

# Weekly Credit Update

## Summary

- CDS spreads are wider following higher risk aversion
- The Obama administration has put forward a new proposal for regulating the US financial sector
- In Denmark, Fionia Bank Holding has conceded that all equity capital is lost. The healthy part of the bank is expected to be sold.

## Headlines from the credit market this week

A sense of weakness seems to have crept into the credit market recently and in the Nordic region it is once again the Baltic exposures of the banks that grabs the negative headlines. CDS spreads have widened somewhat as volatility has increased. In the cash market, which has performed strongly for several months, we also see more offers and we expect this picture to remain the same at least until the end of Q2. Still, the shorter end of the curve continues to be well bid.

The investment grade index, iTraxx Europe, currently trades at 123bp, which is 15bp higher than last week. The high yield index, iTraxx Crossover trades at 750bp up from 682bp last week.

During the week we continued to see good activity in the primary market. If the recent increased volatility gathers speed, the activity in the primary market may slow considerably in the coming months as the summer season is approaching fast.

### iTraxx Europe (5Y CDS)



Source: Markit

### iTraxx Crossover (5Y CDS)



Source: Markit

### VIX volatility index



Source: Bloomberg

### Table 1. Selected new issues during the week

Name	Rating	Coupon	Maturity	Currency	Size	Bond spread on issue date, ASW (bp)*
Swedbank (gov guar)	Aaa/AAA	Fixed	4Y	USD	1.0bn	45
Swedbank (gov guar)	Aaa/AAA	FRN	4Y	USD	0.5bn	45
Storebrand Liv (UT2)	Baa2/BBB	Fixed	6Y	NOK	1.0bn	Yield = 11.9%
EDP	A3/A-	Fixed	7Y	EUR	1.0bn	Gov +155
Commerzbank	Aa3/A	Fixed	6Y	EUR	1.0bn	Gov +198
Imperial Tobacco	Baa3/BBB	Fixed	3Y	EUR	1.25bn	Gov +321
Lafarge	Baa3/BBB-	Fixed	7Y	EUR	0.75bn	Gov +447

Note: Ratings are Moody's and S&P. \* Mid-Swaps for Fixed, Discount Margin for floating

Source: Danske Markets & Bloomberg

## New proposal for regulation of US financial industry

In a White Paper published on Wednesday, the Obama administration presented its proposal for a new framework for regulation of the US financial industry. The plan is to create a superior council which purpose is to monitor the financial sector and identify any emerging risk in firms or the market. The proposal intends to increase supervision of all financial firms that are found to pose a threat to the financial stability. Furthermore, it is expected that the capital and liquidity requirements for all financial institutions will increase. A more detailed proposal in this regard will be presented by the end of 2009.

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Concerning loan loss provisioning, the US intends to make it more forward-looking. This will bring it closer to how it was done before (in e.g. Denmark) with banks building up reserves in the good periods, which implies that we most likely will not see periods of large net reversals as we did in 2005-2007 in the Nordic countries for example.

There are a number of other things that will be changed including limiting off-balance sheet accounting, controlling managers' compensation, limiting the supply of structured and other products that the consumer does not understand, increasing the control of hedge funds and, finally, strengthening the supervision of securitisation.

The proposal is not a major surprise as everybody was expecting stricter regulation including a higher capital requirement (in this respect it is worth noticing that a de-facto higher capital requirement has already been imposed by the market). Generally, bond holders across the capital structure are likely to benefit from the new rules as the equity cushion most likely will increase. Note that so far it is only a proposal – tough negotiations remain and the final outcome is therefore far from carved in stone. However, additional regulation is a certainty.

#### **Fionia Bank Holding has lost its equity – retail bank set to be sold off**

In connection with the preparation of the financial statement for the first six months of 2009 Fionia Bank (total assets of DKK 34bn by end Q1 09) ascertained that a considerable write-down must be expected. The main reason is the very negative market conditions for investment property.

Fionia Holding A/S owns all, bar one, shares in Fionia Bank. A couple of months ago shares and voting rights were pledged to “Financial Stability” (the Danish winding-up company owned and guaranteed by the Danish Government) in exchange for a capital injection of DKK 1bn. Due to the additional write-downs management of Fionia Bank has subsequently stated that the equity of Fionia Holding A/S must be considered lost.

Financial Stability will inject the necessary capital in the bank to ensure that the bank remains a going concern but a sales process has now started in which the healthy part of the bank will be sold to a third party. So far, Spar Nord Bank has confirmed its interest and Nordea has also indicated that it may post a bid. The old Fionia Bank (Holding) and toxic assets will be in wind-up.

For senior bondholders nothing has changed but the recovery rate on the subordinated debt is likely to be smaller (we believe nothing will be left for subordinated bond holders).

## Fixed Income Credit Research

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