

# Credit Outlook

Credit Implications of Current Events

27 MARCH 2014

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## RATINGS & RESEARCH

### Rating Changes

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Last week we upgraded Anheuser-Busch InBev and California Department of Water Resources, and downgraded Solvay, Wm Morrison Supermarkets, Evrofinance Mosnarbank, First Niagara Financial Group, Argentina, 10 Argentine utilities and infrastructure companies, 26 Argentine banks, and eight Argentine provinces and municipalities, among other rating actions.

### Research Highlights

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Last week we published on US restaurants, US chemicals, North American energy, US pharmaceuticals, North American manufacturing, US consumer products, US retail and apparel, US technology, Canadian retailers, European telecoms, Chinese corporates, Chinese property developers, North American diversified manufacturers, US corporates rated B3 negative and lower, EU auto suppliers, US speculative grade liquidity, North American diversified utilities and power companies, the ECB's bank assessment, global bank debt issuance, Latin American banks, Irish banks, Lebanese banks, Italian banks, Danish mortgage institutions, Hungary, Slovenia, Netherlands, UK sub-sovereigns, Jefferson County Alabama, European RMBS and ABS and US ABS, among other reports.

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## Corporates

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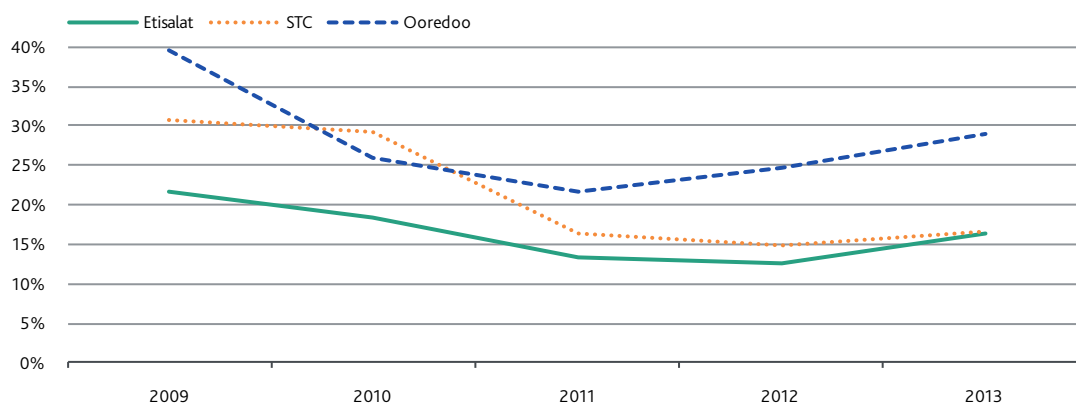
### Gulf Telecom Operators' Deal to Share Mobile Networks Is Credit Positive

On 18 March, [Etisalat Telecommunications Ltd](#) (Aa3 stable) announced that it had signed a memorandum of understanding with six other mobile telephony companies active in the Middle East and Africa – among them [Ooredoo Q.S.C.](#) (A2 stable) and [Saudi Telecom Company](#) (STC, A1 stable) – to share their mobile networks. The pact is credit positive because the telecom operators within Gulf Cooperation Council (GCC) countries – Etisalat, Ooredoo and STC – will benefit from lower operating costs and more efficient uses of capital owing to the infrastructure-sharing agreement. Reduced costs will help operating profitability, which has been declining for a number of years.

The three operators' capital expenditures have been high compared with group sales and relative to European telcos, averaging 21% in 2013, up from 17% in 2012 and 2011, which is more in line with the average for European telecom operators (see Exhibit 1). Joint use of parts of their respective networks could either help preserve capital to strengthen financial profiles or enable the companies to redeploy capital in growth markets to gain a competitive advantage by rolling out new technology. A reduction of the capex to sales ratio closer to European averages of around 17% would result in combined annual savings for the three GCC operators of approximately \$1.3 billion, or around 20% of the average 2013 capital expenditures.

EXHIBIT 1

#### Gulf Cooperation Council Telecoms' Capex to Sales Ratios



Source: Moody's Financial Metrics

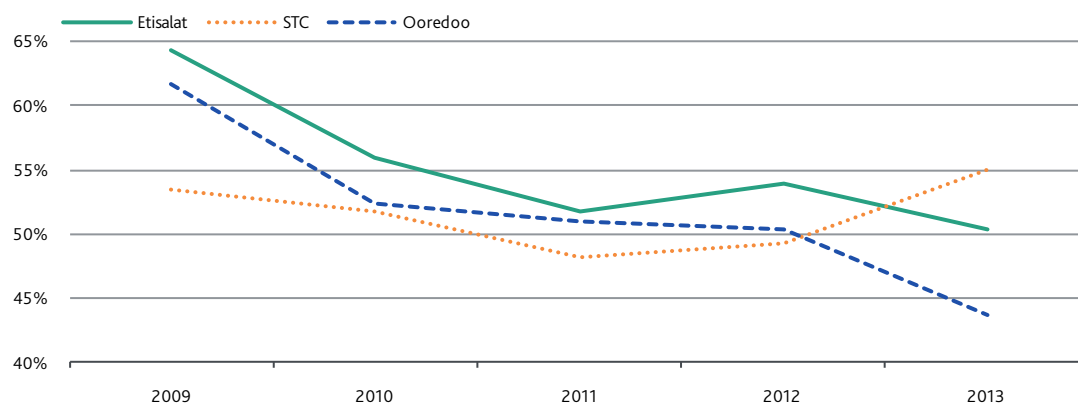
After market liberalisation over the past decade, some incumbent GCC telecom operators faced double-digit EBITDA margin declines in the early years (see Exhibit 2), which slowed in recent years as the initial effects from newly introduced competition dissipated. Although the implementation of the infrastructure-sharing agreement may not stop further future margin erosion, it will help slow the pace of declining profitability.

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EXHIBIT 2

## Gulf Cooperation Council Telecoms' EBITDA Margin Erosion



Source: Moody's Financial Metrics

Apart from network sharing, many GCC telcos individually have already taken other steps such as outsourcing, reducing headcount, sharing best practices across their operations and centralising procurement to offset negative pressure on profitability. Some of these measures have slowed their profitability margin erosion, but the network-sharing pact is evidence that incumbent GCC telco operators continue to implement mitigating actions. The improvement in STC's EBITDA margins in 2013 resulted from a change of its accounting for the consolidation of its subsidiaries and investments.

Nonetheless, future additional benefits will be more challenging to achieve, and mobile operators are likely to lose their differentiating factors and thus pricing power when they share their networks with competitors.

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## China Reopens Domestic Equity Issuance for Property Developers, a Credit Positive

On 19 and 20 March, property developers Tianjin Tianbao Infrastructure Co. (unrated) and Join.In Holding Co. (unrated), both of which are listed on mainland Chinese stock exchanges, received regulatory approval for new share sales in China, according to the companies' filings with the Shanghai and Shenzhen stock exchanges. The approvals are credit positive for the companies and are the first the China Securities Regulatory Commission has granted to Chinese real estate companies in more than three years.

Lifting the suspension on share sales in China is credit positive for Chinese property developers because it will provide funding at a time when the companies' funding needs are increasing. Issuing new share capital would reduce their debt leverage by enlarging their equity bases.

Among rated developers, the ability to issue new shares would benefit those that are currently unlisted, already listed in China but unable to issue new equity shares and, to a lesser extent, those listed outside China that are likely to spin off their onshore assets on the mainland.

[Greenland Holding Group Company Limited](#) (Baa3 stable) will likely be one of the first rated developers to benefit from the increased funding option. Greenland plans to list on the Shanghai stock exchange through an asset swap with Shanghai Jinfeng Investment Co., Ltd. (unrated), according to Jinfeng's 17 March filing with the Shanghai stock exchange. The transaction is subject to regulatory approval.

Chinese authorities have not permitted property developers to raise onshore equity since late 2010, when the government took steps to cool China's real estate market. Since then, many Chinese developers have relied on debt funding to support their business growth.

We believe that the approval to sell shares, together with the earlier approval of [China Vanke Co., Ltd's](#) (Baa2 stable) plan to convert B-class shares to H shares, is consistent with the government's stated policy to support market-oriented capital distribution mechanisms. However, the speed and sustainability of further share-sale approvals remain to be seen.

According to their regulatory filings, Tianjin Tianbao and Join.In will use the funds they raise for property development. Tianjin Tianbao announced in September 2013 that it plans to raise as much as RMB1.55 billion in a private placement to build a commercial project and two housing projects in Tianjin. Join.In announced in August 2013 that it plans to raise as much as RMB1.72 billion by selling shares to a group of investors to develop serviced apartments, office buildings, commercial properties and supermarkets in Xuzhou in eastern China's Jiangsu Province.

The approval to sell shares came after Zhejiang Xingrun Real Estate Co. (unrated), a real estate developer based in Ningbo, Zhejiang Province, collapsed because it was unable to service more than RMB3.5 billion in outstanding debt, according to 17 March news reports.

## Infrastructure

### SNAM's 2014-17 Strategy Plan Is Credit Positive

On 19 March, [SNAM S.p.A.](#) (Baa1 stable), Italy's leading gas transportation, distribution and storage group, disclosed its 2014-17 strategy plan. The new plan is credit positive because it pushes off capital expenditures compared with the previous plan, keeps the dividend the same in 2014 and 2015 and eliminates interim dividends starting in 2014.

SNAM's 2014-17 strategy plan targets €6 billion in investment, 3.3% average annual growth of its 2013 consolidated €24 billion regulated asset base (RAB), flat real-term controllable fixed costs and a net debt/RAB ratio of around 55% during the plan period. The new plan is a continuation of SNAM's strategy to establish the company as the southern Europe gas hub through the development of reverse flow gas export capacity to Europe of approximately 40 million of cubic meters (mscm) per day and the construction of 45 mscm per day of new import transport capacity mainly connected to new entry points from Southern Italy.

Although all the main projects included in the previous plan were confirmed, the new plan shifts out part of their capital cost, resulting in a lower average annual investment. This is particularly true for 2014, during which the company now expects €1.3 billion of capital expenditure versus a previous estimate of €1.5-€1.6 billion. Also, the new plan factors in dividend guidance of €0.25 per share in 2014 and 2015, which is in line with the 2013 dividend, but will now be paid on an annual basis, instead of being partially paid in advance. This will result in a €340 million reduction in cash outflow for dividends in 2014.

The change in payment frequency and the capex back-loading will have a positive effect on 2014 cash flows and are included in SNAM's target net debt for 2014 of €13.8 billion (versus €13.3 billion in net debt for 2013, as reported). We estimate that this will have a positive effect on funds from operations (FFO)/net debt for 2014 of 30-50 basis points, pushing it to the upper end of our expectations for 2014-15 (i.e., 11%-12%). It will also help SNAM contain its balance sheet leverage in the lower range of our 2014-15 estimate (i.e., net debt/adjusted fixed assets of 68%-70%).

However, SNAM remains exposed to deflationary pressures on its RAB and cash flows, which would likely have a negative effect on its medium-term leverage sustainability. Also, the plan's 2% RAB inflation and 4% risk-free rate assumptions for 2014-17 are optimistic compared with our current 1.0%-1.6% inflation expectations for Italy in 2014-16, near zero gross investment deflator as of December 2013 and 3.4% nominal 10-year government yields at current market prices.

During the plan's presentation, SNAM's management also commented further on the signing of a memorandum of understanding with [Cassa Depositi e Prestiti S.p.A.](#) (CDP, Baa2 stable) to start negotiations to acquire CDP's 89% stake in the Trans-Austria Gasleitung, the main regulated Austrian gas transport pipeline, which has 47.5 billion cubic meters of annual transport capacity. According to SNAM's management, the acquisition may take place by the end of 2014 if SNAM reaches an agreement with CDP, which is also SNAM's main shareholder with a 30% stake. No value considerations were disclosed at this stage, nor any final indication regarding the structure of the acquisition, although management said that a dedicated capital increase to CDP is one option under consideration. We see limited event risk from the acquisition because it would likely be effected in a credit-neutral way (e.g., share-swap agreement and no significant cash payment/re-leverage involved).

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## Banks

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### US Court Ruling on Swipe Fee Is Credit Positive for Banks Issuing Debit Cards

On 21 March, the US Court of Appeals for the District of Columbia reversed a lower federal court ruling that a Federal Reserve (Fed) cap on the fee a bank charges a retailer for each debit-card swipe was too high. The court decision is credit positive for US banks, particularly the largest debit-card banks that stood to lose billions of dollars in debit-card fees had the lower court's July 2013 decision been upheld.

The Appeals Court ruled that the Fed's setting of debit-card swipe fees at 21 cents per swipe plus five basis points of the transaction amount (which, on average, comes to 24 cents per swipe all-in) was a reasonable interpretation of the Dodd-Frank Act, which had tasked the Fed with setting debit interchange transaction fees that are "reasonable and proportional" to the actual cost of transaction processing.<sup>1</sup> Transaction fees are the fees that merchants pay to banks to process payments from customers.

The ruling is particularly positive for the top five debit-card banks, such as [Bank of America Corporation](#) (BAC, Baa2 stable). As shown in the exhibit below, we estimate that BAC's debit-card fees exceeded \$2 billion in 2012 (the most recent year for which debit-card purchase volume figures are available). A 50% cut in the debit interchange fee rate to approximately the level the district court cited would reduce BAC's pre-tax pre-provision income (PPI) by more than \$1 billion, or more than 5% of its 2013 consolidated PPI.

#### Top Five US Banks' 2012 Debit-Card Fees

Bank	Purchase Volume \$ Millions	Purchase Share	Debit Fees \$ Millions	50% Cut	Cut as Percent of Pre-Provision Income
Bank of America	\$264,997	13.4%	\$2,064	\$1,032	5.2%
Wells Fargo	\$234,352	11.9%	\$1,833	\$917	2.6%
JPMorgan Chase	\$177,687	9.0%	\$1,386	\$693	2.7%
US Bank	\$51,297	2.6%	\$400	\$200	2.2%
PNC	\$49,876	2.5%	\$385	\$193	3.1%

Sources: Company reports, The Nilson Report, Federal Reserve Board and Moody's Investors Service estimates

Smaller debit-card banks that historically have gotten a larger share of their PPI from debit interchange fees could also have been adversely affected. For example, [TD Bank US Holding Company's](#) (A1 stable) PPI would fall by 6.7%, while TCF Financial Corporation's (unrated) would decline by 8.1% and [Regions Financial Corporation's](#) (Ba1 stable) would drop by 6.8%. On the other hand, [Discover Financial Services](#) (Ba1 stable) would barely be affected by a cut in debit interchange fees. Discover has an emerging debit-card issuing business by virtue of its 2013 introduction of an online checking account product, but to date the business is quite small.

The retailers' options now are to ask the appellate court to reconsider the case or petition the US Supreme Court to review the Fed rules. At this point, it is unclear which path they will pursue.

<sup>1</sup> The federal district court's July 2013 decision said that the Fed had misinterpreted Dodd-Frank and had included costs not intended to be incorporated in setting the fee. The district court judge also noted that current fee is well above the Fed's initial proposal of seven to 12 cents per swipe in December 2010.

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## WGZ BANK's Capital Increase Cushions Against Sovereign Bond Risk, a Credit Positive

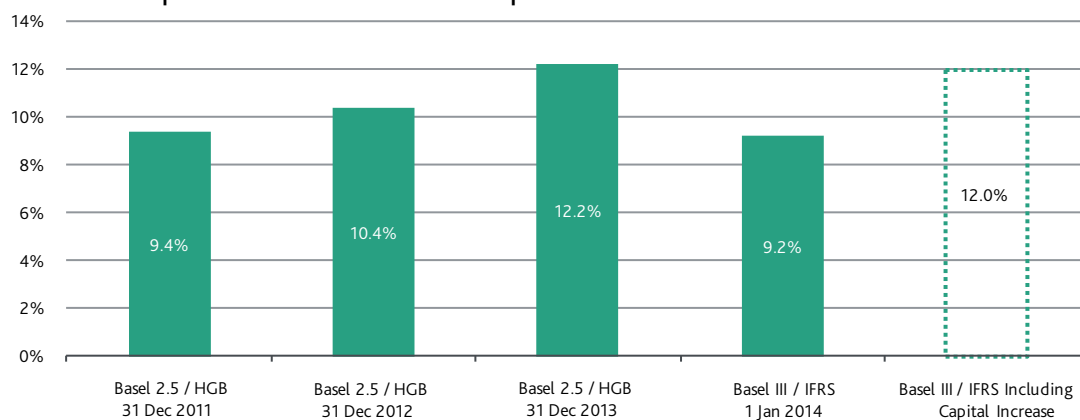
On 19 March, [WGZ BANK AG](#) (A1 negative, C-/baa2 negative<sup>2</sup>), the smaller of the two central institutions of Germany's cooperative sector, announced a capital increase of around €300 million. During the subscription period, which is open until 10 April, we expect its member banks to fully subscribe to this capital increase. Together with retained earnings, the measure will raise the bank's Tier 1 capital ratio under Basel III to about 12% from 9.2% currently.

The capital increase is credit positive for bondholders because it reduces the risk in the bank's large holdings of sovereign bonds under a stress scenario and enhances the bank's position ahead of the upcoming asset quality review (and subsequent stress test) by the European Central Bank (ECB).<sup>3</sup> It also increases WGZ BANK's capacity to participate in the capital increase of [DZ BANK AG](#) (A1 stable, C-/baa2 stable), the other central institution of Germany's cooperative sector, which is planned to occur by 31 July.<sup>4</sup>

In recent years, WGZ BANK successfully increased its capital ratios to levels more in line with its national and international peers. However, as of 2014, the bank has to apply the stricter capital requirements under Basel III and transition its capital reporting to international financial accounting standards instead of local accounting rules, Handelsgesetzbuch (HGB), which has a strong negative effect on WGZ BANK's capital ratios, as illustrated in Exhibit 1. The planned capital increase allows the bank to move back again to more comfortable capital levels.

EXHIBIT 1

### WGZ BANK's Capitalisation Before and After Capital Increase



Source: WGZ BANK

<sup>2</sup> The bank ratings shown in this report are the bank's deposit rating, its standalone bank financial strength rating/baseline credit assessment and the corresponding rating outlooks.

<sup>3</sup> See [European Banking Authority Stress Test Details Are Credit Positive for Banks](#), 6 February 2014, and [ECB's Comprehensive Assessment: Answers to Frequently Asked Questions](#), 20 March 2014.

<sup>4</sup> See [DZ BANK's Capital Increase Is Credit Positive](#), 10 March 2014.

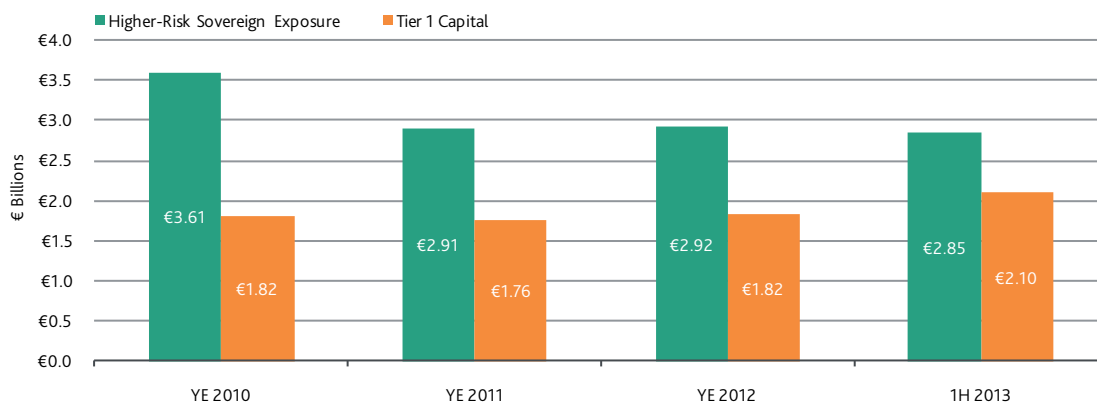
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A key vulnerability of WGZ BANK results from the low-yielding public-sector finance activities at the bank's 90.9%-owned subsidiary WL BANK (unrated), which drive WGZ BANK's high leverage of 2.3% (Tier 1 capital/total balance sheet). Exposures to higher-risk sovereigns (Greece, Ireland, Italy, Portugal and Spain) amounted to €2.85 billion or 140% of Tier 1 capital as of 30 June 2013 (see Exhibit 2). Although WGZ BANK benefits from European sovereign credit profiles having stabilized recently, this portfolio will remain critical under the ECB's stress test.

EXHIBIT 2

#### WGZ BANK's Higher-Risk Sovereign Exposure to Tier 1 Capital, € Billions



Source: WGZ BANK

WGZ BANK's capital increase also supports the planned capital increase by DZ BANK. We expect WGZ BANK to sustain its 6.67% share in DZ BANK (as of 31 December 2012) by subscribing to DZ BANK's current €1.5 billion offer. The resulting €100 million participation in DZ BANK's capital measure by WGZ BANK will partly offset the positive effect of its own capital measure from a regulatory perspective.



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## Increase in Delinquent Real Estate Loans Weighs on Spanish Banks' Credit Quality

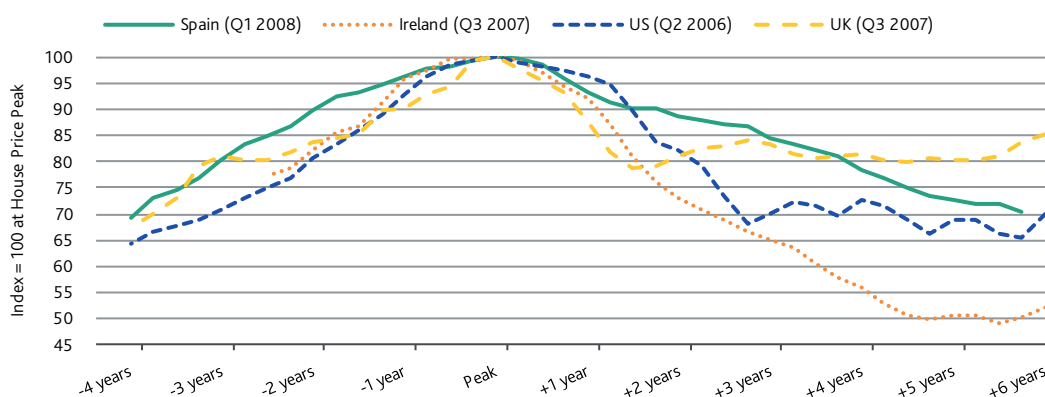
On 18 March, the Bank of Spain published December 2013 nonperforming loan (NPL) data by asset class, which showed that the NPL ratio on real estate related corporate loans had climbed four percentage points since September 2013 to a record 37.05%. The increase in delinquent real estate related loans is credit negative because beyond the negative consequences of increased arrears on the credit profiles of Spanish banks, the data show that the negative pressure on Spain's real estate sector continues.

As we highlighted in our [Spanish residential mortgage-backed securities outlook](#) in January, we expect further declines in Spanish property prices, given the imbalance between housing supply and demand. The decline in house prices negatively affects banks' credit profiles in several ways. The direct effect is through the significant amount of real estate properties that banks have on their balance sheets, which we estimate totalled around €105 billion in September 2013. Another effect is the depreciation of the collateral backing loans, which forces banks to rely more on cash loan-loss provisions than on the collateral to reduce their losses. Banks will also be affected because the decline in real estate values has not concluded and NPLs in this segment will continue increasing.

After several boom years of strong sales and house price growth, Spanish real estate sector sales began decelerating at the end of 2007 and then declined, resulting in an oversupply of residential and commercial properties. This translated into a slump in property prices and the collapse of several real estate developers and construction group Martinsa-Fadesa, Spain's largest corporate failure ever.

However, in contrast to other countries whose real estate bubbles burst, such as Ireland, the UK and US, Spain's real estate market has not adjusted as quickly, as the housing price trend in the exhibit below shows. Prices in those three countries reached a floor sooner and began to recover, while Spain is in the seventh year of declining real estate prices.

### House Price Trends for Spain, Ireland, the US and UK



Note: Legend provides the quarter in which home prices peaked in that country.

Source: National Statistics Institutes, government agencies and the European Central Bank

Another factor pointing to Spain's real estate sector not yet recovering is the large inventory of unoccupied dwellings, which, according to a European Commission report, range between 700,000 and 1 million units. In addition, according to Spain's Ministry of Development, the stock of unsold new housing at the end of 2012 (latest data point available) was similar to 2008 levels (583,000 properties), and just 10% down from the 2009 peak. Even if the volume of house sales rises from currently depressed levels, in line with Spain's modest economic recovery, we expect it will take several years to reduce the current oversupply.

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The construction and real estate sectors were at the core of Spanish banks' and savings banks' growth model in the years preceding the crisis. Backed by ever-rising land and property values, banks steadily increased their exposure to property developers, almost exclusively with the ultimate goal of obtaining mortgage lending to individuals. As of the end of 2013, residential mortgages and loans to real estate related companies constituted 57% of all loans made by Spanish banks to Spanish corporates and individuals, and the performance of these two segments will remain poor until the real estate sector recovers.

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## Fondazione MPS Reduces Its Ownership in BMPS, a Credit Positive for the Bank

On 18 March, the Fondazione Monte dei Paschi di Siena (Fondazione MPS, unrated), the largest shareholder of [Banca Monte dei Paschi di Siena S.p.A.](#)'s (BPMS, B2 negative, E/caa3<sup>5</sup>), reduced its stake in BPMS to 15.07% from 29.90%, which followed its sale of a 1.59% stake the prior week.

The Fondazione MPS decision to cut its stake in BPMS is credit positive for the bank and marks a turning point. The reduction dilutes the importance of Fondazione MPS, which has until now exerted a dominant influence on the bank and most recently was responsible for the December 2013 postponement of the BPMS planned €3 billion capital increase,<sup>6</sup> which is now planned sometime after 12 May this year.

In recent years, BMPS has come under increased credit pressure and scrutiny following its 2007 acquisition of Banca Antonveneta and subsequent decisions to use complex derivative products to mitigate some of the ensuing earnings volatility. The bank's higher percentage of problem loans<sup>7</sup> versus gross loans – 18.38% at September 2013 versus a system average of 11.3% at June 2013, according to the Bank of Italy – also points to weaknesses in its risk management and governance framework. This ultimately resulted in the Italian government needing to support BMPS.

A more diversified ownership structure dominated by professional investors is apt to create stronger and more effective governance and control of the bank. In addition, a broader shareholder base is likely to reduce the risk of potential conflicts of interests that could derive from a strong shareholder whose objectives may not fully coincide with those of the wider shareholder base. We expect bondholders to benefit from these developments in terms of enhanced transparency and policies that aim to benefit all stakeholders equally.

Prospective and current shareholders will be able to exert greater influence and control over the bank, which will likely increase the appeal of the rights issue for new investors and therefore make it easier to execute. As long as Fondazione MPS tried to maintain its dominant stake and limit a dilutive rights issue, the bank's capital-raising ability was curtailed because of Fondazione MPS's limited ability to subscribe to any share capital increase and policies aimed at safeguarding the value of its stake in the bank.

Part of the shares sold by Fondazione MPS were bought by US-based [BlackRock, Inc.](#) (A1/P-1 stable), the world's largest asset manager, which is now the bank's second-largest shareholder with a 5.75% stake. In our opinion, this acquisition already indicates a widening of the professional, liquid shareholder base, which is likely to push for more market-driven policies and decisions. This will also benefit bondholders through a more balanced risk appetite and stronger action aimed at maximising the bank's profitability and efficiency.

<sup>5</sup> The bank ratings shown in this report are Banca Monte dei Paschi di Siena's deposit ratings, its standalone bank financial strength rating/baseline credit assessment and the corresponding rating outlook.

<sup>6</sup> See [Banca Monte dei Paschi di Siena's Shareholders Postpone Capital Raising](#), 3 January 2014.

<sup>7</sup> Problem loans include nonperforming loans, watchlist, restructured and past-due. We adjust these numbers and incorporate 30% of the watchlist category as an estimate of those more than 90 days overdue.

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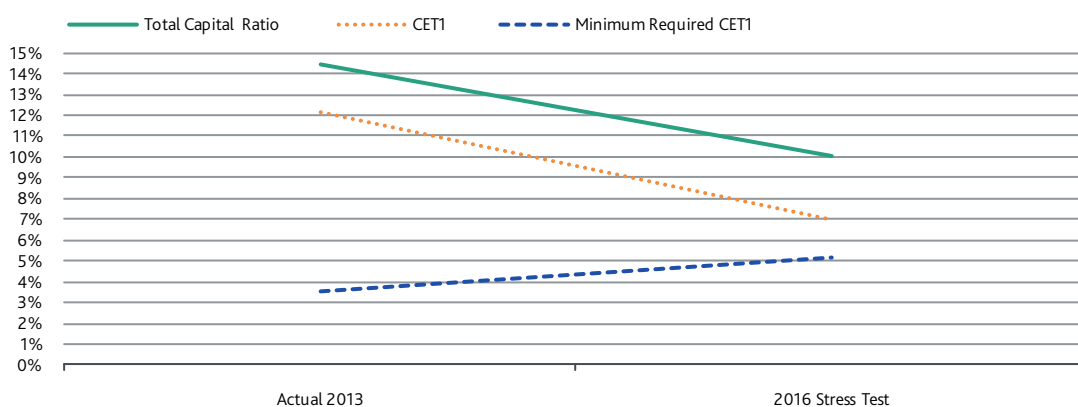
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## Malaysian Banks' Stress Test Results Are Credit Positive for Banks

On 19 March, Bank Negara Malaysia, Malaysia's central bank, published the results of its stress test of the country's banks, which showed that banks are well capitalized to withstand a scenario worse than the 2008-09 global financial crisis. The results of the stress test are credit positive for Malaysian banks because they show the banks are resilient to severe credit and market losses.

According to Bank Negara Malaysia's adverse stress test, the aggregate total capital ratio of Malaysia's banks would be 10% under the central bank's adverse stress scenario, while their common equity Tier 1 (CET1) ratio would be 7% (see Exhibit 1). The central bank's scenario includes severe loss assumptions such as up to a six-fold increase in probability of default to around 11.6% versus current impaired loan ratios, a 330-basis-point increase in yields on government bonds and a severe drop in real estate prices of up to 30%.

EXHIBIT 1  
Effect on Malaysian Banks' Capital Under Bank Negara Malaysia's Adverse Stress Test



Note: Minimum required 2016 CET1 ratio includes a 0.625% capital conservation buffer.

Source: Bank Negara Malaysia and Moody's Investors Service

As of 30 September 2013, our rated Malaysian commercial banks had an average CET1 ratio of 9.5%, way above Malaysia's Basel III minimum requirement of 4.0% for 2014. As seen in Exhibit 2, banks such as [HSBC Bank Malaysia Berhad](#) (A3 positive, C-/baa1 stable<sup>8</sup>), [Malayan Banking Berhad](#) (A3 positive, C/a3 stable) and [Hong Leong Bank Berhad](#) (A3 positive, C-/baa1 stable) would better withstand unexpected losses owing to their higher capital buffers, although this assessment does not consider the relative riskiness of their loan books, which the central bank's stress test did take into account.

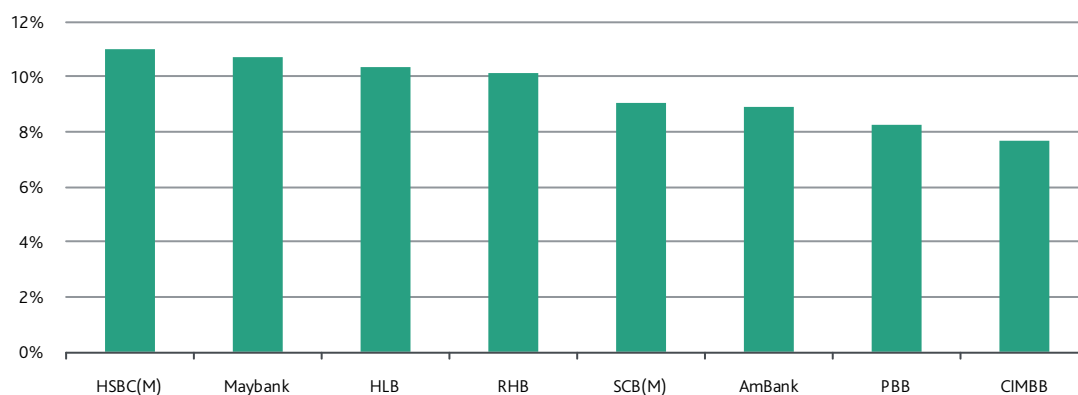
<sup>8</sup> The bank ratings shown in this report are the bank's deposit rating, its standalone bank financial strength rating/baseline credit assessment and the corresponding rating outlooks.

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EXHIBIT 2

## Rated Malaysian Banks Have High CET1 Ratios



Note: Data as of 30 September 2013. HSBC (M) = HSBC Bank Malaysia Berhad; Maybank = Malayan Banking Berhad; HLB = Hong Leong Bank Berhad; RHB = RHB Bank Berhad; SCB(M) = Standard Chartered Bank Malaysia Berhad; AmBank = AmBank (M) Berhad; PBB = Public Bank Berhad; CIMBB = CIMB Bank Berhad

Source: The banks

Bank Negara Malaysia's stress test results are consistent with our own stress test and support our stable outlook on Malaysian banks.<sup>9</sup> Under our adverse scenario, the aggregate total capital ratio for Malaysian banks fell to around 12.5% from 14.4% as of the end of December 2013, while the CET1 ratio decreased to 10.3% from 12.1% over the same period. Under our scenario, we assume an average probability of default of 8% and a loss-given default of 40% for business loans and up to 100% for consumers' loans over six quarters.

Malaysian banks' capitalization is particularly sound in the context of their low impaired loans ratio, which was a stable 1.8% at 31 January 2014 and fully covered by reserves. However, as in other ASEAN<sup>10</sup> markets, Malaysian banks' asset quality is vulnerable to a shift in interest rates and the negative effect of higher rates on borrowers. The leverage of Malaysian households is a particular risk: at 87% of GDP at the end of 2013, it was the highest among ASEAN countries. However, based on Bank Negara Malaysia's and our stress test results, Malaysian banks have enough capital to withstand significantly higher default rates and price corrections.

We note that Bank Negara Malaysia's stress test, while credible, spans a three-year period, whereas there is a risk that a downside scenario could unfold more quickly, causing bank balance sheet problems to materialize faster. This would result in banks having to absorb credit costs more quickly and without the benefit of a longer stress test horizon, which takes into account higher retained earnings generated by the banks. For example, [the recent stress test by the US Federal Reserve](#) had a two-year horizon, while our scenario for Malaysia usually looks 1.5 years ahead.

<sup>9</sup> See [Malaysia Banking System Outlook](#), 15 May 2013.

<sup>10</sup> ASEAN stands for Association of Southeast Asian Nations, and includes ten countries in South and Southeast Asia, with the largest ones being Indonesia, Malaysia, Singapore, Thailand, Philippines and Vietnam.

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## Vietnam Central Bank's Continued Regulatory Forbearance Is Credit Negative for Banks

On 20 March, the State Bank of Vietnam (SBV), the country's central bank, issued new regulations that extended its regulatory forbearance on problem loan classification to 1 April 2015 from 1 July 2014. The new Circular 9 rules are credit negative for Vietnam's banks because they are less stringent than earlier Circular 2 rules and they allow banks to continue classifying restructured loans in "performing" or low-risk categories for another 12 months, without making additional provisions.

According to the SBV, around 5% of loans in Vietnam were restructured in 2013, and these were only thinly provisioned in our opinion. Our nine rated banks disclosed little publicly about restructured loans in 2013. If we assume all restructured loans were classified in Group 2 (the special mention loans),<sup>11</sup> we estimate that three banks' problem loans plus special mention loans as a percentage of gross loans would exceed 8%. As seen in Exhibit 1, these banks include [Vietnam Technological and Commercial JSB](#) (B3 stable, E/caa1 stable<sup>12</sup>), [Saigon-Hanoi Commercial Joint Stock Bank](#) (B3 stable, E/caa1 stable) and [Bank for Investment and Development of Vietnam](#) (B3 stable, E/caa1 stable). As a forbearance tool, these banks will likely use Circular 9 more than other banks, a credit negative for their loss-absorption capacity and for transparency.

EXHIBIT 1

### Asset Quality Indicators of Rated Banks in Vietnam, Year-End 2013

Bank	Ratings	Reported Problem Loan Ratio*	Reported Problem Loans + Special-Mention Loans/Gross Loans	Loan-Loss Reserve/Reported Problem Loans + Special-Mention Loans
Vietnam Technological and Commercial JSB (Techcombank)	B3 stable, E/caa1 stable	3.7%	9.3%	18%
Saigon-Hanoi Commercial Joint Stock Bank (SHB)	B3 stable, E/caa1 stable	5.6%	8.7%	19%
Bank for Investment and Development of Vietnam (BIDV)	B3 stable, E/caa1 stable	1.9%	8.3%	19%
Vietnam International Bank (VIB)	B3 stable, E/caa1 stable	2.8%	7.6%	34%
Military Commercial Joint Stock Bank (MB)	B3 stable, E/caa1 stable	2.4%	6.9%	32%
Vietnam Prosperity Jt. Stk. Commercial Bank (VPB)	B3/stable, E/caa1 stable	2.8%	7.5%	15%
Asia Commercial Bank (ACB)	B3 stable, E/caa1 stable	3.0%	5.8%	25%
Saigon Thuong Tin Commercial Joint-Stock Bank (Sacombank)	B3 stable, E/caa1 stable	1.5%	2.2%	57%
Vietnam Bank for Industry and Trade Sec. JSC (VietinBank)	B3 stable, E+/b3 stable	1.0%	1.7%	51%

Note: \* Problem loans are loans in Groups 3, 4 and 5 (substandard, doubtful and loss categories).

Source: Banks' financial reports under Vietnam accounting standards and Moody's Investors Service

<sup>11</sup> In Vietnam, loans are classified in five categories from Group 1 (best) to Group 5 (worst).

<sup>12</sup> The bank ratings shown in this report are the banks' deposit ratings, their standalone bank financial strength ratings/baseline credit assessments and the corresponding rating outlooks.

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Circular 9 also delays the implementation of a uniform problem asset classification for all banks in Vietnam. The SBV was to have launched its previous plan in July, which would have applied a common risk classification of assets. For example, if two banks both had exposures to a bankrupt company, the two bank's loan classification would have been uniform. Now, the SBV will launch this mechanism at the end of 2014. This delay is a setback for reforms since 2012 to improve accounting and transparency in the banking system. Exhibit 2 shows loopholes that contribute to Vietnam's banks understating asset quality problems.

#### EXHIBIT 2

#### Practices Contributing to Underestimating Asset Quality Problems at Vietnamese Banks

Problems	Current Practice	SBV's Proposed Fix	Previous Implementation Date	New Date	Implication
Restructured loans	Banks are allowed to restructure loans without moving the loans to a higher risk category. The size of restructured loans in a bank's loan book is undisclosed.	Banks must improve their risk management system and conduct both qualitative and quantitative assessments.	1 July 2014	1 April 2015	This loophole allows banks to continue understating problem loans.
Harmonization of problem loan reporting	Banks' exposures to the same problematic borrowers are classified differently.	Banks must submit their loan classification to the central bank's Credit Information Center (CIC), which will then produce a unified list of borrowers' categorizations. When banks report their results, they have to classify the account in accordance with the CIC's specified borrower's risk group.	1 July 2014	1 Jan 2015	A uniform borrower classification will improve consistency among banks and impose market discipline.
Gaps in the scope of problem assets classification (and therefore provisioning requirements)	Prescriptive definitions of problem assets focused on "loans." Credit extension through credit card issuance, investment in debt securities may not be consistently subject to credit risk classification and provisioning.	Broadened the definition of nonperforming assets so that it includes credit cards, leases, negotiable instruments, other valuable papers, trust investments, interbank deposits, corporate bonds, receivables and off-balance sheet items.	1 July 2014	1 July 2014	This will provide a more comprehensive estimation of problem assets and associated provisioning.

Source: State Bank of Vietnam and Moody's Investors Service

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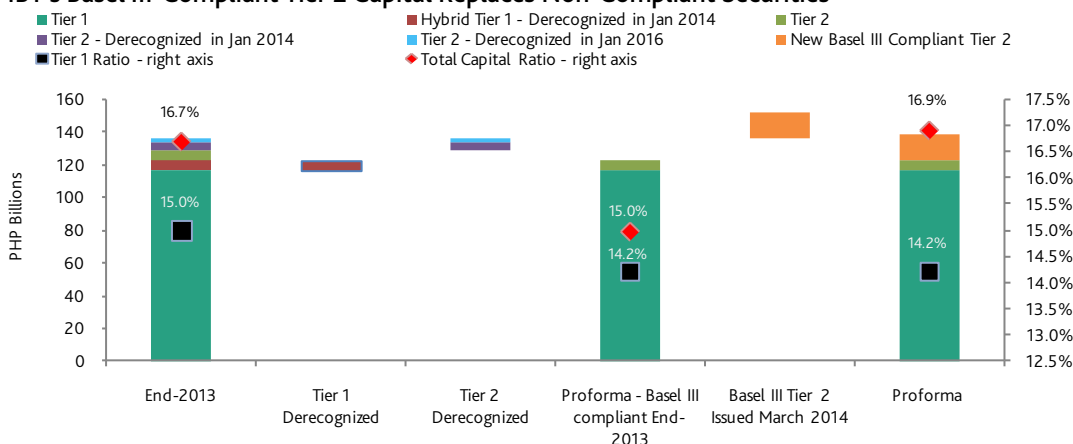
## Metropolitan Bank & Trust Issuance of Basel III-Compliant Subordinated Debt Is Credit Positive

Last Friday, [Metropolitan Bank & Trust Company](#) (MBT, Baa3 positive, D+/baa3 positive<sup>13</sup>) announced that it had raised PHP16 billion (\$353 million) from the issuance of subordinated debt with loss-absorption features at the point of non-viability (PONV). The new subordinated debt, which qualifies as Tier 2 capital under Basel III, is credit positive for bank creditors because it will support MBT's capital adequacy, which would have declined as the bank phased out its existing Tier 2 capital securities from regulatory capital between January 2014 and December 2015.<sup>14</sup>

For MBT's depositors and senior debtholders, the new debt is positive because it is of higher quality than the existing subordinated debt that the new debt replaces. The new debt is more loss-absorbing and can better shield creditors from losses in the event the bank reaches the PONV.

Assuming MBT's existing Tier 2 subordinated debt and hybrid Tier 1 capital securities are fully redeemed and derecognized, and including the newly raised Basel III-compliant subordinated debt, we estimate the bank's total capital ratio would rise to 16.9% from 16.7% reported at the end of 2013. Without the newly raised subordinated debt, the ratio would fall to 15% (see exhibit).

### MBT's Basel III-Compliant Tier 2 Capital Replaces Non-Compliant Securities



Note: MBT announced it will exercise the call option on its PHP4.5 billion Tier 2 in May 2014.

Source: Metropolitan Bank & Trust Company and Moody's Investors Service

<sup>13</sup> The ratings shown are the bank's deposit rating, its standalone bank financial strength rating/baseline credit assessment and the corresponding rating outlooks.

<sup>14</sup> Most capital instruments that are not loss-absorbing at the PONV became ineligible to count towards regulatory capital in the Philippines from 1 January 2014. However, the country's central bank made a limited exception for securities issued after 1 January 2011, which banks are allowed to count toward capital adequacy until 31 December 2015.



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The loss-absorption feature requires the debt to be written down at the PONV, which is determined at the discretion of Bangko Sentral ng Pilipinas (BSP), the Philippines' central bank. Under the terms and conditions of the debt, the PONV occurs either if BSP notifies MBT that without such write-offs, the bank would become non-viable, or if BSP decides to make a public-sector injection of capital without which the bank would become non-viable. MBT may determine if the write-off is partial or full, but the amount must be sufficient to ensure that the bank does not become non-viable and requires regulatory approval.

For subordinated debt with PONV loss-absorption features that qualifies as Tier 2 capital under Basel III, our rating for such securities is typically two notches below the bank's adjusted baseline credit assessment (BCA). Our outlook on MBT's D+ bank financial strength rating – equivalent to a BCA of baa3 – is positive. The bank's BCA could be revised upwards if we upgrade the [Philippines government's](#) (Baa3 positive) sovereign rating and the bank's credit fundamentals remain robust.

MBT's issuance also benefits commercial banks in the Philippines because we expect other banks to follow its lead in issuing Basel III-compliant capital securities. The completion of MBT's debt issue reflects good investor acceptance of the PONV loss-absorption mechanism. We expect this deal to help establish pricing benchmarks that will open up new issuance of Basel III capital securities in the Philippines as the country's banking sector experiences growth. Before MBT's issuance, only the Development Bank of the Philippines (unrated) had issued Basel III-compliant securities in the domestic market in late 2013.

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## Insurers

### UK Budget Will Reduce Sales and Margins for UK Annuity Writers, a Credit Negative

On 19 March, the UK government, as part of its annual budget, announced that insurance policyholders will be given significantly more flexibility to withdraw their pension funds at retirement in what is one of the most far-reaching pension reforms in decades. In particular, the UK government is effectively eliminating a requirement for many policyholders to purchase an annuity, which will significantly reduce UK life insurers' revenues and future profits from individual annuities. These changes are credit negative for UK life insurers.

The changes are subject to a government consultation process and are due to take effect in April 2015. We estimate that individual annuities currently account for up to approximately 50% of UK life insurers' UK value of new business, which is the measure of profits insurers expect to generate from new premiums written, net of the cost of capital. Moreover, individual annuities are one of the most profitable lines of business for UK life insurers. We predict that these changes will result in individual annuity sales declining by 50%-75% from their current values.<sup>15</sup>

Maturing pension funds typically roll over into annuities, with approximately 75% of UK retirees purchasing an annuity on retirement. Annuities have suffered recently because of low interest rates and therefore low annuity rates, and as a result we expect many policyholders to use their maturing funds for alternative investments or consumption. In the US and Australia, where policyholders already have much greater flexibility in how to use their funds at retirement, typically fewer than 5% of policyholders purchase a conventional annuity.

We recognise that over time some of the assets that policyholders previously invested into annuities may remain on insurers' balance sheet as insurers look to increase their individual savings accounts sales and create new drawdown products. Such products could draw on experience that insurers gain from selling non-fixed annuity products in other global markets, such as variable annuity products in the US. The insurers best positioned to take advantage of the greater demand for drawdown products will be those with advanced wrap/platform propositions and those able to draw from experiences in other similar retirement markets.

The exhibit below highlights those insurers with the strongest market position in UK individual annuities. [Aviva Plc](#) (A3 stable), [Prudential Public Limited Company](#) (A2 stable) and [Legal & General Group Plc](#) (A3 stable) collectively control around 50% of the market and therefore have the most exposure to a decrease in new sales.

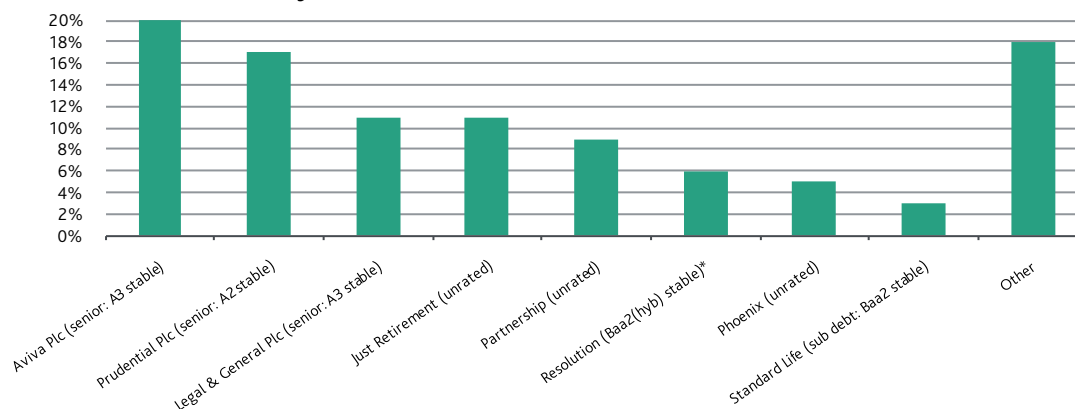
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<sup>15</sup> According to the UK Treasury, an average of £11 billion of new individual annuities are purchased each year in the UK.

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## UK Insurers' Individual Annuity Market Share in 2013



\* Rating for Resolution is that of Friends Life Group Plc's guaranteed senior subordinated debt.

Source: Association of British Insurers and Financial Times

However, we note that there are mitigating factors for many large UK life insurers, including that some groups such as Aviva and Prudential are well diversified by product and geography and thus will be less affected by a decline in individual annuities. In addition, some insurers own sizable asset management operations or well-established fund platforms that may allow them to capture some of the asset flows as customers choose to withdraw their pension funds. Such groups include Prudential, Legal & General Group and [Standard Life Plc](#) (subordinated debt Baa2 stable).

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## Tokio Marine Cat Bond Fully Collateralizes Earthquake Protection, a Credit Positive

On 18 March, Aon Benfield Securities announced that it had completed a private placement of a \$245 million catastrophe bond for Kizuna Re II Ltd, sponsored by [Tokio Marine & Nichido Fire Insurance Co.](#) (financial strength Aa3 stable). This is Tokio Marine & Nichido Fire Insurance's second cat bond since the March 2011 earthquake, but the first for a private insurer to provide fully collateralized catastrophe protection for Japanese earthquake risk covering commercial and industrial exposures using an indemnity trigger, which diversifies its risk transfer tools and access to capital markets, a credit positive.

Compared to Tokio Marine's previous catastrophe bond issuance in August 2011, shown below, this issue covers Japanese earthquake, a risk that since March 2011 has not smoothly transferred into the reinsurance market, the main risk-transfer mechanism Japan's property and casualty insurers use. One protective feature of the bond is that its payout is linked directly to actual loss experience (indemnity) instead of the common practice of using proxy triggers like a parametric index or market index. This helps shield Tokio Marine from basis risk whereby a non-indemnity catastrophe bond's trigger does not fully match actual loss.

### Japanese Insurers' Outstanding Catastrophe Bonds

Issuer	Cedent	Covered Risk	Amount \$ million	Date
Kizuna Re Ltd.	Tokio Marine & Nichido	Japan earthquake	\$245	March 2014
Nakama Re Ltd.	Zenkyoren	Japan earthquake	\$300	September 2013
Akibare Re Ltd.	Mitsui Sumitomo Insurance	Japan typhoon (wind & flood losses)	\$130	April 2012
Kizuna Re Ltd.	Tokio Marine & Nichido	Japan typhoon	\$160	August 2011

Source: Artemis Deal Directory

Other Japanese private property and casualty insurers also benefit because the bond sets a precedent for covering commercial and industrial earthquake exposures in Japan, including [Mitsui Sumitomo Insurance Co., Ltd.](#) (financial strength A1 stable) and [Sompo Japan Insurance Inc.](#) (financial strength A1 stable), both of which we believe are keen to diversify risk transfer tools for their own earthquake exposures.

The cat bonds broaden insurers' risk-management tools and diversify their capacity procurement measures. Although insurers already use traditional reinsurance to reduce underwriting risk, rising prices after the March 2011 earthquake, particularly for placing commercial/industrial earthquake risk, has led to rising hesitancy to underwrite related policies. For investors, cat bonds' relatively higher yields than Japanese government bonds or corporate bonds and lack of correlation with market risks are appealing. We expect more insurers to follow Tokio Marine's lead and issue their own cat bonds.

## Asset Managers

### Asset Managers Stand to Benefit from UK Pension Rule Changes

On 19 March, the UK government announced a proposal that will bring about a radical change to the country's pension system. If approved, UK defined contribution (DC) plan participants starting in April 2015 will not be required to buy an annuity with their retirement savings, giving them flexibility to consider other investments. In addition, the tax-free individual savings accounts will be simplified starting this July, with the total limit increased to £15,000 per year. These changes will likely trigger a significant shift in retirement savings away from annuities to investment funds and, on the margin, increase retail savings allocated to investment funds, both credit positives for asset managers.

Currently, DC pension scheme participants have little flexibility over the investment options for their retirement money given the 55% tax charge if they withdraw the entire account at once. To avoid the tax penalty, the only option available at retirement is to buy an annuity.

The annuity requirement has long been one of the most unattractive aspects of the UK's private pension saving regime because ultra-low interest rates and rising longevity have translated into meager incomes. Annuities are income streams bought with savings that ensure older people receive a sum of money each year until death. The proposed changes will likely prompt individuals to move away from annuities and pensioners will instead seek investment funds in higher-yielding asset classes to secure higher incomes.

The shift to investment funds is likely to foster growth of investment products available to the retail sector. Asset managers that have already invested capital and established a strong infrastructure for retail distribution and advisory service, such as [FIL Limited](#) (Baa1 stable), [SAM Investment Holdings Limited](#) (Ba2 positive), Henderson Global Investors (unrated) and Jupiter Fund Management (unrated), will likely benefit more immediately than those focused mostly on the institutional investor base.

The investment shift away from annuities into investment funds will likely build up gradually over a long time horizon, and managers are unlikely to see immediate shifts in assets under management. Nevertheless, the eventual boost to managers' total revenues will likely be substantial. The Investment Management Association showed that UK-authorized retail funds typically charge ongoing fees of between 1.25% and 1.75% for services including investment management, advisory and administration. In some cases, funds charge one-off entry and exit fees, each amounting up to 0.5% of asset value. Approximately £800 billion<sup>16</sup> is held in the sectors where the government is proposing additional flexibility: defined contribution and associated annuity products. The remaining £1.2 trillion of assets are held in defined benefit schemes.

Given that the vast majority of investments backing the pensioners' annuities are fixed income, as shown in the exhibit below, equity and alternative asset managers clearly have the greatest potential to benefit from a shift in retirement flows. However, fixed-income asset managers that offer products with greater returns, including emerging market bond, private debt, high-yield bond and absolute-return bond funds, will also have opportunities to capture a portion of the potential retirement savings.

<sup>16</sup> According to the HM Treasury's report, pensions and annuities account for a significant proportion of investment in UK domestic financial markets, with £2 trillion of assets in funded pension schemes and annuities as of 2011, equivalent to 130% of GDP. HM Treasury, [Freedom and Choice in Pensions](#), March 2014.

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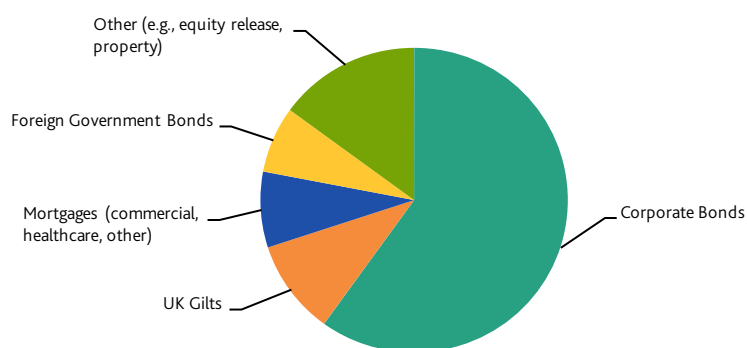
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### Estimated Distribution of Assets Held by Major UK Annuity Writers, December 2012



*Source: UK Prudential Regulation Authority, Her Majesty's Treasury, and Moody's Investors Service*

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Beyond the effect on the annuities sector, the UK government noted that the greater flexibility within the DC market might even lead to private-sector defined benefit members looking to transfer to a DC plan. However, for public-sector defined benefit pension funds, the government intends to introduce rules to ban transfers because public defined benefit funds are largely underfunded.

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## Sovereigns

### Argentine Trade Surplus Continues to Fall, Negatively Pressuring International Reserves

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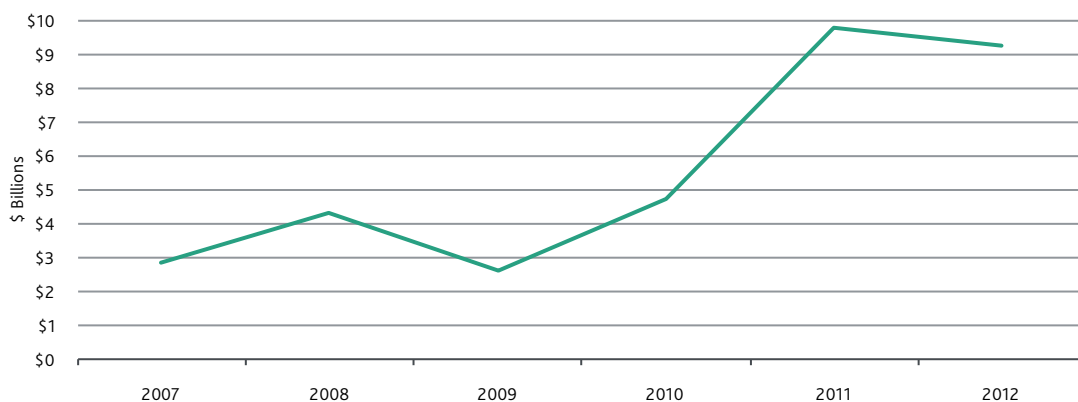
Last Thursday, [Argentina's](#) (Caa1 stable) Instituto Nacional de Estadística y Censos, the country's national statistical office, reported that the country's commercial trade balance had dropped to \$44 million in February from \$520 million a year earlier. The lower trade surplus is credit negative because it saps already declining international reserves, which remain Argentina's sole funding source to meet foreign currency obligations.

We estimate that Argentina faces dollar debt payments of more than \$20 billion in 2014 and 2015, with private creditors and international (multilateral and bilateral) financial institutions owed \$9.3 billion this year and \$12.5 billion next year, although the final numbers could be higher. If reported economic growth in 2013 is higher than 3.2%, it will trigger payments of Argentina's GDP warrants and add more than \$3 billion in debt payments for this year. Moreover, an agreement with Spanish oil company [Repsol S.A.](#) (Baa3 stable)<sup>17</sup> to compensate it for the 2012 nationalization of its ownership in [YPF Sociedad Anonima](#) (Caa1 stable), Argentina's largest oil producer, could add another \$1.5 billion in payments over the next two years. To meet all these obligations, Argentina today relies solely on its stock of international reserves because it lacks other external funding options.

Argentina is one of the few Latin American countries with a capital account deficit because of persistent capital outflows and a lack of access to international debt markets. The commercial trade surplus, which helped prop up dollar inflows for years, fell 27% in 2013 to \$9 billion from 2012 levels. In the first two months of this year, Argentina's trade balance has fallen even further. A lack of confidence in government economic policies, along with one of the region's highest inflation rates, will make it difficult to prevent further capital flight. A lack of investment in the energy sector has also increased energy imports, reducing the overall trade surplus (see Exhibits 1 and 2).

EXHIBIT 1

#### Argentina's Annual Oil-Related Imports



Source: Instituto Nacional de Estadística y Censos

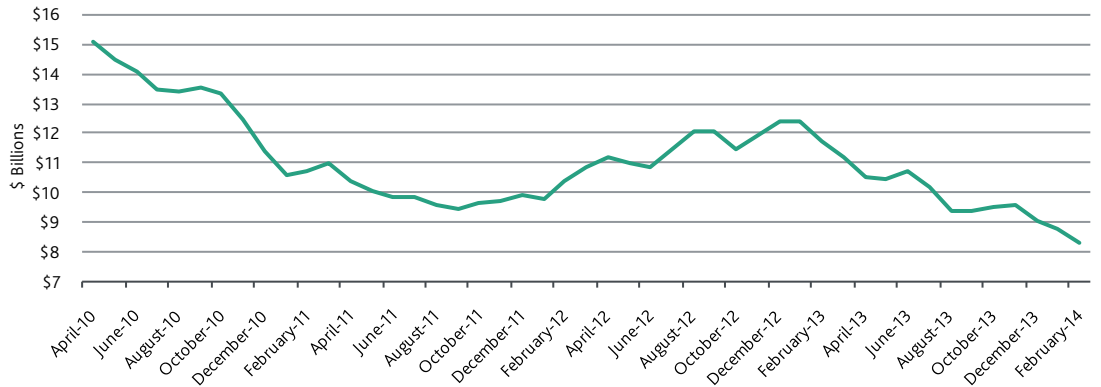
<sup>17</sup> See [Repsol Compensation Agreement over YPF Is Credit Positive for Both Companies](#), 3 March 2014.

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EXHIBIT 2

## Argentina's 12-Month Trailing Trade Surplus



Source: Instituto Nacional de Estadística y Censos

Falling trade surpluses and persistent capital flight are compounding a decline in international reserves that has been taking place for years (see Exhibit 3), with reserves dropping to \$27 billion in March 2014 from \$52 billion in April 2011.

EXHIBIT 3

## Argentina's International Reserves



Source: Central Bank of Argentina



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## US Public Finance

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### Lawsuits Challenge College Sports' Amateur Model, a Credit Negative for the NCAA and Colleges

On 26 March, the Chicago office of the National Labor Relations Board ruled in favor of Northwestern University football players' right to unionize, the latest credit-negative challenge to the prevailing business model of uncompensated athletes in college sports.

The ruling follows the 17 March filing of sports attorney Jeffrey Kessler's lawsuit against the [National Collegiate Athletic Association](#) (NCAA, Aa2 negative) and major athletic conferences. The suit seeks removal of the NCAA's limit on student-athletes' benefits. The litigation in federal court in New Jersey adds to mounting legal challenges against the NCAA and many member institutions.

The NCAA's challenges arise from the potential for negative financial pressure from legal judgments, settlements, regulatory change or self-imposed policies. Universities could face increased labor costs for players who are currently considered to be student-athletes.

Other credit negative developments in recent months include:

- » The judge in the Ed O'Bannon class-action antitrust lawsuit against the NCAA signaled that the trial would begin in June
- » The same judge deemed that the case of Shawne Alston, a former West Virginia University football player, is closely related to the O'Bannon matter and can proceed

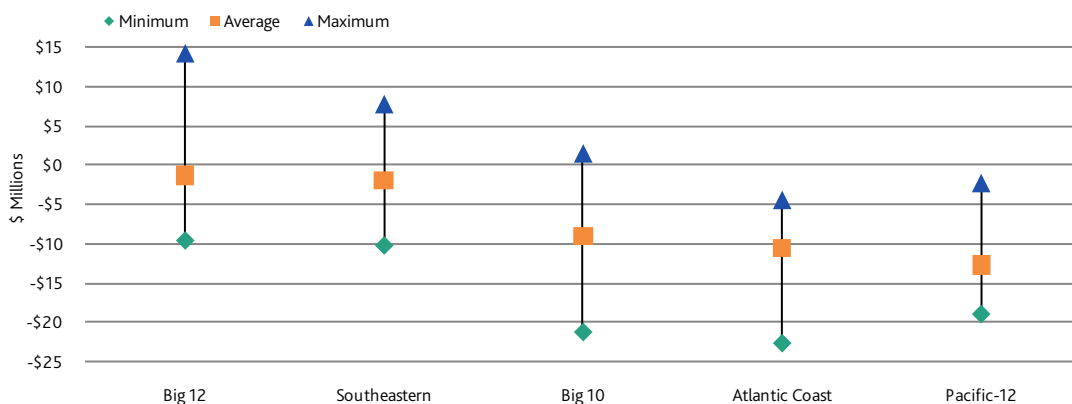
Although each of these developments has unique aspects, they all pose a threat to the model of amateurism in college sports. The Kessler complaint names the NCAA along with five athletic conferences: the Atlantic Coast, Big Ten, Big 12, Pacific-12 and Southeastern.

The potential expense increase would put additional pressure on universities, which are already dealing with a challenging operating environment. Most athletic departments involved in the Kessler suit require a subsidy from their universities (see exhibit). For the public universities within those five conferences, the median subsidy requirement is around \$7 million. In the absence of amateurism, players would likely gain additional compensation, greatly increasing the need for subsidization. In a market regime with no limits on player benefits, we would expect wide variation in both the ability and willingness of universities to compete for top players.

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### Athletic Program Net Income of Colleges in Conferences Named in Kessler Suit



Notes: Fiscal 2012 data reflect public universities only; net income excludes university subsidy and mandatory student fees

Source: Indiana University School of Journalism in conjunction with USA Today

We believe most universities would manage the challenge of the potential new expenses while avoiding deficit operations and maintaining operating equilibrium. In the case of a hypothetical university with \$500 million in total university expenses and \$20 million of annual revenue from athletic media contracts, a decision to share 50% of the media payments with players would total \$10 million per year, or an increase 2% of campus-wide expenses.

The challenges to amateurism could evolve in numerous ways. If faced with abrupt change, we believe some universities or conferences might choose to compete under a new set of rules, in which some different form of amateurism would be retained. The prospects for self-regulated and gradual change within the NCAA have been hampered by the divergent interests of the various member institutions. One failed member proposal focused on allowing a stipend to student-athletes, but was voted down by less commercially successful members because of the financial burden it would have imposed.

A change in the compensation model for athletes would ultimately precipitate a major retooling of college sports programs, which are often critical to the identity of universities and help with student recruitment and donor support. For more information about the credit effect of college sports, see our October 2013 Special Comment, [Eye on the Ball: Big-Time Sports Pose Growing Risks for Universities](#).

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## Proposed GSE Reforms Include Provisions for Housing Finance Agencies, a Credit Positive

On 17 March, US Senate Banking Committee Chairman Tim Johnson (D-South Dakota) and the committee's ranking member Mike Crapo (R-Idaho) released the text of their proposed legislation to reform the housing finance system. If enacted, the proposed legislation would wind down Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs), replace them with a new mortgage origination platform and provide a federal guarantee for home mortgages meeting the bill's criteria.

Although passage anytime soon is uncertain, the draft is a significant milestone in defining the congressional approach to a new mortgage system if Fannie and Freddie are discontinued. Sections of the proposal are credit positive for housing finance agencies (HFAs) because they make qualified HFA mortgages eligible for the federal guarantee, allow HFAs to participate in the new mortgage platform and preserve the GSEs' multifamily lending activities. The bill provides a basis for HFAs to continue their lending program, which is their primary source of revenue for future operations and management of existing obligations.

GSEs have been important partners for state HFAs, whose primary business is financing home mortgages for low- and moderate-income buyers. Since the 2008 financial crisis, HFAs have relied increasingly on direct loan sales to GSEs and sales in the "to be announced" (TBA) market to finance single family mortgages.

If the GSEs are wound down, they would be replaced by a new federal agency, the Federal Mortgage Insurance Corporation (FMIC), which would provide an express federal guarantee for single-family mortgage losses only after private sector investors absorb at least the first 10% of the loss. The bill provides that HFA loans may be eligible for the guarantee, and it requires that other loan criteria conform as closely as possible to qualified mortgage rules recently enacted by the US Consumer Finance Protection Bureau and which favor HFA loans by exempting them from key restrictions on mortgage suitability.

The Johnson-Crapo legislation provides continued backing for existing GSE obligations during and after a wind-down, which is credit positive because it assures that existing GSE securities held by HFAs continue to have protection. The legislation provides for securitization of eligible home mortgages through a new member-owned securitization platform and includes provisions to ensure access for smaller lenders. HFAs are eligible to participate and thus can continue to securitize loans. The platform is designed to assure continued access to the TBA market. The securitization platform may adopt a tiered usage fee structure for HFAs to encourage affordable housing.

HFAs, like all lenders, would face a considerable challenge in creating new financing structures to provide for the top-loss private capital and meet the requirements of the new system, which will increase financing costs and risks posing barriers to serving moderate-income buyers. The provisions in the draft legislation that expressly recognize the role of HFAs provide a framework for their continued role as providers of affordable housing finance in a post-GSE world.

For multifamily financing, the draft provides greater continuity by directing that the GSEs' multifamily business be transferred to new entities and continued, subject to specific affordability targets. This will preserve a smaller but also significant part of HFA business because GSEs provide guarantees for affordable multifamily mortgage loans meeting their underwriting criteria. Sustained multifamily business also is positive for maintaining or growing revenues.

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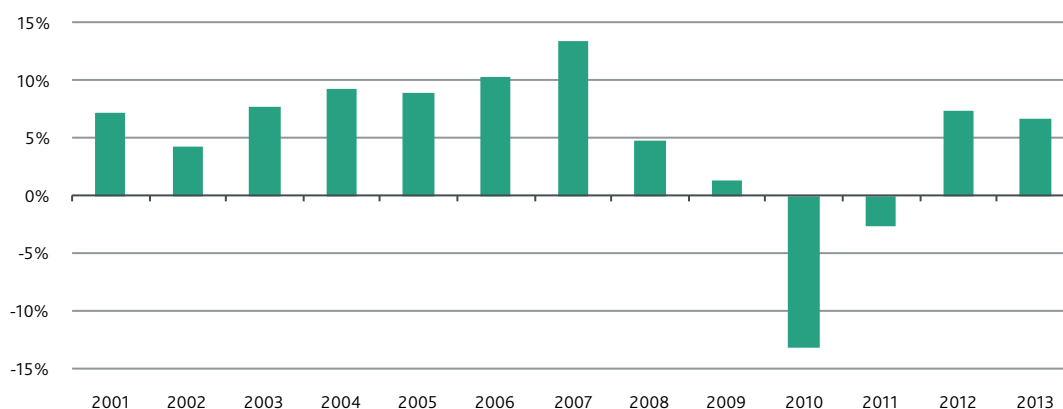
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## Central Falls, Rhode Island, Recovery Plan Results in a Surplus

On 20 March, less than two years after emerging from bankruptcy, [Central Falls, Rhode Island](#) (B1 positive), reported a \$1.6 million surplus, before capital transfers, for the fiscal year ended 30 June 2013. These credit positive results provide evidence that the city's six-year recovery plan, developed as part of the bankruptcy process, is on track to stabilizing the city's financial operations. Central Falls has achieved structural balance of its operations and fixed costs, allowing it to begin addressing deferred capital needs. Its steady recovery contrasts with Vallejo, California (unrated), which emerged from bankruptcy in 2011, but remains in structural imbalance and projects a deficit in 2014.

Central Falls' recovery plan includes a combination of annual property tax increases, ongoing spending controls and savings in pension and healthcare-related costs. The city transferred \$1.79 million to its capital reserve fund during fiscal 2013 to fund some of the more than \$125 million in deferred maintenance, a requirement of the recovery plan. Because of the transfer, total general fund reserves dropped to \$1.2 million (6.7% of revenue) from \$1.37 million the previous year. The surplus resulted from favorable variance to budget on current year property tax revenue (\$759,494), non-tax fee revenue (\$147,367) and medical insurance/unemployment compensation (\$168,985).

### Central Falls, Rhode Island, General Fund Reserves as a Percent of Revenue Remain Healthy After Large Transfer to Capital Fund



Source: Central Falls, Rhode Island, audited financial statements

The city adopted the six-year financial plan (2012 through 2017) as a condition of its exit from bankruptcy. In addition to the requirement that any surplus in excess of \$50,000 be used for deferred capital spending, the plan also requires the adoption of balanced budgets using annual levy increases (within the state's 4% levy cap), full payment of actuarially required pension costs and significant staffing and benefit expenditure cuts in 2011 and 2012. The city is well ahead of its original projection that it would end fiscal 2013 with a \$46,000 surplus after transfers and that it would bring total general fund reserves to \$197,000.

The city's recovery from bankruptcy included a 45% cut in retiree pension benefits and significant relief from accounts payable to general contractors and equipment leases. The city also increased its property tax levy by 19.5% in 2011. Just before the bankruptcy filing, the city's state-appointed receiver issued a report projecting sizable annual operating deficits from 2011 through 2015 if the city continued on its course without action.

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## NEWS & ANALYSIS

### *Credit implications of current events*

Unlike Central Falls, Vallejo's plan did not include adjustments to employee pension benefits, which require escalating contributions that will only further the structural imbalance. Vallejo's financial position is challenged as pension costs escalate. The city's budget for the fiscal year ending 30 June 2014 originally projected a \$5.2 million structural imbalance, or 6% of its general fund revenues, and expects to narrow the gap to approximately \$2-\$3 million, partly through a reduction in retiree health benefits. However, without some adjustment to pension benefits, we expect rising costs to continue to negatively pressure Vallejo's finances.

# RATING CHANGES

Significant rating actions taken the week ending 21 March 2014

## Corporates

### Adecco S.A.

	27 Jun '12	Outlook Change 18 Mar '14
Long-Term Issuer Rating	Baa3	Baa3
Outlook	Stable	Positive

The outlook change reflects Adecco's solid underlying performance and improved profitability, despite several key markets being very challenging in the beginning of 2013. It also reflects our expectation that the operating environment will become more favorable, notably in Europe, as several markets are improving with the support of a favorable macroeconomic environment.

### Anheuser-Busch InBev SA/NV

	20 Jan '14	Upgrade 20 Mar '14
Long-Term Issuer Rating	A3	A2
Outlook	Review for Upgrade	Positive

The upgrade reflects our expectation that ABI will sustain good business momentum and strong operating margins, and that its robust cash flow will allow it to reduce leverage following the 2013 acquisition of Modelo and the upcoming acquisition of Oriental Brewery.

### Huntington Ingalls Industries, Inc.

	24 Jan '11	Outlook Change 17 Mar '14
Corporate Family Rating	Ba2	Ba2
Outlook	Stable	Positive

The outlook change reflects the growth of Huntington Ingalls' backlog and operating profit in 2013. It also reflects our expectation that the company's income will grow in 2014-15, owing to a recent set of profitable ship construction projects and the possible recovery of pension costs under the company's existing contracts.

### Novelis Inc.

	6 Dec '10	Review for Downgrade 21 Mar '14
Corporate Family Rating	B1	B1
Outlook	Stable	Review for Downgrade

The review for downgrade results from the continued weak performance of Novelis, which has led to a deterioration of debt protection metrics, as evidenced by a contraction in the EBIT/interest ratio to 1.7x and a worsening in the debt/EBITDA ratio to 6.9x. The review will focus on (1) the outlook for shipments and conversion premiums within the company's geographic operating regions; (2) the company's ability to contain or reduce costs; and (3) planned capital expenditure levels.

# RATING CHANGES

Significant rating actions taken the week ending 21 March 2014

## Solvay S.A.

	8 Oct '13	Downgrade 21 Mar '14
Senior Unsecured Rating	Baa1	Baa2
Outlook	Negative	Stable

The downgrade reflects our reduced expectations for the pace of recovery in operating performance in 2014-15, owing to the fact that the reorganization of Solvay's portfolio is taking longer than we had anticipated.

## Vodafone Holding GmbH

	4 Sep '13	Outlook Change 18 Mar '14
Long-Term Issuer Rating	A3	A3
Outlook	Stable	Negative

The outlook change reflects our expectation that Vodafone's credit metrics will deteriorate following its acquisition of Grupo Corporativo ONO, because the primary source of funding will be existing cash resources and debt.

## Wm Morrison Supermarkets plc

	19 Sep '13	Downgrade 18 Mar '14
Long-Term Issuer Rating	Baa1	Baa2
Outlook	Stable	Negative

The downgrade reflects the reported 13% year-on-year decline in Morrison's underlying profit before tax, as well as its rising dividend payments and its weak position in the growing online and convenience store channels.

# RATING CHANGES

Significant rating actions taken the week ending 21 March 2014

## Infrastructure

### Aeropuertos Argentina 2000 S.A.

	26 Oct '12	Downgrade 19 Mar '14
CFR/Senior Unsecured Notes	B3	Caa1
Outlook	Negative	Stable

### Empresa Distribuidora de Electricidad de Salta S.A.

	4 Sep '13	Downgrade 19 Mar '14
Senior Unsecured Notes	B3	Caa1
Outlook	Negative	Stable

### Camuzzi Gas Pampeana S.A.

	28 Sep '12	Downgraded 19 Mar '14
CFR	B3	Caa1
Outlook	Negative	Stable

### Gas Natural BAN S.A.

	28 Sep '12	Downgrade 19 Mar '14
CFR	B3	Caa1
Outlook	Negative	Stable

### Transportadora de Gas del Sur S.A.

	13 Jan '14	Downgrade 19 Mar '14
Senior Unsecured Notes	B3	Caa1
Outlook	Stable	Stable

### Hidroelectrica El Chocon S.A.

	30 Sept '13	Downgrade 19 Mar '14
CFR	B3	Caa1
Outlook	Stable	Stable



# RATING CHANGES

Significant rating actions taken the week ending 21 March 2014

## Genneia S.A.

	12 Dec '13	Downgrade 19 Mar '14
Senior Secured Notes	B3	Caa1
Senior Unsecured Notes	B3	Caa1
CFR	B3	Caa1
Outlook	Stable	Stable

## Central Termica Loma de la Lata S.A.

	15 Mar '13	Downgrade 19 Mar '14
Senior Secured Notes	B3	Caa1
Outlook	Stable	Stable

## Generacion Independencia S.A.

	2 Dec '13	Downgrade 19 Mar '14
Senior Unsecured Notes/CFR	B3	Caa1
Outlook	Stable	Stable

## Empresa Provincial de Energia de Cordoba

	12 Apr '13	Downgrade 19 Mar '14
Senior Secured Notes/CFR	B3	Caa1
Outlook	Negative	Stable

We downgraded the ratings on utilities and infrastructure companies operating in Argentina so that the ratings align with our sovereign and foreign currency country ceiling in Argentina after we downgraded them to Caa1 from B3. The alignment reflects our view that the creditworthiness of these companies cannot be completely de-linked from the current operating environment and regulatory regimes in Argentina, which have made credit quality more uncertain for companies operating within its borders.

## California Department of Water Resources

	10 Aug '11	Upgrade 17 Mar '14
Power Supply Revenue Bond	Aa3	Aa2
Outlook	Positive	Stable

The upgrade reflects the improved risk profile of the CA DWR power supply revenue bonds, owing to substantially reduced operations coupled with a long history of California Public Utility Commission (CPUC) support of full and timely cost recovery in compliance with a rate agreement with CA DWR. The stable outlook reflects our view that the CPUC will continue to adhere to its rate agreement and annually approve all rate filings to ensure full cost recovery through debt maturity in 2022. It also reflects our expectation that CA DWR will maintain its indenture required reserves for a liquidity cushion.

# RATING CHANGES

Significant rating actions taken the week ending 21 March 2014

## Financial Institutions

### Ratings of Argentine Banks Downgraded

19 Mar '14

We downgraded various ratings of Argentine banks and financial institutions, owing to the economic policy decisions that have led to very high inflation, currency depreciation, capital flight and economic stagnation. Some rating actions follow our downgrade of the Argentine government bond rating to Caa1 from B3 on 17 March 2014, which also adjusted the local and foreign currency bank deposit and bond ceilings for Argentina.

We have (1) lowered the standalone bank financial strength ratings of 24 Argentine banks; (2) lowered the baseline credit assessments of 24 banks; (3) downgraded the local currency deposit ratings of 26 banks; (4) downgraded the issuer ratings of two financial institutions and the corporate family ratings of two finance companies; (5) downgraded the local and foreign currency senior and subordinated debt ratings of 19 banks; (6) downgraded the local-currency national scale deposit ratings of 27 banks; (7) downgraded the national scale issuer ratings of two financial institutions and the national scale corporate family ratings of two finance companies; (8) downgraded the local-currency national scale debt ratings of 19 banks; (9) downgraded the foreign-currency national scale deposit ratings of 26 banks; and (10) downgraded the foreign-currency national scale debt ratings of 18 banks.

### Ratings of 10 Turkish Banks Placed on Review for Downgrade

18 Mar '14

We placed on review for downgrade the ratings of 10 Turkish banks. The review reflects (1) pressures on the standalone credit strength of the institutions; and (2) our evolving views on the level of systemic support that we should incorporate into the senior ratings. The banks on review for downgrade are Akbank Tas, Asya Katilim Bankasi A.S., Sekerbank T.A.S., T.C. Ziraat Bankasi A.S., Turk Ekonomi Bankasi A.S., Turkiye Garanti Bankasi A.S., Turkiye Halk Bankasi A.S., Turkiye Is Bankasi A.S., Turkiye Vakiflar Bankasi T.A.O., and Yapi ve Kredi Bankasi A.S.

### Denizbank A.S.

	3 Jun '12	Review for Downgrade 20 Mar '14
Bank Financial Strength/Baseline Credit Assessment	D+/ba1	D+/ba1
Long-Term Bank Deposits (Foreign/Domestic)	Baa3	Baa3

The review for downgrade reflects (1) pressures on Denizbank A.S.'s standalone credit strength; and (2) our evolving views on the level of systemic support that we should incorporate into the bank's senior ratings. The review will focus on (1) the size of the Turkish banking sector relative to the government's resources; (2) the government's capacity to provide broad-based support in the context of a systemic banking crisis scenario; and (3) the predictability of policy responses in light of political and historical patterns, and any recent shift in government priorities.

# RATING CHANGES

Significant rating actions taken the week ending 21 March 2014

## Evrofinance Mosnarbank

	9 Sep '05	Downgrade 18 Mar '14
Long-Term Bank Deposits (Foreign/Domestic)	Ba3	B1

The downgrade reflects our decision to remove one notch of systemic support uplift that we previously incorporated into Evrofinance Mosnarbank's deposit ratings. The removal of this systemic support uplift is the result of significant uncertainties regarding the creation of a joint Russian-Venezuelan development bank.

## First Niagara Financial Group, Inc.

	18 Apr '11	Downgrade 20 Mar '14
Long-Term Issuer Rating (Domestic)	Baa2	Ba1
Senior Unsecured (Domestic)	Baa2	Ba1

The downgrades reflect our concerns about First Niagara Financial Group's future asset quality given its lead bank's high organic loan growth.

## GarantiBank International NV

	26 Mar '09	Review for Downgrade 20 Mar '14
Bank Financial Strength/Baseline Credit Assessment	C-/baa2	C-/baa2
Long-Term Bank Deposits (Foreign/Domestic)	Baa2	Baa2

The review for downgrade reflects (1) our decision to place on review for downgrade the ratings of GarantiBank International NV's (Garanti-NV) parent company Garanti-AS; and (2) the potential for deterioration in Garanti-NV's asset quality and overall performance, given likely weakening in Turkey's operating environment. The review will focus on (1) the extent to which Garanti-NV's franchise and operations are independent of Garanti-AS; (2) the degree to which the geographic balance sheet and revenue diversification of Garanti-NV's operations shield the bank from the expected significant economic slowdown in Turkey; (3) the level of the geographic alignment between assets and liabilities; (4) internal risk management practices, which seek to mitigate the short-term nature of the bank's deposits funding base; and (5) the changing credit profiles and geographic distribution of parties involved in Garanti-NV's trade finance activities.

## Turkiye Sinai Kalkinma Bankasi A.S.

	3 Jul '12	Review for Downgrade 20 Mar '14
Long-Term Bank Deposits (Foreign/Domestic)	Baa3	Baa3

The review for downgrade follows our decision to place the ratings of the bank's 50% shareholder, Turkiye Is Bankasi AS, on review for downgrade on 18 March 2014.

# RATING CHANGES

Significant rating actions taken the week ending 21 March 2014

## Sovereigns

### Argentina

		Downgrade
		17 Mar '14
Government Currency Rating	B3	Caa1
Foreign Currency Deposit Ceiling	Caa1	Caa2
Foreign Currency Bond Ceiling	B3	Caa1
Local Currency Deposit Ceiling	Ba3	B1
Local Currency Bond Ceiling	Ba3	B1
Outlook	Negative	Stable

Driving our downgrade of Argentina's government bond rating was, first, a significant fall in official reserves, which have dropped to \$27.5 billion from a high of \$52.7 billion in 2011, thereby increasing the risk that Argentina may not meet its foreign-currency debt service obligations, and, second, an inconsistent policy environment that increases the likelihood that official reserves will remain under pressure this year and next.

# RATING CHANGES

Significant rating actions taken the week ending 21 March 2014

## Sub-sovereigns

### Provinces of Buenos Aires, Cordoba, Chubut, Entre Rios, Mendoza; City of Buenos Aires; Municipalities of Cordoba, Rio Cuarto (Argentina)

		Downgrade
		19 Mar '14
Issuer/Debt Rating – Local Currency	B3/A3.ar-Baa3.ar	Caa1/Ba1.ar-Ba3.ar
Issuer/Debt Rating – Foreign Currency	Caa1/Ba1.ar-Ba3.ar	Caa2/B2.ar
Outlook	Negative	Stable

Our downgrade of the ratings on most of most rated Argentine provinces and municipalities followed our downgrade of Argentina's sovereign bond rating to Caa1. The downgrade of the global scale foreign-currency ratings reflect the growing risks that sub-sovereigns face in accessing foreign currency to continue honoring their obligations denominated in foreign currency. The Global Scale local-currency ratings of all rated Argentine sub-sovereigns remain in line with or below Argentina's Caa1 stable government bond rating. The downgrade captures the close institutional and financial links these issuers have with the federal government which effectively exposes their credit quality to higher systemic risks. As such, we do not rate any Argentine sub-sovereigns above the sovereign rating.

### University of Sydney (Australia)

		New
		20 Mar '14
Issuer Rating		Aa1
Outlook		Stable

The University of Sydney's rating reflects its strong market position in Australia and globally, healthy financial performance supported by predictable and secure Commonwealth grants, and ample liquidity to meet financial and debt obligations. While the university's modest debt levels will increase as its capital improvement program progresses, we anticipate that its debt burden will remain moderate.

# RATING CHANGES

Significant rating actions taken the week ending 21 March 2014

## US Public Finance

### Newark, New Jersey

	1 Jan '13	Review for Downgrade 17 Mar '14
General Obligation	A3	A3
General Obligation Limited Tax	Baa1	Baa1
Outlook	Negative	Review for Downgrade

The outlook change reflects the fact that the city will introduce its fiscal 2014 budget late, continues to operate with a structural deficit and is likely to increase the size of its tax anticipation note borrowing this year. It also reflects the city's estimated 2014 structural gap in financial operations for which the city could need financial aid. The review will examine if the city's financial position has weakened and if the 2014 budgeting process will be delayed significantly and have a material budget gap.

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# RESEARCH HIGHLIGHTS

*Notable research published the week ending 21 March 2014*

## Corporates

### [Restaurants: Activist Shareholders Like What's on the Menu at Some Restaurants](#)

Shareholder activists were relatively busy in the restaurant space in 2013 as soft consumer spending and high levels of discounts continued to weigh on same-store sales and earnings growth – a situation that is likely to persist in 2014. Darden and Cracker Barrel Old Country Store, Inc. are the only two companies currently under fire, though activists will likely also be looking at other opportunities in the restaurant space, where many remain under pressure.

### [Chemicals: Activists Pursue Chemical Companies, But No Downgrades So Far](#)

Activist investors have targeted some of the largest companies in the North American chemicals sector over the last two years. Consequently, companies have agreed to sell underperforming businesses and implement cost-reduction programs. The net result has been a reduction in financial flexibility at these firms, with lower cash balances and a reduced ability to undertake large capital projects or debt-financed acquisitions.

### [Energy: The Sector Will Remain a Prime Target for Activists in 2014](#)

The North American energy sector is one of the biggest targets for activist investors. Companies with heavy capital spending plans, weak returns on capital, disparate assets, lagging stock performance, low financial leverage and high cash balances will be the most vulnerable in 2014.

### [Healthcare: Drug Companies Are the Most Vulnerable as Blockbuster Patents Expire](#)

We expect activist shareholders to continue to target select pharmaceutical companies. The most vulnerable targets are companies with large cash balances and earnings outlooks that are weakening as the patents on their blockbuster drugs near expiration. However, the majority will not be targets, owing to their large capitalizations and recent reinvigoration in pharmaceutical pipelines.

### [Manufacturing: Activists are Being Drawn Toward Those with Cash Flow, Diverse Product Portfolios](#)

Strong North American manufacturers with established market shares, industrial brands, distribution channels and tangible assets have been drawing the attention of activist shareholders in search of revenues and cash flows capable of supporting higher financial leverage. Furthermore, diverse, multi-segment portfolios can help some conglomerates mitigate the impact of business cycles.

### [Consumer Products: Sector Could See More Activist Activity as Developing Markets Slow](#)

A potential slowdown in developing markets could lay the groundwork for shareholder activism in the consumer products industry during 2014. Shareholder activists have had a mixed influence on credit quality in the sector. Shareholder activism can be beneficial but can also lead to credit negative pressure on companies to break up, increase leverage or lift shareholder distributions.

### [Retail and Apparel: Sagging Stock Prices Keep the Sector Ripe for Activists](#)

The retail and apparel industry is set to be one of the more targeted industries for shareholder activism in 2014. In fact, the impact of shareholder pressure can already be seen with announcements by auction house Sotheby's and supermarket chain Safeway Inc., both under pressure from activist investors. This trend will likely continue as many retailers have sold off following a weaker-than-expected holiday season.

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## RESEARCH HIGHLIGHTS

*Notable research published the week ending 21 March 2014*

### [Technology: Cash-Rich Companies and Strong Cash Flows Continue to Attract Activists](#)

With their large cash balances, minimal debt levels and small, if any, dividend payments, technology companies will continue to be targets for activist investors calling for more aggressive capital returns. In 2013, a quarter of all activist cases at non-financial companies were in this sector. Among the most vulnerable are companies with low valuations resulting from lagging performance or those with valuable assets that can be sold off or spun out into a separate entity.

### [Canadian Retailers Face Tough Fight at Home](#)

Nine large Canadian retailers will have lower operating income growth in 2014 as US retailers gain market share and make it difficult for the Canadian players to preserve margins. We expect operating income for these nine retailers to grow 2.0%-2.5% in 2014, compared with 3.0% growth in 2013.

### [European Telecoms: In-Market Consolidation Is Set to Accelerate; Cross-Border Deals Will Have to Wait](#)

Consolidation in the European telecoms sector is set to accelerate while interest rates remain low, mobile players seek fixed broadband assets to support revenue stabilization through convergent offerings, and some companies opt to sell non-core assets to regain financial flexibility. In-country consolidation will provide substantial costs savings and should lead to a more rational competitive environment.

### [Chinese Corporates: National People's Congress Reaffirms Changing Landscape for Chinese Corporates](#)

The economic growth targets that the National People's Congress (NPC) presented during its annual meeting are credit positive for consumer industries in China, including education, agriculture, Internet, logistics, retail, and medicine. The government maintained a GDP growth target of 7.5% for 2014, unchanged from 2013, and reduced its fixed-asset investment growth target to 17.5% from 18.0% in 2013. These projections reinforce China's commitment to shifting economic growth drivers to domestic consumption from infrastructure spending.

### [Chinese Property Sector: Local Developer's Debt Woes Will Heighten Liquidity Risk for Highly Levered Companies](#)

Zhejiang Xingrun Real Estate Co., a real estate developer based in Zhejiang Province, has collapsed because it was unable to service its outstanding debt. This incident highlights the vulnerability of small, highly levered developers with weak sales execution ability and high refinancing needs. As a result, we believe financiers and investors will become more selective and favor borrowers with relatively strong credit quality, further pressuring the liquidity of financially weak developers.

### [North American Diversified Manufacturers: GDP Growth, Recovering Demand in Key End Markets to Boost Operating Income](#)

The change in outlook, to positive from stable, for North American diversified manufacturers reflects our expectations that gains in operating income will widen amid upticks in US and UK GDP growth and improving prospects for key end markets over the next 12-18 months. Europe has emerged from recession, and public sector expenditures in advanced economies should at least be flat over that period.



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## RESEARCH HIGHLIGHTS

*Notable research published the week ending 21 March 2014*

### [Chinese Property Sector: Reopening of Domestic Equity Issuance Gives Developers More Funding Options](#)

The lifting of the suspension on share sales is credit positive for Chinese property developers because it will provide funding at a time when their funding needs are increasing. We believe that the approval to sell shares is consistent with the government's stated policy to support a higher level of market-oriented mechanisms. However, the speed and sustainability of further share-sale approval remains to be seen.

### [Moody's B3 Negative and Lower Corporate Ratings List: After Five Years, Rating List Remains a Leading Indicator of Default Trends](#)

Our B3 Negative and Lower Corporate Ratings List has proven to be a leading indicator of default trends since it was first published in March 2009. The list has looked past the "noise" of short-term market gyrations to perform well through the ups and downs of the past five years, including the credit crisis, the European sovereign debt crisis and economic slowdown in China.

### [Suppliers of Automotive Bearings Fined by the EU; More Investigations Into the Car Parts Sector Loom](#)

On 19 March, the European Commission imposed fines totaling €953 million against two European and three Japanese producers of car and truck bearings in a cartel settlement. With this settlement, the focus now shifts to other ongoing Commission investigations in the auto supply sector, including airbags, safety belts and steering wheels; air conditioning and engine cooling products; and lighting systems. These investigations are credit negative because they expose these companies to fines that could total up to 10% of sales in each case.

### [SGL Monitor: Liquidity-Stress Index Signals Stable Liquidity Conditions](#)

Moody's Liquidity-Stress Index continues to reflect steady liquidity conditions for US speculative-grade companies and a still-low default rate. Cash flow pressures, upcoming maturities and a tightening cushion under financial maintenance covenants at a few companies have caused the index to move up from the record low of last April, with a slight increase to 4.6% as of mid-March from 4.5% at the end of February.

## Infrastructure

### [Diversified Utilities and Power Companies: Looking to MLPs, Yieldcos, and REITS While Keeping Credit Quality Intact](#)

Yield-oriented structures such as master limited partnerships, yieldcos and even energy real estate investment trusts are the current financial engineering fad in the utility/power sector. Yield vehicles are credit-negative, but we expect them to start out as a minor part of a large diversified organization, so that it will take a long time to reach a point that pressures the ratings of their sponsors.

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# RESEARCH HIGHLIGHTS

*Notable research published the week ending 21 March 2014*

## Financial Institutions

### [ECB's Comprehensive Assessment: Answers to Frequently Asked Questions](#)

Our FAQ addresses the European Central Bank's 'Comprehensive Assessment' that is meant to contribute to a fundamental repair of banks' financial footing and restore market confidence. We view the Comprehensive Assessment as credit positive for euro area bank creditors, since it will help ensure greater transparency and consistency in banks' reported financials, including a more rigorous view of nonperforming exposures.

### [Global Bank Debt – 2013 Issuance Trends](#)

European banks are leading the decline in global bank debt issuance, as post-financial crisis fallout lingers. With many European countries still mired in slow economic growth and persistent pressure on banks to reduce leverage, balance sheets are shrinking, cutting funding needs and driving issuance volumes down.

### [Latin America Bank Debt Report](#)

International debt issuance by Latin American banks nearly halved in 2013 from the previous year, reflecting the region's general slowdown in loan growth and a more volatile macroeconomic environment. Regional drivers differ, as banks in Brazil pulled back from recent Basel III capital-raising efforts, and Colombia's shrinking M&A activity trimmed accompanying financing.

### [Ireland Banking System Outlook](#)

Our outlook for the Irish banking system remains negative, as it has been since 2008, and primarily reflects the extremely high level of problem loans, amounting to nearly 30% of the rated banks' total loans. The sheer scale of impaired assets in the system presents material credit risks for the banks, whose capital levels have weakened significantly since their recapitalization in 2011.

### [Lebanon Banking System Outlook](#)

The outlook on Lebanon's banking system remains negative, reflecting our expectations of high and growing exposure to B1-rated Lebanese government securities, which leaves the banks' modest capital buffers susceptible to sovereign event risk, asset-quality pressures, owing to weak economic growth that continues to be adversely affected by the ongoing conflict in neighboring Syria and domestic political tensions, and high provisioning needs and limited new business generation that will dampen profitability.

### [Italian Banks Under Administration: Exit Scenarios and Implications for Bondholders](#)

We examine five possible outcomes for Italian banks taken under administration by the Bank of Italy: (1) acquisition by another bank; (2) recapitalization through capital raising; (3) public-sector recapitalization (state aid); (4) liquidation/run-off; or (5) banks returning to normal activity. Each of these scenarios poses specific challenges, and has different implications for bondholders.

### [Danish Financial Institutions: New Bill Regarding Refinancing Relating to Mortgage-Credit Bonds Reduces Refinancing Risk in the Danish Mortgage System](#)

Overall, the bill is credit positive for Danish mortgage credit institutions and covered bond issuing banks, because it reduces their exposure to refinancing risk. Furthermore, the removal of refinancing risk for covered bond issuers and the established framework for dealing with bond refinancing for issuers under administration is also credit positive for covered bonds.

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# RESEARCH HIGHLIGHTS

*Notable research published the week ending 21 March 2014*

## Sovereigns

### [Moody's Sovereign Monitor - Focus on Euro Area Rating Actions - March 2014](#)

Featured in this issue are discussions of the key drivers of our recent European rating actions, such as changing the outlooks on Germany's and Italy's ratings to stable, affirming France's Aa1 rating with negative outlook, and upgrading Spain's rating to Baa2 with a positive outlook.

### [2014 Government Gross Financing Needs Series: CEE6: Hungary and Slovenia with Highest Financing Needs Relative to GDP](#)

This report presents the 2014 gross financing needs of the CEE6 – Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia – which will amount to €94.2 billion. Slovenia and Hungary will have the highest financing needs, at 14.3% and 22.7% of GDP, respectively, while Poland, Slovakia and Romania will have the lowest, at less than 10% of GDP.

### [Netherlands Analysis](#)

The Netherlands' Aaa rating and stable outlook is supported by the country's highly competitive, diversified and export-oriented economy, while the Netherlands is also one of the richest countries in the world. It regularly runs large current account surpluses and its export market share has performed well relative to its euro area peers.

## Sub-sovereigns

### [UK Sub-sovereign Quarterly](#)

Feature articles discuss the resilient results of the English housing associations in fiscal year 2013 despite a challenging operating environment, frequently asked questions about why UK universities will benefit from the removal of regulated student caps; and the potential benefits of a municipal bond agency, among other topics.

## US Public Finance

### [Jefferson County's Lower GO Leverage Fuels Higher Recovery than Sewer](#)

Jefferson County's General Obligation Limited Tax creditors realized an overall recovery rate of 88%, much higher than the overall recovery rate of 54% realized by Jefferson County sewer warrant creditors. The GOLT creditors realized higher recoveries because Jefferson County's sewer system was far more overleveraged prior to the bankruptcy relative to its ability to pay.

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# RESEARCH HIGHLIGHTS

*Notable research published the week ending 21 March 2014*

## Structured Finance

### [Credit Insight: European RMBS & ABS](#)

This edition discusses the credit negative implications for ABS backed by loans to small and medium enterprise (SME) of the record high level of Spanish corporate insolvencies in 2013. We also discuss the credit positive impact of strong economic development in the UK on PCL Funding I Limited, the first publicly rated UK ABS of premium receivables in Europe. Finally we describe how the performance of Dutch mortgage loans benefitting from a Nationale Hypotheek Garantie (NHG) will remain strong in 2014, a credit positive for Dutch RMBS pools containing NHG mortgage loans.

### [Moody's ABS Spotlight](#)

This edition analyzes how Ally Financial has so far mitigated the risk to its revolving CARAT transactions, explains why the increased number of student loan refinancing offers will have a limited credit negative impact on securitizations, and details how lower levels of federal crop insurance support will cause defaults to climb in 2015.

# RECENTLY IN CREDIT OUTLOOK

Select any article below to go to last Thursday's Credit Outlook on [moody's.com](http://moody's.com)

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- » French Court Rules Credit Registry Plan Is Unconstitutional, a Credit Negative for Structured Finance Transactions
- » Italian Proposals to Aid Low-Income Workers and Struggling Companies Are Credit Positive for Securitizations

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