) uneven recognition of certain types of commission expenses year-on-year.

Source: Sberbank's financial statements prepared under local GAAP

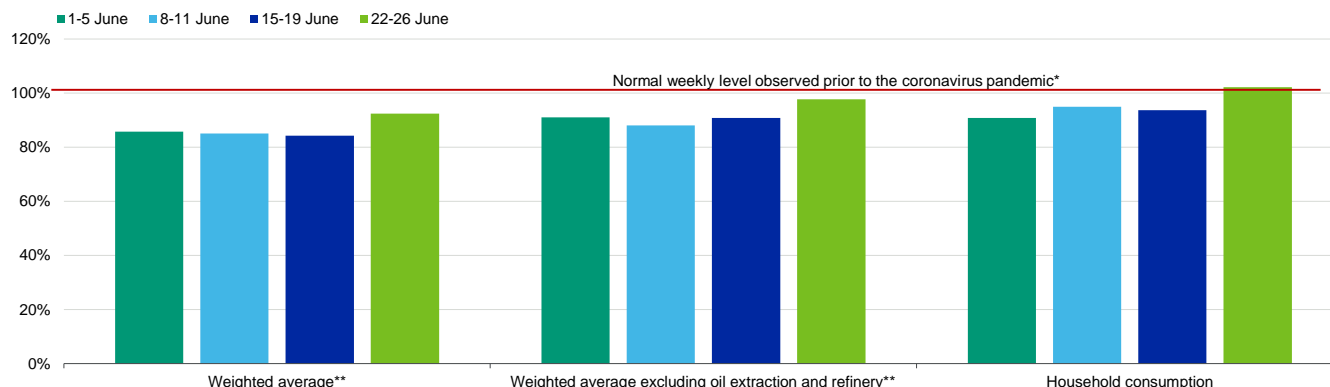
According to Sberbank, growth in a number of transactional businesses, including cash and settlement transactions, bank card operations and brokerage services, increased the bank's fee-and-commission income for June. We expect that the sector overall will record increases in net fee-and-commission income for June 2020. Most Russian banks will report their results at the end of July.

Strengthening the argument that Russia's economy is rebounding are [statistics recently published by the Central Bank of Russia \(CBR\)](#) showing that the volume of weekly incoming payments to corporate bank accounts has begun to recover (Exhibit 2). That recovery follows Russia's gradual easing of lockdown measures and a revival of domestic consumption.

Exhibit 2

Volume of weekly incoming payments to corporate accounts

Comparison of recent levels versus those recorded before the coronavirus pandemic



*Normal level is the average seasonally adjusted weekly amount of incoming payments for 20 January to 13 March.

**The average levels are weighted by share of industry in GDP.

Source: Central Bank of Russia

If Russia's recovery continues, it will strengthen banks' earnings after deteriorating in April and May amid the pandemic-driven economic slump. Higher provisioning charges and lower earnings, including a substantial drop in fees and commissions, resulted in the banking sector's profits falling to RUB45 million in May and RUB51 million in April. In contrast, banks in first-quarter 2020 recorded a strong RUB612 billion of net profits, the equivalent of a 2.6% annualised return on average assets.

In addition to the increase in bank customers' activity generating higher fee-and-commission income, banks' asset quality will also stabilise, easing the negative pressure on profits from heavy credit losses. Exhibits 3 and 4 show that a majority of the industries represented in Russian banks' loan portfolios are reporting increases in weekly incoming payments.

Exhibit 3

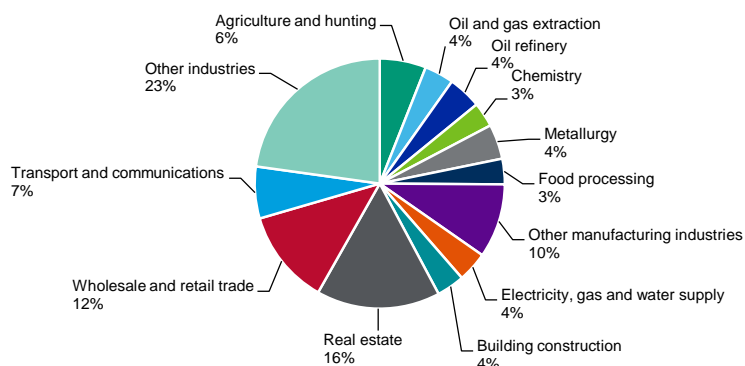
Select industries' weekly volumes of incoming payments to corporate accounts as a % of pre-coronavirus levels

	1-5 June (%)	8-11 June (%)	15-19 June (%)	22-26 June (%)
Retail trade	116.9	117.0	115.8	131.1
Land transport and pipelines	92.5	104.5	77.8	110.0
Electricity supply	85.8	78.1	89.9	106.1
Wholesale trade	98.4	96.4	95.7	105.9
Building construction	94.7	92.2	97.6	105.3
Chemistry	80.1	84.9	101.5	104.3
Agriculture and hunting	90.4	69.2	73.2	84.9
Real estate activities	70.2	82.7	87.3	84.3
Oil refinery	56.1	69.4	56.9	82.9
Hotels and accommodation	51.4	54.7	50.6	72.1
Restaurants and catering	53.1	63.3	58.0	67.7
Metallurgy	61.8	73.6	71.2	67.3
Oil and gas extraction	49.6	63.3	41.3	56.1

Source: Central Bank of Russia

Exhibit 4

Russian banks' loan-book breakdown by industry as of 1 January 2020



Source: Central Bank of Russia

Based on the [CBR data](#), we estimate that as of the end of June 2020, banks restructured 3% of gross loans issued to individuals, 14% of gross loans issued to small and midsize enterprises and 7% of gross loans issued to large corporates. Banks began restructuring loans amid the coronavirus-driven recession, but if economic activities continue to recover, we expect some portion of restructured loans to return to the performing category.

Endnotes

¹ The bank ratings shown in this report are the bank's domestic deposit rating and Baseline Credit Assessment.

Olga Ulyanova, VP-Sr Credit Officer

Moody's Investors Service
olga.ulyanova@moodys.com
+7.495.228.6078

Victoria Voronina, Associate Analyst

Moody's Investors Service
victoria.voronina@moodys.com
+7.495.228.6113

More losses from Swiss-franc mortgages add to mBank's profitability challenges, a credit negative

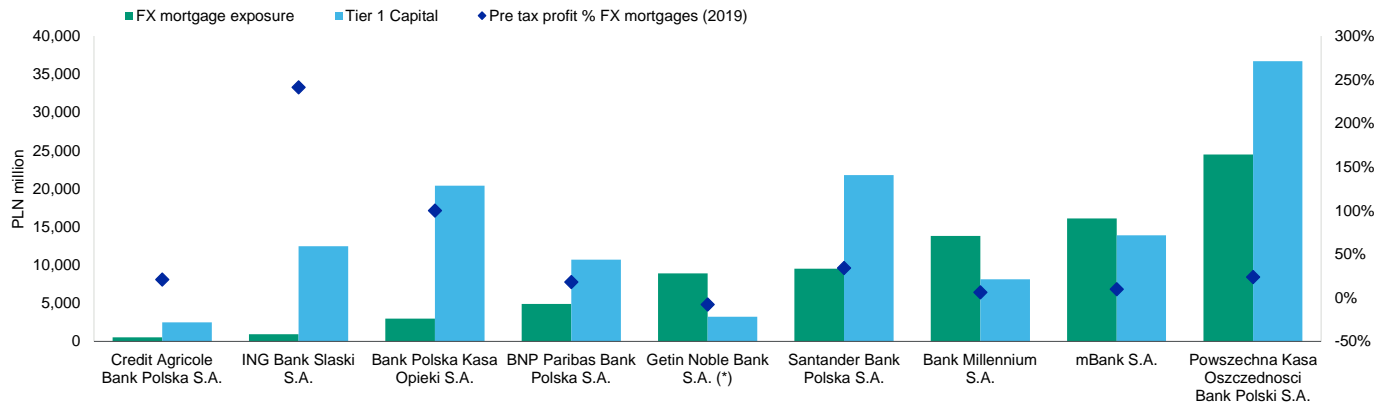
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On 7 July, [mBank S.A.](#) (A3 stable, baa3¹) announced that it had established a PLN189 million provision against legal risk stemming from its Swiss-franc mortgage portfolio in the second quarter. The provisions against legal risk are consistent with our expectation that Polish banks that are heavily exposed to Swiss-franc mortgages will grapple with losses from these loans for many quarters, a credit negative. The provisions will add to banks' profitability challenges derived from high credit costs, a collapse of business volume and a sharp decline in interest rates owing to the coronavirus pandemic.

The second-quarter figure is significantly higher (equivalent to 36% of mBank's first quarter pre-provision income) than the PLN13 million that it booked in the first quarter, and in addition to a jump in the bank's loan loss provisions to around PLN318 million, or an annualized 1.2% of gross loans, in the first quarter, up from 0.6% as of year-end 2019.

mBank is one of the most exposed Polish banks to mainly indexed Swiss-franc mortgages (see exhibit), which accounted for around 13.1% of its gross loans as of March 2020. Although a small percentage of clients (some 6% of borrowers with Swiss-franc loans) had sued the bank as of March, claiming abusive loan tactics, mBank, like other Polish banks, is at significant risk that more clients with these types of loans will sue if Polish court rulings favour borrowers. Polish borrowers claim the way banks calculate their monthly installments are not transparent and use exchange rates that favour the banks.

mBank is among the most exposed rated Polish banks to Swiss franc-denominated mortgages



Sources: Banks' financial statements and Moody's Investors Service

[Rulings favouring borrowers](#) are increasing after the European Court of Justice (ECJ) in October 2019 issued a long-awaited ruling on a case involving a Polish couple with a Swiss franc-indexed mortgage who claimed their contract terms were abusive. The ECJ's judgment, which serves as a guide for Polish judges, was more favourable to borrowers than Polish court rulings had been up to that point.

In response, Polish banks developed models to estimate the likely losses they would sustain from their Swiss-franc mortgage books and booked significant provisions by year-end 2019. However, with courts closed amid the coronavirus pandemic, banks had limited data to input into their models and thus the provisions they booked were relatively low. Now that the courts have reopened, banks are increasing their provisions. Although mBank is the only rated Polish bank to announce increased litigation provisions, we expect other highly exposed Polish banks to follow suit.

Polish banks have built sizeable buffers against foreign-currency mortgages. Although the system's high 3% systemic risk buffer requirement was [repealed in response to the coronavirus crisis](#), banks must still hold excess capital because regulatory requirements

call for a 150% risk weight to be assigned to these exposures. Banks must also hold additional capital as part of their stress test evaluation process, which in mBank's case is 3.11% of risk-weighted assets. Dividend payments are also restricted by the regulator depending on individual banks' exposures and their excess capital, although the pandemic has prompted the regulator to temporarily suspend all dividend payments at this time.

The higher provisions add to the profitability challenges that mBank and other Polish banks face owing to significantly less new business, with total system gross loans declining in April from March, a [140-basis-point decline in the policy rate to a low of 10bp](#) and significantly higher credit costs as a result of the coronavirus pandemic. For the three months to March 2020, mBank reported net profit of PLN90.9 million, a 44% decrease from the PLN163.2 million it reported a year earlier. The decrease mainly reflected higher loan loss provisions that were mainly driven by the weaker macroeconomic environment and customers' prospects owing to the coronavirus pandemic. Other large rated Polish banks [reported similar declines in profit](#).

Foreign-currency mortgages have long been a [challenge](#) for Polish banks. The Swiss franc's abrupt appreciation against the zloty in 2015 negatively affected Polish homeowners whose mortgages were indexed to or denominated in Swiss francs, because the local-currency value of their mortgages rose.

Following President Andrzej Duda's election in 2015, the authorities proposed legislation to force banks to convert foreign-currency mortgages into zloty at exchange rates favourable to borrowers. Those plans were discarded after an assessment by the Polish financial supervision authority showed that the toll on banks would be likely to be unmanageable. Instead, the authorities established a PLN600 million relief fund, funded by the banks, to support mortgage repayments of struggling borrowers. In 2017, Duda proposed that domestic banks fund a foreign-currency mortgage relief fund by paying up to 2% of their stock of foreign-currency mortgages annually to support conversion and repayment of these mortgages. These plans again proved controversial and were dropped last July.

Endnotes

¹ The ratings shown are mBank's deposit rating and Baseline Credit Assessment.

Katja Reise, AVP-Analyst
Moody's Investors Service
katja.reise@moodys.com
+49.69.70730.765

Romy Van Rooij, CFA, Associate Analyst
Moody's Investors Service
romy.vanrooij@moodys.com
+44.20.7772.1638

Melina Skouridou, CFA, AVP-Analyst
Moody's Investors Service
melina.skouridou@moodys.com
+357.2569.3021

Carola Schuler, MD-Banking
Moody's Investors Service
carola.schuler@moodys.com
+49.69.70730.766

Australia extends loan deferrals, benefitting banks during coronavirus disruption

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On 8 July, the Australian Prudential Regulation Authority (APRA) announced an extension of its temporary capital treatment for bank loans with coronavirus-related repayment deferrals to a maximum period of 10 months from the start of the repayment deferral, or until 31 March 2021, whichever comes first. APRA has allowed banks to treat loans with coronavirus-related deferred repayment as performing for regulatory capital purposes, which conserves bank capital because of the higher credit risk weights applied to impaired and restructured loans.

By allowing loans with repayment deferrals to be treated as performing, banks have greater flexibility to manage stressed borrowers through this economic disruption, which likely will reduce ultimate credit losses for the borrowers and for banks' asset quality. Banks are less likely to foreclose on homes or implement other aggressive efforts to extract payments from delinquent and at-risk borrowers, which should support consumer confidence and spending, and avoid a potential collapse of property prices induced by widespread foreclosures. The forbearance also increases banks' capacity to continue to support the economy by maintaining lending to households and businesses.

As at 31 May, around 11% of housing loans and 18% of business loans (by dollar amount) had been granted a deferral, creating a significant risk to Australian banks' asset quality. Australian banks have offered up to six month deferrals to complement a range of government stimulus measures in response to the coronavirus outbreak.

APRA's extension of existing forbearance measures highlights the significant number of borrowers that are having financial problems during the current coronavirus-related economic disruption. The ultimate effect of disruptions from the coronavirus on asset quality will depend on many variables, including the duration and severity of the economic disruption and the effectiveness of large stimulus measures by the [Government of Australia](#) (Aaa stable).

Although we expect banks' asset quality to weaken, it will come off a strong base. Nonperforming housing loans, which include 90 days past due loans and impaired loans, made up less than 1% of total residential mortgages before the coronavirus outbreak.

In the short to medium term, APRA's forbearance will provide some offset to the rise in nonperforming loans and risk weighted asset densities from weakening asset quality. However, if employment conditions remain weak when planned deferral periods ultimately expire, there is a risk of a sharp increase in credit risk weighted assets as borrower impairment is recognized, putting strain on bank capital ratios.

Additionally, the large numbers of customers not able to make repayments will hurt banks' net interest income, further straining profitability and weakening the banks' organic capital generation. Bank profitability is already being adversely affected by significant increases in credit provisions, current ultra low interest rates and subdued credit growth.

Despite our expectations for capital to weaken, Australia's banks are in a much stronger position heading into this downturn than they were during previous crises, providing significant support to their credit profiles. Bank capital has strengthened significantly since the global financial crisis in 2008.

Daniel Yu, CFA, VP-Senior Analyst
Moody's Investors Service
daniel.yu@moodys.com
+61.2.9270.8198

Patrick Winsbury, Associate Managing Director
Moody's Investors Service
patrick.winsbury@moodys.com
+61.2.9270.8183

Chubb reports record catastrophe losses, driven by coronavirus pandemic

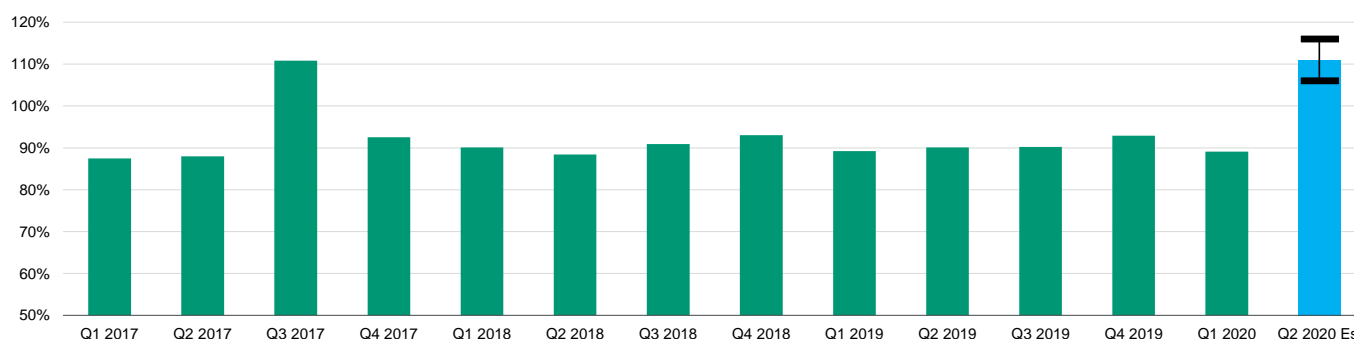
Originally [published](#) on 10 July 2020

On 6 July, [Chubb Limited](#) (A2 positive) pre-reported estimated pretax catastrophe losses of \$1.8 billion for second-quarter 2020 (\$1.5 billion after tax), of which \$1.4 billion relates to coronavirus global pandemic losses (\$1.2 billion after tax), a credit negative. Given that the company has averaged almost \$700 million per quarter in property and casualty (P&C) underwriting income since 2018, we expect the charges to largely offset P&C underwriting income for the first half of the year.

In addition to the coronavirus losses, the \$1.8 billion net-of-reinsurance charge includes \$312 million of pretax losses for other natural catastrophes (e.g., tornado and hail) and \$130 million for US civil-unrest losses. Chubb also recognized \$259 million of pretax losses related to US child molestation claims including revivor statute-related claims, which are not included in the \$1.8 billion. Overall, we expect the second quarter combined ratio to increase significantly above historical levels as a result of the catastrophe losses, with combined ratios likely similar to those experienced for third-quarter 2017, which included hurricanes Harvey, Irma and Maria. Exhibit 1 shows Chubb's quarterly combined ratio, including our range estimate for second-quarter 2020.

Exhibit 1

Chubb's quarterly combined ratio including our estimated range for second-quarter 2020



Combined ratio estimate based on average pre-catastrophe combined ratio for last five quarters, with \$1.8 billion of catastrophe losses and a +/- 5% range

Sources: Company filings and Moody's Investors Service

We estimate that coronavirus losses are the largest of any catastrophe since ACE's acquisition of Chubb (adopting the Chubb name in the process) in 2016. Exhibit 2 shows the 10 largest catastrophe losses for Chubb since the acquisition.

Exhibit 2

Top 10 Chubb catastrophe losses since 2016

Catastrophe	Year	Losses[1]
COVID-19	2020	\$1,365
Hurricane Irma	2017	880
Hurricane Harvey	2017	650
Hurricane Michael	2018	285
N. California wildfires	2017	277
Tornado in Dallas, Texas	2019	213
Hurricane Maria	2017	201
California wildfires	2018	195
Hurricane Florence	2018	173
S. California wildfires	2017	157

[1] Pretax losses as of event year-end, including reinstatement premiums in millions.

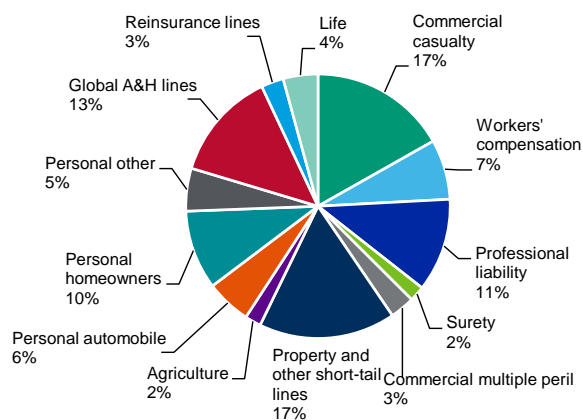
Sources: Company filings and Moody's Investors Service

Other insurers that have reported significant coronavirus loss estimates include [Zurich Insurance Company](#) (A1 stable), which in May reported estimated coronavirus losses of \$750 million; [Munich Reinsurance Company](#) (A2 (hyb) stable), which in May reported coronavirus losses of €800 million, particularly from event cancellation insurance; and [Swiss Re Ltd.](#) (Aa3 stable), which in April reported a pretax charge of \$476 million from losses related to coronavirus. Among US insurers, [American International Group, Inc.](#) (Baa1 stable) in May reported \$272 million of coronavirus losses from its travel, event cancellation, commercial property, trade credit, workers' compensation and reinsurance lines of business. We expect that further coronavirus losses will be reported for the second quarter, particularly for commercial insurers and reinsurers.

Chubb's coronavirus catastrophe losses are likely higher compared to many US P&C insurers because of Chubb's business mix, which includes significant premiums for event cancellation insurance, professional liability including financial lines, travel insurance products and specialty lines such as surety, political risk and trade credit insurance. In contrast, Chubb has a smaller market share in products that likely had lower claim frequency as a result of coronavirus, such as personal and commercial auto insurance, which accounted for about 9% of Chubb's 2019 US premiums compared to 42% for the US P&C industry. Exhibit 3 and 4 break down Chubb's premiums by line of business and geography. The company also expects to reduce its second-quarter net written premiums by \$184 million as a result of exposure reductions on its in-force policies because of the economic downturn.

Exhibit 3

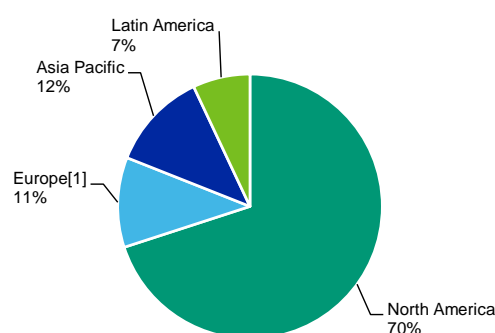
Chubb net premiums written by line of business, first-quarter 2020



Sources: Company filings and Moody's Investors Service

Exhibit 4

Chubb net premiums earned by geography, 2019



[1] Europe includes Africa and Eurasia

Sources: Company filings and Moody's Investors Service

Chubb disclosed that some of the losses are from business interruption (BI) claims from commercial property coverages. BI claims from coronavirus closures have generally not been covered in the US because of policy language that requires direct physical damage to the property to trigger business interruption coverage. Many policies also include virus and bacteria exclusions. As with many P&C insurers, we expect that Chubb's BI reserves are mostly related to non-US business or to affirmative coverages in the US, in which insureds have bought policies which specifically cover pandemic BI claims. Several US states have filed legislation that would require insurers to retroactively cover BI losses from the coronavirus to small businesses, but so far none has become law. However, insurers will face potentially higher expenses and claims associated with rising litigation relating to the coronavirus.

Although Chubb's catastrophe losses for second-quarter 2020 are significant, we expect that they will be partially offset by recovering investment losses in the quarter. The company reported \$958 million of investment losses in the first quarter, primarily related to the effect of lower global equity valuations on the company's variable annuity reinsurance portfolio, which we expect have largely recovered in the second quarter. Also boosting Chubb's core earnings will be rising commercial insurance prices, which have continued to increase for the industry in 2020. Despite the charge, Chubb's capital position is solid, with shareholders' equity of \$52.2 billion as of 31 March 2020.

Jasper Cooper, CFA, VP-Sr Credit Officer

Moody's Investors Service
jasper.cooper@moody's.com
+1.212.553.1366

Sarah Hibler, Associate Managing Director

Moody's Investors Service
sarah.hibler@moody's.com
+1.212.553.4912

Erica Reynolds, Associate Analyst

Moody's Investors Service
erica.reynolds@moody's.com
+1.212.553.1866

Marc R. Pinto, CFA, MD-Financial Institutions

Moody's Investors Service
marc.pinto@moody's.com
+1.212.553.4352

Acquisition of National General increases Allstate's leverage and integration risk

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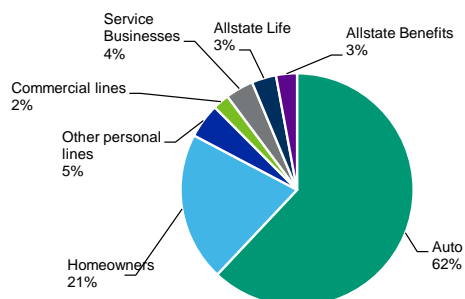
On 7 July, [The Allstate Corporation](#) (ALL, A3 stable) agreed to acquire nonstandard auto insurer National General Holdings Corp. (NGHC) for approximately \$4 billion in cash (a 69% premium to the 6 July closing price). The proposed transaction is credit negative for Allstate because it will likely use debt to help fund the transaction and there is integration risk. However, the acquisition bolsters Allstate's independent agent distribution channel and gives it a meaningful presence in the nonstandard auto insurance market. The companies expect to complete the transaction in early 2021, subject to regulatory approvals.

Allstate will fund the transaction using \$2.2 billion in cash and plans to issue \$1.5 billion of new senior debt. Although the transaction has strategic benefits for Allstate, it also increases the company's leverage on a pro forma basis from the low 30% range to the mid-30s as of 31 March 2020. Allstate is an efficient generator of capital given its profitable operations, but also consistently gives capital back to shareholders via dividends and share repurchases, which the company indicated would not be affected by the transaction.

Allstate is currently the fourth-largest writer of personal auto insurance in the US, and operates in all distribution channels, including the exclusive agent (Allstate brand), independent agent (Encompass brand) and direct (Esurance brand). The transaction will position Allstate as the second-largest personal lines insurer in the US, and the fifth-largest in the independent agent channel. Allstate writes multiple products but primarily personal auto and homeowners' insurance (Exhibit 1). National General provides a range of property-liability products through a network of approximately 42,300 independent agents nationwide, with nonstandard auto insurance representing about 57% of its \$5.6 billion of net premiums written (Exhibit 2).

Exhibit 1

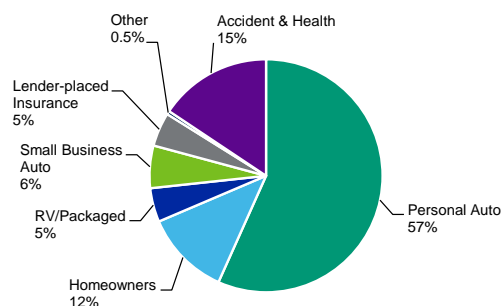
Allstate's net premiums written by segment, 2019



Sources: Company filings and Moody's Investors Service

Exhibit 2

National General's net premiums written by segment, 2019



Personal auto, Homeowners and Other segments include NPW from Reciprocal
Sources: Company filings and Moody's Investors Service

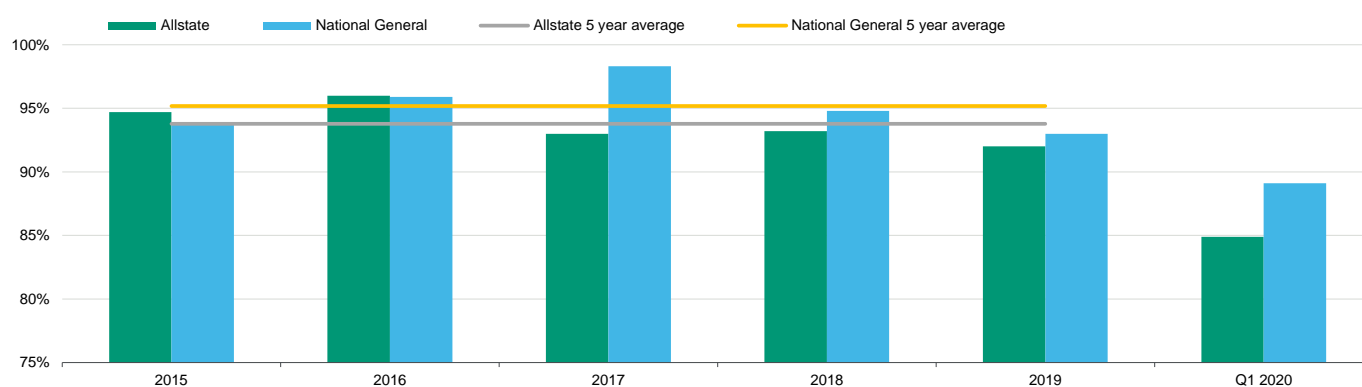
Allstate's premiums from its Encompass brand have been stagnant in the past few years as the company focused on improving underwriting margins. While Allstate's current market share in the independent agency channel is around 1.5%, adding National General's business will give the company approximately 4% market share in this highly fragmented channel. Since most of National General's independent agents sell both standard and nonstandard insurance, Allstate can expand its standard and preferred products through National General's agents as well as increasing bundling of auto and homeowners policies which tend to have higher retention rates. However, the transaction carries integration risk because Allstate intends to consolidate its independent agency platform with National General, folding in Encompass and its other independent agency business.

National General also has an accident and health business providing small group stop-loss and individual medical business, which comprised 15% of the company's net written premiums in 2019. Additionally, National General is the second-largest lender-placed homeowners' insurer. These businesses give Allstate opportunities to grow in new product lines.

Allstate's combined ratio has been strong but somewhat volatile, driven by catastrophe losses in 2017 and 2018, but the company maintains a significant reinsurance program to manage the risk. National General's combined ratio has averaged 95% over the past five years (Exhibit 3) as a result of improved pricing and favorable reserve development. We expect that National General's book of business could benefit from Allstate's leading data collection and analytics, as well as from enhanced scale as part of Allstate. In addition, following the shelter-in-place restrictions, both miles driven and auto loss frequency declined significantly and Allstate provided premium refunds to its customers. National General's book of nonstandard auto business carries lower retention rates, and top-line premium growth could slow meaningfully given the coronavirus-related recession.

Exhibit 3

Allstate's and National General's combined ratios; coronavirus-related economic downturn reduces auto accident frequency



Includes results from Reciprocal

Sources: Company filings and Moody's Investors Service

Additionally, the National General book of business increases the concentration Allstate has in some catastrophe prone states, including California, New York and Florida, which also happen to be more difficult regulatory environments.

Michael Dion, CFA, VP-Senior Analyst

Moody's Investors Service

mike.dion@moodys.com

+1.212.553.1897

Sarah Hibler, Associate Managing Director

Moody's Investors Service

sarah.hibler@moodys.com

+1.212.553.4912

Kripa Thapa, Associate Analyst

Moody's Investors Service

kripa.thapa@moodys.com

+1.212.553.8924

Marc R. Pinto, CFA, MD-Financial Institutions

Moody's Investors Service

marc.pinto@moodys.com

+1.212.553.4352

Virtus Investment's partnership with Allianz Global is credit positive

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On 7 July, [Virtus Investment Partners, Inc.](#) (Ba2 positive) announced that it has entered a strategic partnership with Allianz Global Investors, LLC (AllianzGI), in which Virtus will assume about \$23 billion of AllianzGI's retail assets. AllianzGI's investment teams will continue to manage the assets in a sub-advisory capacity. Additionally, AllianzGI's Dallas-based value equity team, which manages approximately \$7 billion of the \$23 billion, will join Virtus as an affiliated manager. The transaction is likely to close by year end and does not involve payments from either party at closing.

The agreement is credit positive for Virtus because it enhances the company's business profile, without the use of external loans. Although full details of the agreement have not been disclosed, it aligns with both companies' economic interests: Virtus gains scale and an opportunity for further growth while AllianzGI holds onto a portion of its existing revenue stream.

The agreement increases Virtus' size, grows its presence in the US retail fund market and adds complementary investment capabilities that diversify the company's asset mix. As a result of the partnership, Virtus' mutual fund assets under management (AUM) will increase by about 40% to \$54 billion and its total AUM to \$128 billion, pro forma as of 31 May.

Virtus will become the administrator, investment manager and distributor of about \$16 billion of open-end funds, \$5 billion of closed-end funds and \$2 billion of retail separate accounts. A snapshot of the funds the company will be adopting are shown on Exhibits 1 and 2.

Exhibit 1

Virtus will assume more than \$10 billion of four- and five-star mutual funds

Data as of 31 May 2020

Mutual Fund	Tickers (A / C / R / I / P / R6 shares)	Asset Class	Total Assets (\$M)	Fund Inception Date
AllianzGI Mid-Cap	RMDAX/RMDCX/PRMRX/DRMCX/ARMPX/—	Growth Equity	342	Nov-79
AllianzGI Mid-Cap Value	PQNAX/PQNCX/PRNRX/PRNIX/ANRPX/ANPRX	Value Equity	1,223	Apr-88
AllianzGI Convertible	ANZAX/ANZCX/ANZRX/ANNPX/ANCMX/—	Fixed Income	1,300	Apr-93
AllianzGI Technology	RAGTX/RCGTX/—/DRGTX/ARTPX/—	Thematic	1,756	Dec-95
AllianzGI Global Allocation	PALAX/PALCX/AGARX/PALLX/AGAPX/AGASX	Asset Allocation	288	Sep-98
AllianzGI International Value	AFJAX/AFJCX/ANJRX/ANJIX/AFVPX/ANAVX	International Equity	126	Jan-03
AllianzGI Income & Growth	AZNAX/AZNCX/AIGRX/AZNIX/AIGPX/—	Asset Allocation	4,771	Feb-07
AllianzGI Water	AWTAX/AWTCX/—/AWTIX/AWTPX/—	Thematic	616	Mar-08
AllianzGI Global Dynamic Allocation	ASGAX/ASACX/ASFRX/AGAIX/AGSPX/ADYFX	Asset Allocation	116	Apr-09
AllianzGI Emerging Markets Value	AZMAX/AZMCX/—/AZMIX/AZMPX/—	International Equity	110	Dec-12
AllianzGI Small-Cap	AZBAX/AZBCX/—/AZBIX/AZBPX/ASCFX	Small Cap	108	Jul-13
AllianzGI Emerging Markets SRI Debt	AGMAX/AGMCX/—/AGMIX/AGMPX/—	Fixed Income	24	Sep-14
AllianzGI Global Sustainability	ASUAX/—/—/ASTNX/ASTPX/—	Global Equity	162	Dec-14
Total			10,942	

Sources: Fund websites and FactSet

Exhibit 2

Allianz closed-end funds that will be assumed by Virtus

Data as of 31 May 2020

Closed-end Fund	Ticker	Asset Class	Net Assets (\$M)	Fund Inception Date	Rating
AllianzGI Convertible & Income Fund (Aa3 watch)	NCV	Balanced	770	Mar-03	★★
AllianzGI Convertible & Income Fund II (Aa3 watch)	NCZ	Balanced	587	Jul-03	★★
AllianzGI Dividend, Interest & Premium Strategy Fund	NFJ	Balanced	1,229	Feb-05	★★★
AllianzGI Equity & Convertible Income Fund	NIE	Balanced	688	Feb-07	★★★★★
AllianzGI Diversified Income & Convertible Fund	ACV	Balanced	358	May-15	-
AllianzGI Convertible & Income 2024 Target Term Fund	CBH	Balanced	234	Jun-17	★★★
AllianzGI Artificial Intelligence & Technology Opportunities Fund	AIO	Active Allocation	733	Oct-19	-
Total			4,597		

Sources: Fund websites and FactSet

The main challenge for Virtus will be to effectively use its distribution infrastructure to grow the new business. The company will use its existing expense base to manage the new business, which we believe will keep incremental costs minimal. Additionally, to ensure mutually beneficial growth, Virtus and AllianzGI plan to collaborate on developing new investment solutions for US retail clients.

The transferring assets comprise less than 5% of AllianzGI's total AUM of \$590 billion. However, the agreement allows AllianzGI to shed the operational burden of managing a fund complex that has had mixed success within the US retail market. About 55% of AllianzGI's retail fund assets had Morningstar ratings of four or five stars compared to 82% for Virtus' funds. In late May, AllianzGI announced the liquidation of its suite of retirement solutions, citing challenges facing investment managers in the target date marketplace. The agreement will allow AllianzGI to refocus its efforts on the institutional side of its US asset management business.

Rokhaya Cisse, CFA, AVP-Analyst

Moody's Investors Service
rokhaya.cisse@moodys.com
+1.212.553.3870

Sydney Kyne, Associate Analyst

Moody's Investors Service
sydney.kyne@moodys.com
+1.212.553.4540

Robert M. Callagy, Associate Managing Director

Moody's Investors Service
robert.callagy@moodys.com
+1.212.553.4374

UK government's Summer Statement adds further policy support to mitigate coronavirus-induced shock

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On 8 July, the UK's (Aa2 negative) Chancellor Rishi Sunak presented a Summer Statement, setting out a number of measures to support employment and the sectors most affected by the coronavirus pandemic. A £30 billion (1.4% of GDP) 'Plan for Jobs' package and a further outlay of public services spending brings the government's total direct fiscal support so far to around 8.5% of 2019 GDP, a significant figure. The additional stimulus will help to support the gradual economic recovery that we expect will materialize during the second half of the year; however, the additional measures add further pressure on the UK's fiscal position.

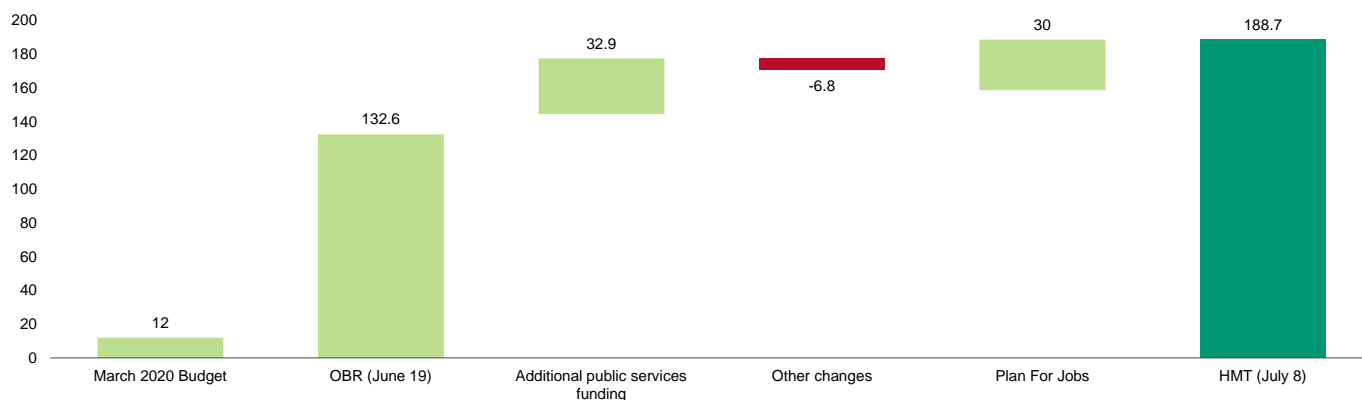
The new measures largely focus on employment retention and support for the hospitality and housing sectors. They include a one-off payment to employers for retaining furloughed employees until the end of January 2021 (the 'Job Retention Bonus' scheme, costing up to 0.4% of GDP), a temporary VAT rate cut for the hospitality sector, and a temporary reduction in the stamp duty threshold in order to spur activity in the housing market. In addition, the Treasury revealed £32.9 billion in new spending on public services that had not previously been accounted for, the majority of which is intended for the provision of health services.

The extensive policy response provides support to the economy against the continuing challenges posed by the coronavirus-induced shock. We forecast a contraction of 10.1% in the UK's GDP for this year, but expect a gradual subsequent recovery on the back of the easing in lockdown measures, with growth rebounding to 7.1% next year. High-frequency indicators suggest that economic activity has gradually begun to recover after reaching a trough in April, when GDP is estimated to have contracted by 20.4%.

Exhibit 1

The UK's policy response has been comprehensive

Direct fiscal support in response to the coronavirus-induced shock, £ billion



Sources: HMT, OMR, Moody's Investors Service

Our forecast [estimates a sharper peak-to-trough contraction for the UK than for any other G-20 economy](#), taking account of our view that lingering uncertainty around Brexit will hold back the recovery in the second half of the year.

The shock will have a lasting impact on the UK's labour market. The effect on unemployment has so far been cushioned by the Coronavirus Job Retention Scheme, through which the government helps to subsidise wages, providing job security and keeping workers attached to their employers. As of early July, 9.4 million jobs have been furloughed under the scheme, equivalent to more than a quarter of the UK workforce, and concentrated disproportionately in the hospitality, arts, and construction sectors. In addition, 2.7 million self-employed workers have also been receiving financial support.

However, with the furlough programme gradually tapering off and coming to an end in October, and with jobs-rich services activities likely to face a slow normalization, we project that unemployment will rise later in the year, averaging 8% across 2020 as a whole. Since mid-March, the number of new Universal Credit welfare benefit claims has risen to around 3.2 million, underscoring the material impact of the shock affecting the labour market. The newly introduced 'Job Retention Bonus' programme aims to limit a cliff edge of unemployment once the furlough scheme ends, but relies on an acceleration in underlying labour demand by the start of next year.

We expect a significant deterioration in the UK's deficit and public debt ratio for this year, given the impact of the economic downturn and the discretionary fiscal policy measures announced to date. According to our baseline scenario, the public debt ratio will likely rise by 24 percentage points of GDP or more relative to 2019 levels. In the autumn, the government will announce the budget for the next fiscal year as well as the spending review, which determines departmental spending limits for the next three years. The autumn budget will be key to providing greater clarity on the government's medium-term fiscal objectives and the future path of government indebtedness.

Mickaël Gondrand, Associate Analyst

Moody's Investors Service
mickael.gondrand@moodys.com
+44.20.7772.1085

Dietmar Hornung, Associate Managing Director

Moody's Investors Service
dietmar.hornung@moodys.com
+49.69.70730.790

Sarah Carlson, CFA, Senior Vice President

Moody's Investors Service
sarah.carlson@moodys.com
+33.1.5330.3353

Yves Lemay, MD-Sovereign Risk

Moody's Investors Service
yves.lemay@moodys.com
+44.20.7772.5512

Morocco's existing fiscal and external buffers mitigate weak fiscal and growth projections in revised budget

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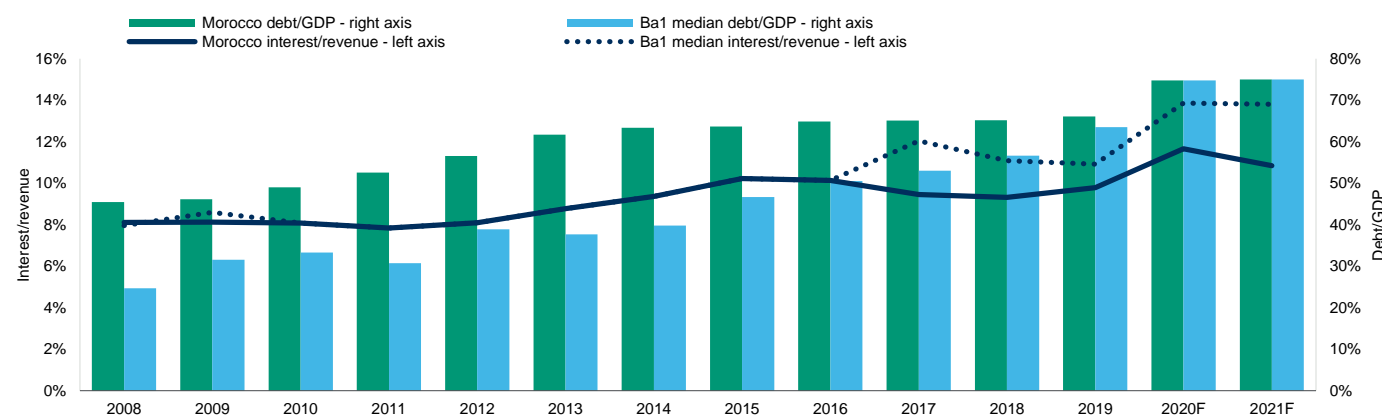
On 6 July, the council of ministers chaired by King Mohammed VI of [Morocco](#) (Ba1 stable) approved a revised budget for 2020, which forecasts an economic contraction of 5%, a fiscal deficit of 7.5% of GDP and a central government debt/GDP ratio that increases to 75% of GDP from 66% in 2019. Although the budget's forecast of weak growth and fiscal projections is credit negative, Morocco's robust debt affordability as measured by interest/revenue in the 10%-12% range over the next two years, will mitigate the deterioration in fiscal strength.

The concomitant spike in the current-account deficit to 7% of GDP that we expect in 2020 (from 4.1% in 2019) implies macroeconomic imbalances akin to the ones last recorded eight years ago. In 2012, negative spillovers from the European sovereign debt crisis added to Morocco's domestic challenges, resulting in the drawdown of fiscal and external buffers that led to the assignment of a negative outlook. In our central scenario, we expect Morocco's credit profile to absorb the sharp, but temporary, economic shock caused by the coronavirus pandemic, despite the increase in the debt/GDP ratio.

In contrast to 2012, Morocco entered the pandemic in a stronger financial position based on three measurements. First, permanently lower oil prices after the energy price collapse in 2014-15 have reduced energy imports and underpinned the implementation of energy subsidy reform, which has contributed to a structural narrowing of both fiscal and external imbalances given Morocco's significant reliance on oil imports. In line with our subdued oil price forecasts, we consider Morocco's current spike in fiscal and external imbalances to be temporary rather than structural.

Second, Moroccan domestic borrowing costs across the yield curve have declined significantly from the peaks reached in early 2014. The fall came despite an approximately 20-percentage-point increase in Morocco's debt/GDP ratio over the past decade to 66% in 2019 and supports Morocco's debt affordability as measured by the ratio of interest to revenue. In 2020, we expect the interest/revenue ratio to increase to almost 12% owing to weaker revenue intake, but remain below the median of Ba1-rated peers (see exhibit).

Morocco's debt/GDP ratio increased in line with peers, but debt affordability is strong



Ba1-rated peers include Guatemala, Paraguay, South Africa and Trinidad and Tobago
Source: Moody's Investors Service

Third, the full drawdown of the \$3 billion (2.6% of GDP) Precautionary and Liquidity Line from the International Monetary Fund on 8 April and access to the World Bank's \$275 million Disaster Risk Management Development Policy Loan, among other sources of external funding, boosted foreign-exchange reserves to \$27.7 billion in June from \$23.7 billion in March. This corresponds to more than

six months of import cover compared with 3.7 months in 2012. Importantly, an external vulnerability indicator in the 60%-70% range over the next two years suggests that upcoming external debt service payments remain covered, even assuming a significant drawdown of foreign-exchange reserves in response to the coronavirus pandemic.

Negative credit pressures on Morocco would increase if the pandemic persists and nonagricultural growth fails to return to the 3.0%-3.5% range recorded before the crisis from the deep recession recorded over the first half of this year. An inability by the government to restore fiscal consolidation starting in 2021 and to stabilize the debt ratio at about 75% of GDP would also be credit negative, especially when taking into account the share of guaranteed external debt held by state-owned enterprises. Such debt accounts for an additional 16% of GDP and is not included in the government's debt/GDP ratio calculation. In our assessment, a persistent deterioration in debt affordability from the current 10%-15% range would not easily reverse and risks leading to a downgrade.

THIS REPORT WAS REPUBLISHED ON 10 JULY 2020 TO INCLUDE A DISCLAIMER ABOUT NON-PARTICIPATING ISSUERS.

As of the date of this report, this Issuer has declined to participate in the Credit Rating process, and has not provided Moody's with access to its books, records and other internal documents. For more information about Non-Participating Rated Entities, see [Moody's Policy for Designating Non-Participating Rated Entities](#).

Elisa Parisi-Capone, VP-Senior Analyst

Moody's Investors Service
elisa.parisicapone@moody's.com
+1.212.553.4133

Matt Robinson, Associate Managing Director

Moody's Investors Service
matt.robinson@moody's.com
+44.20.7772.5635

Camille Chautard, Associate Analyst

Moody's Investors Service
camille.chautard@moody's.com
+971.4.237.9549

Marie Diron, MD-Sovereign Risk

Moody's Investors Service
marie.diron@moody's.com
+65.6398.8310

Australian banks' extension of coronavirus relief measures will support RMBS

Originally [published](#) on 09 July 2020

On 8 July, the Australian Banking Association announced that banks would extend coronavirus-related financial relief measures for borrowers unable to resume loan repayments at the end of six-month payment deferral periods. Banks' extension of relief measures will reduce the risk of losses in Australian residential mortgage-backed securities (RMBS) portfolios because it will lower the likelihood of distressed property sales and severe price drops.

Australian banks have granted six-month repayment deferrals to around 480,000 home loan borrowers for around AUD175 billion of loans, or about 8% of the Australian residential mortgage market.¹ As part of extended relief measures, banks will lengthen payment deferrals for an additional four months for borrowers unable to resume repayments. Alternatively, banks will assist borrowers who cannot resume repayments by restructuring or varying loans, including by converting loans to interest-only payments for a set period or increasing the length of loans. However, this also highlights the significant number of borrowers that have been adversely affected by the current economic downturn, which could convert into risks for Australian RMBS future performance.

The Australian Prudential Regulatory Authority will support banks in extending borrower assistance by lengthening regulatory capital and reporting concessions for loans subject to payment deferrals.

Most of the initial six-month coronavirus-related payment deferrals that Australian banks granted borrowers expire in September and October 2020. The Australian government's Jobkeeper and Jobseeker programs, which are key parts of the government's response to the economic fallout from the coronavirus, are also scheduled to end in late September.²

Had banks not extended relief measures, the expiration of banks' initial repayment deferral arrangements, together with the withdrawal of government support measures, would have significantly increased financial strain on mortgage borrowers. Consequently, distressed property sales would have increased significantly, which would have reduced property values. In this scenario the number of defaulting loans and loss on those loans would increase in Australian RMBS portfolios. Banks' extension of relief measures will reduce this risk.

Banks' extension of borrower support measures will also mitigate risks for RMBS stemming from the economic fallout from a potential second wave of coronavirus cases. The Victorian state government introduced a six-week lockdown for Melbourne and the Mitchell Shire on 8 July after earlier relaxing restrictions, following a recent increase in coronavirus cases (see exhibit). Banks' extended assistance will support Victorian borrowers hurt financially by renewed business activity and mobility restrictions. Borrowers in other states and territories will also have access to the support measures. Uptake will depend on the success of policies to contain the coronavirus and the extent of the economic fallout from the outbreak.

Coronavirus cases are increasing in Victoria

Number of coronavirus cases in Australia, by state and territory

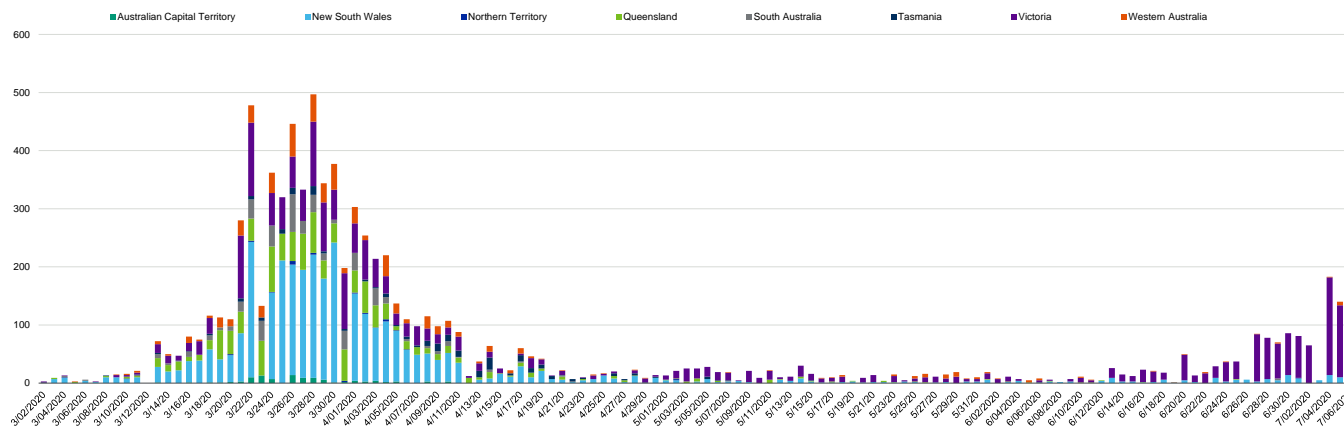


Exhibit excludes 189 historic coronavirus cases reported in crew members on board a ship, which were classified as Australian cases and included in the NSW total on 3 July 2020.

Source: COVID-19 Data Repository by the Center for Systems Science and Engineering at Johns Hopkins University

Endnotes

- 1 Figures as of 19 June. Source: Australian Banking Association.
- 2 The Jobkeeper program assists companies to retain staff amid the coronavirus disruptions by providing a fortnightly payment of AUD1500 for each eligible employee. The programme is currently scheduled to end on 27 September. The Jobseeker program provides a supplementary unemployment payment to unemployed Australians amid the coronavirus disruptions and is scheduled to end in late September.

John Paul Truijens, *VP-Senior Analyst*

Moody's Investors Service
johnpaul.truijens@moodys.com
+61.2.9270.1423

Christopher Chambers, *AVP-Analyst*

Moody's Investors Service
christopher.chambers@moodys.com
+61.2.9270.8119

Ilya Serov, *Associate Managing Director*

Moody's Investors Service
ilya.serov@moodys.com
+61.2.9270.8162

Cyber interference in elections raises sovereign risk

Originally [published](#) on 09 July 2020

Cyberattackers are increasingly targeting the electoral process in many countries, with the potential for impeding policymaking and damaging a sovereign's creditworthiness. Interference tactics include not only technical intrusions that alter results or prevent voting, but also social media disinformation attacks. Governments with strong legislative and executive institutions are best placed to defend the electoral process and mitigate the impact of successful attacks. Still, even sovereigns with the strongest institutions are increasingly likely targets of cyber election interference and are not immune to the related risks.

- » **Increased digitization of elections has led to rising cyber risks for sovereigns that hold popular elections.** Cyber threats to elections have increased as the targets for election hacking have multiplied to encompass voting machines, election information technology infrastructure and social media platforms. The amount of digitization, however, varies around the world.
- » **Cyber election interference has potential to impede policymaking.** Cyber interference that exacerbates sociopolitical tensions or disrupts the stability and functioning of institutions and governance could hinder or delay policymaking. In such cases, credit-negative economic or political developments, or both, could result.
- » **Strong institutions and governance can mitigate, but not eliminate, credit risks related to cyber election meddling.** Through proper planning and resource allocation, sovereigns can prevent many forms of cyber interference and detect and respond more effectively when it occurs. However, strong institutions and governance are not guarantees against cyber election interference.

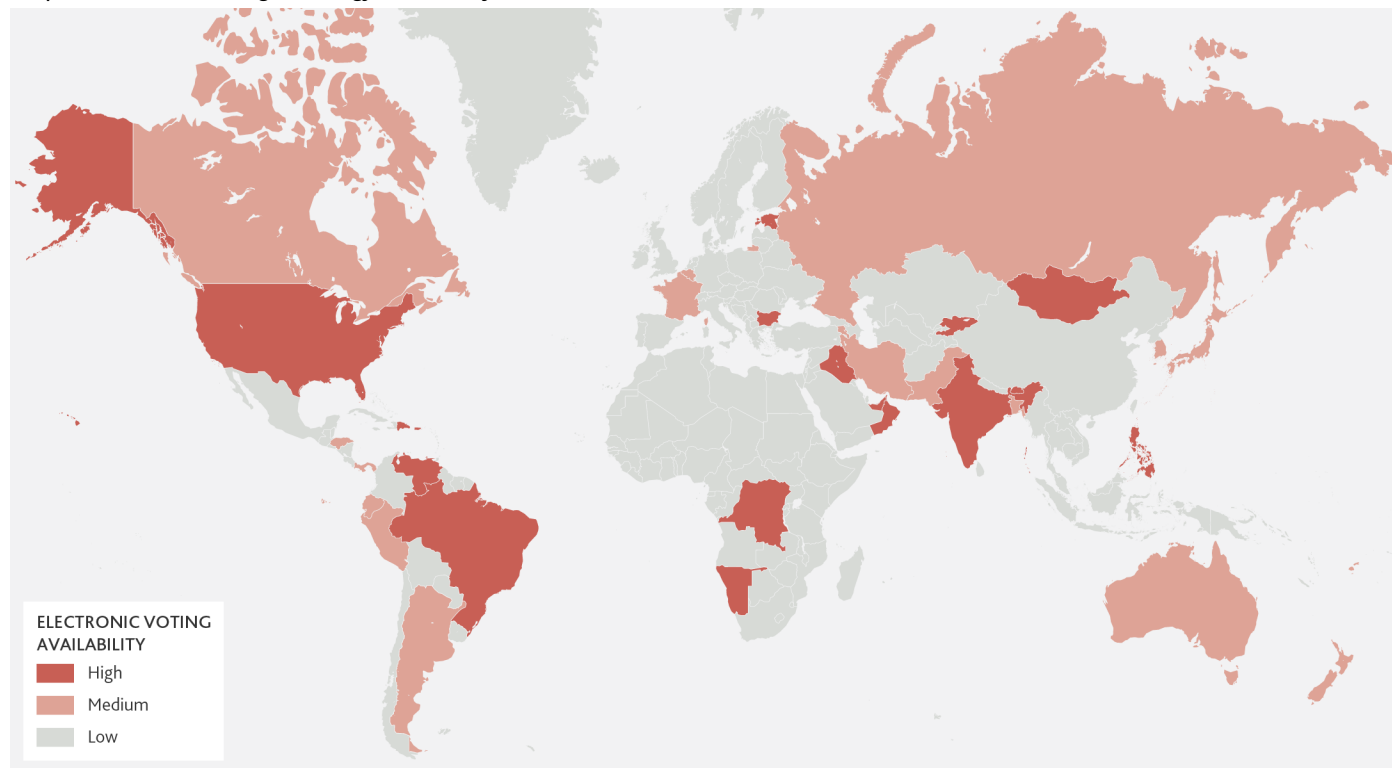
Coronavirus pandemic will disrupt elections in the coming months

The pandemic will pose challenges to elections around the world. Most countries hold in-person elections in which voters cast votes at polling stations, but such large gatherings can also lead to the spread of the virus. Election organizers will wrestle with determining how to adhere to social distancing directives without disenfranchising voters.

Worldwide, at least 67 countries and territories have [postponed](#) planned national and subnational elections because of the pandemic since February 21, while at least 44 went ahead with them. Participation levels have varied, depending largely on countries' success in managing the pandemic. An April 15 parliamentary [election](#) in [Korea](#) (Aa2 stable) achieved turnout of 66.2%, the highest level since 1992, owing in large part to the country's early successes in stemming the spread of the virus. By contrast, in Iran, where the government has struggled in its coronavirus response, the February 21 parliamentary elections drew only 42.6 percent of the electorate, the [lowest turnout](#) since the Iranian revolution in 1979.

From a cyber perspective, the disruption of established processes often enables malicious cyber activity. Initiatives to adopt vote-at-home paper ballot solutions will diminish the risk from electronic vote casting machines. However, unless officials conduct vote tallying by hand, the process will remain vulnerable to cyber interference.

Sovereigns with more electronic voting have the highest exposure to cyber election interference
Adoption of electronic voting technology varies widely



High-exposure countries (red) make national or subnational electronic vote casting/tallying available to all voters. Moderate-exposure countries (pink) make national or subnational electronic vote casting/tallying available to few voters, typically expatriates. Low-exposure countries do not use electronic vote casting/tallying.

* Estonia is the only country to implement universal internet voting.

† Electronic voting in Korea is not used in elections for public office; however, it is used in private elections such as intraparty competitions and elections for heads of agricultural/fisheries/forestry cooperatives in small regional units.

Sources: *Institute for Democracy and Electoral Assistance* and *Moody's Investors Service*

[Click here](#) for the full report.

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PODCASTS AND VIDEOS

Podcasts and Videos

Podcast: [Cyber election interference poses growing risk to sovereign credit](#), 10 July 2020

Leroy Terrelonge of the Cyber Risk group and Bill Foster of the Sovereign team discuss the rising cybersecurity risks related to elections as voting and vote tallying in many countries become more digitized.

Related report: [Cyber interference in elections poses rising risk to sovereigns](#)

Podcast: [Pandemic shines spotlight on credit challenges in Turkey](#), 8 July 2020

Sarah Carlson of the Sovereign team examines Turkey's economic and credit prospects following the coronavirus shock. Plus, Merxe Tudela Carreres of the Model Development group discusses the findings of our new Emerging Markets Financial Conditions Indicators series.

Related report: [Financial conditions stabilise, but pandemic fallout casts shadow on H2 credit prospects](#)

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Editors

Elisa Herr, Jay Sherman, Andrew Bullard, Julian Halliburton and Phil Macdonald

Production Specialist

David Dombrovskis

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