Credit Markets and Products

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The Credit Rating Agencies

The "Big Three" credit rating agencies control approximately 95% of the global ratings business.

The "Big Three" credit rating agencies
Standard & Poor (S&P)
Moody's Investor Service
Fitch Ratings

Fitch	S&P	Moody's		Rating grade description (Moody's)
AAA	AAA	Aaa	Investment grade	Minimal credit risk
AA+ AA AA-	AA+ AA AA-	Aa1 Aa2 Aa3		Very low credit risk
A+ A A-	A+ A A-	A1 A2 A3		Low credit risk
BBB+ BBB BBB-	BBB+ BBB BBB-	Baa1 Baa2 Baa3		Moderate credit risk
BB+ BB BB-	BB+ BB BB-	Ba1 Ba2 Ba3	Speculative grade	Substantial credit risk
B+ B B-	B+ B B-	B1 B2 B3		High credit risk
CCC+ CCC CCC-	CCC+ CCC CCC-	Caa1 Caa2 Caa3		Very high credit risk
CC C	CC C	Ca		In or near default, with possibility of recovery
DDD DD D	SD D	C		In default, with little chance of recovery

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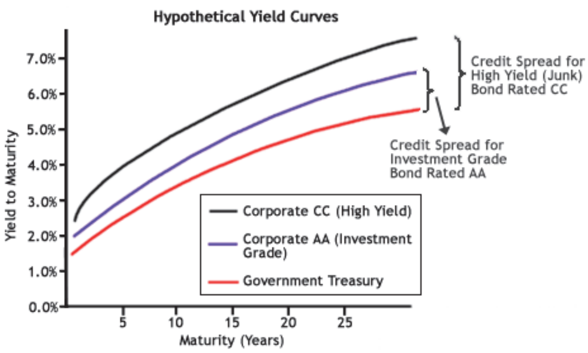
Credit Spreads

A Nominal Credit Spread is the difference in YTM between a non-treasury item and a treasury security of the same duration.



Risk premium ('spread') =

investment yield less treasury yield

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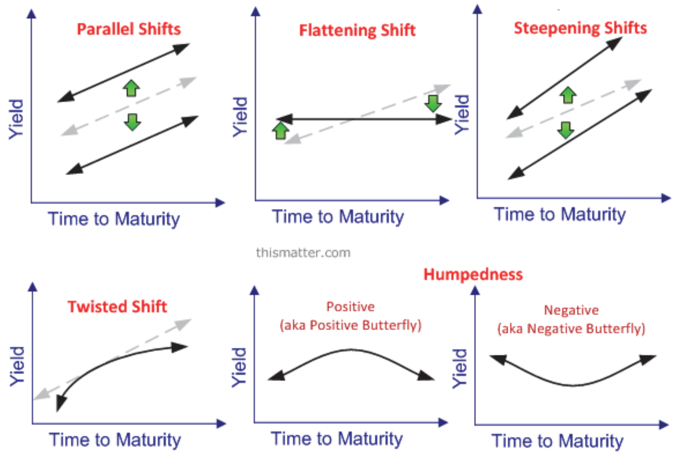
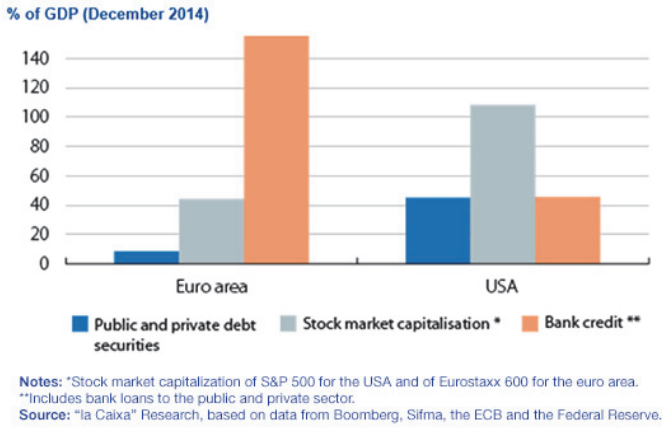
Trading on Credit Spreads and Shifts

Expectation of creditworthiness of corporate bond	Spread	Trade: Treasury Bond	Trade: Corporate Bond	Trade: CDS
IMPROVES	Contract	Sell (?)	Buy	Sell CDS and receive premium
MAINTAINED	Unchanged	No trade	No trade	No trade
DETERIORATES	Widen	Buy (?)	Sell	Buy CDS and pay premium

Yield Curve Shifts



European vs U.S. Markets



US Debt Markets

The U.S. is the largest debt market globally representing around one third by total USD$ value

Outstanding U.S. bond market debt	USD$ (billions)	%
Treasury	13,954	35
Mortgage related	8,969	23
Corporate debt	8,631	22
Municipal	3,823	10
Federal Agency Securities	1,982	5
Asset-Backed	1,393	4
Money Markets	937	2
Total	**39,689**	**100**

Source: Securities Industry and Financial Markets Association (SIFMA) (Q1 2017)

Specialist Bond Variations

Callable bonds
Can be redeemed by the issuer from the investor

Eurobonds
Denominated in currency other than home currency

Puttable bonds
Can be sold by the investor to the issuer

Samurai bonds
Yen-denominated, issued by non-Japanese Co.

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Callable (Redeemable) Bonds

Callable Bonds can be redeemed (bought) by the issuer before the maturity date, at a pre-defined price

Issuer has a call option on the bond

Investors are writing this call option so will require higher coupons

Issuer will call the bond if interest rates have come down and they can secure cheaper refinancing elsewhere

Investors do not get the same upside in callable bonds when interest rates are falling as they would to ordinary bonds

A callable bond always has a lower price than price of a straight bond

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Puttable Bonds

Puttable Bonds can be sold back by the investor to the issuer before the maturity date, at a pre-defined price

↓

Investor has a put option on the bond

↓

Investors own this put option so will require lower interest

↓

Investors will sell the bond if interest rates rise sufficiently and they can find better yields elsewhere

↓

A puttable bond always has higher price than price of a straight bond

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Other Specialist Bonds

Eurobonds	Samurai bonds
International Bonds	Yen denominated bonds
NOT denominated in the currency of the country where it is issued	Issued in Japan by non-Japanese companies
Named after the currency in which they are denominated e.g. Euroyen and Eurodollar	Subject to Japanese regulations
Traded in many countries - not just in Europe	Could provide issuer with lower funding costs OR serve as a hedge on the issuers overall currency exposure

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Contingent Convertible Bonds (CoCos)

Is a fixed-income instrument that is **convertible** into equity if a pre-specified trigger event occurs.

Recapitalises the bank in times of distress.

Trades at a **discount** vs straight bond.

Collectively known as 'trigger events'

- **Regulatory Capital Requirements** as per the Bond documentation , e.g. Min Tier 1 or 2 Capital or CET 1 ratio
- A **ratings downgrade** e.g. (AAA→AA)
- A **regulatory compliance breach** or penalty

Typical IB Credit Markets Structure

Trading Desks: Agency flow transactions

IB DCM Market Groups:

Investment Grade Capital Markets High-credit quality	Structured Finance Securitisation
Leveraged Finance Capital Markets High-yield	Emerging Markets Financing Group Issuance & structured


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