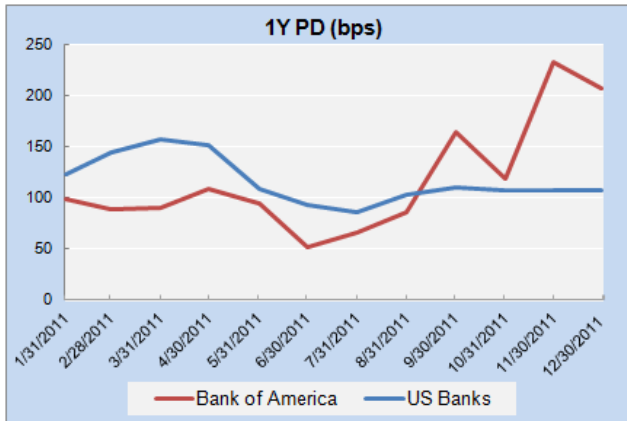


**Story of the Week:**

**Cost uncertainties cloud Bank of America's credit outlook**

After about \$50bn of asset sales since early 2010 that saw Bank of America (BoFA) cede its position as the largest US bank by assets, the bank is considering selling additional assets to improve capital levels. BoFA, currently one of the weakest US banks after damages inflicted by the US subprime mortgage crisis, may need up to \$45bn more capital by 2019 to satisfy Basel III capital requirements. If BoFA raises capital through retained earnings or other methods instead of selling assets, the capital accumulation may be slow. This could leave BoFA lagging behind its major US competitors in complying with new capital requirements. The consideration for ramping up asset sales came after the bank made a series of attempts to boost its capital, including the sale of its stake in the China Construction Bank (CCB), \$5bn in investments from Berkshire Hathaway, and an issuance of \$400mn common shares. Notably, BoFA's gain from selling its stake in CCB, and other cost cutting led the bank to post a profit of \$6.2bn in the third quarter of 2011, recovering from a loss in the previous quarter.



However, BoFA faces mounting challenges as the bank has been suffering from considerable legal settlement costs. BoFA originally agreed on an \$8.5bn settlement with investors seeking compensation stemming from faulty mortgage bonds that they purchased from Countrywide, a loss-making BoFA subsidiary. The case was recently moved to state court, where BoFA could face higher settlement costs, as investors considered the original settlement amount to be too low. Some estimates put BoFA's settlement costs for the Countrywide case at \$53bn, after \$33.2bn losses

already incurred in relation to the subsidiary. Meanwhile, BoFA is in dispute with Fannie Mae over the government sponsored entity's new stance on mortgages that lost insurance coverage, which would see banks buying back uninsured loans. This could lead to a surge in BoFA's loan buyback expenses, or claims and penalties if BoFA refused to accept the new demand.

BoFA's revenue generating capacity has also been affected after the Fed imposed a new ceiling on fees for debit-card purchases in October, and BoFA cancelled its plan to charge a monthly \$5 debit card fee, which was originally intended to replace lost revenues.

BoFA's credit outlook is worsening in line with the uncertainty over its legal costs and an impaired revenue generating ability. The RMI CRI's 1-year PD for BoFA soared to 206.8bps on December 30 2011, compared to 52.2bps on June 30 when its \$8.5bn settlement agreement brought some temporary relief about legal costs. Reflecting its relative weak position among US banks, its PD has been higher than the aggregate PD of the US banking sector since September. The US banking sector's 1-year PD was 106.6bps on December 30.

**Read more:**

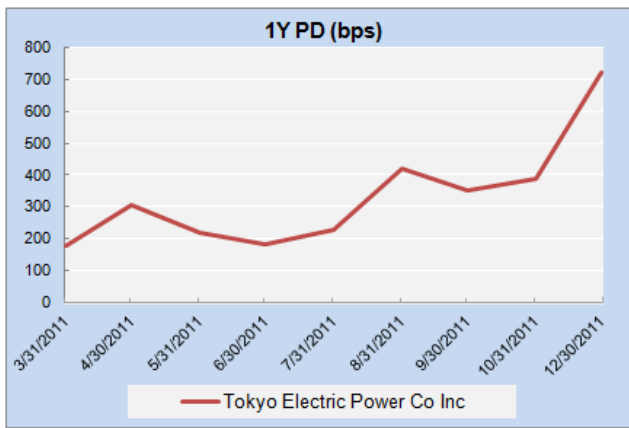
- [BoFA mulls more asset sales to boost capital](#) (Reuters)
- [Heavy Is the Head That Wears Crown](#) (WSJ)
- [The Lawsuits Plaquing Bank Of America](#) (Forbes)
- [Uncertainty Looms In Bank Of America's \\$8.5 Billion Countrywide Settlement](#) (Forbes)
- [BoFA's Clash With Fannie Escalates Over Loan Buyback Stance](#) (Bloomberg)
- [Bank of America Eliminates Plan for \\$5 Debit-Card Fee](#) (Bloomberg)
- [BoFA Agrees to \\$8.5 Billion Settlement. Sees Quarterly Loss](#) (Bloomberg)

**Tepeco credit outlook exacerbates**

The financial position of Tokyo Electric Power (Tepeco) has deteriorated substantially in the wake of the Fukushima nuclear disaster, with the company facing increasing government pressure to nationalize. Approached by Japanese officials on December 27, Tepeco was urged to consider a range of options to restore its financial health, in order to facilitate responsible handling of the crisis, including temporary nationalization. On the same day, Tepeco requested ¥689.4bn in government aid, the second such request after the Japanese government's Nuclear Damage Liability Facilitation Fund disbursed about ¥900bn to Tepeco in November.

The Fukushima nuclear disaster has left considerable cost pressures on the company. Compensation payments to victims is likely to reach around ¥4.5tn by 2013, crippling the financial health of Tepeco, which has already reported a ¥1.2tn net loss in 2010 and is expecting a ¥600bn loss in the year ending March 2012. In addition, Tepeco's operational costs are increasing after the company shut down a majority of its nuclear plants and switched to more costly thermal power.

Meanwhile, Tepeco's financing is at risk, after the company's second-largest lender, Mizuho Financial Group, stressed three conditions that Tepeco needs to meet before it can obtain additional borrowing. Backing from the Japanese government, restarting its nuclear power plants and increasing electricity rates to cover costs are the



three key criteria Mizuho specified.

Whether Tepco can be saved from bankruptcy is still uncertain. Aside from the massive compensation costs and increased operation costs Tepco faces, the idea of nationalization is strongly opposed by Tepco's president. Reflecting Tepco's negative credit outlook, the RMI CRI's 1-year PD for the company surged to 722bps on December 30 2011. The PD was 3.6bps at the end of February of the same year.

**Read more:**

- [Tepco under pressure to nationalise](#) (FT)
- [Tepco Requests \\$8.8B More Aid for Japan Disaster](#) (Bloomberg)
- [Tepco shares fall on fears that it may be nationalised](#) (BBC News)
- [Japan May Plan 'Good Tepco, Bad Tepco'](#) (Bloomberg)

Date	Country	Title	Summary
Dec 28, 2011	US	Fed seeks to curb repo market risk	<p>The Federal Reserve has sponsored an industry taskforce to work on a plan to reduce systemic risk in the tri-party repurchase (repo) market, which provides crucial financing for securities dealers, and currently has about \$1.8tn in daily turnover.</p> <p>Tri-party repos are collateralized loans between cash investors, such as money market funds, and security dealers, with clearing banks acting as an intermediary. Clearing banks provide securities dealers with intraday credits to cover daily timing mismatches between investors' demand for cash, and dealers' collateral availability. Such credits effectively transfer the default risks of dealers (the borrowers) from cash investors to clearing banks. This arrangement can be problematic as the intraday credit exposures faced by clearing banks are usually large relative to their capital. More importantly, dealers stand the risks of being refused credits by the clearing banks, which could in turn create instability in the repo market and spill over to other markets. If distressed dealers (borrowers) have to liquidate their security portfolios, the value of the collaterals owed to the clearing banks may further decline, which could create excessive market volatility.</p> <p>The taskforce aims to bring greater automation to the repo market by setting up real-time settlement processes for new and maturing repos, which would reduce dealers' need for intraday credit from clearing banks.. The plan could also lead to a public sector body clearing repo trades, a role currently undertaken by JPMorgan and BNY Mellon in the US.</p> <p>However, disparity in the operational capacities of dealers and cash investors, as well as potential conflicts with business and commercial interests, could make implementation of such a system uncertain.</p> <p><b>Read more:</b>  <a href="#">Fed seeks to curb repo market risk</a> (FT)  <a href="#">Tri-Party Repos Remain Vulnerable to Systemic Shock</a> (WSJ)  <a href="#">Remaining Risks in the Tri-Party Repo Market</a> (Federal Reserve Bank of New York)</p>
Dec 25, 2011	China	China May Establish Credit Rating Agency	China's central bank Governor Zhou Xiaochuan on December 25 urged large financial institutions in China to reduce reliance on credit ratings provided

			<p>by foreign credit rating agencies. The advice came at a time when global credit rating agencies' business model is being questioned due to its lack of independence from borrowers. In related news, China is considering creating credit-rating companies backed by the government.</p> <p>Amid the expansion of China's bond market, senior bankers and government officials are calling for a larger role for China's own credit rating firms, due to their local expertise. Moreover, China's domestic rating firms could serve as alternatives to the top three global credit rating agencies in local financial products.</p> <p>The first credit rating agency in China that generated earnings from investors rather than borrowers was established in September 2010, called China Credit Rating Co. China's first domestic rating agency, Dagong Global Credit Rating Co Ltd, released the first Chinese assessment of sovereign credit ratings for 50 countries in July 2010.</p> <p><b>Read More:</b>  <a href="#">China may establish credit-rating agencies</a> (China Economic Review)  <a href="#">PBOC's Governor Zhou Says China Should Cut Reliance on Foreign Ratings</a> (Bloomberg)  <a href="#">PBOC Urges Less Reliance on Foreign Credit Ratings</a> (ChinaDaily)</p>
Dec 2011	25, Global	US and Japanese Firms See Opportunities in Europe's Woes	<p>The ongoing debt crisis in Europe is presenting firms and financial institutions in the US and Japan with opportunities to buy assets unloaded by European banks, ranging from loans and real estate, to subsidiaries both within and outside Europe. European banks are selling their assets as they attempt to raise capital ratios, while US and Japanese firms are motivated by significant expansion opportunities in the markets ceded by European banks, including lending and trading businesses.</p> <p>By asset sales, European banks can increase cash levels, and have fewer assets they need to hold capital for, thereby increasing the capital ratio. Some market participants believe that more asset sales are coming in the following months as European banks are rushing to increase their core tier 1 capital ratio to 9% by June, the deadline imposed by the European Banking Authority (EBA).</p> <p>Buying assets from European banks may seem attractive to Japanese banks who are facing credit contraction and US firms who can snap up market shares. But investing in Europe still bears risks considering the economic and financial woes in Europe.</p> <p><b>Read more:</b>  <a href="#">US Firms See Opportunities in Europe's Woes</a> (NY Times)  <a href="#">Japan lenders eye European bank assets</a> ( FT)</p>
Dec 2011	26, South Korea	Regulator to tighten guidelines on credit card issuance	<p>South Korea's financial regulator, the Financial Services Commission (FSC), announced December 26 it plans to toughen requirements for credit card issuance, as it attempts to contain the country's soaring household debts, and the risks the debts pose to the financial sector.</p> <p>Under the plan, the FSC would raise requirements for credit card applications, intensify monitoring of credit card firms with heavy marketing costs, and increase inspection on firms aggressively expanding consumer credit card businesses.</p>

			<p>South Korean credit card purchases climbed to 415.6tn won in the first nine months of 2011, a 9.1% increase from the same period in 2010, driven by soaring consumer credit spending. Many credit card users are believed to have relatively low credit worthiness, which has increased concerns about consumer defaults.</p> <p>A further increase in credit card loans could add to default risks to credit card issuers. The average default rate for South Korea's credit card companies increased by 0.17% to 1.74% at the end of September 2011, from 1.57% in June.</p> <p><b>Read more:</b>  <a href="#">Regulator to tighten guidelines on credit card issuance</a> (Yonhap News Agency)</p>
Dec 28, 2011	China	Funds expect surge of bad loans in China	<p>According to some foreign and domestic distressed debt funds, the Chinese debt market is bracing for a significant influx of bad loans as Chinese banks dispose of their existing ones. The move is believed to prepare the banks for a surge of new bad debts that are expected to emerge following the Chinese government's credit binge during the 2008-09 financial crisis. The influx may also be motivated by Chinese banking regulators urging banks to boost their capital cushions, as regulators believe that banks are underreporting their bad loans. Another reason could be tougher reporting requirements for banks listing in Hong Kong. However, banks could make room for new lending by disposing legacy bad loans.</p> <p>Many foreign distressed asset investors have tapped the Chinese market before, only to be left unsatisfied due to problems arising from enforcing rights over assets, and inaccurate financial statements. However, many other foreign investors are still interested in buying China's distressed debts, which have become more attractive because the government has increased protection of investor's rights.</p> <p>Chinese regulators contend that the amount of bad loans in China is less than \$500bn, while Fitch estimated that the amount could be over \$2tn.</p> <p><b>Read More:</b>  <a href="#">Funds expect surge of bad loans in China</a> (FT)</p>