

# Debt Markets

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# Background

## Key Issues

- Term Funding
- Capital
- Balance sheet restructuring

## Challenges

- Regulation
- Rating agencies
- Market congestion
- Uncertainty around market reaction to withdrawal of ECB purchases
- Demand bottleneck
- Economic outlook and sentiment

## Investors

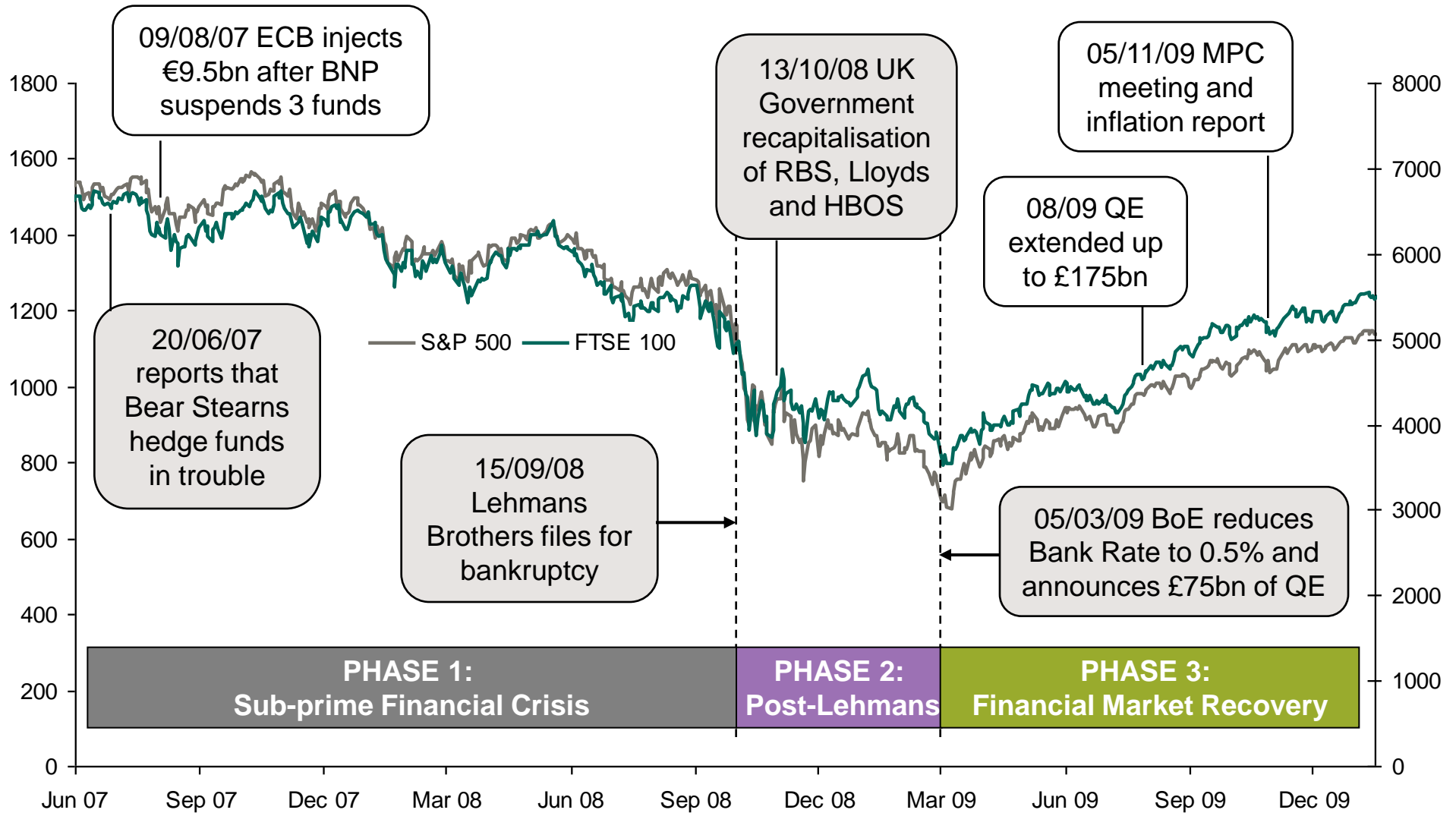
- Largest investors are looking for the exit
- Insurance regulations are changing



## Review of 2009

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# Evolution of the Financial Crisis



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# Recovery in Financial Markets: Bond Markets

## Bond Markets

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### Start 2009

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#### Post Lehmans Crisis

- Spread correction as multi-year credit bull run brought to an end
  - Capital markets reopened but only to non-cyclical, defensive sectors.
  - Market closed to low investment grade and sub-investment grade issuers
  - Large new issuance premiums and poor secondary market liquidity
  - Markets still volatile, with issuance limited to “windows” of opportunity
  - Oversubscription for the right names at the right price
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# Recovery in Financial Markets: Bond Markets

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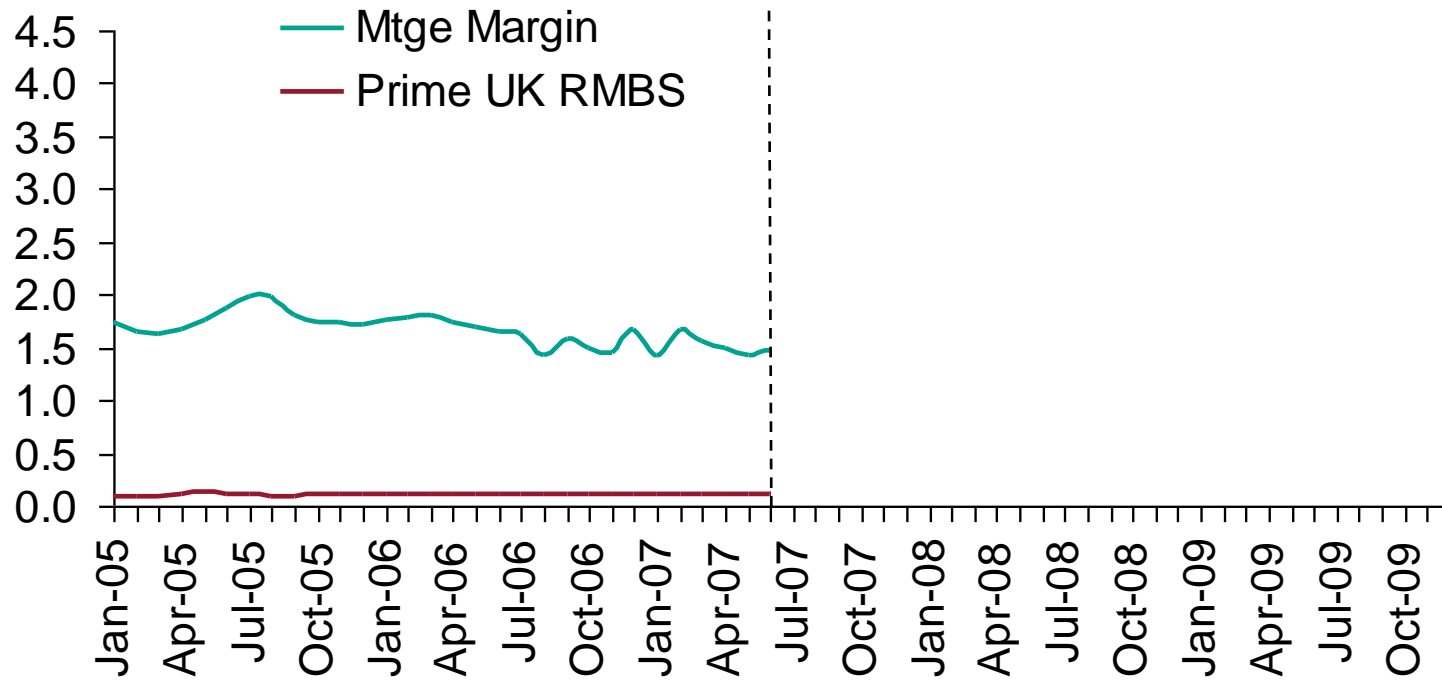
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### End 2009

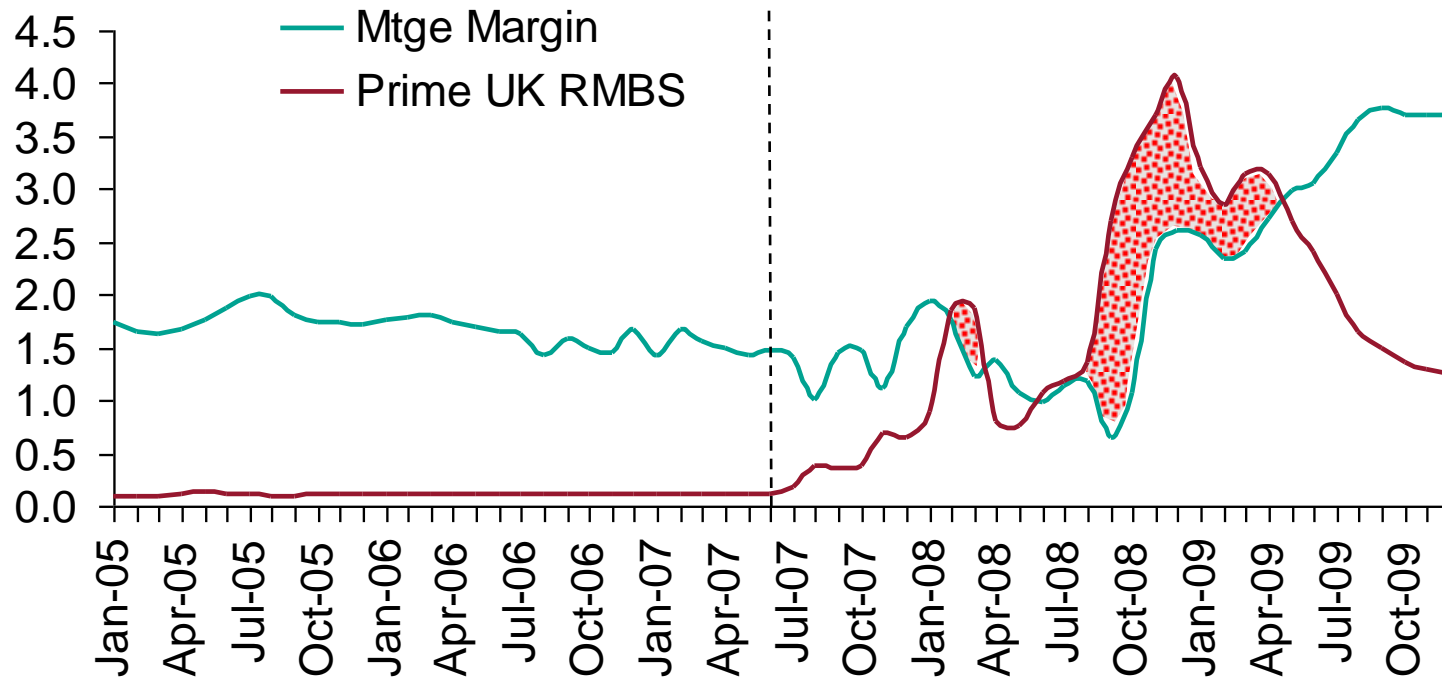
#### Buoyant financial markets

- Significant inflow into corporate bonds in second half of 2009 and covered bonds as funds reallocate.
- Yield on corporate bonds begin to fall
  - Significant tightening of both gilt yields (from QE)
  - Oversubscription levels increase
  - Spreads tighten significantly
- Crossover, unrated and high yield markets also open
- Concerns over ‘bubble like’ conditions

# UK Prime Mortgage Net Margin (%)



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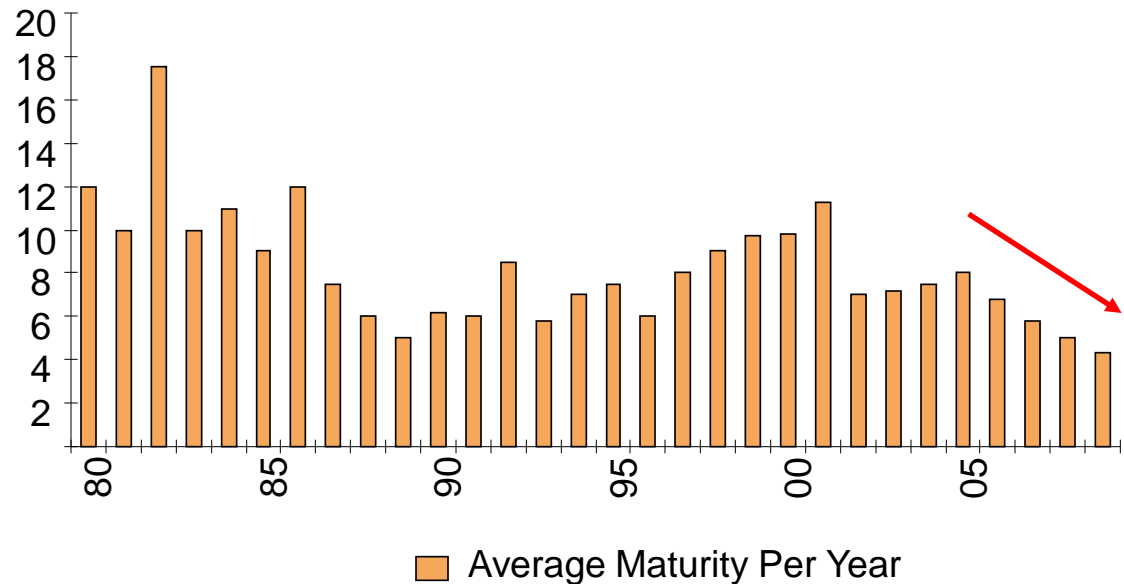




# Key Market Issues

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# Refinancing needs exacerbated by shorter maturities

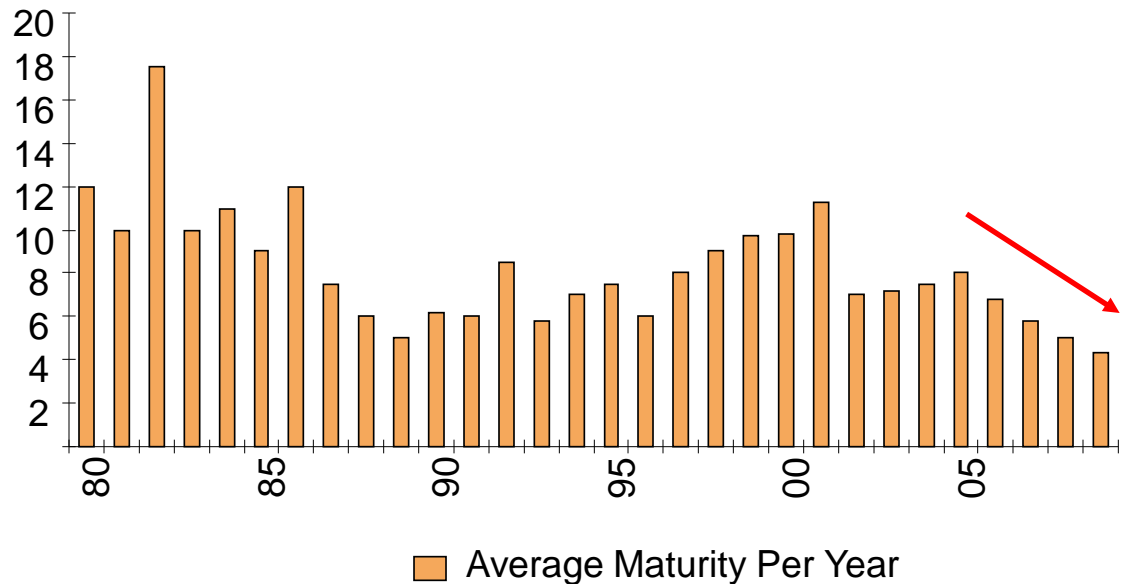


- Moody's highlight a shortening of wholesale debt maturities across several banking systems
  - At a global average maturity of 4.7 years
  - New debt issuance in the banking sector is at a 30-year low
  - UK fell from 11.3 years in 2001 to 4.3 years in 2009

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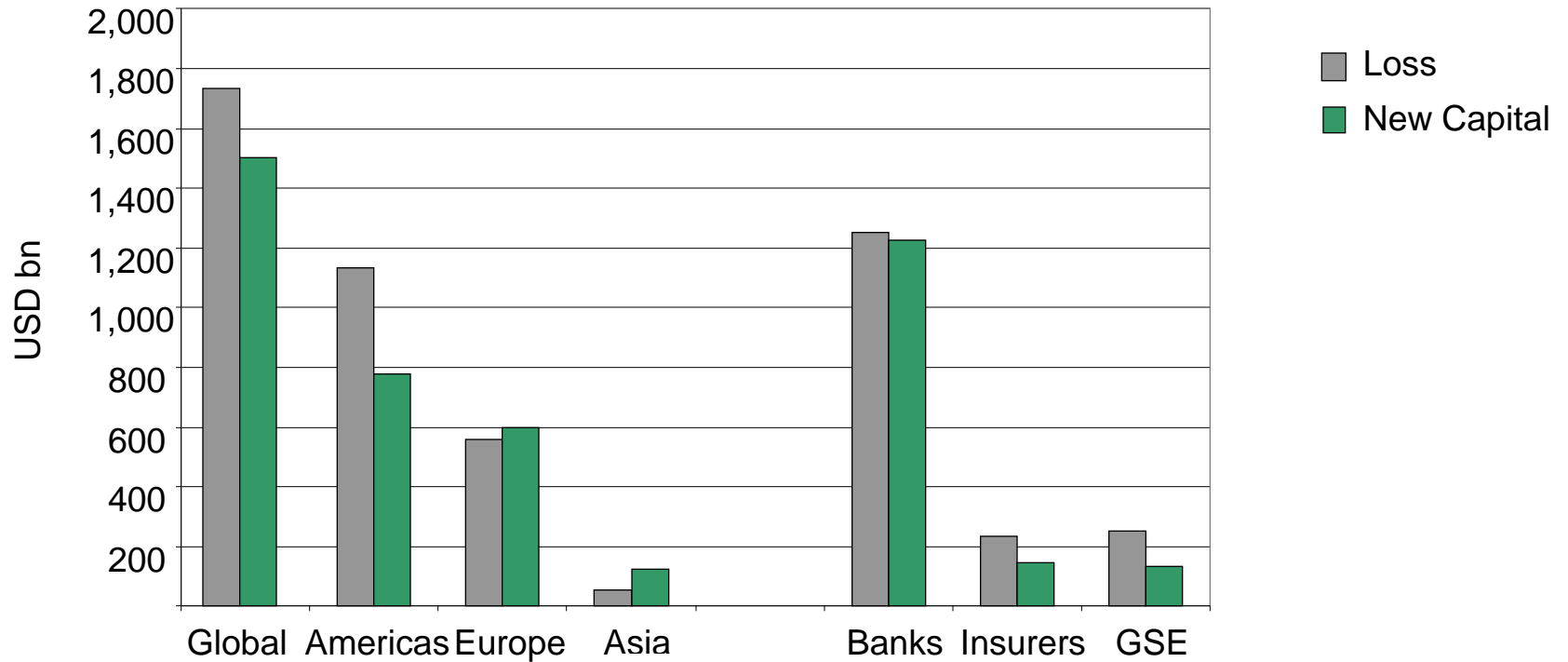
## United Kingdom

	Maturing (USDm)
2009	140,280
2010	146,955
2011	192,574
2012	169,377
2013	86,116
2014	75,295
2015	36,647
<b>Total</b>	<b>847,244</b>

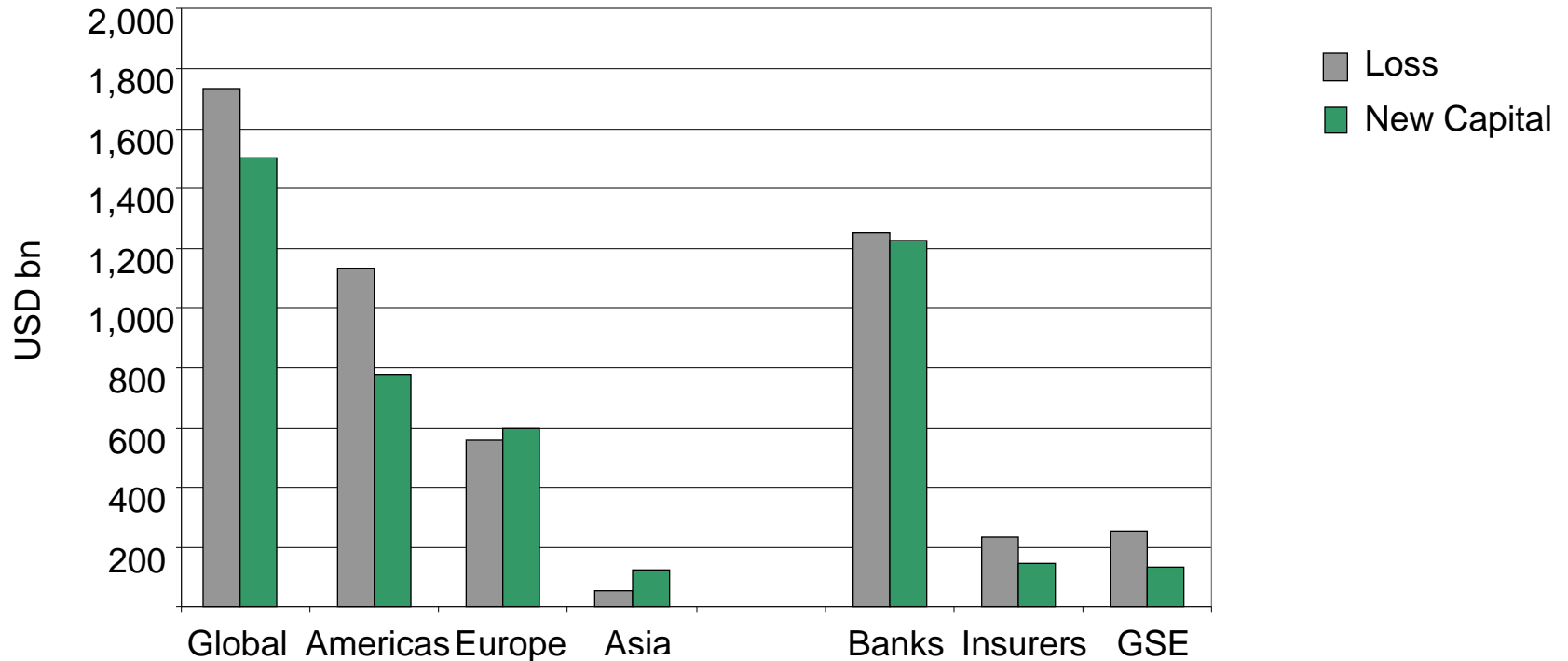


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- Moody's estimates that banks will face maturing debt of USD10 trillion by the end of 2015

# Writedowns & Credit Losses v Capital Raised



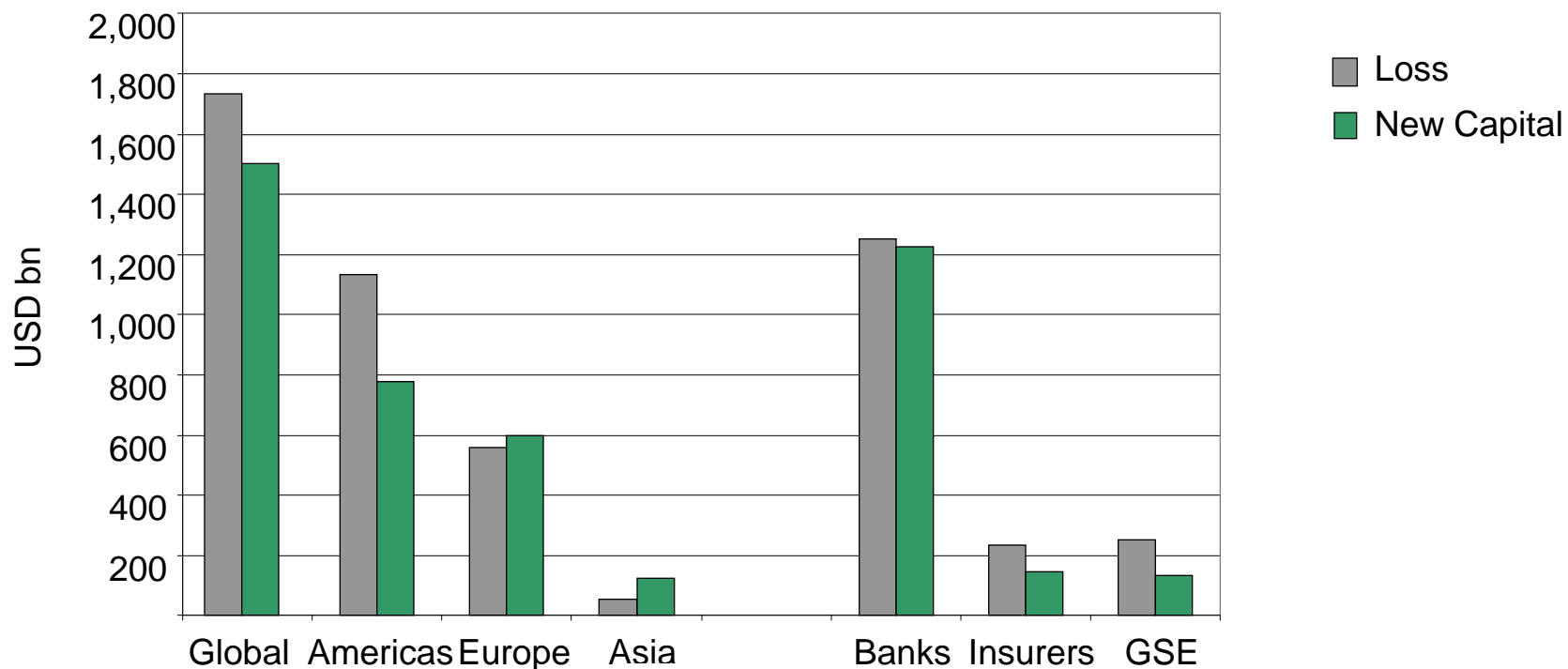
# Writedowns & Credit Losses v Capital Raised



## Drivers

- Higher capital requirements
- Increasing RWA's under Basel 3
- Narrower definition of capital
- Continued losses

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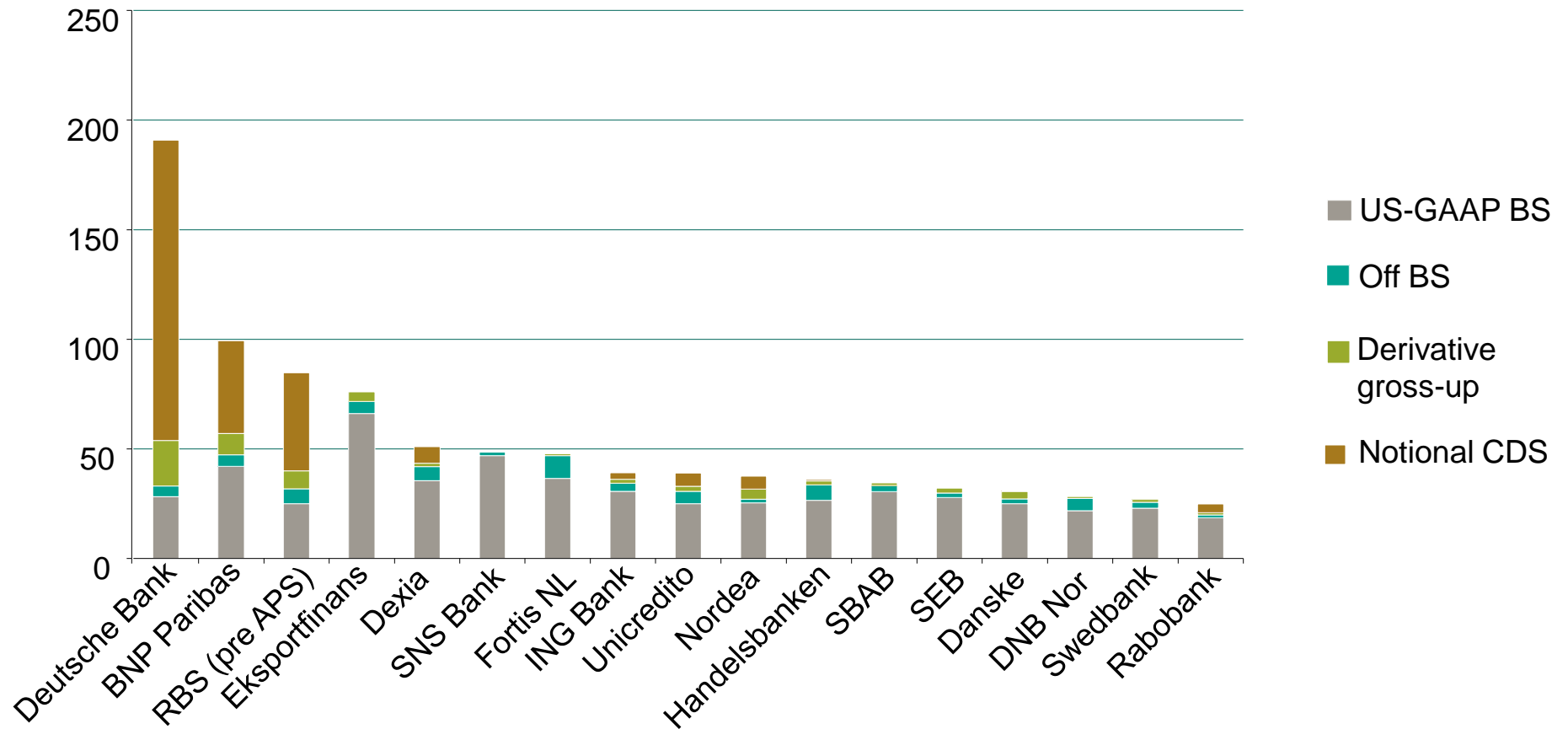
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## Result

- Raising additional capital
- Designing new instruments
- Liability management
- RWA reduction trades

# Leverage Ratio's (Total BS / Tier 1)



- New measure introduced in Basel 3
- More punitive than expected
- Expect robust discussion regarding the right measure

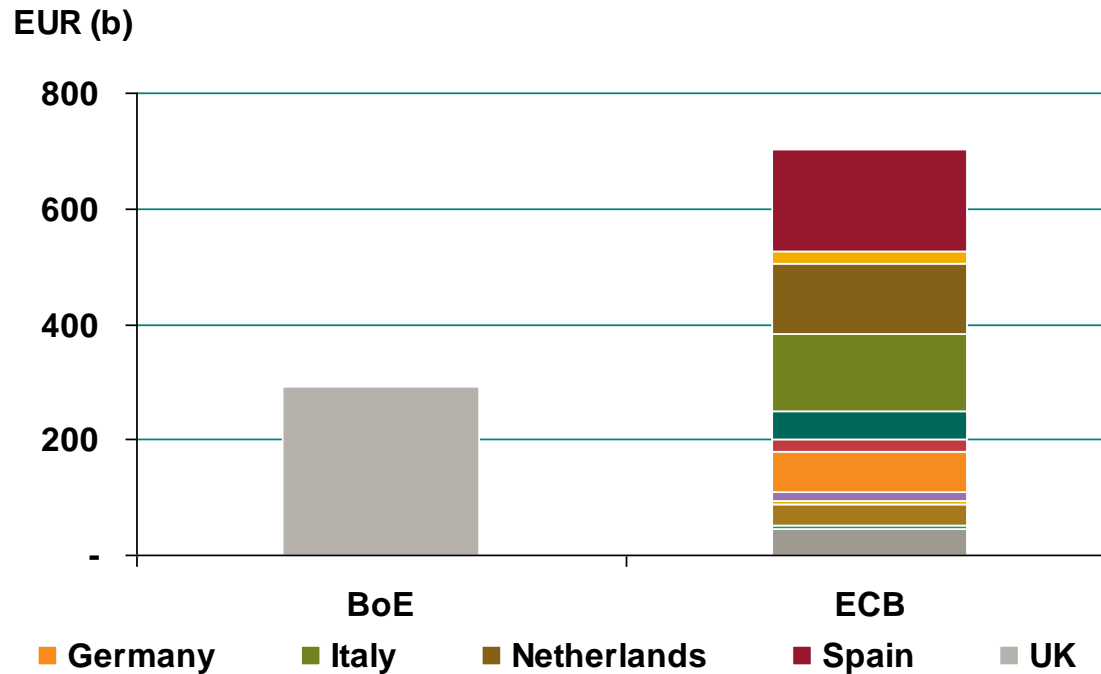
## Retained Issuance – Dominated by UK and Spain

Retained Issuance by Country and Asset Type, 2007-2009YTD, € millions

	UK	Spain	Italy	Holland	Germany	Belgium	Ireland	Europe	Other
<b>RMBS</b>	312,786	114,951	119,390	112,092	59,185	49,116	54,363	-	42,193
<b>CMBS</b>	5,551	-	-	-	1,173	-	-	13,780	-
<b>CDO</b>	10,780	71,732	6,054	10,175	7,539	2,504	1,662	27,408	21,808
<b>Credit Card</b>	11,732	-	-	-	-	-	-	-	580
<b>Auto Loans</b>	978	2,710	250	255	13,544	-	-	-	1,262
<b>Consumer</b>	-	580	17,202	-	280	-	-	-	2,747
<b>Other</b>	3,091	14,564	8,634	804	5,028	-	-	208	16,183

Source: RBS

# Central Bank Support



- Central banks looking to withdraw liquidity support over the coming years
- Significant amounts of ABS collateral will have to be refinanced
- Central banks tightening criteria for admissible collateral
- Clients continuously working to liquefy their balance sheets

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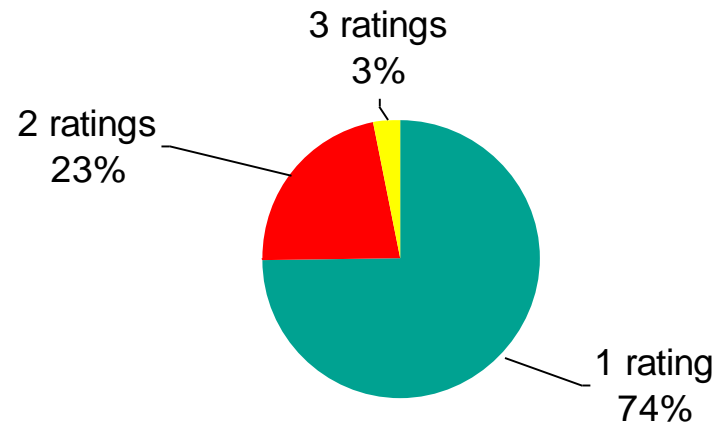
# Most Recent ECB Regulatory Amendments

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- **74% of ECB collateral has 1 rating !**
- Additional disclosure rules



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# Potential impact of CEIOPS/NAIC

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- Framework will require considerable amounts of capital to be held against long dated bonds
- Approximately one third of the medium - long dated £ iBoxx Index is held by UK annuity funds
- We are likely to see a significant steepening of the credit curve
- CEIOPS framework is expected to come into place at end 2012
- The bulk of the adjustments will occur in 2011 and 2012



# Future Issuance

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# Potential for 'Perfect Storm'

## Key factors in considering funding quantum and costs in 2010

- **Extension of debt maturities**

- As regulators demand banks push duration longer, CEIOPS is likely to reduce demand
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- Significant refinancing requirements once government guaranteed issuance matures and central bank liquidity withdrawn
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- **Withdrawal of government support**

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- **Secured markets open but remain fragile**

- Refinancing requirement of central bank collateral creates a potential market oversupply

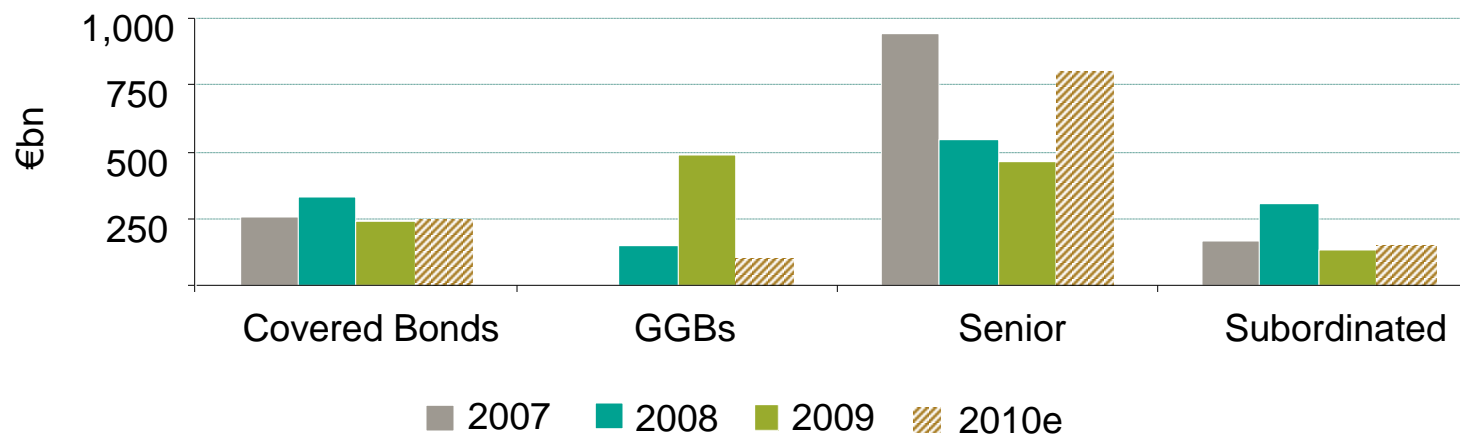
# Issuance Outlook 2010

Type	Volumes 2009 (in bn)	Volumes 2010 (in bn)	Trend	Change
Euro Area Sovereigns	€ 935	€ 970		+ 4%
UK Sovereigns	£ 231	£ 196		- 15%
US Treasuries	\$ 2,110	\$ 2,450		+ 15%
FDIC / Govt. Guaranteed Banks	\$ 580	\$ 50-75		- 90%
Supras & Non-US Agencies**	€ 370	€ 340-360		- 5%
US Agencies*	\$ 1,250	\$ 650		- 48%
Covered Bonds	€ 126	€ 150-175		+ 30%
Asset-Backed	€ 14	€ 50-75		+ 446%

## 2010: What we have seen in the first 3 weeks.....

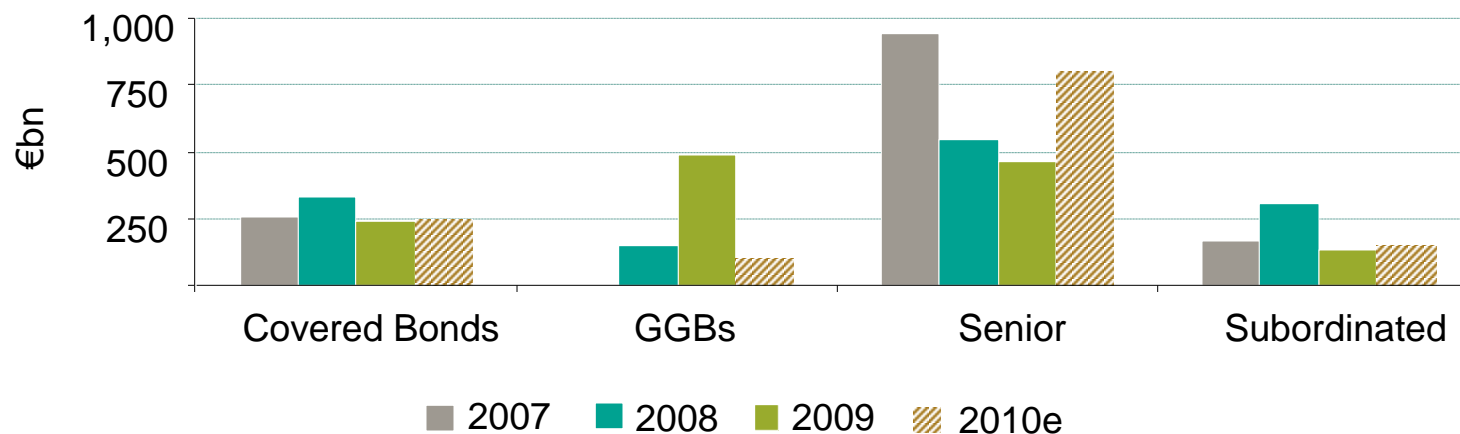
	2010 YTD	2009 YTD	% 09 YTD	09 Full Year	% 09 Full Yr	Comment	
€							
	Corporate IG	11,719	35,250	33%	361,897	3%	• Corporates took advantage to prefund so <b>low supply</b>
	Corporate Non-IG	3,528	275	1283%	20,522	17%	• Investors searching for yield so <b>record supply</b>
	Financial Senior (non-GG)	33,356	22,982	145%	292,697	11%	• Banks need longer dated liabilities driving supply
	Financial Covered Bonds	24,744	10,971	226%	231,667	11%	• Issuers looking for duration
	Corporate IG	21,167	45,841	46%	604,610	4%	• Corporates took advantage to prefund so <b>low supply</b>
\$							
	Corporate Non-IG	9,000	1,894	475%	160,504	6%	• Investors searching for yield so <b>record supply</b>
	Financial Senior (non-GG)	51,800	13,514	383%	271,193	19%	• <b>Record supply</b> now deepest market and competitive pricing

## New Issue Volumes of Banks (Europe, US & Australia/NZ)



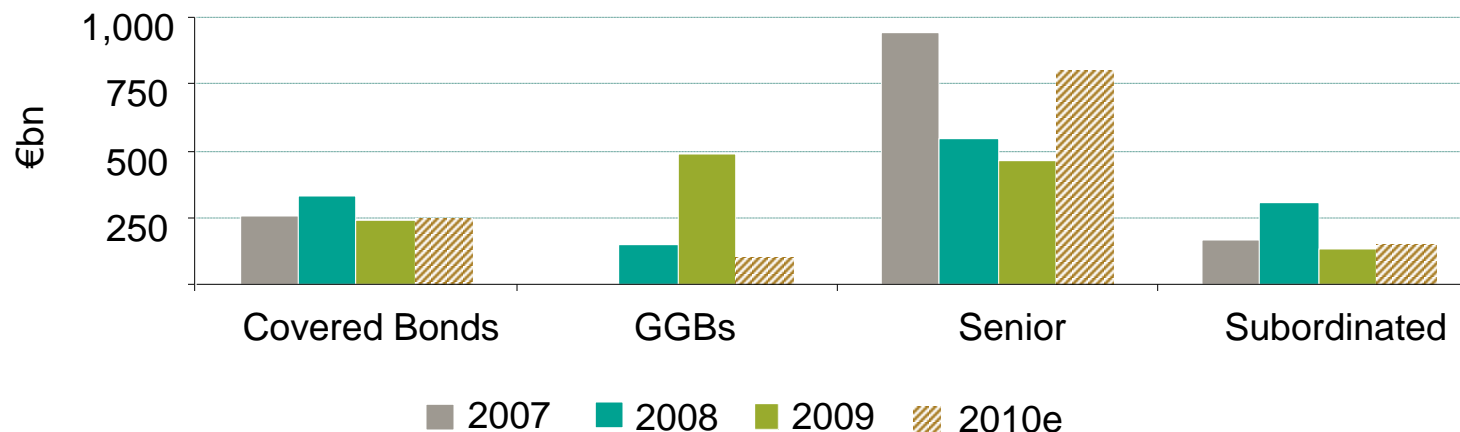
- In 2007 covered bonds accounted for 20% of total banks issuance, and senior made up 68.5%

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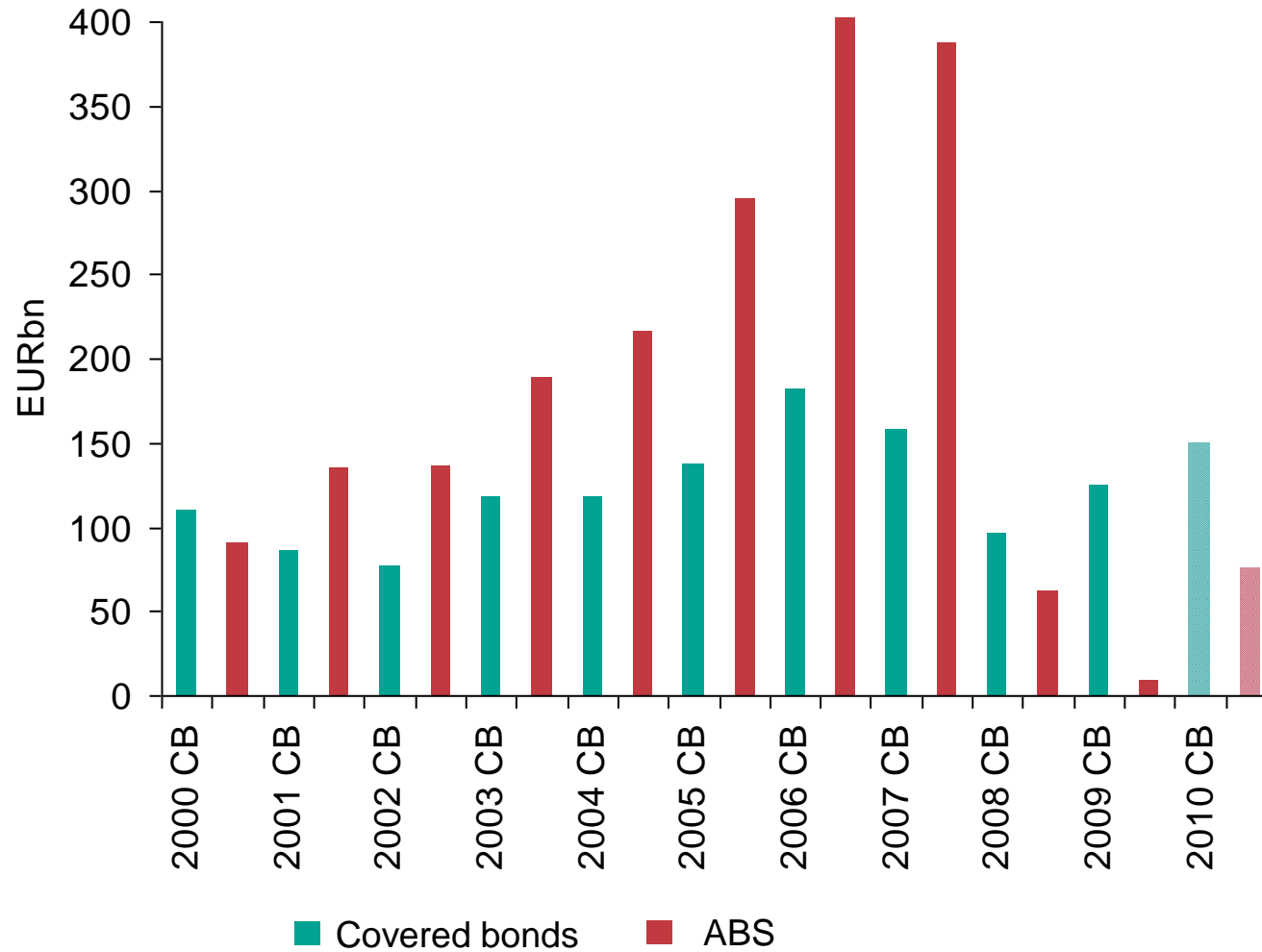
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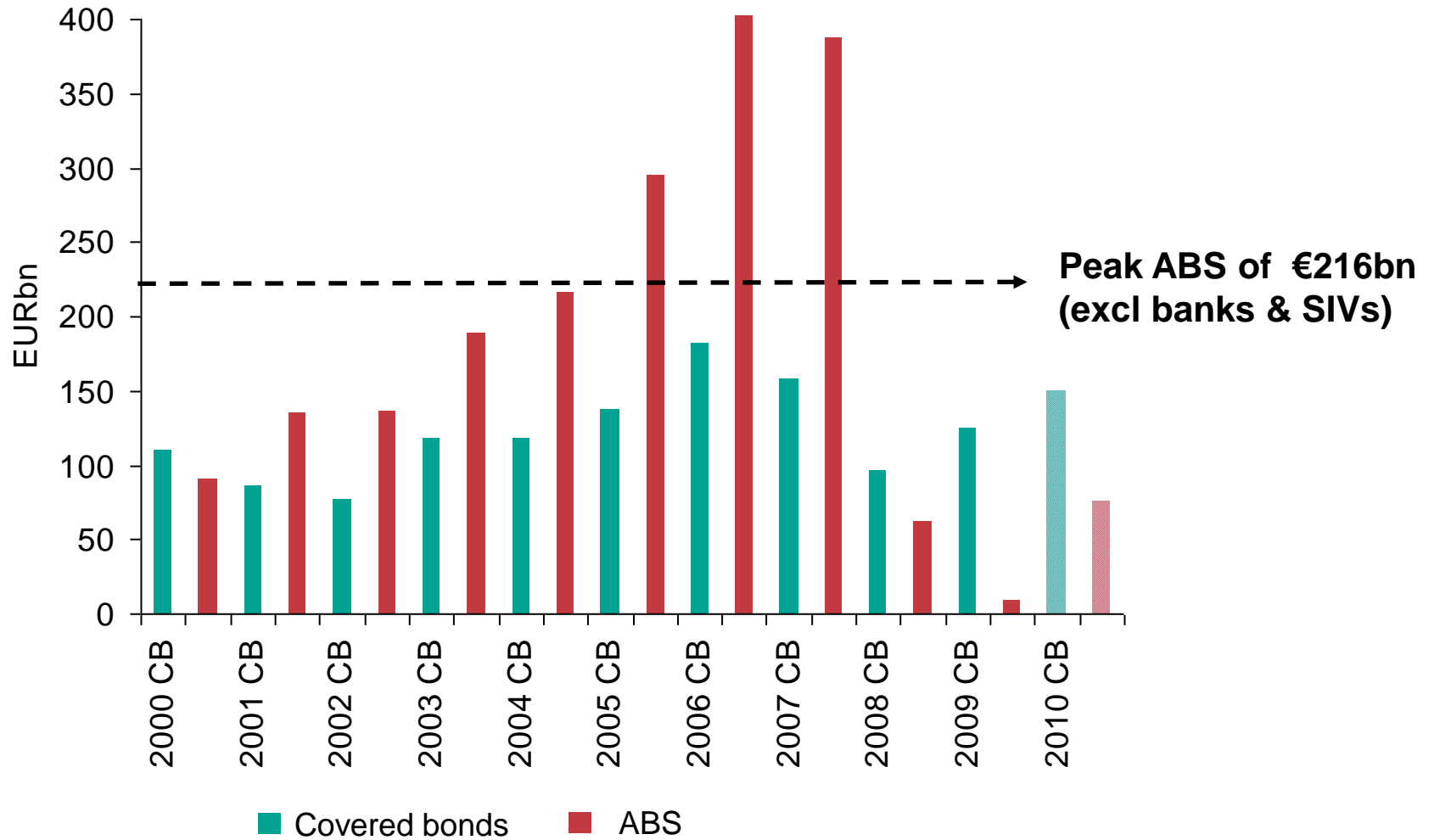


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- In 2010, the overall issue volumes from banks will probably remain quite stable
- Composition will change given that most of the guarantee schemes closed by year-end 2009

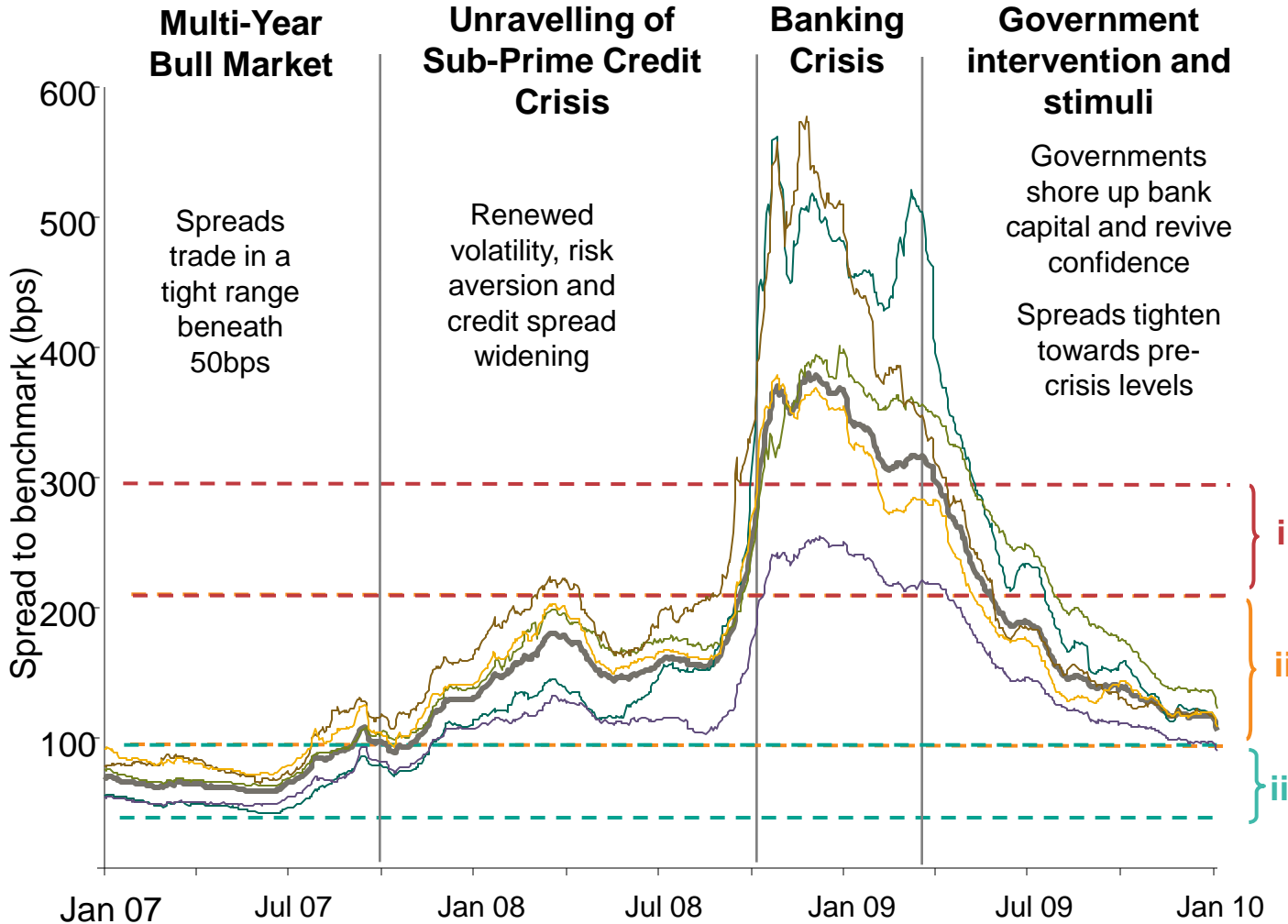
# European ABS and Covered Bonds



# European ABS and Covered Bonds



# Credit Spreads – Where to from here?



## Where next for Spreads?

**i. Risks of Renewed Widening**

**ii. Stabilisation into Current (Pre-Lehman) Range**

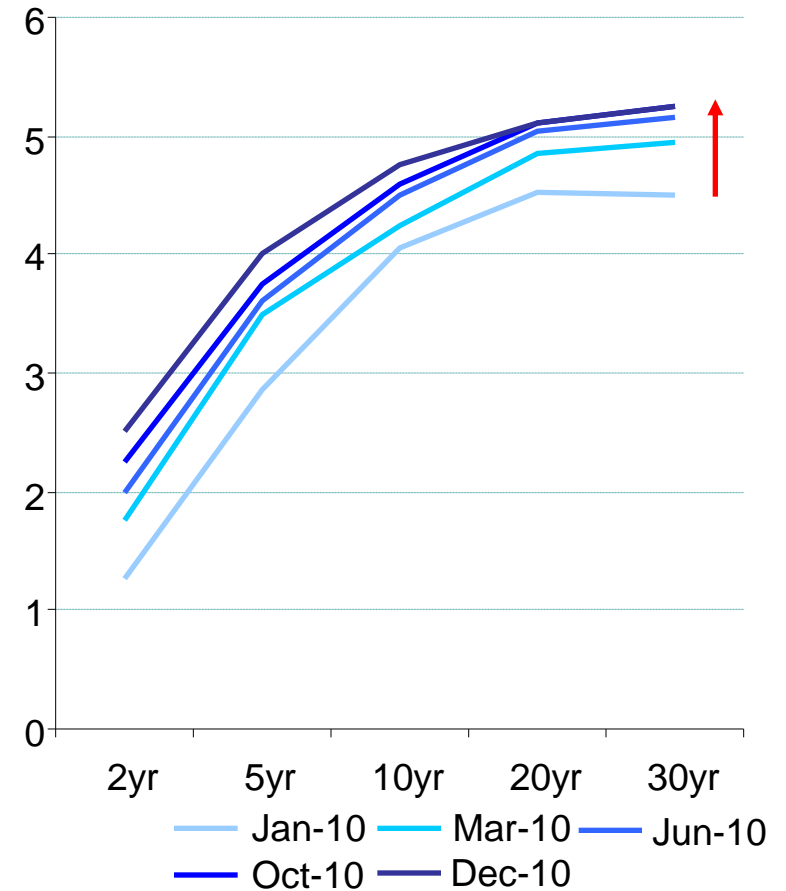
**iii. Return to Bull market levels**

Source: iBoxx / RBS

# Implications for Issuers

- Slower economic growth
- Unemployment – key factor to watch
- Wage growth looking slower
- Interest rates on hold at low levels

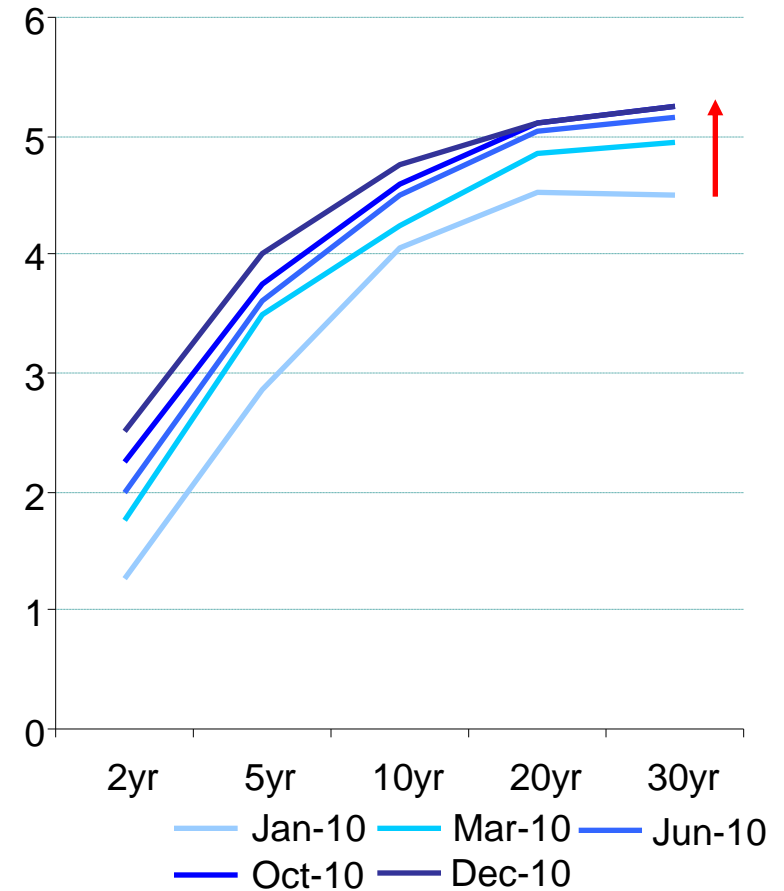
UK Rates Forecast



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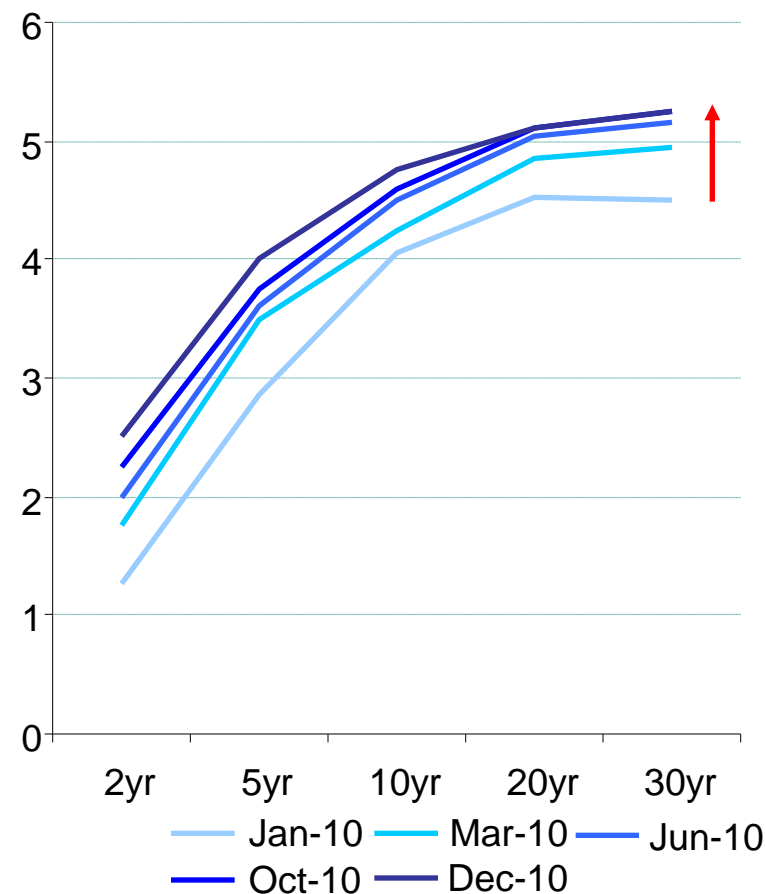
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- Pressure on gilt market likely to push overall yields upwards over the course of 2010
  
- Investors will do their own analysis:
  - Pricing will be more differentiated
  - Investor reporting is paramount
  - Ongoing dialogue important
- Investors remain focused on liquidity:
  - Arranging banks to make markets in bonds
  - Tranche sizes important

UK Rates Forecast



**Questions ?**

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