Credit Outlook

6 August 2020

NEWS AND ANALYSIS

Corporates

» Apple's exceptionally strong operating results in difficult quarter reflect diversity and resilience 2

» Alfa's potential spin-off of stake in Nemak is credit negative for the auto parts manufacturer 4

» Diageo's weak results in lockdown and early refinancing temporarily raise leverage 6

» International Airlines' proposed €2.75 billion rights issue is credit positive amid uncertain recovery 8

» LG Chem's second-quarter results are credit positive, but leverage remains elevated 10

» Bayan has better-than-expected second quarter 12

Banks

» Europe's global investment banks reduced operating leverage in second quarter, mitigating higher provisions 14

» Baden-Wuerttemberg savings banks' first-half securities transactions increase sharply, a credit positive 16

» Bank of England publishes new daily Sonia compounded index, helping market participants transition from Libor 18

» Strong underlying second-quarter helps Erste withstand loan loss charges 19

» New consumer-friendly loans will pressure Hungarian banks' net interest margins 21

» Attica Bank's quarterly before-tax loss is credit negative 23

» Bank of Cyprus' sale of nonperforming exposures is credit positive 25

» Russia expands subsidised mortgage programme, supporting banks' earnings 27

Exchanges and Clearing Houses

» London Stock Exchange's sale of MTS and Borsa Italiana stakes would be credit positive if proceeds reduce debt 30

Insurers

» Large Mexican insurers' strong first-half earnings enhance capacity to withstand economic contraction 32

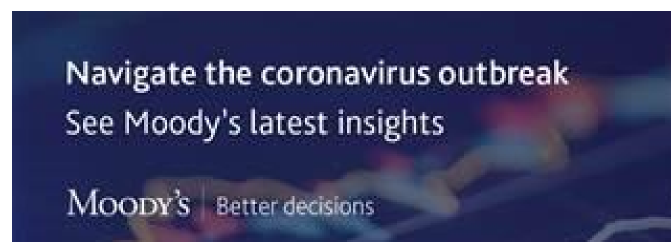
US Public Finance

» California Supreme Court upholds certain pension changes yet maintains protections, a credit positive 34

RECENTLY IN CREDIT OUTLOOK

» Articles in last Monday's Credit Outlook 36

» Go to last Monday's Credit Outlook



See the latest from Moody's: moodys.com/coronavirus

Rate this Research

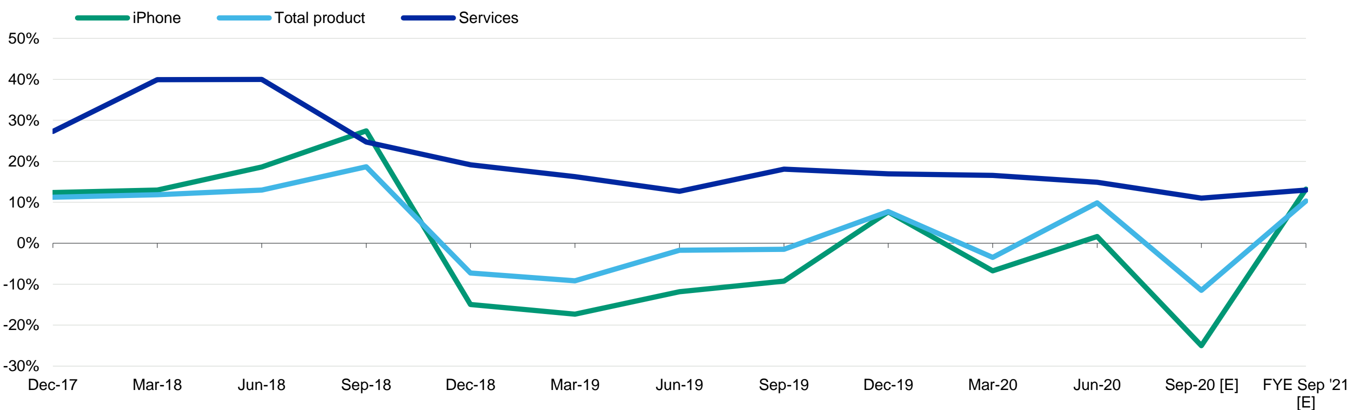
Apple's exceptionally strong operating results in difficult quarter reflect diversity and resilience

Originally published on 31 July 2020

On 30 July, Apple Inc. (Aa1 stable) reported strong operating performance in the fiscal third quarter (ended 27 June) in very challenging conditions, a credit positive. The company's business diversity and resilience was reflected in broad-based year-over-year growth in all product categories and services as well as in all geographic regions.

We expect Apple's loyal and large installed base of users and growth opportunity from 5G iPhone upgrades, wearables and services will increase profits and free cash flow over the next 12-18 months, despite the iPhone's delayed launch weighing on the September quarterly performance (see exhibit).

Delays in iPhone launch will weigh on September quarter's performance, but Apple is poised for an acceleration in revenue growth
Apple's annual revenue growth rates for iPhone, total products and services



[E] = Moody's estimates
Sources: Company filings and Moody's Investors Service estimates

Apple reported 11% revenue growth in the fiscal third quarter over the prior year, and operating profit growth of 13% over the prior year. Operating margins increased by 40 basis points over prior year to 21.9% from a larger mix of higher margin services revenues. Product revenues increased 10%, as the mature Mac grew by 22% and iPad by 31%, driven by robust demand from remote work, learning, entertainment and other use cases in the pandemic. iPhone revenue growth turned positive (2%) after annual declines in five of the last six quarters, benefiting from the strong demand for iPhone SE, which was launched in April 2020, and continuing demand for the iPhone 11 series. Revenue growth in the Wearables, Home and Accessory segment slowed to 17%. The services segment was impacted by the decline in Apple Care and advertising revenues but revenues increased 15% driven by growth in App Store, Music and Cloud services. Apple generated $11 billion in free cash flow (after dividends) in the quarter and had $81 billion in net cash at the of June quarter. If the European Union does not appeal the ruling in favor of Apple by the lower court regarding its tax dispute with Apple, we expect Apple will be able to release $18.3 billion of funds that were restricted from general use.

Apple's strong operating performance in the quarter reinforces our view that the company's broad portfolio of products and services, product innovation, and execution capabilities provide a strong platform for growing profits. During the quarter, Apple navigated supply chain constraints, especially for Mac and iPad products, and store closures for a portion of the time. Apple expects the disruptions will

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.

lead to a delay in the launch of the new iPhone models by a few weeks from the typical late September annual cycle. We expect Apple to unveil its 5G phones this year.

Apple's stronger than expected revenues reflect the company's ability to offset the impact of store closures and shelter-in-place restrictions with increasing demand in its digital channels. The company has effectively deployed trade-in and low-cost financing programs to stimulate demand for devices. In nearly each product and services category, new products contributed to revenue growth. The installed base of iPhone and other devices increased and the total paid subscriptions for services grew sequentially by 35 million in the quarter to over 550 million. Apple's large installed base, its strong product satisfaction ratings and growing ecosystem of tightly integrated hardware and services provide a platform to cross- and up-sell products and services.

The weak economic conditions and risk of a prolonged and uneven recovery continue to pose significant challenges for Apple. We expect the delay in the launch of new iPhones and continuing economic uncertainty will weigh on operating performance and revenues could decline by about mid-single digits in fiscal fourth-quarter 2020, although revenues would still be up by 4% for the full fiscal year 2020. We expect revenue growth to accelerate to 11% and approximately $50 billion in free cash flow in fiscal 2021. The revenue growth opportunity from the 5G upgrade cycle over time, growing penetration of Apple Watch and Air Pods in Apple's user base and services support our revenue growth outlook. Apple's anticipated 5G iPhones could have large upside potential but the realization of the opportunity will depend upon the pricing of the products, the speed and extent of deployment of low-latency versions of 5G networks globally, and availability of a large number of software applications that exploit the 5G capabilities and entice users to the new devices.

Raj Joshi, ***VP-Sr Credit Officer***
Moody's Investors Service
raj.joshi@moodys.com
+1.212.553.2883

Lenny J. Ajzenman, ***Associate Managing Director***
Moody's Investors Service
lenny.ajzenman@moodys.com
+1.212.553.7735

Alfa's potential spin-off of stake in Nemak is credit negative for the auto parts manufacturer

Originally published on 03 August 2020

On 31 July, Mexican conglomerate Alfa, S.A.B. de C.V. (Baa3 stable) announced it will hold an extraordinary shareholders' meeting to present a proposal for the spin-off of its subsidiary Nemak, S.A.B. de C.V. (Ba1 negative). Alfa holds a 75% stake on Nemak and the balance is traded in the Mexican stock exchange. If approved, the spin-off of Nemak will be credit negative for the auto parts manufacturer because it will lose the implicit support of Alfa, its parent company.

According to Alfa, following the spin-off, Nemak will have the same current shareholders as Alfa, but it is still unclear whether shareholders will be able or willing to provide future support to Nemak. Even if some form of support continues, it may not be as strong or readily available as what Alfa currently provides. We acknowledge that Nemak has its own committed and advised credit facilities to finance its working capital requirements and to support its liquidity and the company has not needed financial support from its parent company durng the coronavirus pandemic.

We expect Nemak will continue to have strong corporate governance practices, even if spun-off from Alfa, as it follows the Code of Best Corporate Practices set by the Mexican stock exchange. In addition, Nemak's internal policies include maintaining a maximum net leverage ratio of 2.5x (net debt/EBITDA); a prudent dividend policy to maintain its leverage policy; the use of derivatives for hedging purposes with different levels of approval (CEO, finance committee or board of directors) depending on the size of the notional; the use of committed credit facilities to support liquidity; and a board of directors that includes at least 25% independent members. Furthermore, Nemak's senior management has been conservative and Nemak and Alfa will share the same chairman, which in our view suggests continuity in corporate governance practices.

Nemak's operations are closely linked to the performance of the automotive industry in North America and Europe, where about 90% of its revenue is derived. We have a negative outlook for the global automotive manufacturing industry. We forecast light vehicle sales in the US to drop by 25% in 2020 and to recover posting a 16.2% growth in 2021. We expect Western European auto unit sales to plunge 30% in 2020 amid a projected 6.5% contraction in euro area GDP and to rise 17.5% in 2021. While auto production has restarted in the region, dealerships in some countries remain closed and demand is likely to remain very weak.

Accordingly, we expect Nemak's revenue and EBITDA to decline in 2020 and recover in 2021, in tandem with the automobile industry and economy recovery. The company has done efforts to reduce its operating costs in face of the coronavirus outbreak. Still, we estimate its EBITDA margin will drop to around 13% in 2020 and gradually return to its historical levels above 14% in 2021.

The company's credit metrics and EBITDA are affected by the coronavirus, which prompted the temporary closure of manufacturing facilities around the world. In March the company withdrew around $500 million from its credit facilities to strengthen its liquidity. As a result, Nemak's adjusted gross debt/EBITDA increased to 4.9x as of 31 March 2020, up from 2.9x as of 31 December 2019. Going forward, we estimate Nemak will reduce its adjusted gross debt/EBITDA below 4.0x by the end of 2021 from higher EBITDA generation and debt reduction. Interest coverage will improve as well with adjusted EBITDA/Interest expense reaching around 6.5x in 2021; up from an expected 4.5x in 2020.

Nemak produces aluminum cylinder heads, engine blocks, transmission components, and structural and electric vehicle components for light vehicles manufactured by more than 50 customers worldwide, with 60% of its sales volumes coming from the Big Three US carmakers (Ford Motor Company, General Motors Company and Fiat Chrysler Automobiles N.V.). Nemak's products are sold mainly in North America and Europe, which account for 91% of its consolidated revenue. Nemak reported revenues of $3.2 billion over the twelve months ended June 30, 2020.

Alfa is one of the largest publicly traded business groups in Latin America. The company has five lines of business, including petrochemicals, high-tech aluminum auto components, refrigerated food, telecommunications, and exploration and exploitation of natural gas and hydrocarbons. Alfa reported revenue of $15.9 billion over the twelve months ended June 30, 2020.

Alonso Sanchez, *VP-Senior Analyst*
Moody's Investors Service
alonso.sanchezrosario@moodys.com
+52.55.1253.5706

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

Diageo's weak results in lockdown and early refinancing temporarily raise leverage

Originally published on 04 August 2020

On 4 August, UK-based spirits maker Diageo Plc (A3 stable) reported an 11% decline in EBITDA to £4.3 billion for the fiscal year that ended 30 June 2020, driven by the lockdown measures related to COVID-19 and an increase in gross debt to £17.3 billion[1], from £14.5 billion at 31 December 2019, reflecting recent bond issuance to strengthen liquidity. The increase in debt raised its Moody's-adjusted leverage to around 4.2x from 3x in December. The higher leverage is credit negative, but we expect it to decline gradually as ontrade sales recover from the restrictions placed on restaurants and bars in recent months.

As we previously expected, the increase in leverage based on Moody's-adjusted gross debt was partly driven by lower EBITDA, but also by the higher gross debt resulting from the issuance of £2 billion (equivalent) of bonds in April as a precautionary measure to strengthen liquidity, with £3.3 billion cash on balance sheet as at 30 June, up from £950 million at the end of December. Overall, Diageo issued around $6 billion of bonds in fiscal 2020 while repaying only $1.0 billion. The company has taken other precautionary measures to strengthen its liquidity, including pausing share buybacks and putting in place an additional committed credit facility of £2.5 billion, which was undrawn as of 30 June.

We expect Diageo's leverage will further increase in fiscal 2021 and remain well above the 2.75x-3.25x range expected for the A3 rating, but to recover gradually as trade restrictions on restaurants and bars are eased and debt maturities repaid. The company has already repaid $696 million of bonds in July and will likely use some of its excess cash , thus lowering its gross debt. The next bond maturities are €775 million due in November 2020, €900 million in October 2021 and $1 billion in May. As long as uncertainty over market conditions remains high, we expect Diageo to maintain strong liquidity and, therefore, no improvement in leverage on a gross basis. In these circumstances, we will also look at leverage on a net debt basis: indeed, leverage is around 3.6x if measured on a Moody's adjusted net debt basis. Resuming share buybacks before market conditions normalise would be credit negative.

The decline in Diageo's reported EBITDA was better than our forecast of a 20% drop and was in line with the recent announcement made by Pernod Ricard S.A. (Baa1 stable).[2] The main reason for Diageo's relatively milder than expected decline was the resilience of the North American business, which accounts for over a third of group net revenue and around half of operating profit. While sales in bars and restaurants (ontrade, around 20% of sales in the region) collapsed in the second half of the fiscal year, Americans consumed more at home (offtrade), resulting in net revenue rising 2% for the full year on a like-for-like basis. Since May, ontrade premises have been re-opening in certain states, although lockdown measures have since been re-introduced in some states.

Other regions were more adversely affected by the restrictions because alcoholic drinks consumption is geared more toward ontrade than in North America. In Europe, the split is around 50:50, while consumption in China mostly takes place during social occasions (ontrade/banqueting). Overall, net revenue declined between 12% in Europe and Turkey (combined share of 22% of net revenue) and 16% in the Asia-Pacific region (19%) on a like-for-like basis, with Africa and South America in between. The sale of alcoholic drinks has been banned – temporarily – in a few jurisdictions, including South Africa, India and some States in Mexico. We estimate that the combined revenues of Diageo in these countries represented slightly over 10% of its consolidated net revenues in previous years.

While Diageo's profit was relatively resilient, the wine and spirits subsidiaries of LVMH Moet Hennessy Louis Vuitton SA (A1 stable), in which Diageo owns a 34% stake, saw profit decline by a third in the second quarter of 2020 because of the challenges caused by the coronavirus pandemic, after a 14% decline in the first quarter. Although these operations are equity accounted in Diageo's accounts and, therefore, their profit is not included in Diageo's EBITDA and debt metrics, the value of the stake supports Diageo's credit profile and a sharp decline in their profitability will be credit negative if prolonged for a sustained period.

Endnotes

1 Adjusted gross debt including post employment benefit liabilities.

2 On 22 July, Pernod stated that it expects a 15% decline in operating profit for fiscal 2020 ended 30 June, as compared to its previous expectation of a 20% decline.

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

International Airlines' proposed €2.75 billion rights issue is credit positive amid uncertain recovery

Originally published on 04 August 2020

On 31 July, International Consolidated Airlines Group, S.A. (IAG, Ba1 negative) announced that it proposes a capital increase of up to €2.75 billion, to be executed by a rights issue. The company's largest shareholder, Qatar Airways, which owns a 25.1% stake, has provided an irrevocable undertaking to take up its rights in full. The capital increase would be credit positive and support the company's liquidity while reducing net leverage amid material uncertainty about the coronavirus pandemic's evolution, government responses to it, future travel restrictions and the recovery of passenger demand.

IAG also announced its first half results, which were broadly in line with our expectations. Second-quarter passenger volume was down 98% from second-quarter 2019. After mitigating actions and furlough schemes, the company recorded a €1.9 billion first-half operating loss before exceptional items, marginally exceeding our forecasts. In addition the company incurred exceptional charges of €2.1 billion, including charges for over-hedging of fuel and foreign currencies and for fleet impairments on aircraft retirements.

First-half free cash outflow, before raising additional financing, was around negative €3.5 billion, around €700 million worse than our forecast, principally because of the short-term timing of cash costs of over-hedging. Liquidity as at 30 June was €8.1 billion and will be boosted by this month's £750 million cash inflow from American Express Company (A3 negative), relating to the renewal of IAG's global partnership and which includes a substantial component of advance sale of air miles. The company made a small £20 million provision for its fine related to the theft of customer data from British Airways' website in 2018: the small provision for the proposed fine of £183 million indicates potential for a positive outcome in the company's appeal to reduce the fine.

IAG said that its proposed rights issue size reflects a downside case scenario that assumes available seat kilometers (ASK) 66% below 2019 levels in 2020 and 35% below in 2021. The company expects only a slow recovery in load factors from current low levels and as a result passenger volumes would be further below forecast ASK. The assumptions are relatively close to our downside case scenario modeling for IAG as presented in our credit opinion of 17 June.

Amid substantial ongoing uncertainties because of the coronavirus pandemic, there are material risks to passenger volume forecasts, particularly given IAG's exposure to international and long-haul flights and the business travel market. Around 67% of the company's capacity is for flights outside domestic and intra-European travel. For British Airways, Plc (Ba1 negative), IAG's largest operating subsidiary, this figure is around 80%. The company said that it expects structural change for the business travel sector. This segment may not recover fully from the crisis as corporate travel patterns evolve. IAG's long haul forward bookings are currently around 80% below prior year, demonstrating the challenges in achieving recovery forecasts and the company's aim the return to operating cash flow breakeven by the fourth quarter of this year.

In addition the company is undertaking a substantial restructuring, including potentially up to 13,000 redundancies at British Airways, and other headcount reductions elsewhere across the group. There are risks of industrial unrest and planned cost reductions may not be achieved by the time the UK government's furlough scheme ends in October 2020.

The proposed new equity financing, the cash receipt from American Express and an additional €380 million aircraft sale and leaseback completed in July would increase the company's pro forma liquidity as at 30 June by nearly 50% to around €12 billion. The proceeds from the proposed equity would cover approximately 14 weeks additional operating cash costs of around €200 million per week. The additional liquidity would effectively increase the company's ability to withstand an extended period of renewed lockdown, depending on the extent of cash refunds and financing for new fleet purchases from 2021. Deferred revenue, comprising both advance sales and customer loyalty programmes, was €4.6 billion at 30 June 2020, and 2021 forecast capital expenditure is €1.9 billion.

We estimate that the new equity financing will reduce forecast leverage by 0.5x-0.7x, with Moody's- adjusted debt/EBITDA in 2023 of around 3.2x under our faster recovery scenario and 4.8x under our slower recovery scenario. Despite the positive effects of the proposed rights issuance, the challenging and unpredictable nature of the operating environment, and longer-term risks to business travel in particular, still leaves IAG's rating relatively weakly positioned, although the additional financing materially improves leverage and liquidity.

Martin Hallmark, ***Senior Vice President***
Moody's Investors Service
martin.hallmark@moodys.com
+44.20.7772.1953

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

Yijie Iris Liu, ***Associate Analyst***
Moody's Investors Service
yijie.liu@moodys.com
+852.3758.1532

LG Chem's second-quarter results are credit positive, but leverage remains elevated

Originally published on 03 August 2020

On 31 July, LG Chem, Ltd. (Baa1 negative) reported improved operating results for second quarter 2020, a credit positive. Still, we expect the company's financial leverage to remain elevated over the next one to two years because of increased debt to fund large capital spending.

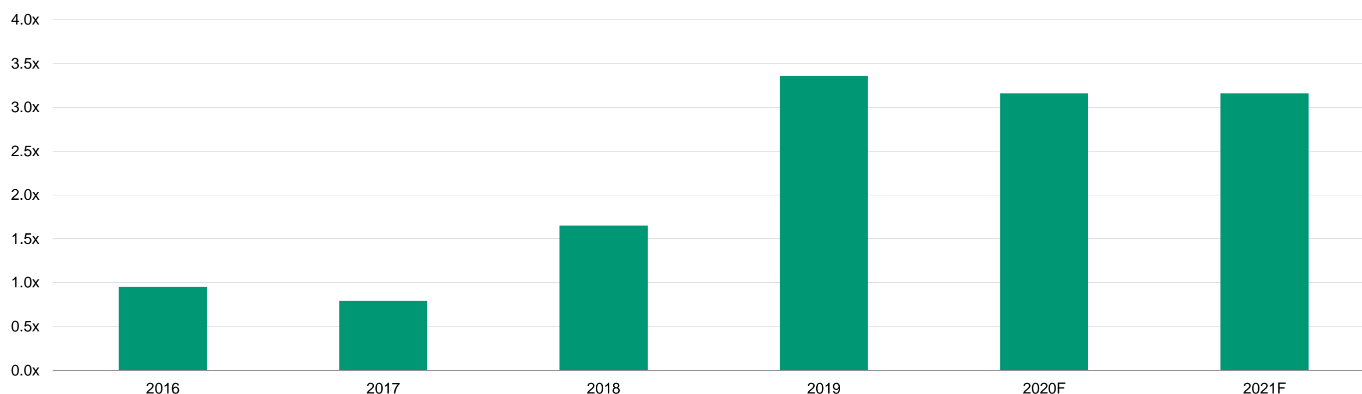
LG Chem's consolidated operating income more than doubled to KRW572 billion in second quarter 2020 from KRW247 billion during the same period a year earlier. Improved battery and core petrochemical business supported the significant increase in earnings. Specifically, battery business operating income was KRW156 billion versus an operating loss of KRW128 billion during the same period a year ago. The improvement reflects better production yield at its electric vehicle (EV) battery plant in Poland and robust sales for energy storage system battery products. At the same time, the company's core petrochemical business benefited from low feedstock costs amid low oil prices and recovery in demand for acrylonitrile butadiene styrene (ABS).

LG Chem's reported debt grew to around KRW11.9 trillion as of the end of June 2020 from around KRW8.4 trillion at year-end 2019 because of high capital spending and working capital deficits. The increase in reported net debt was more moderate at around KRW8.5 trillion from around KRW6.5 trillion during the same period given the higher cash balance.

We expect LG Chem's adjusted EBITDA to grow by about KRW1 trillion per annum during 2020-21, largely driven by its battery business. The rebound in earnings in its battery business will be underpinned by better economies of scale supported by a rapid increase in sales, improving operational efficiencies and, for 2020, the absence of the one-off losses incurred in 2019.

Additionally, we expect LG Chem's adjusted debt to increase to KRW14.0 trillion-KRW15.0 trillion by year-end 2021 from KRW9.4 trillion at year-end 2019 because of large capital spending. Consequently, we expect LG Chem's adjusted debt/EBITDA to stay elevated at 3.0x-3.3x in 2020-21, only a slight improvement from 3.4x in 2019, and a weak ratio for its Baa1 rating category, which is reflected in the LG Chem rating negative outlook (see exhibit).

LG Chem's financial leverage will remain weak for its rating category over the next one to two years
Adjusted debt/EBITDA



Sources: Moody's Financial Metrics™ and Moody's Investors Service forecasts

LG Chem has been in a heavy investment cycle since 2018 and we expect its capital spending to stay high at least until 2021. Specifically, LG Chem aims to expand its EV battery capacity in four countries (Poland, China, Korea and the US) to around 100 gigawatt hours (GWh) and 120 GWh by year-end 2020 and 2021, respectively, from about 70 GWh as of year-end 2019. The company is also building a new naphtha cracking center, which is planned to commence operation in 2021.

In response to such heavy capital spending, the company announced in June 2020 the sale of its liquid crystal display (LCD) polarizer business, which should partly offset the pressure on cash flow. We also expect LG Chem to experience little difficulty in raising the incremental debt because the company maintains strong access to the funding market.

Wan Hee Yoo, ***VP-Sr Credit Officer***
Moody's Investors Service
wanhee.yoo@moodys.com
+852.3758.1316

Keun Woo (Chris) Park, ***Associate Managing Director***
Moody's Investors Service
chris.park@moodys.com
+852.3758.1366

Gary Lau, ***MD-Corporate Finance***
Moody's Investors Service
gary.lau@moodys.com
+852.3758.1377

Bayan has better-than-expected second quarter

Originally published on 04 August 2020

On 30 July, Indonesian thermal coal miner Bayan Resources Tbk (P.T.) (Ba3 stable) announced stronger-than-expected second-quarter earnings, with reported EBITDA of $71.3 million, far more than its budgeted EBITDA of $25.5 million.

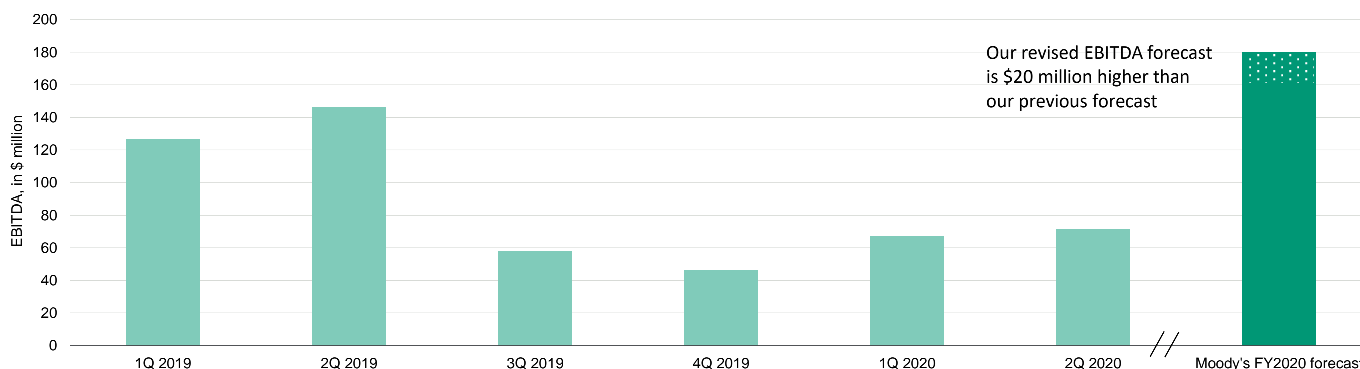
The credit-positive second-quarter results reflect higher sales volumes and lower production costs, despite a challenging operating environment that included low coal prices and a six-week suspension of operations at its key operating mines related to the coronavirus.

Average water levels at the river near its Tabang mines, which is used as the principle form of transport to ship coal out of Tabang, were better than in recent quarters. This allowed Bayan to sell more coal than it expected. The company sold 9.8 million tons of coal in second-quarter 2020 compared with 8.25 million tons that were budgeted for the quarter. The higher sales volume helped to considerably reduce costs on a unit cost basis to $30.70 per ton against its budgeted cost of $34-$35 per ton.

Its strong second quarter results means that we have increased our 2020 EBITDA projections for Bayan by 12.5% to around $180 million from our previous estimate of around $160 million (see Exhibit 1).

Exhibit 1

We expect Bayan to generate $180 million EBITDA in 2020



Sources: Company and Moody's Investors Service estimates

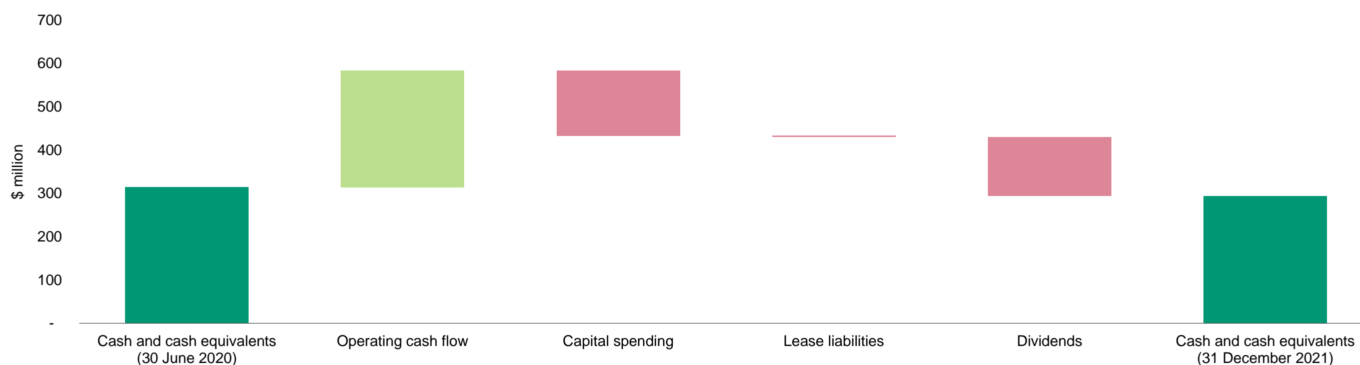
We expect Bayan to maintain its credit profile despite low coal prices, which have weakened to their lowest level since 2016. Around 68% of Bayan's 32.6 million tons of committed coal sales for 2020 have been contracted at an average fixed price of $38.80 per ton. This will help protect Bayan's earnings if coal prices continue to decline this year.

We expect Bayan to maintain leverage, as measured by adjusted debt/EBITDA, of 2.0x-2.2x over the next 12-18 months. This allows the company considerable capacity under its downward rating trigger of leverage approaching 3.5x.

We also expect Bayan to maintain very good liquidity. The company increased its cash balance by $42 million during the second quarter to $314 million as of 30 June 2020. Its cash, along with projected cash flow from operations, will be sufficient to meet the projected capital spending, dividends and scheduled debt maturities through 31 December 2021 (see Exhibit 2).

Exhibit 2

Bayan has sufficient cash sources to meet cash uses through December 2021



Source: Moody's Investors Service estimates

The company also has around $325 million of undrawn funds under committed working capital facilities with four banks that supplement its liquidity.

Our liquidity analysis does not account for any large cash outflow arising from an adverse court ruling on its ongoing legal dispute with former joint venture partners. Bayan has not taken any provision against this case as yet. According to the company, a final ruling on this case is likely toward the end of 2021. An adverse ruling that will result in significant cash outflow would weaken Bayan's credit quality.

Maisam Hasnain, CFA, ***AVP-Analyst***
Moody's Investors Service
maisam.hasnain@moodys.com
+65.6398.8325

Cathy Lu, ***Associate Analyst***
Moody's Investors Service
cathy.lu@moodys.com
+65.6398.8313

Ian Lewis, ***Associate Managing Director***
Moody's Investors Service
ian.lewis@moodys.com
+65.6311.2676

Europe's global investment banks reduced operating leverage in second quarter, mitigating higher provisions

Originally published on 03 August 2020

On 3 August, HSBC and Société Générale reported second-quarter results, the last quarterly reports from the seven European global investment banks (GIBs), which also includes Barclays, BNP Paribas, Credit Suisse, Deutsche Bank and UBS. In this report, we provide key take-aways from their results. All figures relate to second-quarter 2020, and comparisons are made to second-quarter 2019 unless otherwise indicated.

The seven European GIBs reported an aggregate adjusted pretax profit of $10.6 billion in the second quarter, down 39% from $17.4 billion a year earlier. The decrease from second-quarter 2019 reflects the continued effects of the coronavirus pandemic, which drove sharply higher credit impairment charges, mainly through more severe macroeconomic scenarios, and also reduced revenue in the traditional interest- and fee-earning businesses. However, the European GIBs' second-quarter aggregate pretax earnings was 16% higher than in the first quarter, as operating leverage improved 3% because of reduced operating costs. The regulatory capital ratio improved or remained stable for all banks. Liquidity remained strong and well above regulatory requirements for all banks.

Credit impairment charges more than quadrupled because of the negative coronavirus-led economic shock. Aggregate loan loss charges rose 321% from a year ago and 7% from the previous quarter when pandemic-related lockdowns started, mostly reflecting more severe macroeconomic projections than initially estimated in the first quarter. However, the European GIBs reported lower combined credit charge increases and reserve builds than their US peers (up fivefold from second-quarter 2019 and 21% sequentially) because of differences in accounting standards, macroeconomic assumptions and loan book mix. The asset quality of the European GIBs showed only very modest deterioration.

Operating leverage improved despite revenue decline, as banks' reduced operating costs. Revenue decreased 4%, reflecting a 14% drop in retail and commercial banking revenue because of lower volumes during social and economic lockdowns, and margin pressure. Capital markets revenue grew 29%, driven by higher client financing needs and widened bid-offer spreads in fixed-income sales and trading. Aggregate operating costs decreased 7%, lowering the average cost to income ratio to 70% from 72% a year ago.

Regulatory capital ratio increased; liquidity remains strong. The average Common Equity Tier 1 (CET1) capital ratio of the European GIBs increased around 40 basis points (bps) to 13.3% during the quarter, back to its year-end 2019 level and well above the Maximum Distributable Amount requirement for all seven banks. The increase in average CET1 was broadly in line with that of US GIBs. For the European GIBs, the improvement stemmed mainly from Capital Requirement Regulation (CRR) “quick fix” measures by central banks during the quarter, as well as the dividend ban decided earlier by UK and European authorities. For the US GIBs, the improvement mainly stemmed from share buyback suspensions and management of risk-weighted assets. Liquidity levels remain high: the European GIBs' average liquidity coverage ratio (LCR) was up to 163% from 148% in first-quarter 2020.

Click here for the full report.

Olivier Panis, *VP-Sr Credit Officer*
Moody's Investors Service
olivier.panis@moodys.com
+33.1.5330.5987

Maxwell Price, *Associate Analyst*
Moody's Investors Service
maxwell.price@moodys.com
+44.20.7772.1778

Laurie Mayers, *Associate Managing Director*
Moody's Investors Service
laurie.mayers@moodys.com
+44.20.7772.5582

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

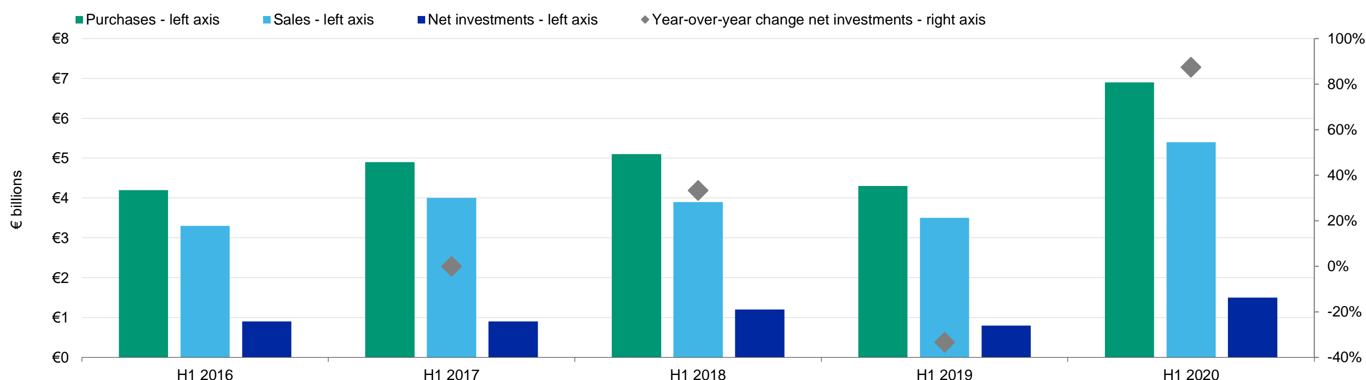
Baden-Wuerttemberg savings banks' first-half securities transactions increase sharply, a credit positive

Originally published on 05 August 2020

On 29 July, the regional savings banks association of Baden-Wuerttemberg, Sparkassenverband Baden-Wuerttemberg (SVBW, Aa2 negative[1]), aggregate first-half 2020 results for its 51 member banks showed a strong increase in customers' securities investment transactions. The increased transactions support the banks' fee and commission income and lowers their long-term dependence on net interest income.

In this year's first half, saving bank customers increased their securities transactions by 58% to €12.3 billion and their net investments by 88% to €1.5 billion, up from €0.8 billion in first-half 2019 (see exhibit). If we assume an average 1% standard transaction fee, it results in €150 million fee and commission income, up from €80 million in first-half 2019.

Net investments of savings banks' customers increased by 88% in the first half of 2020



Source: Company data

Additionally, the number of securities accounts increased by 2.6% to 930,000 in the first six months of 2020, or 5.2% annualized growth. The stronger absolute numbers of securities accounts show that higher net investments partially reflect new clients in this type of investment and not just existing clients' increased activity in response to the coronavirus pandemic. As of June 2019, SVBW said that a fifth of its customers had a securities account. The increased penetration among savings banks clients supports the sustainability of fee income because of recurring income from order and subscription fees.

Even though there are no interim financials available for the entire German savings banks sector, Sparkassen-Finanzgruppe (Aa2 negative, a2[2]), recently published interim results of other regional savings banks associations in Germany show similar trends in customers' securities net investment volumes. For example Sparkassenverband Westfalen-Lippe (SVWL) reported net investment volumes increased by 115% to €0.9 billion in the first half of 2020, up from €0.4 billion compared to first-half 2019. For SVWL, the first-half 2020 increase in investment funds (up 135% year over year to €0.6 billion) and shares (up 356% year over year to €0.3 billion) drove the increase in net investments while net investments in fixed-income securities fell to -€18 million (down 119% year over year). The savings banks association of Lower Saxony (SVN) also reported net investment increased by 130% to €1.0 billion in the first half.

In addition to positive development in securities investment transactions, clients of the savings banks in Baden-Wuerttemberg increased deposits in current and savings accounts by 5.4% or €7.7 billion to €151 billion versus the year-ago period. Deposits of small and mid-sized enterprises and corporates increased by 10% year over year to €25 billion and retail deposits by 6% to €114 billion, showing that customers were hesitant to spend money during the lockdown.

While SVBW's forecasts show that the additional fee and commission income from more securities transaction will be insufficient to mitigate the negative effects of persistently ultra-low interest rates and expected increases in loan loss provisions in response to coronavirus, we expect the net fee and commission income to become a more sustainable and important income source for the savings banks in Germany, a longer term positive development.

Endnotes

1 The rating shown is Sparkassenverband Baden-Wuerttemberg's issuer rating.

2 The rating shown is Sparkassen-Finanzgruppe's corporate family rating and Baseline Credit Assessment.

Christina Holthaus, *Analyst*
Moody's Investors Service
christina.holthaus@moodys.com
+49.69.70730.721

Alexander Hendricks, CFA, *Associate Managing Director*
Moody's Investors Service
alexander.hendricks@moodys.com
+49.69.70730.779

Bank of England publishes new daily Sonia compounded index, helping market participants transition from Libor

Originally published on 04 August 2020

On 3 August, the Bank of England (BoE) published a daily compounded index for its overnight Sterling Overnight Index Average (Sonia) interest rate, and the data series made available goes back to 23 April 2018. The publication of the index is another major milestone in the transition of the sterling market away from the London interbank offered rate (Libor) to Sonia by the end of 2021, when Libor will be discontinued.

Given the importance of Libor as a reference in financial contracts globally, and the risks associated with the transition to new risk-free benchmarks globally, authorities' steps to accelerate and facilitate the adoption of new benchmarks such as Sonia are credit positive. Such steps should reduce risks associated with the transition by market participants such as lenders, borrowers and investors.

The publication of a daily Sonia compounded index will help market participants use a consistent tool to calculate compounded interest rates. This in turn should accelerate the adoption of the new benchmark and add liquidity to this market, with the change in index between dates being available to calculate interest payment payable over that period. It will also give confidence to borrowers that their contracts, when transitioning to new benchmark, will use a standardized and consistent, publicly available daily index. Doing so should limit legal and conduct risks for lenders when they switch contracts, particularly loans, to Sonia.

We expect a gradual transition of Sonia-referencing loans in the coming months. With less than 18 months left before the demise of Libor, the Bank of England has indicated that lenders will not be able to use Libor in new loans starting at the end of March 2021. The BoE will also start applying a gradual haircut increase on Libor-linked collateral starting 1 April 2021, up to 100% at the end of 2021, at which point Libor-linked assets will not be eligible as collateral in the Sterling Monetary Framework. That schedule means that banks not transitioning quickly enough are at risk of reducing their capacity to use the BoE's refinancing window.

Although those milestones were slightly modified from an initial target of third-quarter 2020 because of the coronavirus crisis, they are meant to accelerate the transition of UK market participants, which have lagged in adopting Sonia in derivatives and debt issuances. In the past month, exchange houses began publishing indicative term Sonia rates based on Sonia-indexed overnight interest rate swaps.

Risks associated with the transition will be numerous if not tackled through a transition program and continuity plan. Among the key challenges for banks are operational risks related to the adaptation of systems and models for new benchmarks, term and spread adjustments between LIBOR and risk-free overnight rates like Sonia, and financial and valuation risks. For banks' loan portfolios, the key risks are legal and conduct risks given the large volume and diversity of contracts to amend with market-accepted fallback provisions to transition to Sonia. Lenders' and borrowers' access to a transparent, standardized and consistent Sonia-compounded index will reduce this type of risks.

Olivier Panis, ***VP-Sr Credit Officer***
Moody's Investors Service
olivier.panis@moodys.com
+33.1.5330.5987

Strong underlying second-quarter helps Erste withstand loan loss charges

On 31 July, Erste Group Bank AG (Erste, A2/A2 positive, baa1[1]) reported a second-quarter 2020 net profit of €111.5 million[2], despite massive provisioning. Erste's strong operating result of €805 million in second-quarter 2020 includes provisioning of €613.7 million, equivalent to 148 basis points (bps) of gross loans for potential credit losses.

The bank's ability to withstand credit risk costs amid the corornavirus-related economic downturn is credit positive, reflecting the bank's capacity to digest increased provisioning without impairing its capital position.

Despite credit losses comparable to those of the 2008-09 global financial crisis putting the bank's profitability under meaningful pressure, the bank remained profitable in a very adverse economic environment. The bank's guidance of 65-80 bps for loan losses in 2020 is covered with 82 bps of booked charges in the first half of 2020, potentially giving Erste more stable profitability in the second half if the economic environment does not deteriorate beyond the bank's current expectations of a 4.5% GDP contraction in Austria and up to a 9% GDP contraction in Central and Eastern Europe (CEE).

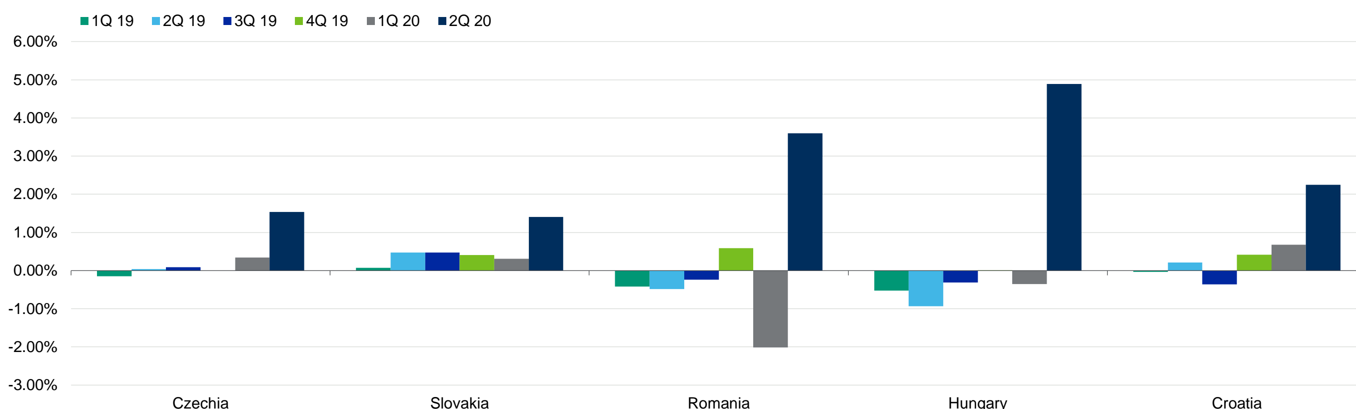
The bank's capital strength is visible in its Common Equity Tier 1 (CET1) ratio of 14.3% as of first-half[3], up from 13.7% at year-end 2019, which largely reflects lower regulatory risk weights for its portfolio of loans to small and mid-size enterprise. Erste's economic capital buffers remained stable despite the more adverse environment. Accumulated loan loss reserves equalled 91.1% of nonperforming loans (NPLs), which was 2.4% of gross loans as of 30 June 2020), provides an additional buffer for the bank to absorb the expected deterioration in asset quality.

Participation in the loan repayment moratoriums, particularly across the CEE, has been lower than the bank's initial expectations, Still, NPL ratios benefit from the payment holidays as these loans are not classified as nonperforming or even automatically as an increased risk exposure. We expect asset quality deterioration to become apparent by year end and in early 2021, as indicated by the sharp increase of riskier Stage 2 loans, which almost doubled to 16.1% of Erste's loan-book as of June 2020.

A surge in credit costs and lower exchange rates reduced revenue contributions from Erste's CEE subsidiaries, which comprised 46% of the bank's assets as of June 2020 and 40% of profit in the second quarter down from 66% in 2019. Nevertheless, Erste's main CEE subsidiaries remained profitable demonstrating their capacity to absorb high credit costs.

The loan loss provisions of the bank's largest CEE subsidiary Ceska Sporitelna a.s (A1 stable, a3) in the Czech Republic increased to 1.54% of gross loans in the second quarter from 0.04% in the same period the prior year. In Slovakia, Slovenska Sporitelna a.s (A2 stable, baa2) also had increased second-quarter credit costs at 1.41% of gross loans, up from 0.47% in the year-earlier period (see exhibit). The steepest increases were at the bank's smaller subsidiaries: Banca Comerciala Romana S.A (Baa1 negative, ba2), whose loan loss provisions rose to 3.60% of gross loans and Erste Bank Hungary Zrt (Baa1 stable, ba2), whose loan loss provisions rose to 4.89% of gross loans, up from net recoveries and a contribution to the banks' profitability previously (see exhibit).

Cost of risk jumped across main CEE subsidiaries
Loans loss provisions % gross loans



Source: Erste Group Bank AG

The increased provisions boosted the CEE banks loan-loss reserves coverage above 100% as nonperforming loan ratios remained broadly stable in the first half and at the lowest level since the global financial crisis following significant balance sheet clean up mainly between 2015 and 2018, particularly in Erste's Romanian and Hungarian operations. According to Erste Bank, its nonperforming loan ratio in the Czech Republic was 1.8% as of June 2020, up from 1.7% at year-end 2019; in Slovakia the NPL ratio declined to 2.7% as of June, from 3.2% at year-end 2019; and in Romania, the NPL ratio was 4.5%, down from 5.5% at year-end 2019, but up from 3.7% in the first quarter. Hungary also showed further asset quality improvement, with the NPL ratio declining to 2.1% as of June, from 3.0% at year-end 2019.

Endnotes

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

2 Including minorities.

3 On a transitional basis. The fully loaded CET1 ratio was 14.2% as of June 2020.

Andrea Wehmeier, *VP-Senior Analyst*
Moody's Investors Service
andrea.wehmeier@moodys.com
+49.69.70730.782

Alexander Hendricks, CFA, *Associate Managing Director*
Moody's Investors Service
alexander.hendricks@moodys.com
+49.69.70730.779

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

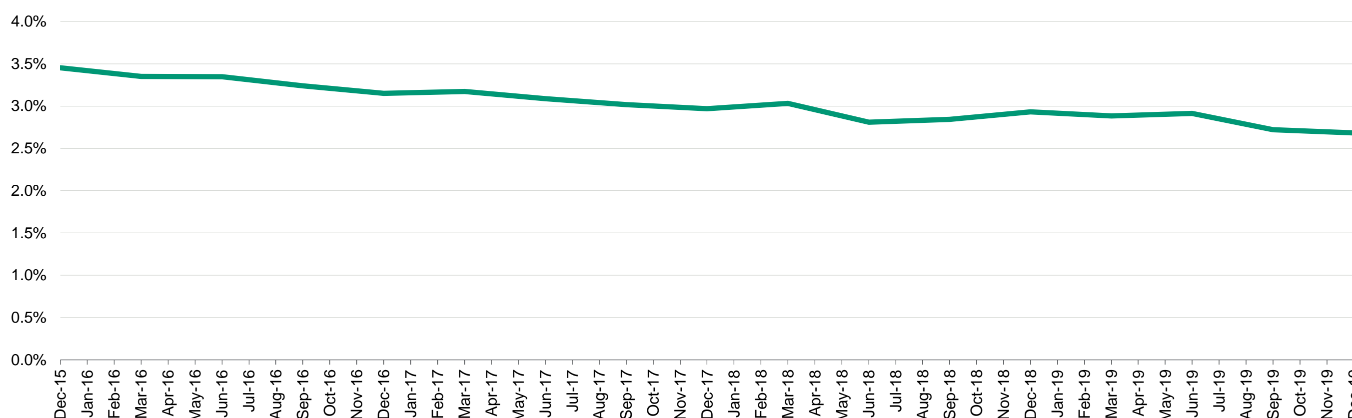
Melina Skouridou, CFA, *AVP-Analyst*
Moody's Investors Service
melina.skouridou@moodys.com
+357.2569.3021

New consumer-friendly loans will pressure Hungarian banks' net interest margins

On 29 July, Magyar Nemzeti Bank (MNB), the central bank of Hungary, published details on certified consumer-friendly personal loans, a new product that it is asking local banks to offer customers from January 2021. The personal loans complement consumer-friendly mortgage and home insurance products that the MNB asked banks to offer in 2017, aiming to improve people's financial awareness, confidence in the banking system, and increase financial penetration. The central bank intends the products to increase competition in the banking sector and lower costs for consumers, which will weaken Hungarian banks' margins, a credit negative.

Although Hungarian banks' systemwide net interest margins has been declining since 2016 (see exhibit), the central bank considers systemwide competition to be weak. OTP Bank NyRt's (Baa1 stable, ba1[1] dominates the system with a market share of around 32% in household savings as of February 2020, a market share of 32% of the Hungarian mortgages[2] and a market share of 39% on newly disbursed cash loans in 2019. In addition to its strong physical presence, OTP's "Simple" mobile application for purchases is widely used, even by non-OTP customers, making OTP a digital leader domestically. With its strong physical and digital infrastructure, OTP is able to defend its market share and to a certain extent its loan pricing. Consumer loans have grown significantly in recent years from a relatively low base. The volume of new consumer loans increased by 20% in 2019. Among rated banks MKB Bank Nyrt (Ba3 stable, b2) and Erste Bank Hungary Zrt (Baa1 stable, ba2) have been growing consumer loans aggressively, although they still have significantly lower market shares and pricing power than OTP.

Hungarian banks' systemwide net interest margin has been slipping
Net interest margin



Sources: Magyar Nemzeti Bank and Moody's Investors Service

According to the MNB, certified products lower borrowers' costs. For example, an average certified consumer-friendly mortgage of HUF10 million with a 20-year maturity and a five-year fixed interest period has an annual percentage rate (APR) of 3.89%, compared with 4.46% for the equivalent non-certified product.

Certified loans have to satisfy certain central bank requirements relating to the loan's term, maximum interest rate, transparency and consistency in pricing, so that consumers are aware of the loan's exact cost and have no hidden charges.

For participating banks' personal loans to qualify as certified consumer-friendly loans, they must have a term of up to seven years, charge a margin above the bank's reference rate of up to 10% for borrowing above HUF500,000 and up to 15% for borrowing up to HUF500,000, and clearly and consistently define disbursement and prepayment fees. The maximum prepayment fee is limited to 0.5% of the prepaid amount and zero if the loan matures in the following 12 months. Banks are required to disclose to customers how risk mitigants they offer, such as salary allocation, will reduce pricing.

Although the government currently restricts the APR on consumer loans to 5.6% (five percentage points above the base rate), the cap will expire on 1 January 2021.

The central bank will also require consumer-friendly personal loans to be offered and managed entirely by digital means by 1 April 2021 for existing loans and 1 July 2021 for new customers, to encourage banks lagging in digital capabilities to improve their digital offerings and customer reach.

Consumers will be able to find the most competitively priced loans on the central bank website and be confident that all the costs are clearly presented. The central bank expects this information to build trust in the banking system and increase the relatively low banking penetration rate in Hungary. Across Central and Eastern Europe, consumer credit at 7.3% of GDP as of Q4 2019, is second lowest in Hungary, after Romania.

Endnotes

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

2 Contactual amounts in 2019.

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

Stelios Kyprou, *Associate Analyst*
Moody's Investors Service
stelios.kyprou@moodys.com
+357.2569.3002

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

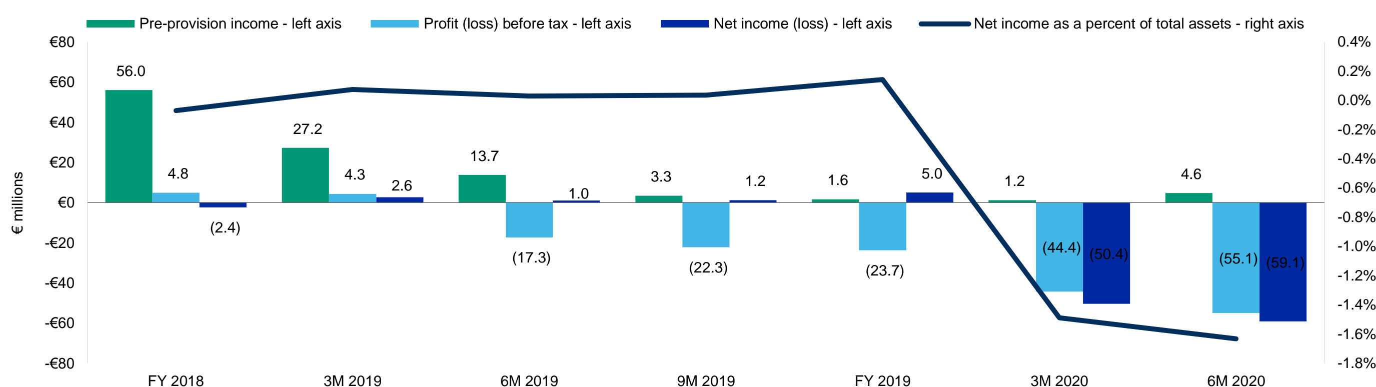
Attica Bank's quarterly before-tax loss is credit negative

On 31 July, Attica Bank S.A. (Caa3 stable, caa3[1]) published its half-year 2020 results, which showed losses before tax. It was Attica's fifth consecutive quarterly loss, exerting negative pressure on its capital base, a credit negative. The bank's losses before tax for the first-half 2020 totaled €27.5 million amid depressed earnings, asset quality pressure and elevated credit losses. The bank's weak profitability will be further challenged in the second half of 2020 and into 2021, constrained by Greece's coronavirus-related economic risks, which are likely to compromise the bank's weak capital metrics.

Attica Bank's annualised net loss was around €59.1 million during the first six months of 2020, mainly driven by weak pre-provision income (PPI) and elevated credit losses (see Exhibit 1). The bank's PPI fell by more than half on a yearly basis for the fourth consecutive quarter to just over €2.3 million. In addition, provisions for credit losses incorporate the full effect from the coronavirus pandemic on the bank's asset quality and at €27.8 billion were 86% higher than the year-earlier period. The bank reported an average ratio of net income to total assets of around negative 1.5% in 2020, which makes Attica Bank among the worst-performing in its local peer group.

Exhibit 1

Attica Bank's losses before tax are driven by weak PPI and elevated credit losses



Note: Annualised figures for comparison purposes.
Source: The bank

The bank's performance during the first six months of 2020 was underpinned by relatively stable but weak net interest income of around €23.6 million, a 2% increase from the year-earlier period. Although the bank provided €87 million of new loans and financing to clients during the first half of 2020, its ability to generate new earnings is weak given the overhang from its large stock of nonperforming exposures (NPE) of around €861 million (or 48% of gross loans as of June 2020) and the challenges confronting the Greek economy amid the current pandemic. Nonetheless, the lower absolute amount of NPEs than its larger local peers, combined with the agreement the bank made with a third party servicer (Qquant Master Servicer) in March 2020 for the management of around €370 million of its NPEs, will likely make it easier to manage.

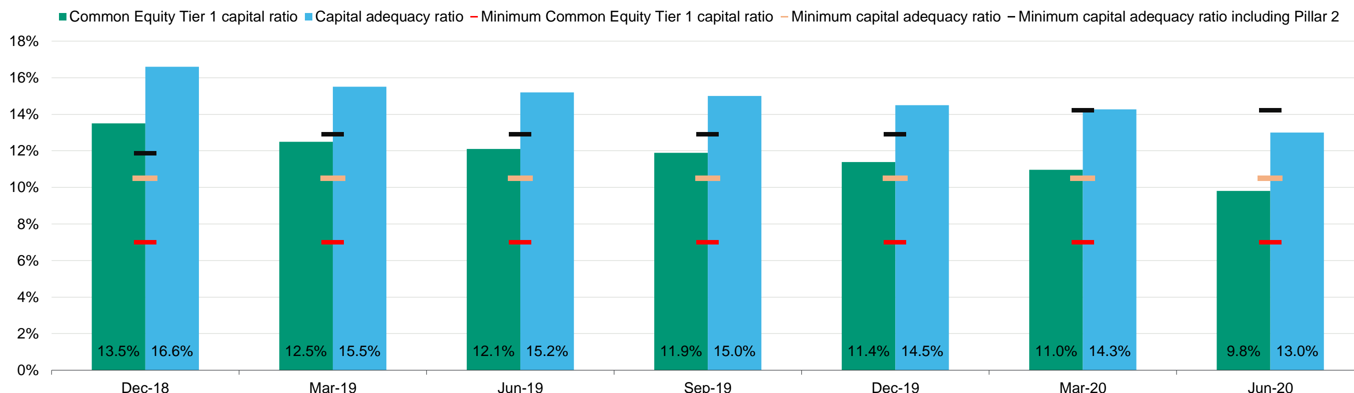
Attica Bank's net fee and commission income declined annually by 31% to around €1.3 million as of June 2020, compared to €1.9 million in the first half of 2019, while the bank's personnel expenses were relatively stable. The bank's operating income was supported by treasury gains on bonds in the first half of 2020, but was also heavily affected by lower nonrecurring income of around €4.9 million compared to the year-earlier period.

Although the bank's NPE sale transaction in the fourth-quarter 2018 provided an additional €47 million of capital for the bank, the losses reported in recent quarters and the first-time adoption of the IFRS 9 accounting standard had a significant negative effect on the bank's Common Equity Tier 1 (CET1) capital ratio, which has been declining and was 9.8% as of June 2020 (see Exhibit 2). This has weakened the bank's loss-absorption capacity, weighing on its overall credit profile. However, the bank's capital metrics remain above

its regulatory minimum, considering that the Bank of Greece, the central bank, has allowed Attica Bank to operate below the 14.2% total capital adequacy requirement (including the Pillar 2 capital guidance), taking into account the pandemic.

Exhibit 2

Attica Bank's regulatory capital metrics are declining



Source: The bank

The quality of Attica Bank's CET1 capital is also weakened by €260 million of deferred tax assets (DTAs) that are eligible for conversion into deferred tax credits included on its balance sheet as of June 2020, and qualify as CET1 capital. According to the relevant law, however, part of these DTAs will convert into final and liquidated claims against the Greek government if bank reports losses after tax by year-end. This would trigger the government to inject new equity into the bank, which would dilute current shareholders and compromise its private-sector status. The bank's management is considering a new strategy to improve operational performance. If successful, this new strategy would support the bank's credit profile and avoid government involvement in the bank. The increase in its customer deposits by around 11% year-on-year as of June 2020 despite the negative effects of the pandemic, is a positive development that supports the bank's liquidity.

Endnotes

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

Nondas Nicolaides, *VP-Sr Credit Officer*
Moody's Investors Service
nondas.nicolaides@moodys.com
+357.2569.3006

Stelios Kyprou, *Associate Analyst*
Moody's Investors Service
stelios.kyprou@moodys.com
+357.2569.3002

Bank of Cyprus' sale of nonperforming exposures is credit positive

Originally published on 05 August 2020

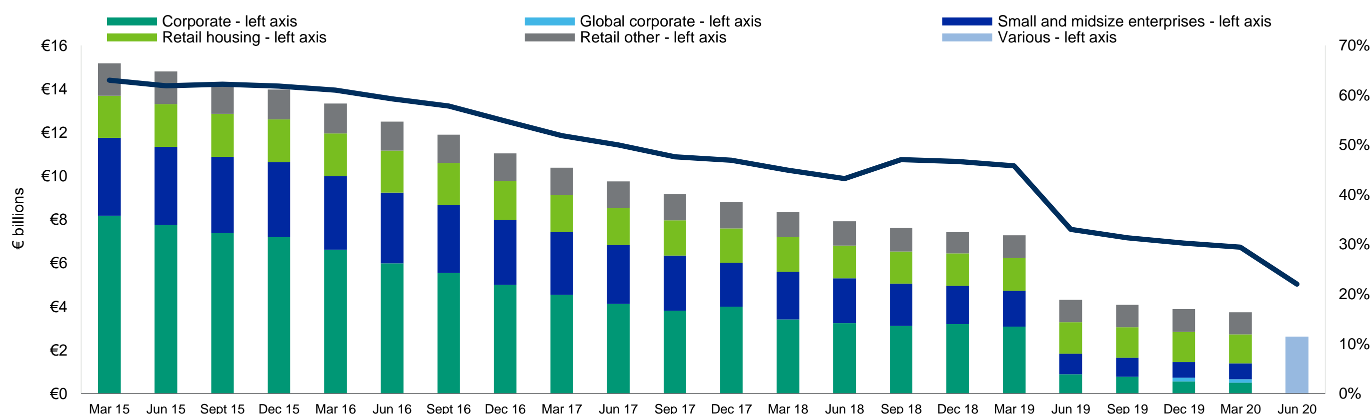
On 3 August, Bank of Cyprus Public Company Limited (B3 positive, caa1[1]) announced that it had agreed to sell a portfolio of nonperforming loans with a gross book value of €916 million to funds affiliated with Pacific Investment Management Company LLC (PIMCO), a global fixed-income investment manager. The bank expects to complete the sale in the first half of 2021, subject to a number of conditions, including customary regulatory and other approvals.

Upon completion, the sale, which relates primarily to nonperforming retail and small and midsize enterprise loans will reduce the bank's nonperforming exposure (NPE) ratio by five percentage points, a credit positive. The bank's pro forma ratio of NPEs to gross loans will fall to 22% as of June 2020, from 30% as of year-end 2019, and includes an organic NPE reduction of €278 million and the completion of an earlier sale of €133 million of primarily retail unsecured NPEs.

Despite its improving NPE ratio, weak asset quality remains the key credit challenge for Bank of Cyprus. With heightened asset quality risks from the coronavirus-induced economic disruption that will lead to new asset quality pressure starting in 2021, the disposal will help maintain an NPE ratio well below the bank's historical levels. We expect a widespread economic disruption caused by the coronavirus outbreak, with the Cypriot economy contracting by 7.5% in 2020, with the economy returning to healthy growth rates from 2021.

The bank has made progress in reducing its high stock of NPEs, with a combination of organic reductions and inorganic transactions. Bank of Cyprus' NPEs have declined to €2.6 billion in June 2020 from a peak of €15.2 billion NPEs in March 2015 (see exhibit), but remain high at 22% of gross loans.

Bank of Cyprus has significantly reduced its NPE ratio over the past five years, but it remains high



Source: Bank of Cyprus

However, the coronavirus pandemic has prompted the bank to make concessions on the size of the sold portfolio, and on the price and structure of the transaction, to complete the sale. Before the coronavirus, Bank of Cyprus expected to finalise its NPE reduction structures, including outright sales of a portfolio around €2 billion, in the first half of 2020, with a positive effect on capital owing to a significant reduction in risk-weighted assets (RWAs).

The announced transaction is around half the amount, while the potential reduction in RWAs upon completion will not offset the related losses of the transaction that will be reported by June 2020. According to the bank, once fully paid the transaction will have a positive nine basis point capital impact on the Group's Common Equity Tier 1 (CET1) ratio despite a €68 million loss reported in the second quarter of 2020. We estimate an overall negative capital impact however if we also include the €75 million related loss

reported in 2019. The consideration amounts to 46% of the gross book value and 29% of the contractual balance (around €422 million) payable in cash.[2] Of the €422 million consideration, 35% is payable at the completion of the transaction and the remaining 65% is deferred over the next four years, without any conditions attached. However, the consideration can rise through an earn-out arrangement if the portfolio outperforms current expectations.

Despite the related losses, the bank expects its CET1 ratio at 30 June 2020 to be broadly unchanged from 14.3% as of 31 March 2020. This is because of the European Union-wide capital benefit resulting from the amendments to capital regulations introduced in June 2020.

Endnotes

1 The bank ratings shown in this report are Bank of Cyprus' deposit rating and Baseline Credit Assessment

2 This compares with Bank of Cyprus' largest transaction to date of €2.8 billion, primarily involving large corporate nonperforming loans announced in August 2018 of around 48 cents of the portfolio's gross book value or 24 cents of the contractual price.

Christos Theofilou, CFA, *VP-Senior Analyst*
Moody's Investors Service
christos.theofilou@moodys.com
+357.2569.3004

Russia expands subsidised mortgage programme, supporting banks' earnings

Originally published on 04 August 2020

On 3 August, Russia's Prime Minister Mikhail Mishustin announced that the government would raise its aggregate limit for its subsidised mortgage lending programme to RUB900 billion ($12 billion) from RUB740 billion. In addition, the government will reduce the minimum down payment for subsidised mortgage loans to 15% of the property value from 20%. The programme started in April and will last until 1 November 2020.

The improved affordability of new mortgages will help banks generate more loans and interest income, supporting their net interest margins. The government will compensate the banks with part of the foregone interest income as the subsidised lending rate is 6.5%, approximately 100 basis points below the market rate for mortgage loans. We estimate that the lower down payment requirements will not lead to a significant increase in banks' credit risks associated with subsidised mortgage lending.

The government's expanded programme will benefit participating universal banks, including state-owned Sberbank (Baa3 stable, ba1[1]) and Bank VTB, PJSC (Baa3 stable, b1), the most active mortgage lenders (see Exhibit 1).

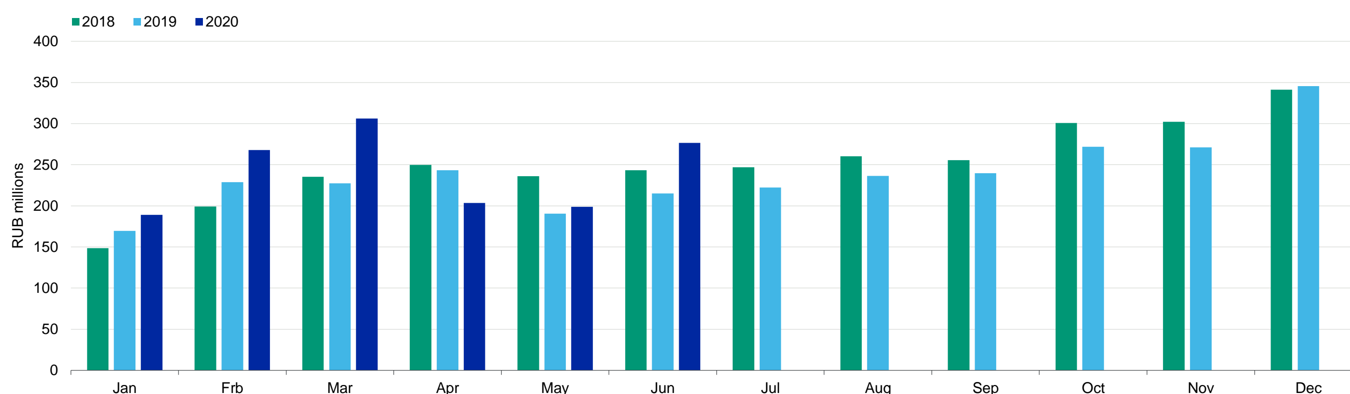
Exhibit 1
Russian banks with the largest exposures to mortgage lending
Data as of the end of 2019

	Total assets, RUB millions	Mortgage loans, RUB millions	Mortgage loans as % of total assets
Sberbank	29,958,900	4,291,200	14%
Bank VTB, PJSC	15,516,100	1,456,800	9%
PJSC ROSBANK	1,218,767	232,307	19%
AO RAIFFEISENBANK	1,273,587	141,447	11%
Absolut Bank (PAO)	221,322	79,053	36%

Sources: Banks' 2019 IFRS reports and Central Bank of Russia

Between April and early May, amid the peak of the coronavirus pandemic in Russia, banks' new lending stalled both because of lockdown measures and creditor and borrower uncertainty about domestic economic prospects. However, by the end of May and into June, mortgage loan origination revived, supported by the subsidy programme (see Exhibit 2).

Exhibit 2
Russian mortgage loan origination increased in June 2020 after declining in April and May



Source: Central Bank of Russia

In the first half of 2020, Russian banks' aggregate retail loan book increased 4%, with the bulk of the increase attributable to mortgage loans. According to the Central Bank of Russia (CBR), in May, 30% of all new mortgage loans were subsidised. Russia's Deputy Prime Minister Marat Husnullin said that by the beginning of August, banks had issued more than 100,000 subsidised loans with a total value of about RUB270 billion. We estimate that after the increase of the programme's aggregate limit to RUB900 billion, the scheme will contribute approximately 36% of the total volume of mortgage origination in 2020.

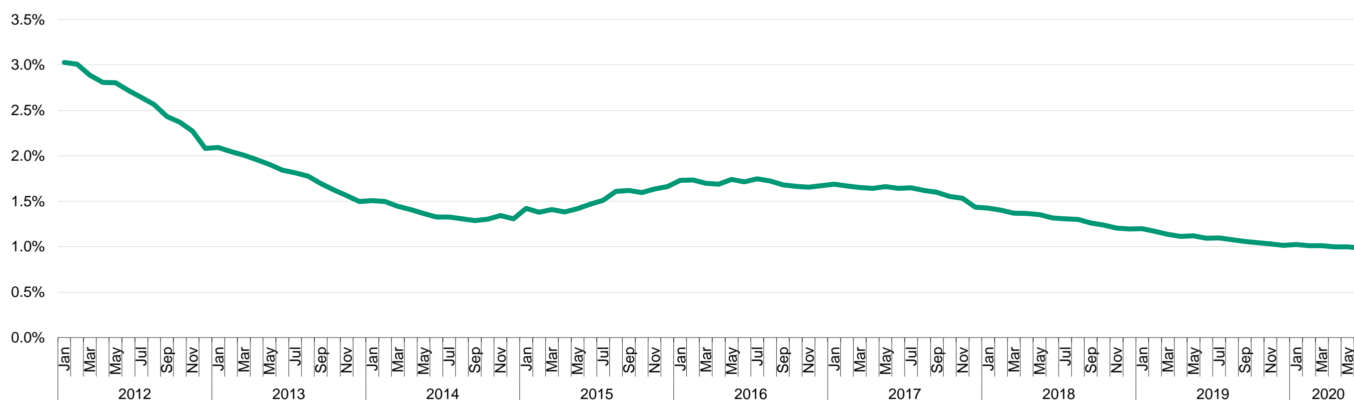
The subsidy programme was one of the main drivers behind the decline of the weighted average mortgage lending rate to 7.4% in May 2020 from 9.0% at the end of 2019. The government compensates banks for the difference between the market lending rates (defined as the CBR key interest rate plus three percentage points) and the 6.5% rate offered to borrowers. After the CBR key rate cut by 25 basis points to 4.25% at the end of July, the amount of the compensation fell to 75 basis points per year from 100 basis points previously. Banks' profitability benefits from mortgage loan growth because fixed-rate mortgages facilitate interest income generation over a longer term and bring low credit losses.

The reduction of the minimum down payment requirement to 15% from 20% will not dramatically increase problem mortgage loans because mortgage loans have superior credit quality compared with other loan segments. The share of mortgage loans overdue by more than 90 days was around 1% of the total mortgage portfolio throughout 2019 and in the first half of 2020 (see Exhibit 3).

Exhibit 3

Russian mortgage loan quality has been consistently good

Share of mortgage loans overdue by more than 90 days



Source: Central Bank of Russia

The CBR discourages banks from excessive risk-taking in mortgage lending by introducing elevated capital requirements for loans with high loan-to-value ratios. According to recently announced regulatory changes, which we expect will take effect before year end, loans with down payments of 15%-20% of the property value carry elevated risk weights of 50%-65%, depending on the borrower's indebtedness level as measured by a payment-to-income ratio. Exhibit 4 shows that through varying risk weights, as applied in bank capital adequacy computation, the CBR incentivises banks to either issue lower-risk mortgages or set aside more capital for higher-risk mortgages, such as those with higher loan-to-value and payment-to-income ratios.

Exhibit 4

Regulatory risk weights for Russian mortgage loans, based on loan-to-value and payment-to-income ratios, as % of loan volume

PTI \ LTV	(0;50]	(50;60]	(60;70]	(70;80]	(80;85]	(85;90]	(90;100]	100+
Not available	25	30	40	50	60	60	70	90
(0; 30]	20	30	35	45	50	50	60	80
(30; 40]	25	30	40	50	60	60	70	90
(40; 50]	25	30	40	50	60	60	70	90
(50; 60]	25	30	40	50	60	60	70	90
(60; 70]	25	30	40	50	60	60	70	90
(70; 80]	25	30	40	55	65	65	75	95
80+	25	30	40	55	65	65	75	95

Key: LTV = loan-to-value ratio. PTI = payment-to-income ratio.
Risk weights applying to loans with down payments between 15% and 20% are marked in blue.
Source: Central Bank of Russia

In broader terms, the extension of the government's subsidised mortgage programme aims to support domestic housing construction, which will positively affect a variety of adjacent industries. However, the Russian population's low disposable income limits its ability to purchase homes even with credit, and constrains potential mortgage growth in current unfavourable economic conditions. Therefore, we do not expect new mortgages origination this year to surpass 2019 levels. According to Mishustin, the government may extend the programme beyond 1 November 2020.

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

London Stock Exchange's sale of MTS and Borsa Italiana stakes would be credit positive if proceeds reduce debt

Originally published on 03 August 2020

On 31 July, London Stock Exchange Group plc (LSEG, A3 review for downgrade) said it had commenced exploratory discussions that may result in a sale of its interest in MTS or potentially the Borsa Italiana group as a whole. MTS is 62.5%-owned by Borsa Italiana, LSEG's Italian exchange business. A reasonably priced cash disposition with the proceeds used to reduce the approximately $13.5 billion incremental debt associated with LSEG's planned Refinitiv acquisition would be credit positive for LSEG, since it would soften the heightened pro forma debt leverage associated with the Refinitiv transaction.

Otherwise, a disposition would have mixed and uncertain credit implications, since the effect on LSEG's creditworthiness would depend on the amount, form and use of the proceeds and the magnitude of the lost earnings and cash flow of the disposed business. LSEG did not provide details on any of these factors in the announcement or during its first-half 2020 earnings call (which took place on the same day).

LSEG's decision to explore these dispositions stems from the European Commission's (EC) Phase II review of LSEG's planned $27 billion purchase of Refinitiv from Refinitiv Holdings Ltd. (affiliated with Refinitiv US Holdings Inc., B3, review for upgrade). In announcing in June an in-depth investigation of the deal, the EC expressed concern over a number of factors, including the possibility of reduced competition in the electronic trading of European government bonds.

This concern has arisen because MTS owns and operates an electronic trading platform for European and US fixed-income securities that competes with Tradeweb (majority-owned by Refinitiv), and the two would have a very large combined market share in the electronic trading of European government bonds.

It is possible that LSEG will use the proceeds from a disposition for purposes other than debt reduction, and this outcome would likely be credit negative. For instance, LSEG's Refinitiv purchase agreement gives LSEG the option to settle up to $2.5 billion of the purchase consideration in cash instead of shares. Should LSEG use cash received from a business disposition to reduce the amount of equity it must issue to acquire Refinitiv, rather than reduce the related debt, it would be distinctly credit negative.

Should LSEG proceed with a disposition, our analysis of the transaction's effect on LSEG's creditworthiness would include assessing the magnitude of the earnings and cash flows of the disposed entity that would no longer be available to help service LSEG's debt. LSEG does not separately report the revenue or profitability of either of the two entities that may be sold, but we estimate that they contributed to roughly 5%-10% of LSEG's total revenue in 2019. Borsa Italiana, including MTS, forms part of LSEG's Capital Markets segment, together with London Stock Exchange plc (LSE, A3 review for upgrade) and some other businesses. LSE contributed slightly more than half of the segment's 2019 revenue, according to information in LSE's standalone financial statements, and the segment as a whole contributed 21% of LSEG's 2019 total revenue.

LSEG said it expects to complete its Refinitiv acquisition by the end of 2020 or early in 2021, after the regulatory review process has been completed.

Donald Robertson, *Senior Vice President*
Moody's Investors Service
donald.robertson@moodys.com
+1.212.553.4762

Laurie Mayers, *Associate Managing Director*
Moody's Investors Service
laurie.mayers@moodys.com
+44.20.7772.5582

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

Large Mexican insurers' strong first-half earnings enhance capacity to withstand economic contraction

Originally published on 04 August 2020

On 31 July, a group of Mexico's top insurers, including Axa Seguros, S.A. de C.V., Chubb Seguros México, S.A., Mapfre México, S.A. and Qualitas Compañía de Seguros, S.A. de C.V., reported aggregate first-half earnings of MXN22.9 billion ($992 million), a 24% increase from a year earlier. Insurers' strong earnings are credit positive because they more than offset the effects of weak premium growth and low interest rates amid Mexico's coronavirus-induced economic contraction.

Although all insurers' capitalization benefitted from the earnings growth, Axa Seguros, Chubb Seguros México, Mapfre México and Qualitas Compañía de Seguros benefitted more because their earnings growth was stronger. Earnings are insurers' primary source of internal capital generation, and their economic capital is critically important because it provides a cushion to absorb unfavorable deviations in results. The 24% earnings increase will make these large insurers more resistant to potential increases in claims driven by the coronavirus pandemic or a greater contraction of premiums toward the end of 2020.

As of 30 July, Mexican insurers provided medical coverage for coronavirus cases totaling MXN2.4 billion ($105 million), and paid out life insurance totaling MXN1.3 billion ($56 million) for 319 deaths. The claims and economic costs related to the pandemic will continue growing at least through the second half of the year, consuming insurers' earnings. In this context, insurers' revenues would be hurt by a second wave of the coronavirus pandemic that leads to another lockdown, rising unemployment and negative effects on small and midsize enterprises. Exhibit 1 shows the effect of the economic contraction in the first half of this year on insurer's underwriting of new policies: aggregate premiums contracted 2.5%, compared with growth of 16% a year earlier.

Mexican insurers' earnings grew significantly in the first half of 2020 despite a contraction in premiums
MXN millions

Company	Net income as of June 2020	Change from June 2019	Gross premums written (GPW) Jan-Jun 2020	Change from Jan-Jun 2019	Total GPW 2019	% of market premiums
Grupo Nacional Provincial	2,690	10%	35,696	8.0%	68,062	12%
Seguros BBVA Bancomer	3,607	2%	23,364	-5.1%	47,054	8%
AXA Seguros	3,731	172%	21,611	2.4%	40,274	7%
Quálitas, Cía. de Segs.	3,652	55%	15,433	-2.1%	34,315	6%
Seguros Monterrey New York Life	1,600	8%	15,687	9.1%	30,259	5%
Mapfre México [1]	117	26%	10,532	-47.6%	28,164	5%
Seguros Banorte	3,594	10%	17,535	2.0%	26,551	5%
Chubb Seguros México	1,150	148%	10,079	-8.9%	20,124	4%
Seguros Inbursa	381	-74%	11,129	9.0%	18,562	3%
Seguros Atlas	586	85%	8,086	-3.0%	15,581	3%
Allianz México	431	7%	8,691	17.5%	15,444	3%
Zurich Santander Seguros México	1,382	11%	6,012	11.2%	10,926	2%
Aggregate	**22,921**	**24%**	**183,856**	**-2.5%**	**355,316**	**64%**

[1] For Mapfre Mexico, the change in premiums include Pemex´s biannual policy, which atypically increased premiums for 2019.
Sources: The companies and Moody's Investors Service

The weaker growth did not lower companies' earnings primarily because insurers recorded fewer claims during the lockdown, which supported stronger underwriting results. The group of insurers listed in the exhibit, which comprises 64% of the market in terms of gross premiums, have an aggregate combined ratio (claims, acquisition costs, general expenses as a percent of net earned premiums) of 86%, down from 100% as of December 2019, and a loss ratio (claims as a percent of net earned premiums) of 59%, down from 73% as of December 2019.

Solid operating results also compensated for a 6% decline in insurers' investment returns arising from a sharp reduction of Mexico's benchmark interest rate – 225 basis points over the past six months to 5%. With growing pressure to lower interest rates in the coming months, we expect insurers' results to fully reflect the negative effect of lower rates in the next 12 months.

Francisco Uriostegui, *Analyst*
Moody's Investors Service
francisco.uriostegui@moodys.com
+52.55.1253.5728

Jose Angel Montano, *VP-Senior Analyst*
Moody's Investors Service
joseangel.montano@moodys.com
+52.55.1253.5722

California Supreme Court upholds certain pension changes yet maintains protections, a credit positive

Originally published on 05 August 2020

On 30 July, the Supreme Court of California ruled that certain changes limiting the types of compensation used to determine employee pension benefits were legally permissible. The ruling, which pertains directly to litigation involving the counties of Alameda (Aaa stable), Contra Costa (Aa2 stable) and Merced (Aa3 stable), is broadly credit positive for California (Aa2 stable) and its local governments because they will avoid liability increases that would have materialized if the court had limited the applicability of the state's 2013 pension changes.

However, the court maintained rigid protections for benefits by reaffirming the "California Rule," a body of case law that significantly limits governments' ability to make pension changes. Under the rule, governments throughout the state generally cannot lower the generosity of pension benefit formulas once employees begin working in order to attain fiscal relief. In the court's view, the disputed benefit changes did not violate the California Rule because they were limited to closing loopholes that allowed certain types of irregular compensation to boost pension payout formulas – commonly referred to as "pension spiking."

The California Public Employees' Pension Reform Act of 2013 (PEPRA), which took effect in January 2013, made numerous changes to state employees' pension benefit formulas as well as those of many local governments. A significant portion of the changes called for by PEPRA applied solely to new employees, but others, such as the limits to types of pensionable compensation, extended to current employees. After the state enacted PEPRA, the retirement systems of Alameda, Contra Costa and Merced counties conformed by limiting the types of compensation included when calculating "final average salary" of employees participating in each system. Final average salaries are a key input in determining retiree pension benefits, and the county retirement systems began to exclude compensation items such as payouts for unused sick leave from benefit calculations, sparking legal challenges from employee groups.

The court acknowledged that the removal of certain items from final salary formulas of active employees imposed disadvantages to employees without providing "comparable" new advantages. The requirement for comparable new advantages in exchange for pension benefit modifications is generally a central tenet of the California Rule. Notwithstanding what employees argued was an illegal change to their pensions, the court deemed legislative flexibility to address loopholes as necessary and legally permissible.

The court's affirmation of the California Rule highlights that pensions are "must pay" obligations for California and its local governments, meaning the benefits of active employees and retirees generally cannot be cut to provide government fiscal relief outside of bankruptcy. Even in their respective municipal bankruptcies, the California cities of San Bernardino, Stockton (A3 stable) and Vallejo all left accrued pension liabilities unimpaired, but cut bonds significantly.

Unfunded pensions are the most substantial form of balance sheet leverage for most California governments, and continue to rise because of volatile investment returns, falling market interest rates and in some cases, weak contributions. Of the California cities we rate, roughly 15% had adjusted net pension liabilities that exceeded 400% of their operating revenues as of financial reporting for fiscal 2019 (which for most California cities, ends 30 June). By comparison, no city in the group had bonded debt that was more than 163% of operating revenue. Similarly, each of the three counties whose retirement systems were specifically named in the state Supreme Court ruling have unfunded pension liabilities that are far greater than their debt (see exhibit).

Like many other California governments, the counties with retirement systems directly involved in the recent state Supreme Court case have pension liabilities that far exceed their bonded debt
Debt and unfunded pension liabilities, as % of operating revenue

	Alameda County	Contra Costa County	Merced County
Net direct debt	38%	27%	8%
Reported net pension liability	76%	48%	109%
Reported discount rate	7.25%	7.00%	7.25%
Moody's adjusted net pension liability	187%	191%	241%
Adjusted discount rate	4.21%	4.22%	4.14%

Government financial reporting for fiscal years ended June 30, 2019
Source: Moody's Investors Service, based on county audited financial reports

Thomas Aaron, *VP-Sr Credit Officer*
Moody's Investors Service
thomas.aaron@moodys.com
+1.312.706.9967

Timothy Blake, CFA, *MD-Public Finance*
Moody's Investors Service
timothy.blake@moodys.com
+1.212.553.4524

Articles in last Monday's Credit Outlook

NEWS & ANALYSIS

Corporates

- Advanced Micro Devices' strong second-quarter results and outlook are credit positive
- Lam posts strong second-quarter results amid robust demand and normalizing supply chains
- Zebra's acquisition of Reflexis reduces liquidity and increases leverage
- VTR Finance's acquisition of Telefónica assets strengthens Costa Rican business for parent LLA
- Despite BAT's positive first-half results, limited contribution from reduced-risk products is credit negative
- Lockdown boosts Iceland VLNCo's first quarter, a credit positive amid rising competition
- CIMIC's Thiess sale would be credit positive if it uses proceeds for debt reduction

Banks

- Record consumer indebtedness and rising delinquencies are credit negative for Brazilian banks
- Loan originations boost Brazilian banks' interest income, but high provisions hurt profitability
- Deutsche Bank's second-quarter strengths in core businesses help offset coronavirus disruption
- Credit Suisse's strong second-quarter capital markets businesses offsets COVID-19 disruption
- UAE's four largest banks' first-half profits decline amid higher provisioning, a credit negative

Insurers

- Humana's investment in home health provider Heal is credit positive

CREDIT IN DEPTH

- CECL reserves buttress US credit card bank bondholders during pandemic uncertainty
- Toll roads' recovery linked to COVID-19 infection rates, movement restrictions and strength of mass transit

Click here for last Monday's Credit Outlook.

Editors

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

© 2020 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND/OR ITS CREDIT RATINGS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MATERIALS, PRODUCTS, SERVICES AND INFORMATION PUBLISHED BY MOODY'S (COLLECTIVELY, "PUBLICATIONS") MAY INCLUDE SUCH CURRENT OPINIONS. MOODY'S INVESTORS SERVICE DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT OR IMPAIRMENT. SEE MOODY'S RATING SYMBOLS AND DEFINITIONS PUBLICATION FOR INFORMATION ON THE TYPES OF CONTRACTUAL FINANCIAL OBLIGATIONS ADDRESSED BY MOODY'S INVESTORS SERVICE CREDIT RATINGS. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS, NON-CREDIT ASSESSMENTS ("ASSESSMENTS"), AND OTHER OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. AND/OR ITS AFFILIATES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS, ASSESSMENTS AND OTHER OPINIONS AND PUBLISHES ITS PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS, AND PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS OR PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing its Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY CREDIT RATING, ASSESSMENT, OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any credit rating, agreed to pay to Moody's Investors Service, Inc. for credit ratings opinions and services rendered by it fees ranging from $1,000 to approximately $2,700,000. MCO and Moody's Investors Service also maintain policies and procedures to address the independence of Moody's Investors Service credit ratings and credit rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold credit ratings from Moody's Investors Service and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any credit rating, agreed to pay to MJKK or MSFJ (as applicable) for credit ratings opinions and services rendered by it fees ranging from JPY125,000 to approximately JPY250,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER 1240415

MOODY'S
INVESTORS SERVICE

MOODYS.COM