# bridging asia 2017-2

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*German Banking – Financial Solutions by NORD/LB Asia*

Thomas Vogel/E+/gettyimages

## SSD: Financing Made in Germany


Here we are: NORD/LB Shanghai Branch
Here we are: NORD/LB Singapore Branch

# Dear Readers,

NORD/LB

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Welcome to the new issue of NORD/LB´s Bridging Asia, the magazine for our clients and business partners in the Asia-Pacific region. This issue's theme is Financing Made in Germany, building on German export success.

Our feature story explains the advantages of the Corporate Schuldscheindarlehen, or promissory note loan, and its increasing popularity as a way of corporate finance. These bond-like loans combine the features of corporate bonds with those of traditional loan agreements. Once regarded as a typical SME financing instrument, Corporate Schuldscheindarlehen are becoming increasingly attractive to larger businesses. Well established in Germany, Schuldscheine are growing in international use, thanks to new groups of issuers and a rising demand from international investors.

While highlighting Schuldschein as a German finance product, the issue also discusses current market opportunities for our clients in Asia-Pacific, such as Japanese Operating Lease in the Aviation space. We review the Asian economy, one of the most dynamic in the world, and look at how sustained growth in this region can be supported. Furthermore, we analyze the challenges of the Asia Pacific Loan Market and the growing appetite of investors for alternative assets.

We hope you enjoy reading Bridging Asia, and we look forward to having the chance to discuss its key points with you personally.

Yours sincerely,
Asia-Pacific Management Team

**Olaf-Alexander Wiedemann**
**Regional CEO Asia Pacific**

**Dr. Stephan Popp**
**GM Shanghai Branch**

# Corporate Schuldscheindarlehen – The best of both worlds

Promissory note loans, called Schuldscheindarlehen, or SSD, in German, have been increasing in popularity over the last few years. Alongside bonds and syndicated loans, they are now seen a key form of financing for companies.


Aleksej Butenkov/123RF

## What is special about Schuldscheindarlehen?

Corporate Schuldscheindarlehen (CSSD) combine the characteristic features of corporate bonds with those of traditional loan agreements, which puts them between these two forms of corporate financing. Often described as “bond-like loans”, CSSD are regarded as a typical SME financing instrument, but also increasingly attractive to large caps.

In legal terms, CSSD constitute a bilateral loan agreement drawn up under German civil law. This means it is not a share and therefore not traded on the stock market, but on the Over the Counter (OTC) interbank market. As CSSD investors are normally following a “buy and hold” strategy, the secondary market is not very liquid, and that trading volumes tend to be small. In terms of fungibility, CSSD rank between the corporate bond and the syndicated loan. The promissory note itself, which must be legally signed by the issuer, is regarded as documentary evidence of the existence of the lender’s claim on the issuer, with title only transferable through assignment.

Compared with a corporate bond, the administrative process behind CSSD is more streamlined. There is no obligation to release an issue prospectus, obtain public authorizations or gain an external rating. The work involved and the costs for the issuer are therefore comparatively modest.

As a rule, CSSD are issued on an unsecured basis, with few differences compared to traditional loan financing when it comes to covenants and reporting obligations. However, there is one key difference compared with corporate bonds: if the coupon is fixed, the law states that the borrower has a right to cancel after a period of 10 years. If the coupon is variable, this cancellation right applies at any time after providing three months' notice. Generally speaking, the number and quality of the covenants increases as company size decreases and its rating lowers, in order to limit the risk exposure of the lender. It is possible that a CSSD will be subject to all the covenants governing bonds or syndicated loans, such as a negative pledge, pari passu clause or cross default clause.

As it is a credit product without a stock market listing, regulatory authorities do not require reporting at fair value, as is the case for corporate bonds or other securities. This avoids any impact on the income statement since changes in the market price level do not influence the valuation (except in the case of a permanent impairment).

If a company issues a CSSD, it works in collaboration with a syndicate consisting of several banks, which support the transaction from beginning to end. They are then entrusted with the task of finding suitable investors. This is normally a group of several investors rather than one sole investor, helping the company diversify its funding channels and reducing dependency on individual creditors. The banks start by recording the key points of the financing in an indicative term sheet. Once the mandate is issued, they prepare the documents and draw up a credit research report. When the marketing process begins, documentation, including the investors' term sheet, credit research and the issuer's economic data, are passed to investors. In a best-case scenario, having examined these documents in depth, investors provide a binding commitment to participate in the CSSD. The time between the mandate being issued and disbursement usually ranges from six to 10 weeks – much shorter than the average for issuing a bond or a syndicated loan.

Three factors are critical in terms of pricing: creditworthiness (shown via an internal or, if available, external rating), the level of awareness of the issuer, and its business model. Generally, the pricing process is opaque, since each CSSD constitutes a loan agreement and they are therefore only comparable to a limited degree. The capital market environment also plays a key role in pricing – currently the low level of interest rates is playing into corporates' hands.

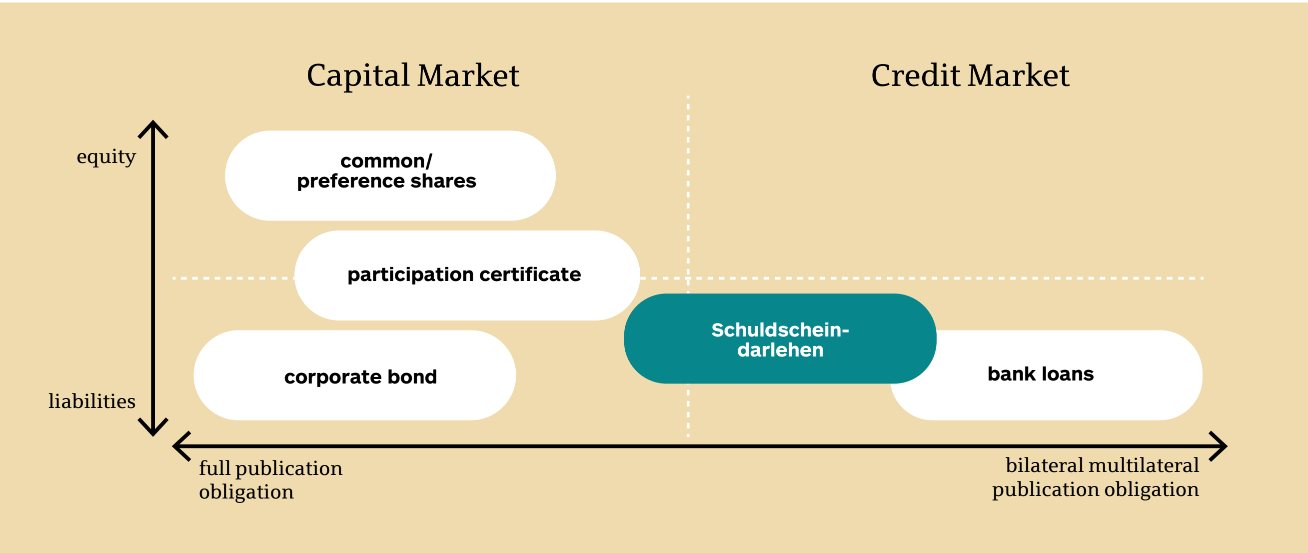
## 2016 – a record year

Based on our own data 2016 saw records broken for CSSD across every metric, for the second year in a row. Total volume of EUR 26.8bn had increased by 39.6% compared with 2015's EUR 19.2bn. There were 126 transactions (previous year 106), spread across 559 tranches (compared to 443 in 2015). Volume per transaction averaged EUR 223m, which also represents a high point. Many transactions had at least two different maturities, which included both variable and fixed coupons, meaning that they appealed to investors with different needs in terms of duration. Consequently, this extended the investor base as well as giving issuers more flexibility, as they can manage capital outflows individually by using different tranches.

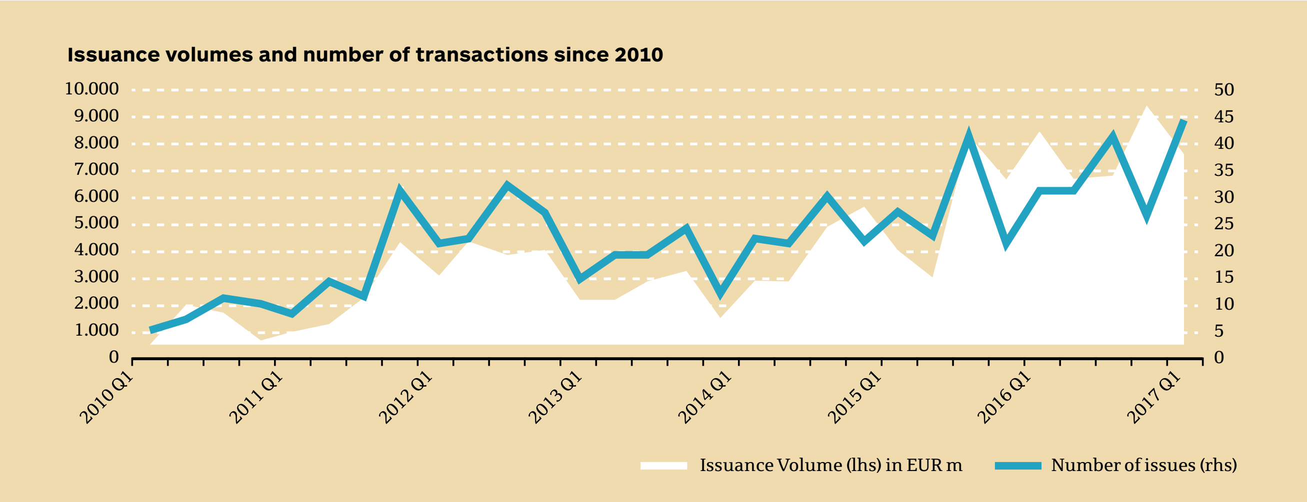
Maturity ranges were primarily between four and five years or six and eight years, primarily due to changes in investor expectations regarding inflation and, consequently, interest rates. However, switching into shorter maturities is not really an option with yields at their current levels, meaning that decisions are still driven by a search for yield.

In FY 2016, just under half of transactions, (44.5% weighted by number) exceeded EUR 200m, while the second-largest share, at 36.5%, was in the EUR 80–200m range. The final purchase/launch volume stood at a factor of 1.7.

The Industrials sector dominated with 156 tranches (28.0% of the total), followed by Consumer (Non-cyclical) with 121 tranches (21.7%) and Consumer (Cyclical) with 96 tranches (17.2%). Over half of issuers




Source: NORD/LB Research




Source: NORD/LB Research

(54%) were using the CSSD market for the first time. Companies with established issuance programs are using CSSD to supplement their existing funding, which allows them to benefit from economies of scale in terms of transaction and publication costs.

The favorable interest-rate environment, which currently makes it attractive for companies to raise borrowed capital, was primarily responsible for the record year. Given the advantages of CSSD compared with bonds, more and more issuers are now turning to this means of refinancing. Looking at credit quality, it is more difficult to assess this and the appropriateness of the spread level unequivocally, given 79% of issuers do not have an external rating. However, the small number of credit events and the substantial internal ratings point to the CSSD market offering high credit quality.

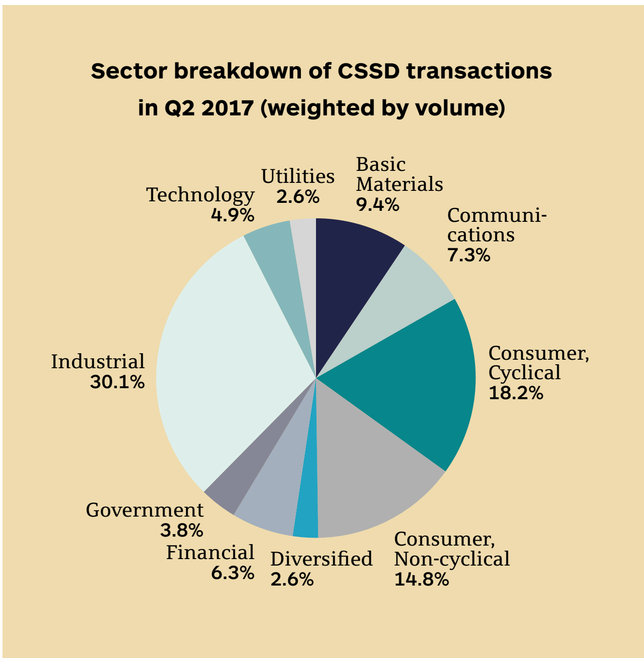
## 2017 – where are we today?

Figures up to the end of June point to 2017 being another record year overall. For example, a total volume of EUR 7.63bn was issued in Q2. This is a record number of transactions, although it has been offset by a sharp reduction in average issuance volumes compared to Q1 2017. The average volume per tranche is EUR 32.5m in Q2 (Q1 2017: EUR 71.7m), while the absolute number of deals has increased dramatically – we counted 45 transactions in total (Q1 2017: 26 transactions).

It is worth noting that the absolute number of transactions could be even higher due to private placements, a mechanism used particularly by smaller issuers. However, as the issuance volumes of these companies is also smaller, this virtually halved the average issue size (EUR 170m vs. EUR 332.5m in Q1 2017). However, despite the large number of smaller transactions, the number of tranches per issue also rose slightly compared with the previous quarter.

Companies continued, as in FY 2016, to prefer medium maturity ranges. Investors are more prepared to invest in longer maturities if the market fails to offer alternative investments with comparable yields ("moving down the yield curve") and/or the credit risk can be clearly assessed. Under current capital-market conditions, with tapering on the horizon and a slight move away from the ultra-low interest-rate policy, investors will definitely be less willing to invest in long (eight-to-10-year) or ultra-long (over 10-year) maturities. This can be explained, firstly, by risk-strategy considerations concerning long-term default rates among corporates and, secondly, by the assumption that the ECB will move away from its ultra-low interest-rate policy and, consequently, interest rates will rise.

In our opinion, the most interesting transactions in Q2 2017 were placed by Porsche Holding GmbH (EUR 500m), O2 Czech a.s. (EUR/CZK 132m) and Cargolux Airlines International S. A. (EUR 70m). The Porsche Holding transaction should be highlighted for two reasons in




Source: NORD/LB Research

andreafidone/iStockphoto

particular. It achieved the largest final volume in Q2 2017, while the final volume (EUR 500m) exceeded the launch volume (EUR 100m) fivefold. O2 Czech is the first Czech CSSD issuer and a good example of the growing internationalization of the market. The low barriers to issuing CSSD in the German market means that this trend will continue, albeit with certain restrictions. Cargolux is an example that shows how issuers increasingly tap the CSSD market multiple times – this marks its second CSSD. In this respect, the need to renew currently outstanding CSSD will increasingly feature on the agenda of issuers and arrangers over the next few years.

Sector granularity in the CSSD market has risen again compared with Q1 2017 (7 vs. 10), with existing sectors joined by Basic Materials, Communications and Financial – according to Bloomberg's sector classification. Industrials remained the strongest sector, accounting for 30.1% of issuance volume, followed by Consumer (Cyclical) on 18.2%. In terms of spreads, there are signs of a slight trend towards a lower marketing range, from which less creditworthy issuers benefit disproportionately. The reason for this is the low level of yields. However, it is important to highlight that CSSD spread seems to have a floor, meaning that there are only a small number of transactions with spreads below ms +50bp (seven-year tenor). This is primarily due to issuer-independent liquidity premiums and individual investor funding costs.

## Internationalization of the CSSD market

The CSSD product is well established in Germany, meaning it unsurprisingly accounts for the lion's share of issuers. However, there are signs of the market becoming more international. The proportion of German issuers has decreased overall, from 74% in Q2 2015 to 44% in Q2 2017, while the number of other countries has increased. From just five countries in the first quarter, in addition to Germany, the number grew to 11 countries in Q2 2017, along with a supranational institution, in which the ownership or guarantee structure is spread across several countries. The increasing variety of countries of origin is striking – according to our data, the Czech Republic, Poland and the supranational category entered the SSD market for the first time in the quarter.

The euro continued to serve as the main funding currency in Q2 2017, responsible for approximately 90% of the tranches, with the remaining 10% split between USD and CZK. From our perspective, increasing interest in CSSD, among both issuers and investors, will drive currency diversification, and there are already signs of this trend materializing. In Q4 2016, there were transactions in which individual FX tranches were denominated in Polish zloty and pounds sterling, for instance.

The recent signs of international market growth are driven predominantly by the simple structure of the CSSD itself. The advantages for issuers and investors balance out the disadvantage of its lack of liquidity. The fact that CSSD are issued in accordance with German law has only a marginal impact on their appeal. In our opinion, access to new groups of issuers, plus the broadening of funding options, are key to further internationalization.

## Conclusion & outlook

Having again achieved record volumes in 2016, activity in the year to date indicates that 2017's total volume will reach a similar figure, hitting more than EUR 25bn. Strong demand for CSSD should persist until year-end, despite rumors that the ECB will start tapering soon. It is possible that an announcement from the ECB of withdrawal from its ultra-loose monetary policy will lead to falling demand among investors in the medium term. However, the absence of alternative investments offering a comparable risk/reward ratio will leave investor interest at a high level. Given its similarities to corporate bonds, the CSSD market will also have to deal with spreads widening over the coming months. However, this increase in spreads will be limited, as SSD are now seen as an established market instrument.


fotografin/fotolia

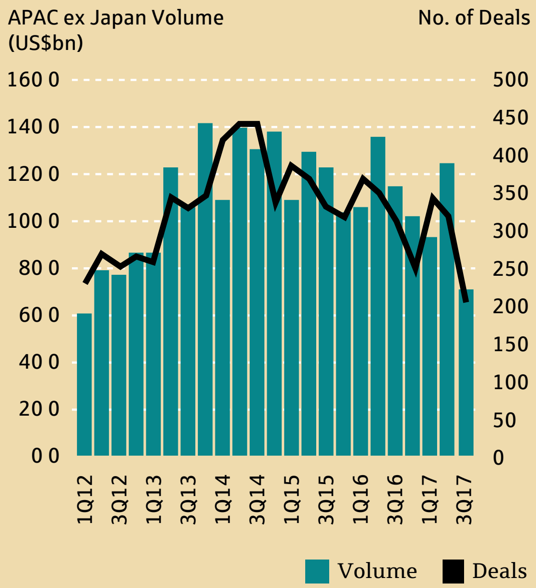
# The Asia-Pacific loan market – Insight into its dynamics

## A dynamic sector in the most dynamic region of the world shows its strength

To date, lending activity in Asia-Pacific this year has been subdued, thanks to bond-market competition, lacklustre regional economic growth and China's curb on outbound acquisition, all of which had resulted in a relative lack of demand for new capital. Syndicated loans in Asia-Pacific (excluding Japan) totaled US$292.47bn for 1Q–3Q2017, a 19% plunge from the same period in 2016, according to Thomson Reuters LPC data. 1Q–3Q2017 loan volumes and the US$72.49bn transacted in the third quarter were the lowest quarterly volume recorded in Asia for seven years.

Deal count in the first nine months of 2017 decreased by 15% year-on-year, falling to 881 deals. Just 210 deals closed in the third quarter, the lowest quarterly tally since the first quarter of 2010.

**Asia-Pacific (excluding Japan) Loan Volumes**
2012–3Q2017




Source: Thomson Reuters Loan Connector

### Ample regional bank liquidity

As a result of the lack of demand for loans in the market, there is ample regional bank liquidity, particularly from Chinese, Taiwanese, Korean and Japanese investors, all chasing limited deals.

In some cases this has led to further compression in loan pricing as lenders compete hard for mandates, particularly for top-tier/sought-after credits.

Meanwhile, as banks continue to target a limited number of deals, institutional investors within the region are also taking an active interest in loan markets, gradually increasing their investment allocations towards higher yielding corporate loans and offshore project financing in a bid for greater returns. This is especially true in Japan and Korea, where negative or low-interest-rate environments and slow economic growth is bringing new entrants, such as life insurance companies and pension funds, into the market.

For instance, in the first quarter of this year Nippon Life Insurance Co bought a US$100m slice of a project financing (PF) for LNG plants in the United States, marking its first overseas PF investment. Subsequently, Nippon Life made its first investment into the Australia market by commiting to a Project-refinancing transaction for a desalination plant. Another Japanese life insurer, Dai-ichi Life Insurance, made a ¥5.7bn (US$52m) investment in a PF backing LNG plants in Qatar, and took a €30m stake in a PF backing offshore wind power plants in Germany.

### Australia Update

The last issue of Bridging Asia discussed the fast growth of renewables projects in Australia. Since then, NORD/LB has accelerated its market momentum, successfully closing three long-term renewable project financings in Australia – a 198 MWp Portfolio Solar Financing across Queensland and Victoria; the 113 MW Bodangora Wind Farm in New South Wales; and the 15 MWp Mugga Lane Solar Park in Australian Capital Territory.

Domestically, Australian superannuation funds have increased their loan investments in recent years, both through third-party managed funds and direct lending, diversifying beyond equity/bond markets with a particular focus on alternative debt investments (including infrastructure). This trend is expected to provide an alternative source of liquidity for borrowers, and will hopefully deepen the institutional loan market Down Under over the next couple of years.

Within the bank market, where project finance debt in the infrastructure/renewables sectors has mainly been structured on a “mini-perm” basis, we have seen international banks (particularly some European and Japanese banks/institutional investors) prepared to lend to/invest in projects for the longer term (i.e., 15 years and above).

Providing evidence of increasing investor interest in well-structured, long-term renewable project financing in Australia, NORD/LB successfully brought in an investor post-financial close to the Bodangora Wind Farm project, which we completed in March 2017.

# "Debt is a portfolio in its own right"

## An interview with John O'Flynn, Corporate Finance, Goshawk Aviation Limited

John O'Flynn, Corporate Finance, Goshawk Aviation Limited

**Mr. O'Flynn, which part of the aircraft-leasing business does Goshawk operate in, and what are the current market challenges and opportunities?**
There is quite a wide-risk spectrum within the aircraft-leasing space, and Goshawk aims to play at the low end of this risk spectrum. We acquire young, new technology, liquid assets, generally via portfolio purchases from other lessors or via direct sale and leasebacks with airlines, and manage these assets to deliver long- term, stable returns for our shareholders.

The returns achievable from investments in aircraft assets are attractive relative to other asset classes, which is bringing a number of new investors into the space. This creates opportunities on the financing side of the business, as well as challenges on the asset acquisition side, as this process becomes more competitive.

**What role does financing play in these challenges and opportunities?**
Availability of financing allows us to raise long-term debt efficiently, which improves our competitiveness while providing certainty to our shareholders. It also allows us to diversify our funding sources, which helps de-risk the liability side of the business.

**What goals are you pursuing in structuring your finances?**
We think of our debt as a portfolio in its own right. We are obviously keen to achieve the lowest-possible funding costs, which, in turn, will increase our competitiveness in the market. However, we are also very risk focused. Matching our average debt term to our average lease term, and maintaining relevance to a diverse range of lenders in terms of both geographies and debt products, are equally important when considering our optimum capital structure.

**What is the role of secured and unsecured loans in your strategy?**
Maintaining relevance to both secured and unsecured lenders is a key component of strategy to maintain diversity of funding.

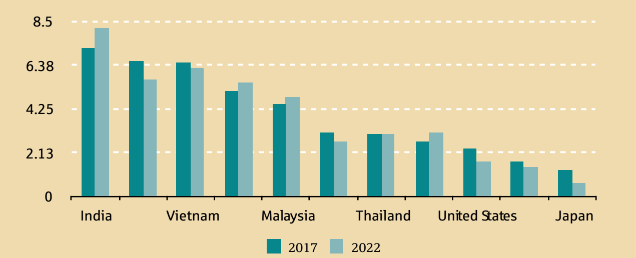
**You carried out a Schuldschein, the German alternative to US private placements, with NORD/LB. What was the rationale behind this deal? Has the Schuldschein achieved the goals that you hoped for? What are your future financing plans?**
To access unsecured debt efficiently, it is important to maintain a significant amount of unsecured debt and unencumbered assets on our balance sheet. We are committed to maintaining these levels as we grow the business, so would like to access as many distinct sources of unsecured debt as practicable while maintaining competitive funding costs. The Schuldschein market provides another source of unsecured debt for our business. Going forward, we intend to continue to tap this as well as other unsecured markets in order to further develop and broaden our investor relationships.

# Asia's economies need to reduce trade barriers to deliver stable growth

## For now, China remains Asia's main driver of growth
By NORD/LB Chief Economist Torsten Windels


According to the International Monetary Fund (IMF), the "Emerging and Developing Asia" region grew by 6.4% in 2016 alone, making it currently one of the most dynamic areas in the world. Additionally, Asia's long-term growth prospects are strong, underpinned by great investment opportunities and expanding consumer demand. With projected growth rates of 6.5% in 2017 and 2018 the IMF shares this optimism for the future. Overall, in the longer term, Asia-Pacific is expected to outperform industrialized parts of the world when it comes to economic expansion. However, to a large extent the growth models of countries in Asia-Pacific are based on export surplus-

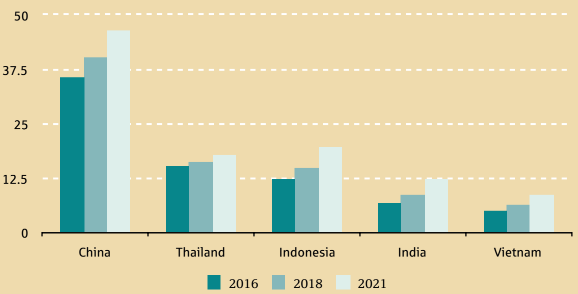
**No. 1: Asia remains the driver of world GDP**
Real GDP Growth Rate Projections Y/Y in %




Source: IMF Economic Outlook, NORD/LB Economics es, making them very vulnerable if the world economy stagnates. This was highlighted by the last global economic crisis. It is therefore vital that Asia-Pacific economies strengthen both domestic demand, and demand within the region, if they are to become more resilient to crisis. As the main powerhouse and driver of regional economic activity, both now and in the forseeable future, China plays a major role in strengthening demand. However, relying solely on China could also prove risky.

Proposed changes to the Chinese growth model, announced by the government in Beijing, will reshape the economic structure of the largest economy in Asia, turning it from the world's workbench into a modern economy focusing on high-tech manufacturing and service industries. At the same time, as wages have risen significantly over the past years, a Chinese middle class has been established, and is looking to adopt a similar lifestyle to its counterparts in industrialized western countries. These changes will also have major implications for China's Asian neighbors. While potential risks should not be ignored, this process provides great opportunities for the region as a whole. Given the heterogeneous economic structures and different levels of economic development across Asia, the direct impact on particular economies will vary greatly. Some of the member states of the Association of Southeast Asian Nations (ASEAN) could replace China as a production base, since their labor is still comparably cheap, with salaries significantly below those in China. That means the variety of the region will play a major role in defining which countries might gain the most. However, the overall Asian economic outlook should not be reduced to a question of which country will be most impacted by China's new growth model or potential slower growth within the middle kingdom. Business activity will also be greatly influenced by the catch-up processes taking place in almost every single Asian economy. However, numerous barriers to sustainable economic growth still have to be addressed.

**No. 2: Rising Middle Class in all Asian Countries**
Share of Households with disposable Incomes > $15,000



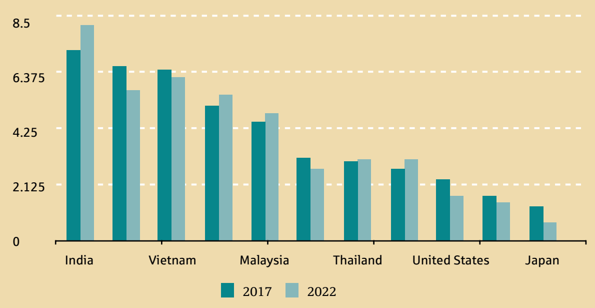

Source: Bloomberg, NORD/LB Economics

## Despite some success stories, intraregional trade still needs to catch up

As mentioned above, the region needs to strengthen its domestic market. One important field which therefore needs to improve to drive sustainable-long-term growth is intraregional trade. In 2015 intraregional trade in Asia-Pacific made up roughly 57% of total trade. At first sight, this appears relatively high when compared to figures of 63% in the European Union and 25% in North America. However, when you remove China from the figures, it drops below 40%, underlining China's current central importance for the region. At the same time, the variety of the region is highlighted when you look at trade shares within and across different sub-regions. For example, South Asia is seen as the least integrated region in the world, with intraregional trade at around only 5% of total trade, whereas East Asia is at levels of about 35%. In some cases it is more expensive to trade with a neighbor than with countries far outside of the region, or even more costly to transport a product within the same country than to import it. Two examples demonstrate this. It is 20% less expensive for Indian companies to trade with Brazil than with its direct neighbor, Pakistan, a gap which cannot solely be explained by their political and cultural differences. In Indonesia it is more expensive to transport fruit from eastern provinces to western parts of the country, compared to just importing from overseas. These phenomena might explain why the share of trade that is interregional (across sub-regions within Asia) is much higher for South Asia, at about 30%. The reasons are as diverse as the countries themselves. Continuing high tariffs, non-tariff barriers between countries, and inconsistent trade policies all play their parts in this.

In this context, the ASEAN region is both a positive and negative role model. On one hand, the association aimed to dismantle trade barriers between member states by establishing the ASEAN Economic Community (AEC) and the ASEAN Free Trade Area (AFTA). Liberalization efforts implemented through AFTA as well as the AEC reduced intra-ASEAN tariffs to close to 0% in the six founding members, and to somewhere between 0% and 5% in the remaining nations, covering about 98% of all goods. This led to increased intraregional trade and a stronger domestic market within the region. However, at the same time, the region has no consistent foreign-trade policy with countries outside of the area. Due to complexity of the numerous connections between ASEAN members and their partner countries across the world through different free-trade agreements (FTAs), this system is often referred to as the "ASEAN Noodle Bowl". However, in order to intensify trade relations with the rest of the world and other Asian countries, and to benefit from the increased bargaining power that would result from acting as a trade block, ASEAN should follow the EU's multilateral approach, in which FTAs are negotiated at the supranational level. After conclusion of an agreement with the EU, outsiders gain access to the EU Single Market as a whole. Through this model, the European Union has concluded numerous FTAs with countries all over the world, including South Korea, Chile and, most recently, Canada. Fruitless efforts to reach a comprehensive FTA between ASEAN and the EU demonstrate the effect of a non-consistent trade policy, which has led to to the EU now negotiating bilaterally with ASEAN member states.

**No. 3: Developing economies taking off**
IMF Forecast GDP Growth (in %)




Source: NORD/LB Economics

## Asia needs state-of-the-art infrastructure

The second major area that requires improvement if trade volumes are to increase is to fix the lack of infrastructure in certain member states, such as Myanmar, Indonesia, and the Philippines. The good news here is that expenditure is expected to significantly increase. For example, earlier this year, Indonesia announced an ambitious government spending plan targeting extensive infrastructure upgrades. Ports, airports, roads, and power stations require comprehensive improvements, which, in turn, could lead to promising investment opportunities and/or public orders. To keep pace with climate change and economic growth, the Asian Development Bank (ADB) estimates that USD 1.7 trillion needs to be spent annually on infrastructure investments until 2030 across Developing Asia. However, currently just USD 900 billion is spent every year. China's new "One Belt, One Road" initiative aims to fill that gap. And, despite some potential for friction between countries, this infrastructure should contribute to rising trade numbers within Asia.

## Looking ahead: The growing middle class will push intra-regional trade

Notwithstanding the region's variety, countries have two things in common: a growing or already very large population, and an emerging middle class, thanks to rising wages and growing household incomes. See Figure 2. Looking at China and India alone, they account for about 36.6% of the world's population. Combined with increasing wages and a growing middle class, this offers enormous markets for sales. At the same time, given the comparably large share of poorer households in the region, the potential for catch-up growth is large. Lesser-developed Asian neighbors could well benefit from demand for everyday products from the lower end of the value chain. Thus, looking ahead, Asia is expected to export less to the rest of the world, and will itself become a large consumer. Analysts estimate Asia-Pacific's share of world consumption will rise from 27% in 2016 to 39% by 2035, with the Chinese and Indian share of world consumption being 27% in 2035, up from 12% today. The primary driver of this will be an expansion of e-commerce. With an estimated 400 million Chinese online purchasers, the country is already the largest e-commerce market in the world. At the same time, Asia-Pacific has the highest growth rates globally in business-to-customer (B2C) e-commerce, hitting 28% in 2015, compared to 13% in Europe and North America, respectively. This trend is likely to continue. Market researchers estimate that, fostered by growth in wages and an expanding middle class, total online retail revenues in China, Japan, South Korea, India and Australia will almost double, rising from USD 733 billion in 2015 to USD 1.4 trillion in 2020. This will contribute to increased intraregional trade across Asia.

Asia-Pacific remains the most dynamic region in the world, with great trading and business opportunities. However, in order to accelerate economic activity, and to achieve sustainable growth, some barriers to trade and investment have to be removed. Naturally, Europe's experience of integration cannot simply be copied and transferred to Southeast Asia, even though the EU does provide important lessons. Economic integration and intensified trade relations have generated impressive growth opportunities and wealth in previously war-torn Europe. Investment in Asia-Pacific infrastructure and consistent trade policies are necessary if the region is to untangle the "Noodle Bowl", push forward intra-regional growth and create stronger domestic markets to make the region less dependent on the world economy. Given the favorable outlook for growth, increasing wages and a rising middle class, we highlight e-commerce as a sector that will prosper over the long term. Diminishing barriers to trade would therefore be a win-win for numerous Asian economies, as well as deliver mutual benefits for the region as a whole.

# The opportunities in niche aircraft finance provided by JOLs and JOLCOs

## An interview with Jan Melgard, CEO FPG Amentum Ltd.


FPG Amentum Ltd.

**Jan Melgaard**

*... has worked with financing, leasing and investing in commercial jet aircraft throughout his career. Prior to joining FPG Amentum in 2010, Jan was CEO of Nordic Aviation Capital and President/CEO of Volito Aviation (spearheaded a joint venture with Goldman Sachs).*

*Jan has been an active speaker at several industry events and conferences, and has authored and co-authored articles appearing in recognized industry publications. He received his MBA from Columbia University in New York.*

**FPG and FPG Amentum are third-party providers of aircraft investment opportunities. What are the current challenges for your business?**
We face the same issue as all other asset classes and markets, from fixed income to equities – the need to identify investment opportunities that have an attractive risk/return profile. In the current age of loose monetary policy, you have to work harder and think outside the box to achieve this. Of course, this issue is not unique to us as third-party providers of aircraft investment opportunities – it also applies to principal lessors. However, the positive in all of this is that investors are now spending more time looking at aircraft financing and investment, which to them are new asset classes. This provides an opportunity for third-party providers and asset managers like ourselves.

**Describe the niche aircraft finance products Japanese Operating Lease (JOL), and Japanese Operating Lease with Call Option (JOLCO). What is the difference between the two?**
Both products serve Japanese corporates looking to invest in real assets, including, but not limited to, aircraft, vessels and shipping containers.
In addition to the return on equity, investors enjoy accounting benefits, including a steep tax depreciation.

Both a JOL and a JOLCO are equity investments. The difference between them is simple. In the case of a JOL, the investor retains the full upside, if residual values (such as of the aircraft) develop favorably. In the case of the JOLCO, the lessee, (such as the airline) has the option to acquire the asset in the future at a certain strike price. That means the returns of the JOLCO are capped.

**Can you tell us a bit on the background of FPG and FPG Amentum, and the company's involvement in JOLs/JOLCOs?**
Financial Products Group (FPG) was founded by its CEO, Mr. Tanimura, in 2001, originally with a focus on JOLCOs, starting with shipping containers. Today it is listed on the Tokyo stock exchange, and is the market's largest arranger of JOLCOs, covering aircraft, vessels and shipping containers. Together with FPG Amentum, the company has been quickly growing in the JOL space since 2013. FPG Amentum is a Dublin-based aircraft asset manager, founded in 2005, which is today majority owned by FPG. We are primarily an aircraft leasing company, buying, managing and selling aircraft for, and on behalf of, the group's investor customers. FPG is independent, and not linked to any banking group in Japan. Over time, we have developed some smart new products, and are constantly thinking about innovation. And we specialize in bringing new lessee customers to the Japanese market, giving them access to an attractive funding source and supplying our investor customers with more choices. FPG Amentum doesn't exclusively work with Japanese capital – we provide aircraft asset management services to equity investors from other parts of the world and have investor customers in Asia, Europe and the US. On the debt side we are working as an advisor to NORD/LB, which is also a minority shareholder in FPG Amentum.

**How is the Japanese economy doing generally and what impact does this have on the level of interest in JOLs/JOLCOs?**
Yen interest rates continue to be extremely low, adding to the appeal of US$ denominated real asset investments with decent returns. Additionally, there are a huge number of profitable corporates, especially SMEs, who are attracted to JOLs and JOLCOs.

**What are the benefits and disadvantages of these products?**
To answer this question, we have to make a distinction between investors and lessees.

JOLCO returns are fairly predictable at the outset of the investment. The equity ticket size per investor starts at a few hundred thousand US$, meaning we usually have multiple JOLCO investors per asset. The lessee credits tend to be the strongest in their class and returns are capped. Lessees enjoy 100% financing at attractive rates and retain the option to acquire the asset, such as the aircraft, at predetermined points in the future, including lease tenor end. As this is a credit-driven product, there is more flexibility regarding the asset type, such as the aircraft variant, compared to a JOL.

The equity ticket size in JOL transactions is bigger. In narrowbody aircraft transactions we typically have one investor per aircraft. In leveraged transactions, around US$ 15m would be the norm. As there is no call option, investors have an uncapped return upside. Also, they retain the flexibility of being able to end the investment by selling the aircraft with the lease attached at any time, just as any conventional aircraft lessor would. In practice, most JOL investors hold on to the aircraft for the duration of the initial lease tenor, and often well beyond that, a characteristic that our lessee customers appreciate.

**How do you see the market size changing going forward and why?**
This market continues to be strong. The main constraint is the ability to find attractive investment opportunities with decent returns. We are seeing greater product innovation and an increasing number of new lessees joining the market, including those introduced by ourselves. All of this adds to market activity. Changes to the Japanese tax code are a risk factor, as that could affect the volume of new JOL and JOLCO deals in the future, but this is not a new issue.

**What are some of the more recent developments/trends in JOL/JOLCO products?**
While not entirely new as a structure, providing JOLCOs to principal lessors has been a growing area of the business in the last few years. At FPG we are very active in this space. Additionally, new lessees are entering the market. JOL investors differ in their risk return preferences, so what we have today is far from a homogenous one-size-fits-all market. For example, FPG introduced JOLs featuring a new Trust structure in December 2016. In terms of the underwriting process, accounting treatment and flexibility to debt lever, this new structure has numerous advantages over classic JOLs, and we are pleased with the first aircraft transactions we have closed using Japanese Trusts.

# On the ground – view from China and Singapore

An interview with Dr. Sandra Reich, Head of German Desk in Singapore, and Dr. Stephan Popp, Shanghai Branch Manager


Stephan Popp, NORD/LB

**China and Singapore are becoming an ever-greater economic powerhouse, driving the Asia-Pacific Region. What are the economic strengths of the different countries within Asia-Pacific?**
**Popp:** Despite the lower Chinese growth rates, it is the largest Asian economy and will remain Asia's most important growth engine. In fact, its new model for growth and ongoing internationalization may well drive growth across the entire region. Moving beyond China, the attractiveness of industrialized economies like Singapore, Japan and South Korea is closely linked to their well-developed financial markets, reliable legal systems and supply of highly skilled labor. Emerging economies such as Vietnam, Malaysia and Indonesia may benefit from their comparably lower wages helping them grow, as well as a rising middle class.

**Singapore is seen as leading the way in digitalization, while China is very advanced in production. What future developments do you see?**
**Popp:** In 2015, China's leadership launched the "Made in China 2025" master plan, which is focused on turning the country into a production hub for high-tech products. Making use of digitalization, network computing and artificial intelligence, China is striving to revamp various sectors of its economy, from e-mobility to aerospace technology, and from transport to medical devices. Germany's "Industrie 4.0"

advances can definitely act as a role model for this plan, enabling German corporates to benefit by using their existing expertise in China.
**Reich:** The Singapore government is always looking into new trends. In 2015 its “Smart Nation” plan began, and this long-time project will digitize all of public life. Under the nuTonomy brand, trials of autonomous mobility-on-demand services have been launched, while an integrated healthcare-at-home service is also available. Additionally, several German corporates have opened new digital manufacturing facilities or Innovation and Technology Centers in Singapore over the past few months. In my view, the environment for innovation is so strong in Singapore that it will be successful in building a digital center that influences the whole region.

**How has NORD/LB reacted to these developments, and what are clients saying?**
**Reich:** Obviously, every client is different. Their needs vary depending on the stage their business is at, and the countries in which they operate. NORD/LB has therefore widened its product offering over the last 20 years, a process that has accelerated over the last five years. At a time of rapid digitalization, the bank is also focusing on innovation in areas such as data analytics and blockchain, which have great potential to change the world of banking in the future.

**How do you work with clients? Do you operate from Germany, or on site in Asia-Pacific?**
**Popp:** Global clients expect a fully-fledged, global service package from their banking partners. Consequently, NORD/LB now provides support from both regions, Europe and Asia-Pacific. For our China business, the vast majority of our clients' subsidiaries rely on their Head Offices for input and/or decisions when it comes to local financing, accounting and taxation issues. In this case, a coordinated communication and information-sharing approach between NORD/LB's German Desk and the primary Relationship Manager in Germany is essential – and is well appreciated by our clients, according to benchmarking surveys.
**Reich:** Having a German contact person is seen as extremely positive by our clients. This is not just about sharing the same language, but often is about having the same understanding of how to do business. The German Desk in Singapore supports clients with solutions for their banking issues – whether it is a guarantee, loan facilities, cash deposits or export finance.


Sandra Reich, NORD/LB

**Ms. Reich, how has Singapore developed for German companies over the last years?**
**Reich:** Generally, German companies launching in Singapore follow a well-thought out process, setting up the business step by step. Normally, then, they expand into other Asia-Pacific countries. Usually German organizations are satisfied when they are successful in such a competitive environment. But, of course, simply because their products are “Made in Germany” doesn’t mean they can sell naturally. There is still a lot of hard work needed to sell their products in a very competitive market where customers sometimes value price over quality.

**Which financial solutions are clients most interested in?**
**Popp:** Due to the specific characteristics of the Chinese banking market, with its tight regulations on financing and capital controls, demand for structured and innovative products is usually rather limited. However, with China's regulatory framework slowly but steadily changing, with the aim of establishing Shanghai as an international financial center, opportunities arise and banks are invited to contribute to create a state-of-the art financial environment. Having said this, NORD/LB's Account Receivables financing scheme is in tremendous demand from our midcap corporate customers. Of course, the "Chinese characteristics" of the market need to be accounted for when implementing financing schemes locally.
**Reich:** It always depends – there is not just one answer. But to highlight two products, companies are usually very interested in export-finance and purchase of receivables. The first product could help them to sell more goods into Asia-Pacific, while the second helps to optimize their cash flow.

**What is attractive about these solutions for your clients? Many companies are only now discovering Asia – are they too late?**
**Popp:** Research indicates that there are about 5,000 organizations with a relationship to Germany operating in China, with about 2,600 being members of the German Chamber of Commerce (AHK). We are still seeing new companies enter the Chinese market. However, the majority of these are extremely specialized, operating in high-tech, niche industries, and are being attracted by specific opportunities in the wake of the "Made in China 2025" program. Entering China now with the intention of creating low-cost products is definitely a thing of the past, and is not a viable future business model.

# “Adding value for NORD/LB’s clients”

## An interview with Sebastian Heddergott of NORD/LB Corporate Sales Asia-Pacific on the bank’s new weekly FX market insight publication

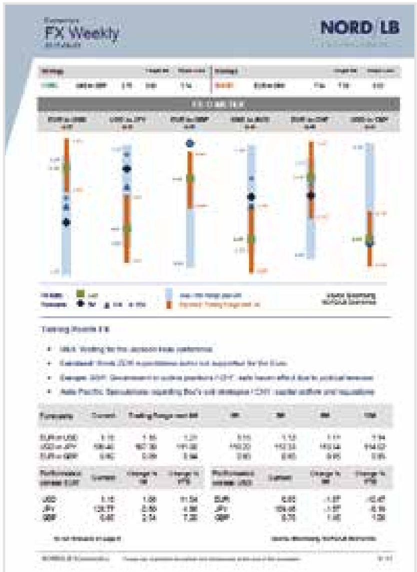
NORD/LB

Sebastian Heddergott, Head of Corporate Sales Asia Pacific

**Mr. Heddergott, working with NORD/LB’s research department, you have developed a new weekly publication focused on the foreign-exchange (Forex) markets. Why have they recently attracted more attention?**
Exchange-rate movements in the Forex markets are one of the most important risks for companies involved in international trade and global financial markets. FX rates can be influenced by multiple forces, such as foreseen or unanticipated changes concerning the monetary-policy stance of the Federal Reserve, the European Central Bank, the Bank of England or the Bank of Japan. In addition to that, central-bank decisions in Australia, Canada, Switzerland and China are increasingly important to the FX market. In this environment, market participants are not only looking at interest rate differentials, but also on any unconventional monetary-policy measures taken by central bankers.

**What other external factors are there that make it worthwhile to take a closer look at FX rates?**
Diverging growth rates, varying levels of unemployment, differing inflation rates and the current account balance all influence the bilateral pricing of currencies. As the renewed tensions between Washington and Pyongyang have shown, geopolitical risk factors have to be considered as well. Additionally, price-building processes for commodity-based currencies such as the Australian or Canadian Dollar have different characteristics compared to safe-haven countries like Japan and Switzerland, or the global reserve, the US Dollar.

**What is the aim of the new weekly FX market insight report?**
We have launched the publication to share the valuable information we have on global FX markets. The weekly report focuses on the most relevant global currency pairs, providing insights into the current drivers behind exchange-rate movements. It includes short- and medium-term forecasts, which aim to add value for our clients. The NORD/LB FX Weekly complements the existing advisory services delivered by our corporate sales team.

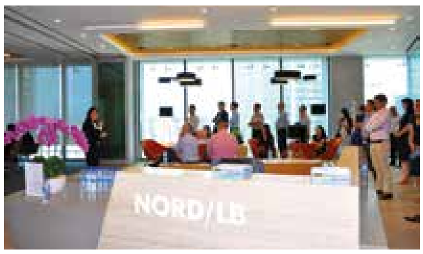



# Schuldscheindarlehen explained

## In-depth Singapore workshop explains financing benefits of Schuldscheindarlehen

On September 21, 2017, as part of the Swiss Club Singapore’s annual Oktoberfest celebration, NORD/LB’s Singapore branch ran a very successful workshop on Schuldscheindarlehen (SSD) financing.

The workshop, led by Ms. Anna Tea, Head of Global Markets Asia-Pacific, was attended by 148 international institutional and corporate clients from across Asia, and looked in-depth at this increasingly popular form of finance. Client attendees included guests of the Shipping, Global Markets, Aviation, Structured Finance, Corporate Sales, Ship Asset Trading and Credit Asset Management divisions.

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# Dr. Anna Tea joins Singapore branch

NORD/LB Singapore wins an expert to strategically develop the bank's Asia strategy even further

Created at the end of 2015, NORD/LB's Global Markets desk is now expanding, appointing Dr. Anna Tea as Managing Director, Head of Global Markets Asia-Pacific. Based in the Singapore branch, Anna will be responsible for contributing strategically towards the bank's Asia Strategy, driving forward NORD/LB's Markets franchise in the region.

Before joining NORD/LB, Anna worked at Commerzbank AG, Singapore, where she was Head of Credit & Rates Sales for Greater China and South East Asia, covering institutional clients and private banks on all credit products, including derivatives and loans. Her key achievements included the expansion of Commerzbank's Asia business by being the first to sell Schuldschein to a client in Asia, as well as playing a key role in the issuance of Commerzbank's first Formosa bond.

Prior to Commerzbank AG, Anna was the Director for Institutional Fixed Income Sales Asia at Mitsubishi UFJ Trust International, and the Director for the Asian Bond Desk at Bank Julius Baer. She began her banking career at HSH Nordbank, where she set up its first representative Asian office for Private Banking, before becoming the Institutional Sales Manager for Capital Markets Asia. Before entering banking, Anna worked at the Association of German Chambers of Industry and Commerce (DIHK) in Hong Kong, and at Accenture GmbH in Austria.

Anna is a Doctor of Philosophy, earning a PhD in Social and Economic Sciences from the Vienna University of Economics & Business Administration in Austria, where she majored in Foreign Trade Policy & Theory and Public Law. She also holds a Masters in Social and Economic Sciences from the same university.

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