NORDIC BANKS TO ISSUE €100BN IN SENIOR NON PREFERRED DEBT THROUGH 2022

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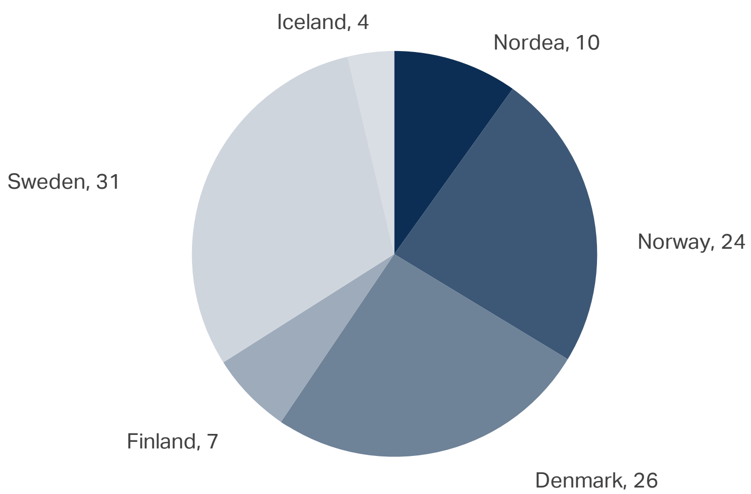
NCR calculates that Nordic banks will need to issue nearly €100bn in senior non preferred (SNP) debt instruments through 2022 for all banks in the region to comply with existing and expected national regulations for minimum requirement for eligible liabilities (MREL)[1]. This would entail a 14-fold increase from existing SNP[2] issuance by Nordic banks, but would represent less than half of outstanding senior unsecured debt, which should allow a smooth transition given stable funding markets.

As of August 22, 2018, Nordea Bank, Danske Bank, Nykredit Realkredit and DLR Kredit have seen strong demand for about €7 billion in SNP[3] instruments as investors sought larger spreads on senior instruments from strong and well-established issuers.

Apart from Nordea, NCR's projection of issuance is similar in Sweden, Norway and Denmark. We separate Nordea in Figure 1 due to its coming move to Finland and its status as the Nordic region's only global systemically important financial institution (SIFI). Nordea has indicated that it plans to issue about €10bn in SNP to ensure total loss-absorbing capacity (TLAC) compliance[4] by 2022, even though Swedish MREL definitions would require closer to €20bn.

Figure 1. NCR estimates of SNP debt issuance by 2022, by country and for Nordea, EURbn



Source: Based on NCR calculations and bank estimates

[1]NCR calculations include the debt mortgage buffer requirements of Danish mortgage instituions, which are not MREL requirements as these institutions are not subject to the Banking Recovery and Resolution Directive.
[2]As Danish mortgage institutions are expected to align their existing and future notes with Denmark's SNP law, we include all Senior Resolution Notes in our discussion of existing and future SNP issuance.
[3]This also includes Senior Resolution Notes issued by Nykredit and DLR.
[4]Nordea is the only Nordic bank subject to TLAC requirements as a global SIFI.

Current data suggest that banks are paying a 40 basis point premium for SNP over senior unsecured issuance, though we expect increased issuance volumes and familiarity to reduce this premium, all else being equal, over the next few years. NCR anticipates that many Nordic banks will start to issue SNP debt in the third quarter of 2018 and that the market will see significant increases in SNP debt volumes as new issuers come to market, existing senior unsecured debt is refinanced with SNP debt, and national legislation is finalized.

INCREASING TRANSPARENCY ON MREL REQUIREMENTS AND SNP DEBT ISSUANCE PLANS

There is no requirement for regulators or banks to publicise their MREL requirements, but increasingly, banks are indicating their MREL requirements and estimates of their future issuance of SNP instruments. Some banks have disclosed details in recent investor presentations and mid-year reports. In Finland, where the regulator does not disclose MREL requirements, OP Financial Group, Aktia Bank and the Central Bank of Savings Banks have disclosed their requirements since May 2018. In Norway, DNB, SpareBank 1 Østlandet and Sparebanken Vest have published estimates based on a proposal on MREL requirements by the Norwegian regulator in June 2018 (see national comparisons below). In Sweden and Denmark, regulators have published bank requirements and banks have been forthcoming about their planned SNP issuance.

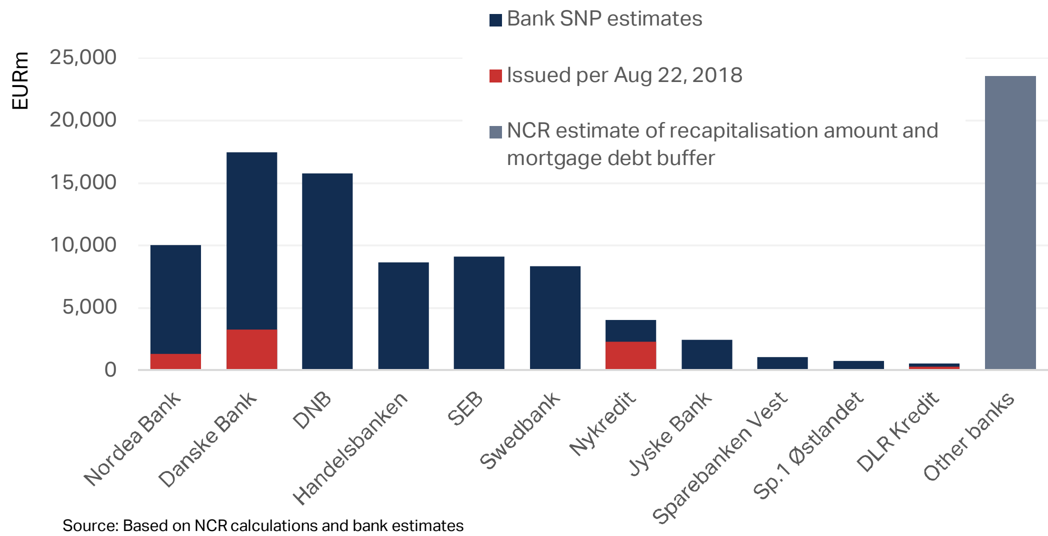
Recent disclosures have indicated requirements for banks that are much smaller than those of typical SIFIs. For example, Sparbanken Skåne (€6.8bn in assets) and Ringkjøbing Landbobank (€6.7bn following its merger with Nordjyske Bank in June 2018) have received MREL requirements, despite not having been included in national definitions of domestic SIFIs previously.

NECESSARY ISSUANCE OF SNP DEBT

Our estimates include €78bn of SNP issuance indicated by specific banks (Figure 2). In addition, we project €23 billion of issuance by other Nordic banks based on public MREL requirements and anticipated MREL implementation in Norway and Iceland. In Norway, we have assumed that the requirement will apply to banks in supervisory review and evaluation (SREP) groups 1 and 2[5]. In Iceland, we have assumed an implementation in line with the Norwegian proposal, applied to the three leading banks.

[5] *Vedlegg 1: Inndeling Av Foretak I Grupper For Srep-Formål*, as of 31 Dec. 2017. SREP groups 1 and 2 are assumed to have full MREL requirements as described in *Minstekrav til ansvarlige forpliktelser (MREL)*, 28 Feb. 2017.

Figure 2. Nordic banks' SNP issuance plans and issuance as of 22 Aug. 2018



Source: Based on NCR calculations and bank estimates

For banks without a stated target for SNP issuance, we assume that the entire recapitalisation amount[6] will be financed with SNP instruments.

SIGNIFICANT USE OF NATIONAL DISCRETION

On 29 June 2018, the Norwegian regulator submitted a request for comment (responses due 14 Sep. 2018) describing its proposed approach to MREL requirements for the country's banks. The proposal, if implemented, would mark a fourth variation of MREL implementation in the Nordic region given the different approaches already in place in Sweden, Finland and Denmark.

The Nordic regulators have used permissible national discretion to alter guidance on MREL requirements from the European Commission's Single Resolution Board. This means that for each Nordic country, the calculation of MREL requirements differs in the inclusion or exclusion of existing capital buffers, which is made necessary in large part due to national discretions used in the underlying capital adequacy calculations, buffers and minimum requirements.

Perhaps the most significant differences in approach are the exclusion of Denmark's mortgage credit institutions from MREL requirements and a similar recommendation from the Norwegian regulator. In place of MREL requirements, Denmark's mortgage institutions have been issuing Senior Resolution Notes to fulfil a debt buffer requirement of 2% of mortgage loans. NCR anticipates that these bonds and future issuance by Danish mortgage institutions will be aligned with a new Danish regulation on SNP instruments.

The Norwegian proposal refers to the exclusion of mortgage institutions from MREL requirements, but there is no equivalent to the mortgage debt buffer in Denmark and the technical details are not provided for jointly owned institutions. We have only adjusted for risk weighted assets (RWA) in wholly owned mortgage institutions in our estimates of Norwegian bank MREL requirements.

[6]MREL requirements are the sum of the loss absorption amount and the recapitalisation amount.

Figure 3 compares the Nordic resolution authorities' MREL requirements with the EU's Single Resolution Board (SRB) requirements and the EU Commission's delegated regulation on MREL in terms of the loss absorption amount (LAA), the recapitalisation amount (RCA), key exclusions and timeline. Iceland has yet to specify its MREL framework, but we assume that it will resemble the Norwegian approach given the already high capital and leverage standards adhered to by Icelandic banks.

NCR'S APPROACH TO RATING SNP INSTRUMENTS

At the highest issuer rating levels ('BBB+' or higher), NCR does not think that the risk of an institution undergoing resolution and SNP instruments being bailed in should be indicated by additional notching below the issuer rating (assuming that SNP instruments are eligible for support included in the issuer rating). However, for lower ratings we believe that the risk associated with SNP instruments becomes increasingly material.

NCR generally expects that the issuer rating will be applied to senior unsecured debt instruments. However, we could increase the respective senior unsecured issue rating by up to two notches if senior unsecured creditors are deemed to have material protection during a resolution. Typically, this occurs where an institution has been assigned a regulatory MREL requirement that is adequately met by bail-in-able debt instruments and the entity is expected to be subject to resolution. In our view, there are diminishing benefits at 'A+' or higher issuer ratings, such that only one additional notch is possible and, by contrast, uncertainty associated with very low rating grades prohibits more than one notch of protection for issuer ratings of 'BB' or lower.

Figure 3. Simplified MREL definitions for the Nordic countries

Country	LAA	RCA	Excluded liabilities & other topics	Timeline
Commission Delegated Regulation (CDR) Guidelines*	- Own funds requirements; - pillar 2 requirements; - combined buffer requirements; - the Basel I floor (where applicable); and - any applicable leverage ratio requirement. - The LAA can be adjusted upwards or downwards for specific institutions, characteristics or buffer requirements.	- Own funds requirements; - pillar 2 requirements; - the Basel I floor (where applicable); and - any applicable leverage ratio requirement. - Additional funds to ensure market confidence, up to full combined buffer requirement.	The resolution authority may: - exclude some of the liabilities normally covered by bail-in from the scope of application; - consider contributions from the deposit guarantee scheme or resolution funds; and - consider leverage ratio and Basel 1 floors when leading to a higher requirement.	Resolution authorities shall determine an appropriate transitional period which is as short as possible and shall communicate to the institution a planned MREL for each 12 month period during the transitional period.
Single Resolution Board**	Follows CDR guidelines without sector-wide LAA adjustments.	Includes the combined amount of minimum capital requirement and additional capital buffers applicable to the institution, less 1.25%.	- Does not exclude specific liabilities. - Does not consider leverage requirements at this time.	- The SRB sets individual transition periods up to four years. – SRB subordination requirements are 13.5% of RWA for global SIFIs and 12.5% for other SIFIs.
Denmark	Equals the total capital requirement, including all buffers.	Equals the total capital requirement, including all buffers.	- Mortgage institutions are exempt from MREL and are not included in the consolidation when determining MREL for groups with banks and mortgage institutions. - The MREL requirement (plus the mortgage debt buffer, where relevant) is at least 8% of the consolidated balance sheet.	MREL must be fulfilled by 1 Jul. 2019 and with subordinated instruments by 1 Jan. 2022.
Finland	Follows CDR guidelines without sector-wide LAA adjustments.	Includes the combined amount of minimum capital requirement and additional capital buffers applicable to the institution, less 1.25%.	- The exclusion of eligible liabilities from bail-in is an extremely exceptional situation and only applied in well justified situations. - The MREL requirement is at least 8% of the balance sheet.	- No single date by which all banks must fulfil MREL requirements. - No subordination requirements are defined.
Norway***	- Excludes the combined capital buffer requirements. - The capital buffers are proposed to be added to the top of the MREL requirement, i.e. the ”stacking order approach”.	Includes minimum capital requirements and the combined capital buffers, excluding the countercyclical buffer.	- Mortgage institutions are exempt from MREL, though special regulations for mortgage institutions that are subsidiaries or jointly owned is expected.	MREL must be fulfilled by 1 Jan. 2019 and with subordinated instruments by 31 Dec. 2022.

Country	LAA	RCA	Excluded liabilities & other topics	Timeline
			- MREL includes the Basel I floor used in capital requirements. - Leverage requirements are binding. - No minimum MREL of 8% of the balance sheet is specified.	
Sweden	The LAA excludes: - the combined buffer requirements; and - macro-prudential elements within pillar 2, specifically the systemic risk add-on and mortgage risk weight floor increase from 15% to 25%.	Generally, includes total capital requirements, but the resolution authority may set a lower amount if: - some combined buffers are not applicable after resolution; or - a lower amount is deemed to be sufficient to sustain market confidence.	- Considers the entire institution, including mortgage institutions. - The bank-financed resolution fund is not considered. - No minimum MREL of 8% of the balance sheet is specified.	MREL must be fulfilled by 1 Jul. 2018 and with subordinated instruments by 1 Jan. 2022.

**Commission Delegated Regulation (EU) 2016/1450*, 23 May 2016.
***SRB Policy for 2017 and Next Steps*, 20 Dec. 2017.
***As per Norway's MREL proposal, *Forskrifter til endringer i finansforetaksloven og til lov om Bankenes sikringsfond*, 29 June 2018.

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