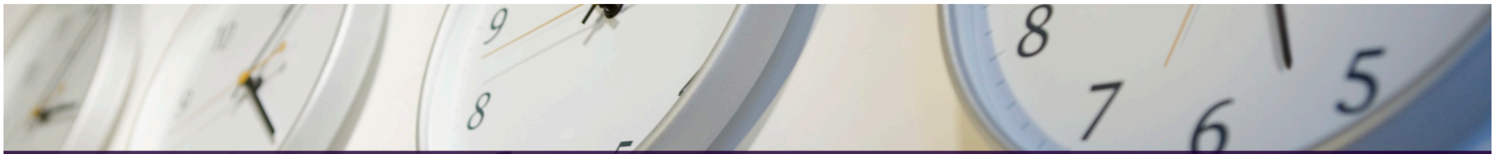


Credit Outlook

27 January 2022

FIRST READS

» European Commission's threat to withhold funding from Poland is credit negative for the country 2

» Chinese government aims to control central state-owned enterprises' leverage, a credit positive 4

NEWS AND ANALYSIS

Corporates

» Adtalem's sale of its financial services portfolio supports deleveraging, a credit positive 6

» Kedrion's combination with BPL will improve its business profile amid still-challenging operating conditions 7

» LG Chem's IPO of wholly owned battery subsidiary is credit positive 9

» Singtel and Grab's investment in Bank Fama is credit positive 10

Fintech

» Russia's proposed prohibition of crypto assets is credit positive for local banks 12

Banks

» Consent order termination is credit positive for Wells Fargo, but work to meet regulatory expectations remains 14

» Ibercaja's planned initial public offering and listing are credit positive 15

» Commerzbank's additional provision on Swiss franc mortgage loans in Poland will burden 2021 earnings 16

US Public Finance

» New Jersey's retiree health liabilities increase sharply, partly driven by medical expenses 18

CREDIT IN DEPTH

» FAQ on 10 key issues that will shape global credit in 2022 20

We summarize our views on 10 key topics ranging from Omicron to global warming that will affect credit this year and beyond.

» Fed's US CBDC report highlights both the potential efficiencies of digital money and funding risks for banks 21

A US central bank digital currency could support faster, lower cost dollar payments and boost financial inclusion, but the systemic and credit effect will depend critically on the design choices in its construction.

RECENTLY IN CREDIT OUTLOOK

» Articles in last Monday's Credit Outlook 23

» Go to last Monday's Credit Outlook

Rate this Research

FIRST READS

European Commission's threat to withhold funding from Poland is credit negative for the country

Originally published on 25 January 2022

On 19 January, the European Commission (EC) announced that it would start to withhold budget funding from Poland (A2 stable) unless the country settled fines related to two ongoing legal disputes. The deepening rift with the European Union (EU, Aaa stable) is credit negative for Poland because it threatens access to more substantial amounts of funding in the future and could weaken investor sentiment, both of which would weigh on Poland's economic growth outlook from 2023 onwards.

The first set of fines relates to a European Court of Justice (ECJ) ruling in July last year that a disciplinary chamber in Poland's supreme court violated EU laws around judicial independence. The ECJ subsequently announced in late October that it was levying fines worth €1 million per day after the government had failed to reverse the regime. The EC has said the Polish authorities have 45 days to pay before the fines are deducted from budget payments. The second set of fines worth €500,000 per day relate to Poland's failure to cease extraction activities at Turów mine near its border with the Czech Republic (Aa3 stable). The EC has given the Polish government 10 days to respond to the latter.

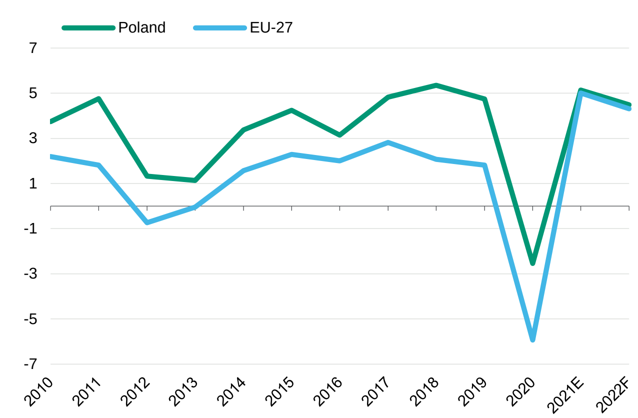
Despite the relatively small amounts involved, the mere fact the EC has considered withholding funds marks a further deterioration in relations and could indicate the EC's willingness to apply a new mechanism designed to protect the EU budget against rule-of-law breaches despite the political and legal complications involved.[1] The application of this mechanism could jeopardise its access to €23.9 billion (4.6% of 2020 GDP) in grants and €12.1 billion (2.3%) in loans under the EU Recovery and Resilience Facility (RRF), as well as the €108 billion[2] it is set to receive under the EU's regular budget (Multiannual Financial Framework (MMF) for 2021-27). EU funding has been a key driver of growth and income convergence in Poland historically. We currently forecast EU funding adding around 0.3 to 0.5 percentage points annually to Poland's GDP growth between 2022 and 2025.

That said, the Polish economy is set to grow strongly over the next few years, having contracted only 2.5% in 2020 (less than half the contraction for the EU as a whole, see Exhibit 1) and likely having grown by more than 5% in 2021. Moreover, the government has the fiscal capacity to limit the near-term credit implications of any potential further delays in EU fund inflows because its debt burden is moderate and debt affordability is strong (see Exhibit 2).

Exhibit 1

The Polish economy has performed better than the EU average

Real GDP growth, % year-on-year

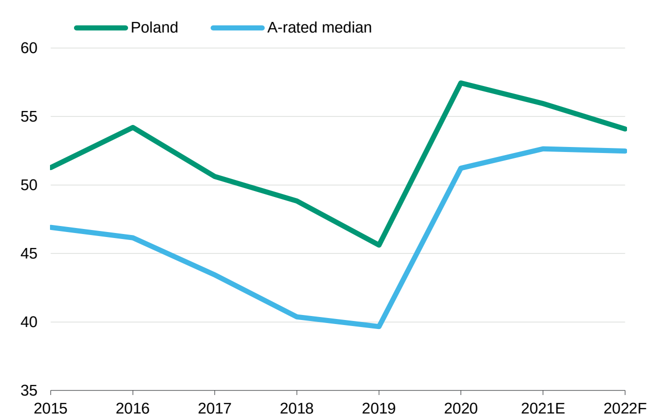


Sources: Ameco, Central Statistical Office of Poland and Moody's Investors Service

Exhibit 2

Poland's moderate debt burden provides some buffer

General government debt, % of GDP



Sources: National statistics offices and Moody's Investors Service

Poland will also still receive disbursements from the previous MFF. As of late 2021, it had spent only €65.9 billion of the €110.8 billion available from planned structural funds.

Despite the ongoing tensions, the risk of Poland leaving the EU remains very low. In addition to the economic benefits from the EU membership, public support for the EU within Poland remains strong. For instance, in the September 2021 Eurobarometer survey, 53% of respondents from Poland had a positive image of the EU, which exceeds the EU-27 average of 45%. Only 8% said they had a negative image, which is one of the lowest in the EU.

Endnotes

1 The EU's new rule of law mechanism is designed to cut funding to member countries in cases when certain rule-of-law breaches affect the EU's financial interests. It is not designed to combat rule-of-law breaches in general terms, which are addressed using existing instruments like the Article 7 procedure, the infringement procedure and the so-called preliminary procedure. Poland and Hungary (Baa2 stable) are currently the only two EU countries under an Article 7 procedure for significant rule-of-law of breaches.

2 This amount consists of Cohesion Policy allocations, allocations under Just Transition Fund, European Agricultural Fund for Rural Development and under European Agricultural Guarantee Fund.

Steffen Dyck, *VP-Sr Credit Officer*
Moody's Investors Service
steffen.dyck@moodys.com
+49.69.70730.942

Javid Mustafayev, *Associate Analyst*
Moody's Investors Service
javid.mustafayev@moodys.com
+49.69.7073.0990

Dietmar Hornung, *Associate Managing Director*
Moody's Investors Service
dietmar.hornung@moodys.com
+49.69.70730.790

Alejandro Olivo, *Managing Director*
Moody's Investors Service
alejandro.olivo@moodys.com
+1.212.553.3837

FIRST READS

Chinese government aims to control central state-owned enterprises' leverage, a credit positive

Originally published on 24 January 2022

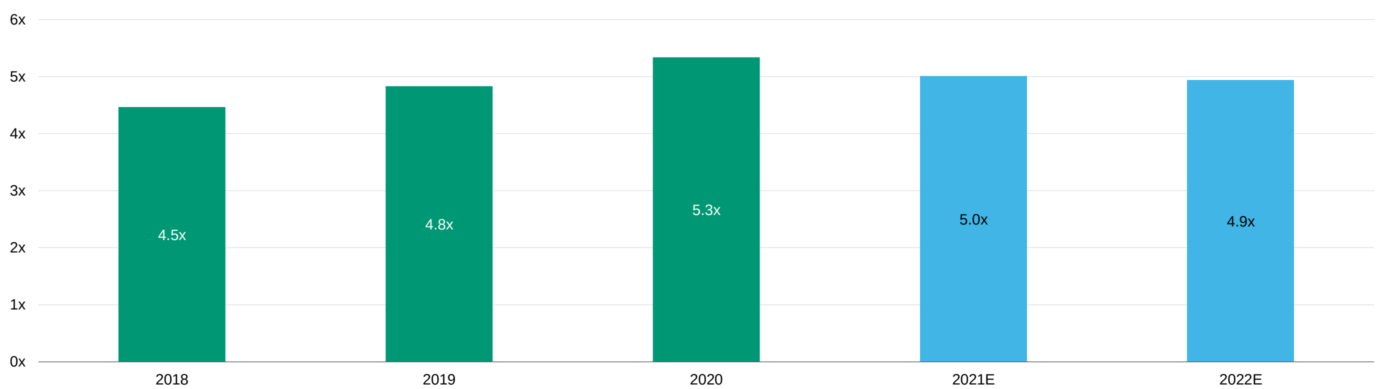
On 20 January, China's (A1 stable) State-owned Assets Supervision and Administration Commission of the State Council (SASAC) published its targets for central state-owned enterprises' (SOEs) operations for 2022. The government's targets are credit positive for central SOEs because they aim to control SOEs' leverage – as measured by total liabilities/assets – and improve their profitability and efficiency in 2022.

One of the SASAC's main policy targets is to keep central SOEs' total liabilities/asset ratio below 65%. If implemented successfully, it will obligate central SOEs to be more prudent in capital spending and investment and, therefore, avoid substantial increases in leverage in 2022.

Other measures announced by the SASAC are likely to improve central SOEs' competitiveness and support EBITDA growth against slower GDP growth and some macroeconomic challenges, such as higher commodity prices, a weak real estate market and uncertainties from the coronavirus pandemic. For example, the SASAC set targets for central SOEs to increase total profit and net profit faster than GDP growth in 2022, increase research and development spending, improve operational efficiency and continue with the consolidation and restructuring of core businesses.

SASAC's targets for central SOEs are in line with our expectation that central SOEs' leverage, as measured by adjusted debt/EBITDA, will remain flat in 2022 (see exhibit) as EBITDA growth keeps pace with growth in debt. Nevertheless, EBITDA growth will be lower this year than last because the strong EBITDA growth last year was achieved from a low base in 2020, when the coronavirus outbreak hit the Chinese economy. Additionally, lower EBITDA growth was a result of slower GDP growth because of a sluggish property market, a likely decline in export growth and a potential pullback in commodity prices from their highs in 2021. The rise in commodity prices was a main driver of central SOEs' EBITDA growth in 2021 in sectors such as oil and gas, steel and mining. The slower growth in EBITDA will be offset by the slower growth in debt under SASAC's leverage target.

Rated SOEs' leverage will remain flat



The exhibit illustrates the trimmed average of 33 rated Chinese SOEs that are not in the property, investment holding, infrastructure and utilities sectors and are not local government financing vehicles. We also excluded rated subsidiaries of rated parents and companies that have recorded negative debt/EBITDA ratios in the past
Source: Moody's Investors Service

Data from SASAC shows that central SOEs performed strongly in 2021, with total revenue increasing by 19.5% and total profit rising by 0.3% over 2020. Meanwhile, total liabilities/assets remained stable at around 64.9%, which met the target set by SASAC at the beginning of 2021.

We also expect that the central SOEs will continue with consolidation and restructuring. However, mergers between large SOEs, such as that between Sinochem Group and China National Chemical Corporation Limited (Baa2 stable) are less likely than in the past three years. The merger and acquisition of central SOEs will mainly be by industry leaders, which will acquire smaller local SOEs or private enterprises to consolidate in certain industries, such as steel. SASAC will also set up new central SOEs in special areas such as grain reserves and processing, logistics and port operations by combining the existing businesses held by multiple entities.

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

Kai Hu, ***Senior Vice President***
Moody's Investors Service
kai.hu@moodys.com
+86.21.2057.4012

Sue Su, ***VP-Senior Analyst***
Moody's Investors Service
sue.su@moodys.com
+86.10.6319.6505

Li Ma, ***MD-Corporate Finance***
Moody's Investors Service
li.ma@moodys.com
+86.21.2057.4015

Adtalem's sale of its financial services portfolio supports deleveraging, a credit positive

On 24 January, Adtalem Global Education Inc. (B1 stable) announced that it had entered into a definitive agreement to sell its financial services portfolio to a consortium of buyers comprising Wendel Group and Colibri Group in an all-cash transaction for an aggregate purchase price of $1 billion. The company expects the transaction to close in the first quarter of this year, subject to customary closing conditions.

The sale is credit positive for Adtalem because we expect it to use the vast majority of proceeds to pay down debt. However, there is no immediate impact on the company's ratings because Adtalem has yet to determine the net cash proceeds after taxes and fees, or how it will use the proceeds.

As part of the transaction, the Association of Certified Anti-Money Laundering Specialists will be sold to Wendel and Becker Professional Education and OnCourse Learning will be sold to Colibri. If closing conditions are satisfied for one buyer party but not the other, Adtalem has the unilateral option to close with one buyer. In the 12 months to 30 September 2021, the financial services segment generated revenue of approximately $215 million and $50 million of company-calculated EBITDA, implying a 20x multiple sale price.

Adtalem previously acquired Walden University in August 2021 for approximately $1.5 billion, funded with $800 million of notes, an $850 million term loan and available cash on hand. We estimate that pro forma Moody's adjusted leverage was approximately 3.8x as of 30 September 2021. We expect Adtalem to use the bulk of the net proceeds from the sale of its financial services portfolio to pay down debt because management has publicly committed to reducing company-calculated net leverage below 2x within 24 months of the Walden transaction's close.

Adtalem has scheduled its second-quarter fiscal 2022 conference call for 8 February, when we expect it to provide additional information on the transaction. Depending on the amount of debt repaid, we estimate that Moody's adjusted leverage could decrease by as much as a full turn. The degree of leverage reduction may result in a positive rating action if we expect that Adtalem would decrease and sustain leverage below 2.75x in the near term while maintaining balanced financial policies and a very good liquidity profile.

Headquartered in Chicago, Illinois, Adtalem is a global provider of educational services with a focus on medical and health care and financial services. The company operates seven educational institutions across the US and the Caribbean. Revenue totaled approximately $1.2 billion for the 12 months to 30 September 2021.

Sean Cray, *Analyst*
Moody's Investors Service
sean.cray@moodys.com
+1.212.553.2925

Karen Nickerson, *Associate Managing Director*
Moody's Investors Service
karen.nickerson@moodys.com
+1.212.553.4924

Kedrion's combination with BPL will improve its business profile amid still-challenging operating conditions

Originally published on 21 January 2022

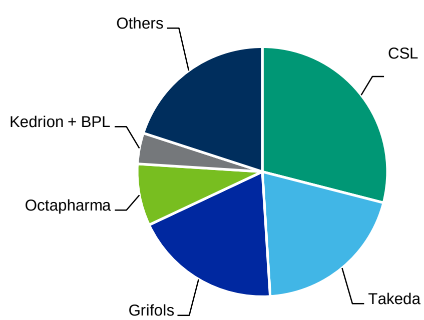
On 20 January, biopharmaceutical company Kedrion S.p.A. (B2 negative) announced that its existing shareholders had entered into a partnership with Permira and a co-investor, a wholly owned subsidiary of the Abu Dhabi Investment Authority, to jointly acquire and combine Kedrion and Bio Products Laboratory (BPL).

The combination with BPL will increase Kedrion's scale and expand its manufacturing footprint. However, its global market position will remain modest because the operating environment remains challenging with the recovery in plasma supply taking longer to return to pre-pandemic levels. Clarity on the future capital structure and financial policy of the combined group will be a key driver of Kedrion's future rating.

The combination will create a group generating revenue of about €1.1 billion; scale is particularly important in the plasma-derivative industry, where fixed costs are large. We also expect some synergies from the combination of the two companies. In addition, BPL will add 28 US collection centers to Kedrion's own network of 29, which will increase the share of collected plasma in its supply mix. BPL has three production lines in the UK, which can fractionate 1.5 million liters of plasma annually, bringing total annual fractionation capacity to 3.5-4.0 million liters for the combined group.

Kedrion, which reported revenue of €697 million in 2020, has a global market share of about 3%. The market is concentrated and dominated by three large producers with a total revenue market share of close to 70% — CSL Limited (A3 stable), Takeda Pharmaceutical Company Limited (Baa2 positive) and Grifols S.A. (B1 negative). The combined Kedrion and BPL group would have a global market share of about 4%, a still modest market position relative to its larger peers (see exhibit).

Together, Kedrion and BPL will have a global market share of around 4%
Based on 2018 revenue share



Source: Company report

After the transaction closes, Permira would have a controlling stake in the combined group. The group's future capital structure and financial policy remain unknown at this stage, although, as is usual in private equity-sponsored deals, we would expect a tolerance for high leverage. These will be key elements in determining the future rating of the combined group.

The transaction arises in a challenging operating context for plasma-derivative producers. Kedrion has been affected by the prolonged effects of the coronavirus pandemic on its operating performance, which has in turn weakened its liquidity profile. Still-low US plasma collection volume and high donor fees will continue to affect its earnings and cash flow in the next 12-18 months, maintaining its leverage at elevated levels.

Established in Italy in 2001, Kedrion is a biopharmaceutical company that collects and fractionates plasma to produce and distribute plasma-derived products for the prevention and treatment of conditions such as hemophilia, primary immunodeficiencies and Rh sensitization. It is the fifth-largest provider of plasma-derived products in terms of revenue, with a global market share of around 3% and 2020 and revenue of €697 million. Kedrion has two main shareholders: the Marcucci family, with 50.27% of company shares, and CDP, through FSI Investmenti S.p.A. and FSI S.G.R. S.p.A., with 49.17%.

Marie Fischer-Sabatie, *Senior Vice President*
Moody's Investors Service
marie.fischer-sabatie@moodys.com
+33.1.5330.3391

Jeanine Arnold, *Associate Managing Director*
Moody's Investors Service
jeanine.arnold@moodys.com
+33.1.5330.1062

LG Chem's IPO of wholly owned battery subsidiary is credit positive

Originally published on 24 January 2022

On 21 January, LG Chem, Ltd. (Baa1 positive) raised around KRW12.7 trillion (around $10.6 billion) at the consolidated level through the IPO of its wholly owned battery subsidiary, LG Energy Solution, Ltd. (LGES), a leader in the global electric vehicle (EV) battery industry. The IPO reduces LG Chem's ownership of LGES to 81.8% from 100%. While the transaction will slightly reduce LG Chem's access to LGES' cash flow, it is credit positive for LG Chem because the sizable net proceeds from the IPO can be used to fund its large capital spending, particularly in its EV battery business, thereby containing debt increases.

Based on the total offering of 42.5 million shares at a final price of KRW300,000 per share, LG Chem sold 8.5 million existing shares for around KRW2.6 trillion, while LGES issued 34 million new shares with net proceeds of around KRW10.1 trillion. The net proceeds of KRW12.7 trillion at the consolidated level equate to around 90% of LG Chem's reported consolidated debt of KRW14.0 trillion as of 30 September 2021, while the net proceeds of KRW10.1 trillion at the LGES level exceed LGES' reported consolidated debt of KRW7.1 trillion as of the same date.

We will review LG Chem's refined capital spending plan, business strategy and shareholder return policy, which we expect to be available in the coming weeks, to assess the ultimate effect of the IPO on its credit quality. If capital spending and shareholder distributions increase significantly, the positive effect of the IPO on its balance sheet could be offset.

Revenue from LGES' battery business will grow strongly and profitability will improve gradually over the next couple of years, underpinned by a large order backlog. However, its contribution to LG Chem's cash flow will remain low because of large capital spending and working capital deficits. This business also faces significant obstacles in maintaining adequate yields and product quality. If these obstacles increase, this could strain LGES' profitability.

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

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

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

Singtel and Grab's investment in Bank Fama is credit positive

Originally published on 24 January 2022

On 21 January, Singapore Telecommunications Limited's (Singtel, A1 stable) wholly owned subsidiary Singtel Alpha Investments Pte. Ltd. acquired a 16.26% equity stake in PT Bank Fama International (Bank Fama) for a cash consideration of IDR500 billion ($35 million). Singtel will fund the acquisition through internal sources, and the company had a cash balance of SGD767.5 million ($565.6 million) as of September 2021. The transaction is credit positive for Singtel because it will accelerate the growth of its digital business and is consistent with its strategy to further its digital banking business across Asia, particularly in markets where it has a strong presence.

Grab Holdings Inc. (B2 stable), Singtel's digital banking partner in Singapore and Malaysia, also acquired a 16.26% equity stake in Bank Fama for IDR500 billion ($35 million). The $35 million initial investment can be funded out of Grab's large cash balance, estimated at $9.6 billion as of September 2021. The investment will benefit Grab and fits well with the company's strategic priority of playing an important role in reinventing mobile payments and financial services that would help further accelerate the growth of the digital economy in Indonesia. The acquisition follows Grab's prior investments in Indonesian digital payment platform OVO in 2018 and 2021.

While Bank Fama is a small Indonesian bank with a market share of less than 1%, Singtel and Grab's investment will intensify competition in Indonesia's developing digital banking sector.

The acquisition marks Grab and Singtel's expansion into Indonesia's banking sector following their winning bid for one of the four digital bank licenses in Singapore, which is expected to launch this year. The same consortium also applied for a Malaysian digital banking license in July 2021.

Indonesia offers greater growth prospects for financial services than Singapore, with total digital financial services revenue expected to grow more than fourfold to $9 billion by 2025. Although Indonesia is the Association of Southeast Asian Nations' (ASEAN) largest unbanked and underbanked market, the country has mobile penetration rates of more than 100%. In Indonesia, more than 70% of the population is either unbanked or underbanked.

Through the investments by Singtel and Grab, Bank Fama will have a strategic advantage of access to a large customer base through Grab's ride-hailing/food delivery platform and e-wallet under the OVO brand in Indonesia, and Emtek Group's e-commerce platform Bukalapak and e-wallet Dana. The latter is Singtel and Grab's local partner, a leading media conglomerate that remains the bank's majority shareholder.

In addition, Bank Fama can leverage the behavioral and transactional data in these platforms for underwriting purposes and extend credit to the unbanked population. The data will serve as alternative information for millennial users, as well as small merchants and private hire drivers providing services on these platforms. The incumbent banks avoid lending to these segments because of their lack of credit history or verifiable income as self-employed individuals.

Unlike several countries in the region, Indonesia's financial regulator does not have a separate licensing framework for digital banks. Instead, the country's licensing rules, which were revised in August 2021 to include digital banks, encourage existing banks to be fully digitalized by setting a higher core capital requirement for newly established banks. The rules, coupled with the increase in minimum core capital for existing commercial banks to IDR3 trillion from IDR100 billion by the end of 2022, have triggered a series of acquisitions of small lenders by local and overseas tech firms, domestic conglomerates and incumbent banks. Gojek, GoTo's ride-hailing and food delivery arm, Sea Limited, which operates regional e-commerce platform Shopee, and leading local banks Bank Central Asia Tbk (P.T) (Baa2 stable, baa2[1]) and PT Bank Rakyat Indonesia (Persero) Tbk (Baa2 stable, baa2) have also acquired stakes in small lenders.

Further investments in Bank Fama could be required to shore up Tier 1 capital before the end of 2022, though Singtel and Grab's proportionate share can be funded through each company's internal cash flows or cash holdings. To achieve full bank status in Singapore, the Singtel Grab joint venture also needs to have SGD1.5 billion in paid-up capital in Singapore, of which Singtel's share is

SGD600 million. We expect the investment to be spread over three phases, with the bulk of it being spent in the final phase, which is expected over four to five years. Singtel is also exploring more digital banking opportunities across ASEAN countries.

Endnotes

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

Nidhi Dhruv, CFA, *VP-Senior Analyst*
Moody's Investors Service
nidhi.dhruv@moodys.com
+65.6398.8315

Stephanie Cheong, *AVP-Analyst*
Moody's Investors Service
stephanie.cheong@moodys.com
+65.6311.2606

Tengfu Li, *Analyst*
Moody's Investors Service
tengfu.li@moodys.com
+65.6311.2630

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

Russia's proposed prohibition of crypto assets is credit positive for local banks

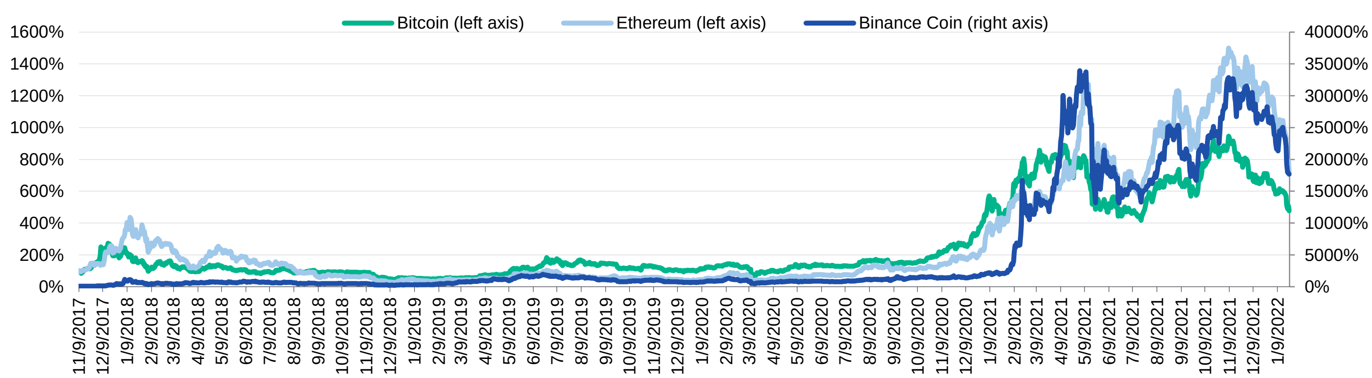
Originally published on 26 January 2022

On 20 January, the Central Bank of Russia (CBR) published a consultation paper for public discussion with banks and market participants on cryptocurrencies and digital financial assets, in particular, private unsecured cryptocurrencies and stablecoins. The CBR proposed a total ban on the issuance, circulation and exchange of private cryptocurrencies in Russia as well as on any operations involving them in the Russian financial system. In addition, the CBR proposed introducing penalties for breaches of the rules if they are approved by the Parliament. The proposed restrictions would not apply to the ownership, purchase and sale of crypto assets by Russian citizens abroad.

Enactment of the CBR proposals would be credit positive for local banks because it would restrict their exposure to entities offering cryptocurrency services, which have so far been largely unregulated. In addition, crypto assets have the potential to increase risks to the stability of the local financial system.

Although private virtual currencies could promote technological development in money and payments, in the CBR's view, crypto assets increase risks to banks and their creditors because crypto assets' prices are highly volatile and largely driven by speculative, rather than fundamental factors (see exhibit). In addition, cryptocurrency participants are highly concentrated, creating the risk of price volatility. For instance, 0.1% of crypto miners control about 50% of cryptocurrency production and 10% of crypto miners account for about 90% of production.

The price (in US dollars) of cryptocurrencies has been extremely volatile over the past five years
Price as of 9 November 2017 = 100%



Source: Yahoo Finance

In addition to crypto assets' credit, market and liquidity risks, banks and their creditors bear operational (including fraud and cyber) risks, money laundering and illegal activity financing risks, as well as legal and reputational risks because the crypto asset market is not universally protected or regulated.

In the CBR's view, the use of private cryptocurrencies in emerging markets may also undermine the national currency because it diverts money from circulation and economic financing, and results in capital flight, higher interest rates in the local economy and systemic risk.

Meanwhile, Russia's Finance Ministry, other government agencies and legislatures have opposed this proposal because the measures to ban the use of private cryptocurrencies may exclude Russia and its financial institutions from potential innovations in global digital currencies and block-chain technology that could bring economic benefits. Instead, they suggested establishing a regulatory framework for cryptocurrencies, while banning their use only as a means of payment for now.

A total ban would also run counter to Russia's adoption of the Cryptocurrency and Digital Assets Bill, which came into force in January 2021. The bill proposed regulating crypto taxation and also gave legal status to cryptocurrencies, helping to make Russia the world's third-largest player in crypto mining, behind the US and Kazakhstan.

Russia is not the only country that may prohibit crypto assets as a means of payment. India is also about to introduce similar prohibitions, while more than 40 countries – among them China, Egypt, Indonesia, Qatar, the UAE, Turkey and Vietnam – have already partially or entirely banned the use of crypto assets. Last year, the Basel Committee on Banking Supervision published a conservative framework on the prudential treatment of banks' crypto (or private digital) asset exposures to protect banks' creditors from increased exposure to such assets.

Petr Paklin, ***VP-Senior Analyst***
Moody's Investors Service
petr.paklin@moodys.com
+7.495.228.6051

Consent order termination is credit positive for Wells Fargo, but work to meet regulatory expectations remains

Originally published on 24 January 2022

On 20 January, Wells Fargo & Company (A1 negative) announced that the Office of the Comptroller of the Currency (OCC) had terminated a 2015 consent order related to add-on products the bank sold retail customers before 2015. This marks the third consent order termination or expiration by Wells Fargo's federal banking regulators since January 2021, a credit-positive indication that the bank will continue to chip away at its regulatory to-do list.

Nevertheless, multiple outstanding regulatory consent orders highlight that Wells Fargo has to continue remedial work on its risk and control infrastructure to meet regulatory expectations, given its size and complexity. The most prominent of these is the Federal Reserve's February 2018 broad consent order, which includes an asset cap, preventing the bank from growing.

As the exhibit below shows, it took Wells Fargo between five and six and a half years to satisfy each of the three recently resolved regulatory consent orders. This indicates that the remaining work will likely be a multiyear process, though we believe Wells Fargo's current leadership team has sharpened the bank's focus on its regulatory requirements, particularly following the appointment of current CEO Charlie Scharf in 2019. Nonetheless, if the consent order that includes an asset cap is outstanding for five years, Wells Fargo's growth restrictions will continue until at least early 2023.

Recent experience suggests that resolving Wells Fargo's regulatory consent orders takes at least five years

Regulator	Consent order area of focus	Month entered into	Month terminated/exited	Time to resolution (months)
Office of the Comptroller of the Currency	Retail bank add-on products	June 2015	December 2021	78
Consumer Financial Protection Bureau	Retail bank sales practices	September 2016	September 2021	60
Office of the Comptroller of the Currency	Bank Secrecy Act/Anti-Money Laundering compliance	November 2015	January 2021	62

Source: Company reports

In short, resolving Wells Fargo's legacy governance, oversight, compliance and operational risk management deficiencies remains a significant undertaking. Moreover, the work has been costly and has weighed heavily on Wells Fargo's expense base in recent years, a credit negative exacerbated by downward pressure on its net interest income from protracted low interest rates.

The recently terminated OCC consent order arose as a result of what regulators labeled unfair billing practices stemming from identity protection and debt cancellation products Wells Fargo sold many of its retail banking customers from 2004 to 2014. As an example, some customers did not receive the full range of services they paid for, according to the OCC. However, terminating the order indicates that Wells Fargo has now built the proper infrastructure such that its current risk management policies and procedures would prevent a recurrence.

Allen H. Tischler, *Senior Vice President*
Moody's Investors Service
allen.tischler@moodys.com
+1.212.553.4541

Matt Cohen, *Associate Analyst*
Moody's Investors Service
matt.cohen@moodys.com
+1.212.553.0814

Rita Sahu, CFA, *VP-Sr Credit Officer*
Moody's Investors Service
rita.sahu@moodys.com
+1.212.553.1648

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

Ibercaja's planned initial public offering and listing are credit positive

On 20 January, Ibercaja Banco SA (Ba1 stable, ba2[1]) announced its intention to launch an initial public offering (IPO) of its ordinary shares and list on Spain's four stock exchanges. If executed, the transaction would be credit positive for Ibercaja because it would improve the bank's ability to access capital markets, as well as encourage financial transparency and enhance brand recognition.

Ibercaja's actions reflect legislation implemented by the Spanish government in the aftermath of the 2008 global financial crisis to regulate Spanish banking foundations (law 26/2013 or *Ley de Fundaciones Bancarias*). The regulation required savings banks to convert into banking foundations and segregate their banking activities into commercial banks. After that, the foundations had to constitute a reserve fund to cover potential capital shortfalls at the bank unless they reduced their stake to less than 50% and lost control of the bank. The law set the end of 2020 as the deadline for foundations to reduce their stakes, but in April 2020, the deadline was extended to the end of 2022 because of the very difficult operating and market conditions caused by the pandemic.

Ibercaja shares are currently owned by four banking foundations, of which Fundacion Ibercaja is the main owner, holding an 88% stake in the bank. After the IPO, Fundacion Ibercaja expects to reduce its stake in the bank to below 50%, but still maintain control of the entity.

The transaction's benefits to Ibercaja would not only be limited to enhanced market visibility, its credit quality would also improve from the protection offered by the reserve fund that Fundacion Ibercaja would have to constitute in order to keep control of Ibercaja. The size of the reserve fund, which is based on the foundation's ownership percentage and the bank's total capital ratio, would initially amount to 0.6% of risk-weighted assets (RWAs), or approximately €110 million based on RWA data as of June 2021, and would have to be recalculated annually.

Although Ibercaja has not disclosed the timing of the IPO, we understand the bank will seek to accelerate the process to take advantage of current market conditions, which have materially improved for Spanish domestic banking institutions since the beginning of the pandemic. The IBEX 35 Bancos, a stock index that tracks the price of quoted Spanish banks, has increased in value by more than 100% since hitting lows in October 2020 and is now close to pre-pandemic levels.

Other former savings banks have already complied with the Spanish Banking Foundations law. Among Spain's midsize savings banks, Liberbank[2] went public in 2013, and Unicaja Banco (Baa3 stable, ba2) did so in 2017. Kutxabank, SA (Baa1 positive, baa2) opted to build the required reserve fund. ABANCA Corporacion Bancaria, SA (Baa3 stable, ba1) changed ownership in 2014 after the entity was acquired by a group of entrepreneurs.

Endnotes

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

2 Liberbank merged with Unicaja Banco in July 2021.

Alberto Postigo, *VP-Sr Credit Officer*
Moody's Investors Service
alberto.postigoperez@moodys.com
+34.91.768.8230

Maria Cabanyes, *Senior Vice President*
Moody's Investors Service
maria.cabanyes@moodys.com
+34.91.768.8214

Alain Laurin, *Associate Managing Director*
Moody's Investors Service
alain.laurin@moodys.com
+33.1.5330.1059

Maria Vinuela, *VP-Senior Analyst*
Moody's Investors Service
maria.vinuela@moodys.com
+34.91.768.8237

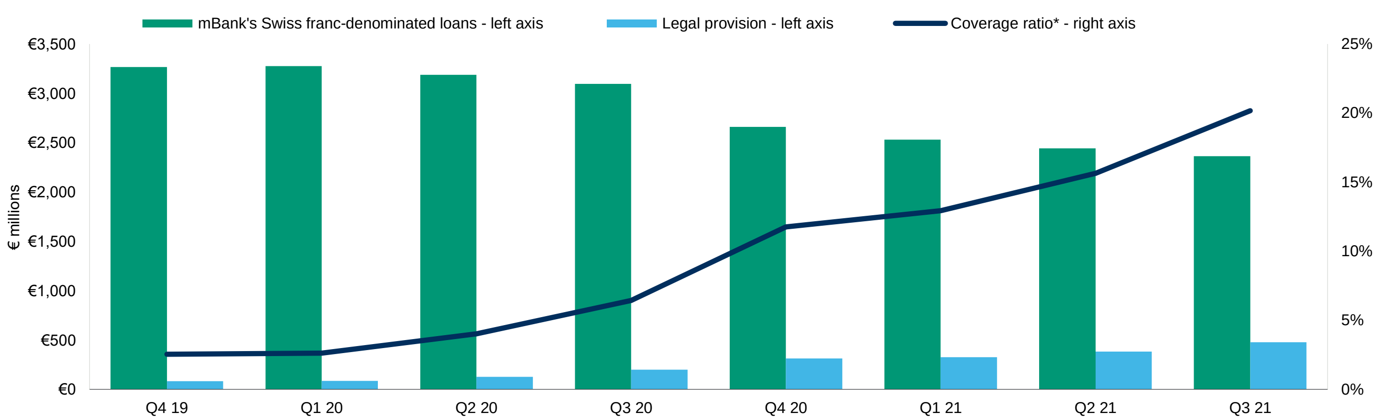
Commerzbank's additional provision on Swiss franc mortgage loans in Poland will burden 2021 earnings

Originally published on 25 January 2022

On 21 January, Commerzbank AG (A1 stable/A1 negative, baa2[1]) announced an additional €436 million legal provision that will burden the bank's fourth-quarter earnings. The additional charge is consistent with our expectation that unresolved litigation risk from Swiss franc-denominated mortgages at mBank S.A. (A3 stable, baa3), Commerzbank's majority-owned subsidiary in Poland, is a major challenge during Commerzbank's transformation. While the charge is likely to reduce full-year 2021 profit, we consider the improved risk coverage beneficial to its long-term profitability and credit positive.

Commerzbank's earnings have been repeatedly reduced by legal reserve building. These legal reserves accounted for 15.2% of the bank's 2020 consolidated pre-provision profit and 4.7% of its 2019 consolidated pre-provision profit, and 12.6% of the total for the January to September 2021 period. As of 30 September 2021, Commerbank's total stock of provisions for this unresolved legal issue was €472 million, or 20% of mBank's €2.4 billion total outstanding volume of Swiss franc loans (see exhibit). Including the new provision, we believe that Commerzbank's coverage improves to around €900 million, or roughly 38%[2] of the total.

Commerzbank has gradually increased its legal risk coverage for Swiss franc-denominated loans at mBank to around 38% as of year-end 2021



* Coverage ratio compares the stock of legal provisions with the outstanding volume of Swiss franc-denominated loans.
Sources: Commerzbank and Moody's Investors Service

We believe that a rising number of individual court cases against mBank as well as more voluntary bilateral settlements between mBank and select clients have triggered the sizeable increase in reserve building. By the end of September 2021, 11,691 borrowers had filed individual court cases against mBank, compared with 6,870 at the end of 2020. The rising charge also reflects a higher probability that a final verdict is in favour of borrower and includes less favorable terms for the bank.

Polish banks are exposed to high legal risks stemming from their exposure to foreign-currency, mainly Swiss franc mortgages, and Commerzbank's subsidiary mBank is one of the most exposed Polish banks. As of 30 September 2021, its Swiss-franc mortgages accounted for €2.4 billion, or around 8.9% of total loans.

The debate around Swiss franc-denominated mortgages has spanned more than a decade in Poland. Following a sharp appreciation of the Swiss franc, Polish borrowers struggled to cope with rising repayment balances. After the Polish government dropped proposals for forced conversions of these mortgages into zloty in 2019, more borrowers turned to the courts. We expect that the ongoing settlement of the legal disputes between Polish banks and borrowers with Swiss franc mortgages will continue to burden Polish banks' profitability and could even wipe out excess capital from some banks. However, the final outcome is unclear at this stage, reflecting that the Polish Supreme Court on 2 September 2021 delayed a decision.

Commerzbank is currently implementing its most ambitious set of measures aimed at improving its long-term profitability, something it has termed Strategy 2024. This latest announcement demonstrates that the bank's path to build a track record of sustainable earnings is challenging and unexpected large expenses can occur during such a comprehensive transformation. Indeed, in July last year the bank recorded an extraordinary write-off of around €200 million related to the cancellation of an outsourcing project associated with its financial securities settlement service.

Endnotes

1 The ratings shown are Commerzbank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

2 We compare the increased coverage to mBank's outstanding Swiss franc loans at the end of September 2021.

Swen Metzler, CFA, ***VP-Sr Credit Officer***
Moody's Investors Service
swen.metzler@moodys.com
+49.69.70730.762

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

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

New Jersey's retiree health liabilities increase sharply, partly driven by medical expenses

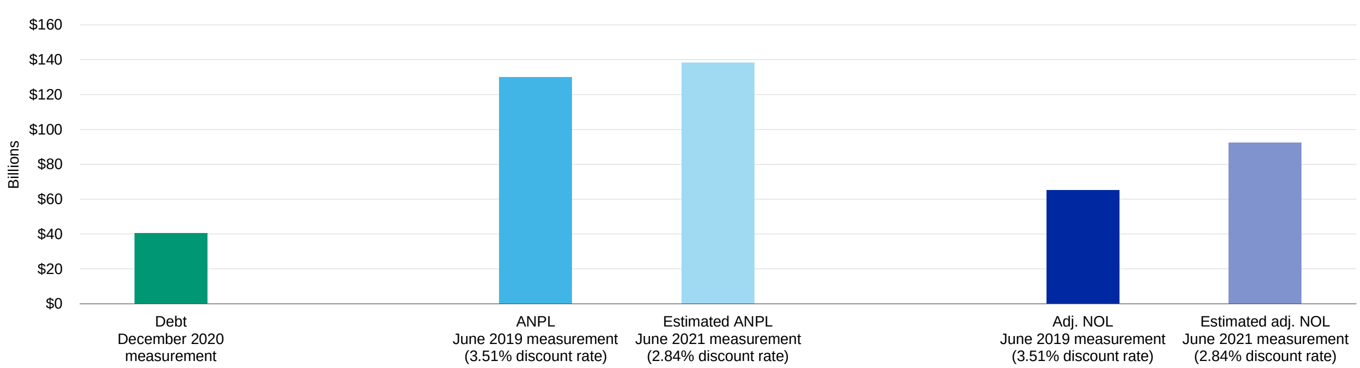
Originally published on 25 January 2022

On 19 January, New Jersey (A3 positive) disclosed an increase of liabilities for retiree health benefits (or OPEBs) that we estimate at roughly $27 billion. The disclosure followed actuaries submitting a draft valuation report for the year ending 30 June 2021. The sharply increased OPEB liabilities are consistent with higher forthcoming annual expenses for retiree healthcare in its budgets, a credit negative. The hike also marks a sudden reversal of a declining trend in New Jersey's unfunded OPEB liabilities, which are among the most substantial of the 50 states.

The state disclosed that its reported Education Retired Fund OPEB liability would increase to about $67.8 billion in the 2021 valuation from $41.7 billion the prior year. Faster growth in Medicare Advantage expenses for retirees accounted for about $12.3 billion of the total $26.1 billion increase. The remainder was attributable to a reduction in the interest rate used to value the liability (a factor that is outside our analysis because we apply a different discount rate to produce our adjusted net OPEB liability).

Based on the state's preliminary update to its OPEB liabilities, we estimate that New Jersey's adjusted net OPEB liability (ANOL) was roughly $92 billion as of 30 June 2021 (see Exhibit 1), an increase of $27 billion from our ANOL of $65 billion measured on 30 June 2019. More than two-thirds of the ANOL increase is attributable to higher projected medical costs, and the remainder to a lower discount rate used in our adjustments.

Exhibit 1
Adjusted Net OPEB Liability increased more than pension liability in latest period, based on our estimate



Source: State audited financial statements and disclosure documents with Moody's adjustments.

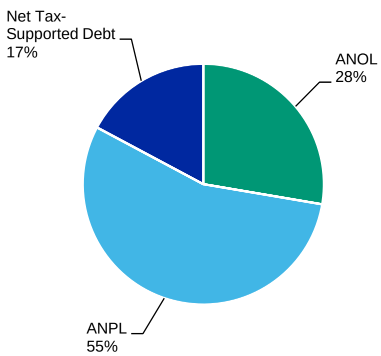
In its disclosure, filed as a supplement to a bond offering document, the state cited "claim and premium experience, primarily resulting from higher-than-expected Medicare Advantage claims leading to an increase in projected Medicare Advantage premiums for Plan Year 2023." As a consequence of the bigger-than-anticipated claims, the actuary revised projected medical cost increases for fiscal years 2023 and 2024 to 22.6% and 18.5%, respectively, from assumed growth of 4.5% in the preceding year's valuation. New Jersey officials noted that these projected high cost trends may be subject to change when additional information about fiscal 2023 costs is available. New Jersey's experience could foreshadow similar challenges for other state and local governments that have looked to Medicare Advantage programs to control mounting OPEB costs.

Unfunded OPEBs account for a large portion of New Jersey's long-term liabilities, in part because the state is one of a minority that carry the funding burden of teacher retirement benefits. Including its outstanding bonds, adjusted net pension liability (ANPL) and ANOL, New Jersey's long-term liabilities amounted to $236 billion as of 2020, before the latest increase.[1] The state's total liability burden is among the highest of all states, comparable to that of Illinois (Baa2 stable) as a share of state GDP. For New Jersey, more of the liability burden is concentrated in health benefits. As of the state's fiscal year 2020 financial reporting, before the latest increase, New Jersey's OPEBs accounted for 28% of total long-term state liabilities (see Exhibit 2), compared with about 18% for Illinois. New Jersey benefits from legal flexibility to reduce benefits for retirees that Illinois lacks, because of retirement benefit protection language in the Illinois state constitution.

The increase marks a reversal of a recent decline in New Jersey's OPEB liabilities (see Exhibit 3). The state in its 2020 annual comprehensive financial report said that its roughly $1.6 billion contribution (which is made on a pay-as-you-go basis) for OPEBs and its liability had both declined in the year ended 30 June 2020. It cited "various cost savings initiatives implemented by the State, including new Medicare Advantage contracts." The magnitude of annual cost increases for OPEBs facing New Jersey in light of OPEB liability increases is currently unknown.

Exhibit 2

OPEBs account for a large share of New Jersey's long-term liabilities

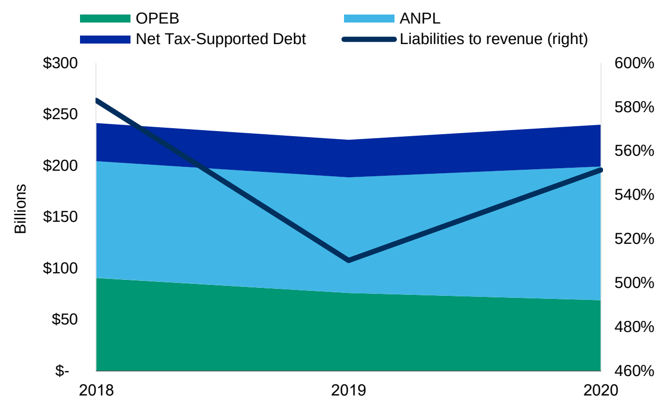


Based on MIS data as of fiscal 2020

Sources: Audited financial statements, Moody's Investors Service

Exhibit 3

New Jersey's adjusted net OPEB liabilities declined in recent years



For comparability, the trend data for ANOL includes liabilities related to business type and component unit activities, which are not included in pie chart. Revenue in "liabilities to revenue" is own source revenue (governmental fund revenue excluding federal revenue).

Source: Moody's Investors Service, based on audited financial statement data

Endnotes

1 The 2020 liability figures include net tax-supported debt as of the end of calendar year 2020 and retirement benefit liabilities based on plan measurement dates in the preceding year.

Ted Hampton, *VP-Sr Credit Officer*
Moody's Investors Service
ted.hampton@moodys.com
+1.212.553.2741

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

Emily Raimes, *VP-Sr Credit Officer/Manager*
Moody's Investors Service
emily.raimes@moodys.com
+1.212.553.7203

Nicholas Samuels, *Senior Vice President*
Moody's Investors Service
nicholas.samuels@moodys.com
+1.212.553.7121

FAQ on 10 key issues that will shape global credit in 2022

Originally published on 26 January 2022

In this report, we answer frequently asked questions from investors and other market participants on the continued credit effects of the COVID-19 pandemic, inflation trends, monetary policy, climate goals and other factors. We have distilled Moody's analysts' responses to these questions, as expressed in our 2022 sector outlooks and other research, to highlight the 10 key considerations that will determine credit performance in 2022.

The questions we address are these:

» Will the Omicron variant derail the global recovery?

» Are we likely to see another spike in defaults this year?

» How long will supply disruptions last?

» What would change our view that inflation will fall back close to central bank targets in advanced economies?

» Which emerging market (EM) countries are vulnerable to a sudden stop if US interest rates rise more rapidly than markets currently anticipate?

» Will the Fed look to reduce its balance sheet once it ends quantitative easing purchases, and at what pace?

» Are banks able to fund the post-COVID-19 recovery? Will asset quality issues emerge?

» What are the implications of high economy-wide debt levels?

» How big are the risks to the Chinese economy and what is the potential knock-on impact?

» Is limiting global warming to 1.5 degrees, relative to pre-industrial levels, now unlikely? What wouldbe the credit implications if that level is exceeded?

Click here for the full report.

Fed's US CBDC report highlights both the potential efficiencies of digital money and funding risks for banks

Originally published on 25 January 2022

On 20 January, the US Federal Reserve published a report outlining the benefits and risks of a US central bank digital currency (CBDC) and soliciting feedback on 22 questions. The report is an important first step in opening a public dialogue on the subject in the US.

The report examines how a risk-free digital currency issued by the central bank may help modernize the means by which people transact using digital dollars, while also increasing the public's access to "safe central bank money," increasing financial inclusion and potentially bolstering the attractiveness of the US dollar as a reserve asset.

In our view, a well-designed CBDC would be a faster, easily accessible form of public money that is free from credit and liquidity risk, and has the potential to introduce cost efficiencies in payment systems and spur innovation in digital money. However, some of these aspects also increase disintermediation and funding risks for banks and payments system providers. A CBDC could also introduce additional risks into the financial system, such as more centralized cyber risks. The actual systemic and credit effect that a potential US CBDC would have would depend critically on the specific design choices in its construction.

A number of Federal Reserve officials have made statements that either support or question the need for a CBDC. In laying out the pros and cons, the report does not take a final stance. Nonetheless, the report highlights the potential public benefits of extending public access to safe central bank money instead of having digital fiat money remain a product of commercial banks. And it recognizes the ability of a CBDC to be a platform of innovation, saying a CBDC would have the ability to level the playing field in payment innovation by allowing private sector firms of all sizes, including banks and nonbanks, to focus on offering new services and functionalities utilizing a CBDC.

The report also cites the high costs of current payment systems, especially cross-border remittances. We believe that in many countries, today's electronic money falls short of its potential because the complex and fragmented systems it navigates to fulfill payments, particularly across national borders, slows the process and increases costs. The report cites a high average cost relative to domestic US payments of 5.41% for sending a remittance from the US to other countries in 2021. Causing the sluggishness and extra costs are multiple gatekeepers and intermediaries that extract rents throughout the process.

A CBDC would be a faster form of public money that is free from credit and liquidity risk, and an interoperable and flexible CBDC also has the potential to offer new capabilities not possible with current electronic money, such as programmability and micropayments.

The Federal Reserve set out several potential risks a CBDC poses, including increased uncertainty in monetary policy management, more centralized cyber risks and potential risks to financial intermediaries and financial stability. A CBDC, by providing individuals and businesses a risk-free direct claim on the central bank, could attract funds away from other cash alternatives such as bank deposits, money market funds and stablecoins. The potential effect on deposits would be credit negative for banks and could lead to a rise in their funding costs as deposits become scarcer.

A CBDC would also be credit negative for payment providers, since it would likely cut the fees they earn from processing transactions. The final design of any CBDC – including whether it is interest-bearing, who is permitted to hold it, for how long and in what amounts – will be a critical determinant of the credit effect on banks and other incumbent financial intermediaries.

The Federal Reserve said its initial view is that the central bank would not directly operate CBDC accounts or wallets itself. Instead, it expects that a US CBDC would likely be intermediated by private-sector participants with accounts and wallets operated by private-sector firms, including banks. This is the so-called two-tier model, a common approach pursued by other central banks.

The report recognizes that, amid rapid global advancements in digital currencies, a well-designed US CBDC could bolster the dollar's continued primacy in international transactions and finance against increasingly competitive CBDCs issued by other countries and currency unions. We believe that a well-designed CBDC could also help preserve the US dollar's status against increasingly competitive private digital currencies, such as stablecoins.

The request for comment lasts for 120 days. The Federal Reserve reiterated that it does not intend to proceed with the issuance of a CBDC without clear support from both the executive branch and Congress, ideally through legislation.

Stephen Tu, *VP-Sr Credit Officer*
Moody's Investors Service
stephen.tu@moodys.com
+1.212.553.4935

David Fanger, *Senior Vice President*
Moody's Investors Service
david.fanger@moodys.com
+1.212.553.4342

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

Atsi Sheth, *Managing Director - Credit Strategy*
Moody's Investors Service
atsi.sheth@moodys.com
+1.212.553.7825

RECENTLY IN CREDIT OUTLOOK

Articles in last Monday's Credit Outlook

FIRST READS

- Microsoft's acquisition of Activision enhances strategy to invest in content, community and cloud services
- For Activision, Microsoft acquisition is credit positive

NEWS & ANALYSIS

Corporates

- Cheplapharm's IPO plans and intended debt repayment are credit positive
- PGE Polska Grupa Energetyczna's planned equity increase is credit positive
- Macao's proposed bill amending gaming laws will reduce regulatory uncertainties, a credit positive

Infrastructure

- PGE Polska Grupa Energetyczna's planned equity increase is credit positive

Banks

- Increasing auto loan charge-offs in Q4 2021 are a harbinger of deteriorating consumer credit in 2022
- Russian mortgage borrowers' debt burden increases, a credit negative for banks
- Potential merger would be credit positive for Sohar International, Bank Nizwa
- UOB's acquisition of Citi's consumer assets will strengthen its market franchise in ASEAN

Sovereigns

- Jamaica's second supplementary budget revises spending higher, while keeping debt on a firmly downward trajectory

Sub-sovereigns

- New Sales Wales' Generations Fund finances AUD1 billion of debt retirement, a credit positive

US Public Finance

- Resolution of Seneca Nation gaming revenue dispute is credit positive for Buffalo and Niagara Falls, New York

MOODY'S MACRO MONDAY

- Tightening external financial conditions will compound emerging market central banks' challenges

Click here for last Monday's Credit Outlook.

Editors

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

REPORT NUMBER 1317483