NORDICS WELCOME NEW MEMBER TO *MUNICIPAL AGENCY CLUB*: NEW ZEALAND'S LGFA

On March 23 representatives from three Nordic municipal funding agencies and New Zealand's Local Government Funding Agency (LGFA) met in Sydney at a roundtable discussion sponsored by **Westpac Institutional Bank**. They discuss their unique positioning within the international agency sector as well as key funding strategies. All four agencies come from regions that have strong safe-haven status.

PARTICIPANTS

■ **Andreas Aleström** Vice President, Funding KOMMUNALBANKEN NORWAY ■ **Carl-Henrik Arosenius** Head of Funding KOMMUNINVEST ■ **Philip Combes** Chief Executive LOCAL GOVERNMENT FUNDING AGENCY ■ **Joakim Holmström** Head of Funding MUNICIPALITY FINANCE ■ **Antti Kontio** Funding Officer MUNICIPALITY FINANCE ■ **Tobias Landström** Senior Funding Officer KOMMUNINVEST ■ **Craig Stobo** Chairman LOCAL GOVERNMENT FUNDING AGENCY ■ **Matthew Walker** Commercial Manager HAMILTON CITY COUNCIL and Chair LGFA SHAREHOLDERS' COUNCIL

MODERATORS

■ **Nick Howell** Director, Debt Capital Markets, New Zealand WESTPAC INSTITUTIONAL BANK ■ **Samantha Swiss** Managing Director KANGANEWS

OWNERSHIP AND CAPITAL STRUCTURES

Swiss Can each of the four municipal funding agencies outline their key their ownership and capital structure features?

■ **AROSENIUS** It is interesting to see new countries like New Zealand take up the idea of a municipal funding body. This concept has existed for some years in the Nordic area. We have heard that France and the UK are also thinking about this concept. This is a win-win situation because it is good for the taxpayers but it's also good for investors as it's a new asset class coming to the market. We offer the best type of risk because it is not sovereign but it is a close proxy to the government and it pays a spread to sovereign.

With regard to Kommuninvest, a unique feature which comes from the Swedish constitution is that the municipalities are at the same level as the state. Therefore, the municipalities have the right to tax income, which is a major part of their revenues (see table on p20). Each municipality has the option to join Kommuninvest and we have been growing our members every year since we started in 1986 – but not as fast as the Finns, as Municipality Finance (MuniFin) has a greater market share (see table on p19). However, we use MuniFin as a good example of where we would like to be in terms of potential membership.

The member municipalities give Kommuninvest the strongest guarantee possible. It is an explicit, unlimited, joint and several guarantee. This is something we have to explain to investors these days, ever since the market turmoil of the last few years.

■ **LANDSTRÖM** When we meet investors it is very important for us to highlight how important the local governments are in Sweden. They take care of 70 per cent of the public sector, which is basically the welfare system in Sweden. Since they are our owners and guarantors, it's important to highlight the role they play in our society.

■ **AROSENIUS** The other important feature to highlight is that we are a bit of a strange animal. We act in the global capital

markets under the same rules as banks do, but on the other hand we are owned by the public sector. We act as the debt office of the municipalities: that is our mission. But we have to report on the same basis as commercial banks. This means that despite our strong guarantee, we have to have share capital that is in compliance with the regulations for banks.

Another unique feature in Sweden is, after withstanding the 2008 crisis and because our membership has grown, we are now regarded as systemically important in the national financial system. Therefore, two years ago Riksbank – our central bank – appointed Kommuninvest as a monetary policy counterpart. So we can do repos with the central bank in the same way as banks, we are now a full member of the payment and clearing system, and all our issued paper is accepted as collateral and as repo-eligible – in Sweden, in Europe via the European Central Bank, and also in the Kangaroo bond market. We have heard the same from the Monetary Authority of Singapore.

All this underlies the notion of Kommuninvest as a public sector institution and it is a very good story to tell investors. We can tell them they have three choices if they want to reclaim money. They can come directly to Kommuninvest, they can go to any of our guarantors, or they can repo the bonds with the central bank. It's hard to imagine how we could provide something less risky for investors. Especially when you add to all this our triple-A ratings.

We have a very simple and transparent business model which is easy for the rating agencies to evaluate. We match funds and the sole purpose of our business is not to take any risk at all. It's hard to imagine any threat to our rating.

HOLMSTRÖM Carl-Henrik Arosenius has already explained many of the great aspects of the local government funding agency concept. All the Nordic countries are relatively small, so only a few of their municipalities would have access to the capital markets on an independent basis. It is very cost-effective to pool all the funding needs of the municipalities and issue via a specialised entity.

We have seen the development of the importance of our institution for the whole public sector. MuniFin's lending has increased dramatically since 2008, before which time competition was fierce. At this time we had a market share of around 40 per cent of new loans granted to local governments. After the Lehman Brothers bankruptcy many of the commercial banks and large European lenders withdrew from the market. Our market share peaked at 100 per cent in 2009 and today our market share still exceeds 80 per cent. So we more or less own the market.

> "All the Nordic countries are relatively small, so only a few of their municipalities would have access to the capital markets on an independent basis. It is very cost-effective to pool all the funding needs of the municipalities and issue via a specialised entity."
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> **JOAKIM HOLMSTRÖM** MUNICIPALITY FINANCE

RATING AGENCY STATUS

New Zealand's Local Government Funding Agency was keen to find out from its Nordic peers whether there is a distinction between the level of understanding and competence of the three main rating agencies.

STOBO Do you view all rating agencies as equally competent?

HOLMSTRÖM As Carl-Henrik Arosenius has pointed out elsewhere in this discussion, we all have very transparent business models. All the rating agencies seem to have a good understanding of our structures.

AROSENIUS One point to consider is that within the European Union there is now discussion about implementing a new directive, saying that banks should have a rotation among the rating agencies because there has been a lot of criticism levelled at the agencies.

As a result, rating agencies are more nervous and I think going forward they will be quicker and more responsive. It is more difficult to get a rating now than it was five or 10 years ago.

ALESTRÖM From our point of view the agencies don't necessarily have different competence levels. But they do have different methodologies that are frequently changed and questioned by many.

We feel investors are doing a lot more risk-related work themselves now.

CREDIT RATINGS OF LOCAL GOVERNMENT FUNDING AGENCIES

	FITCH	MOODY'S	S&P
Kommunalbanken Norway	NR	Aaa	AAA
Kommuninvest Feb 22	NR	Aaa	AAA
Municipality Finance	NR	Aaa	AAA
Local Government Funding Agency, NZ	AA+	NR	AA+

SOURCE: KANGANEWS MARCH 26 2012

Our owners and guarantors have realised the importance of MuniFin. We are the only issuer in the Nordic region that has a split ownership with both the local government and the central government as owners. The central government share consists of 16 per cent direct ownership and a 30.7 per cent ownership by the Local Government Pension Institute.

All our bonds are explicitly guaranteed by the Municipal Guarantee Board, which in turn includes all municipalities, with the exception of one small one, and hence 99.9 per cent of the Finnish taxpayers are backing our bond issuance. As the municipalities also have the unlimited right to levy taxes we feel that this guarantee is equally strong as a central government guarantee. The guarantee is set up in a somewhat similar way to that of Kommuninvest, with the exception that the majority of municipalities in Finland are members. Membership is permanent – so once you join you're a member for life, which makes the quality of the guarantee very stable.

ALESTRÖM Kommunalbanken Norway (KBN) has the same public mandate to provide low-cost funding to the local government sector as the other agencies around the table. But we are a little different in that we are 100 per cent owned by the central government. We don't have a membership base – we just provide our clients, which are purely Norwegian local governments, with loans.

We have a 50 per cent market share of the provision of loans to local governments in Norway. We have seen solid growth in the last few years and we expect this to continue – although at a somewhat slower pace this year due to lower debt growth in the sector. Some of the larger municipalities in Norway can access the capital markets themselves, while the commercial lenders take up the rest of the funding need.

As our sovereign does not issue any bonds, KBN is the closest proxy for Norwegian sovereign debt in the international markets. This is one of our key marketing points and is a very attractive feature for investors – despite the fact that we do not have a direct guarantee from the sovereign. KBN benefits from a maintenance obligation from the government as a 100 per cent owner.

Howell The numbers of municipalities in the Nordic region – between 300 and 400 – shows the difference in scale between the Nordic agencies and New Zealand's LGFA. Philip Combes, can you outline the key strategic elements to this relatively new agency?

COMBES In the New Zealand context the LGFA has become a second high-grade public-sector issuer sector. In that sense we fill a gap between the central government, the international supranational, sovereign and agency issuers in the Kauri market, and the individual local councils. This provides some much-needed diversity for investors.

There are two key features supporting the LGFA. The first is the joint and several guarantee from participating shareholders – 18 councils at this stage. There are 78 councils in total, but the 18 LGFA members comprise two thirds of the borrowing capacity in this sector. Crucial in this context is that there has never been a default among local councils in New Zealand. So that gives us a very strong support base.

The second key feature is the strong support from the New Zealand central government. The government owns 20 per cent of the LGFA but there is no explicit guarantee. However, the central government does provide the LGFA with both liquidity and operational support. The latter comes in the form of support from the New Zealand Debt Management Office (NZDMO), which after almost 25 years has built up a strong track record of issuance in international debt capital markets.

Westpac Institutional Bank

> "Our first domestic deal was syndicated and priced at 70 basis points over the sovereign. When there is uncertainty in southern Europe, investors flee to the safe-haven Nordic sector, which benefits our pricing."
>
> **CARL-HENRIK AROSENIUS** KOMMUNINVEST

KEY COUNTRY STATISTICS

	FINLAND	NEW ZEALAND	NORWAY	SWEDEN
Population	5,401,267 (Mar 2012)	4,327,944 (Jul 2012 est.)	5,000,000 (Mar 2012)	9,103,788 (Jul 2012 est.)
Total area (sq km)	338,145	267,710	385,230	450,295
Currency	EUR (since 1999)	NZD	NOK	SEK
GDP growth (%) (2011 est.)	2.7	2.0	2.7	4.4
Gross / net debt (% of GDP)	49% / -57% (2010 / 2011)	36.5% / 23.7% (Jan 2012)	55% / -160% (2011)	36.2% / -20.8% (2011)
Unemployment (%) (2011 est.)	7.7	6.5	3.4	7.6
Inflation (%)	3.3 (2011 est.)	1.8 (actual: Dec 2011)	1.2 (2011 est.)	2.5 (2011 est.)
Total number of local governments	336	78	429 (municipalities) 19 (counties)	290 (municipalities) 20 (county councils)
No. of authorities which are members of local government funding agency	319	18 (comprise 2/3 of total funding needs in the sector)	98% of the municipals have loans with KBN: 50% market share	269
EU member (27)	Y (1995)	N	N	Y (1995)

SOURCE: KANGANEWS AND ROUNDTABLE PARTICIPANTS (COLLATED FROM VARIOUS SOURCES)

We also have access to strong liquidity support from the central government – initially set at NZ$500 million (US$411.2 million) and rising to NZ$1 billion. In terms of the scale we have been discussing this might not sound that large, but the context here is that the LGFA is likely to grow to NZ$7-10 billion dollars in outstanding debt over the next decade.

Those are the two key elements that underpin the AA+ domestic currency rating and AA foreign currency rating the LGFA has secured from Fitch Ratings and Standard & Poor's.

Swiss What are the LGFA's key strategic objectives in the near term?

■ **COMBES** As a totally new organisation one of our key objectives is to get brand recognition. In this part of the world we are aiming to get recognition as a semi-government issuer as this is a sector that is well understood in the Australasian region. As a result, we will position the LGFA as being equivalent to the larger semi-government issuers in Australia.

Another key objective is to build up scale – quite rapidly. What this means is a clear aspiration to move our pricing towards the semi-government level you see in Australia – which means a target of an average of 50 basis points over the New Zealand sovereign. For us that is a particularly strong pricing point. Because if you look at credit default swap (CDS) spreads, although New Zealand is rated double-A at the foreign currency level in the CDS market, New Zealand is now one of the top 10 sovereigns on a spread basis. Its spreads are trading only 10 basis points wider than Australia – which is rated triple-A.

As the LGFA moves to price off the New Zealand sovereign that will put us in a very strong position in terms of where we price in international markets. We may not have a triple-A rating but we will price better than many triple-As in the world based on the strength of Australia and New Zealand in the sovereign space.

■ **STOBO** The other support mechanism I would highlight is the Crown ownership. The Crown owns 20 per cent of the LGFA but it does not have any directors on the board. So they are an interested but passive shareholder but not an explicit guarantor.

FUNDING AND CURRENCY

Howell The LGFA has had two tenders so far – one in February and another in mid-March. Are you happy with the outcome?

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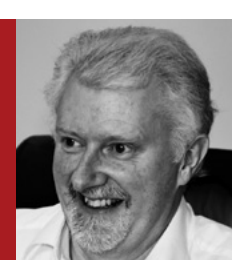
>
> **PHILIP COMBES** LOCAL GOVERNMENT FUNDING AGENCY



TAXATION POWERS OF LOCAL AUTHORITIES

One of the key aspects underpinning the strength of local governments is their ability to collect taxes, and what kinds of taxes they can levy. While the local government authorities in Finland, Norway and Sweden control property and income taxes, in New Zealand local councils are limited to levying the equivalent of a property tax.

WALKER Is the scope of the taxation powers of the Nordic local authorities limited?

HOLMSTRÖM Local governments in Finland have an unlimited right to levy income tax, and they also can independently decide on property taxes within their municipalities.

The average contribution to revenue by income tax for the municipalities is 47 per cent, while state grants comprise 18 per cent. All taxes are collected by the central government and then redistributed back to the local governments.

LANDSTRÖM In Sweden 70 per cent of the total revenue for local governments comes from income tax, while state grants comprise only 15 per cent of revenue. And since local governments have the right to levy their own rates, in Sweden it stands for a very big proportion of the total income. So if taxes are increased just a little, it has a big impact.

ALESTRÖM In Norway the percentage of revenues from income tax is capped at 39 per cent, with 42 per cent of revenue provided by state grants.

WALKER In New Zealand there is a key distinction. Local authorities only have the right to levy the equivalent of a property tax – called rates. We are required to balance budgets so the level of those rates is struck according to the budgetary requirements. There is no right to collect income tax.

COMBES While local councils' taxation ability is not as broad as those described in the Nordic region, the ability to levy rates on each house is quite powerful – in New Zealand rates are very low as a proportion of property values. Also, ultimately councils have the right to sell the property and recover the rates due. So this is one of the most powerful taxes a local government can have.

AROSENIUS That tax doesn't run away either!

STOBO That's right – it's a permanent security.

BREAKDOWN OF LOCAL GOVERNMENT REVENUES (%)

	FINLAND MUNICIPALITY FINANCE	NORWAY KOMMUNALBANKEN NORWAY	SWEDEN KOMMUNINVEST
Income tax	46	39	71
State grants	18	42	15
Charges	26	14	6
Other	10	5	8

SOURCE: KANGANEWS MARCH 23 2012

■ **COMBES** Yes, the issues were very well received. We had two objectives. One was to establish that we could fund in accordance with the volumes we set out to achieve over the next few years. With well over NZ$2 billion of bidding interest in our first two months of tendering, we have definitely achieved that. That massive demand is coming through before we have had any real opportunity to market to offshore investors. It shows the very strong support from the domestic investor base.

Swiss What are your expectations in terms of foreign investor participation?

■ **COMBES** Foreign ownership of New Zealand government bonds now stands at around 60 per cent. That has come down from 75 per cent, which is roughly where Australia is now – because there has been a significant build-up in domestic demand for New Zealand government bonds. For the LGFA, we expect our bonds to be over 95 per cent owned by local investors at the start, but building up over time to an offshore investor take up similar to the sovereign.

Howell Were you happy with the pricing outcome of the first two tenders?

■ **COMBES** As with every start-up issuer, we would like to price initially as close as possible to where we would like to end up. But that is obviously difficult to achieve. In our case pricing was at the lower end of the market range and it is definitely improving already. For example, the longest bond we have offered so far – the December 2017 – has improved from a first tender result of 113 basis points over the sovereign, to now trading at 103 basis points over.

This is a good rate of progress. We are really keen for that to continue, and we are confident that it will as we establish both brand and scale in the market.

Holmström Do you expect only to borrow in New Zealand dollars?

■ **COMBES** That will be a key part of the strategy. We won't only borrow in NZD but the currency will form the benchmark for our pricing. So when we look at other currencies swapped back to our home market, we will be looking for pricing that is not more expensive than funding in NZD.

We don't have the scale of the Nordic local government issuers, so we need to establish a solid domestic curve before issuing in any other market. Our aim is to be a highly-rated, liquid issuer and so we have to build scale first in our home market.

We will be looking to build lines up to NZ$1 billion each at least, in New Zealand, just to be competitive with some of the bigger Kauri issuers. Once we have done this, we can look to build smaller foreign currency deals in markets where pricing is attractive at the time.

Landström Do you think your first new market will be the Kangaroo?

■ **COMBES** Yes. That is a market we looked at closely during my 10-year stint as head of the NZDMO. It was the market deemed most likely to give us the next-best price after our home market.

Howell What about the Nordic agencies – how much do each of you rely on your own domestic markets for funding?

■ **LANDSTRÖM** From Kommuninvest's perspective, we are growing very much right now in the sense that we are getting more and more members and we are also getting a bigger share of our members' borrowing needs. We are focusing on establishing three different benchmark curves – US dollar, Kangaroo and domestic.

We started domestic funding in October 2010 and we have a target to fund about 50 per cent from the domestic market by 2015. So far this year we have funded around 45 per cent in the local market.

■ **AROSENIUS** The year before we started the domestic benchmark programme we funded 90 per cent outside Sweden.

Combes Where do your securities price relative to the Swedish sovereign?

■ **AROSENIUS** That's quite interesting because in Sweden we have had a very liquid bond market since 1983. It started off with two benchmarks – government and covered bonds. These issuers prevented any other high-grade issuer from entering the market because they took all the interest.

During these last 20 years or so, some other high-grade entities such as Kommuninvest tried to enter the domestic market but it was impossible due to the dominance of the sovereign and the covered bond issuers. No other issuer had enough volume to match these two benchmark sectors.

OWNERSHIP, GUARANTEE STRUCTURE, FUNDING VOLUME OF LOCAL GOVERNMENT FUNDING AGENCIES

	FUNDING VOLUME (2012)	OWNERSHIP	GUARANTEE
Kommunalbanken Norway	USD20bn	100% owned by Kingdom of Norway.	No direct explicit sovereign guarantee. But benefits from maintenance obligation from the Norwegian government.
Kommuninvest	USD17-20bn	Owned by 269 Swedish municipalities and county councils.	Explicit joint and several guarantee from members.
Municipality Finance	EUR6bn	53.3% Finnish local governments and Association of Finnish Local and Regional Authorities; 30.7% Local Government Pension Institute; 16% central government of Finland.	No explicit sovereign guarantee. Explicit guarantee on funding from Municipal Guarantee Board, which has most Finnish municipalities as members.
Local Government Funding Agency, New Zealand	NZD1bn	20% New Zealand Crown; 80% 18 local council members.	No explicit sovereign guarantee. Joint and several guarantee from members.

SOURCE: KANGANEWS MARCH 26 2012

Recently, however, regulatory changes have allowed the market to open up. Since we were growing and our board wanted risk diversification, we had another go at issuing in the Swedish domestic market.

While we have been pretty successful in achieving this aim, the big question when we started was where we should price. We had lots of discussions on pricing and at the end of the day we agreed the price should be in between the sovereign and covered bond benchmarks. Our first deal was syndicated and our intermediaries recommended a level of 70 basis points over the sovereign. This was successful and since then we have continued to be around that range, depending on tenors and market environment. When there is uncertainty in southern Europe investors flee to the safe-haven Nordic sector, which benefits our pricing.

■ **LANDSTRÖM** We are continuing to grow – right now we have around 45 per cent of national public sector debt on our books. We also have natural growth coming from increasing the number of local authorities that are members. This is happening at a time when the national debt office is amortising its debt. It will be down to 12.5 per cent of the total in 2015, which means the sovereign won't issue as much and prices will go down. That should also benefit Kommuninvest.

■ **AROSENIUS** That is especially true because at the time of launching our domestic benchmark programme we made the decision to mirror government maturities.

"The Crown owns 20 per cent of the LGFA but it does not have any directors on the board. So they are an interested but passive shareholder but not an explicit guarantor."

CRAIG STOBO LOCAL GOVERNMENT FUNDING AGENCY

"When we meet investors it is very important for us to highlight how important the local governments are in Sweden. They take care of 70 per cent of the public sector, which is basically the welfare system in Sweden."

TOBIAS LANDSTRÖM KOMMUNINVEST

Stobo What size do you aim for in each of your benchmark lines?

■ **LANDSTRÖM** We don't have a specific target in each tenor. The shortest bond, which was our first, is now up to SEK20 billion (US$3 billion). However, I think we will aim for a minimum size of at least SEK3 billion – which is considered a benchmark volume in Sweden and is the level at which market-making kicks in.

Holmström Do you think your local market is big enough for you to raise 50 per cent of your projected funding needs domestically?

■ **AROSENIUS** Yes, given that the government is decreasing its borrowing needs. Taken together, total government and quasi-government outstanding volume in Sweden is decreasing. In addition, as the Nordic area is increasingly being perceived as a safe haven within Europe, the foreign ownership share has increased to some 60 per cent, which is an all-time high. Kommuninvest started that trend – probably because investors already know us. This could grow further, which will also provide appetite for our bonds.

Howell What is the situation in Finland and Norway regarding on- and offshore funding?

■ **HOLMSTRÖM** Our domestic currency is the euro, so in currency terms our local market is much bigger than the other Nordic countries. Domestic institutional investors are large pension funds whose investment policies require benchmark size and liquid transactions. We have not been benchmark issuers in euro, so the products we have sold to domestic investors have been more tailor-made, such as inflation linkers, on a reverse enquiry basis. In any event, we like to look at Scandinavia as our home market.

■ **KONTIO** For example, last year we issued our inaugural USD benchmark deal and Nordic investors purchased 20 per cent of that transaction. This is a very strong message of support from the region. Last year about 10 per cent of our funding came from Norwegian krone and Swedish krona. This is definitely less than Kommuninvest. But if we had a euro benchmark programme, the domestic participation would be higher.

■ **ALESTRÖM** KBN's pricing benchmark is US dollars and we source most of our funding abroad. We have issued a fair quantity of Norwegian krone deals in the last couple of years but those deals have been mostly targeted towards retail investors in Europe.

Stobo Is that a separate retail programme?

■ **ALESTRÖM** No, this is done under our EMTN programme. We fund from a mix of different markets, including retail.

ISSUERS' PRODUCT FOCUS

Howell KBN has four key funding markets, is that correct?

■ **ALESTRÖM** Yes. We aim to complete two or three benchmarks per year, with a minimum size of US$1 billion and maturities of three or five years. In 2011 that comprised 13 per cent of our funding. We source 49 per cent of funding from retail deals – the majority in Uridashi format from the Japanese market. Then we have private placement markets, including USD floating rate notes. In 2010 we added 144A documentation to our programme so we can now sell bonds to institutional investors in the US. This part of our programme contributes around 10 per cent of our funding. Finally, around 20 per cent of our funding comes from other institutional markets around the world, including Kangaroo, Kauri, Swiss and sterling. The Canadian market hasn't worked for a while.

Howell Is MuniFin also a flexible issuer, in terms of accessing the right market at the right time?

■ **HOLMSTRÖM** Definitely. But in the last two years we have shifted more to the public markets, because of the growth in our borrowing needs. It is now worthwhile and economically sensible to access public markets from a diversification point of view. Before this we covered most of our funding needs via retail and private placements.

The USD market has been the biggest game-changer for MuniFin in terms of our focus on public markets. We issued our first USD benchmark last year and we also did our inaugural sterling deal this year.

The one public market in which we have built a curve – in Switzerland, where we have been active since 1998 and we have a curve from one to 20 years – shows the benefits derived from making a strategic decision about markets. Last year both Kommuninvest and MuniFin were able to price through issuers like European Investment Bank and KfW Bankengruppe in this market, because Scandinavia had and still has a very good reputation among Swiss investors. There's no doubt that ongoing, strategic issuance ensured our name was in investors' minds – and of course the safe-haven status of the Nordic issuers also helped achieve this pricing outcome.

> "We don't have a strict internal guidance about what and how much we will issue on a quarter-by-quarter basis. For example, in 2011 we ended up in a situation where we had to close the doors after three months."
>
> **ANTTI KONTIO** MUNICIPALITY FINANCE

Howell Andreas Aleström has mentioned that KBN is the only way for investors to access Norwegian sovereign risk as the Kingdom of Norway does not issue on the international capital markets. What is the situation in Sweden and Finland?

■ **AROSENIUS** We have a completely different situation – as I have mentioned the government has issued in the domestic bond market for the last 25 years. It accesses the local debt market via auctions, which means it is continuously active. We use that curve as a reference.

■ **LANDSTRÖM** The Kingdom of Sweden also issues US dollar and euro bonds, although it is not very active in these currencies.

■ **HOLMSTRÖM** The Republic of Finland has limited borrowing needs and it focuses its issuance firepower on euro benchmarks. From time to time you will see it issue in US dollars and sterling, but this is very limited. As a result, at MuniFin we market ourselves as offering exposure to Finland – as sovereign risk with a spread.

Howell Will the growth of Finnvera as a borrower provide competition to MuniFin's position as a sovereign proxy?

■ **HOLMSTRÖM** While Finnvera has been around for years, until recently it was funded out of the state budget. Now it is in the process of establishing its own funding programme. It will be a pretty small issuer, with a funding programme of around US$1 billion per year. We don't see Finnerva as taking away from our funding opportunities. I definitely don't think you will see it in Aussie dollars or other public markets. I think it will focus on private placements.

Combes Would you consider holding auctions? That is the way the LGFA has done its first two issues.

■ **AROSENIUS** That's a good question and we still don't know exactly how to do it. Right now our issuance is done on tap, like the covered bond issuers. Like the government issuance, syndicated loan deals for 20-year maturities are now are also sold via an auction structure.

Today the banks can't take risk because their balance sheets and risk appetite are shrinking. This is why the auction structure was necessary for the government, particularly when issuing far out the curve. For us it's a learning process and we continue to have dialogue with market participants about the best way to go about domestic issuance.

Howell Given the volatility of the last few years, have your funding strategies changed? For example, are you trying to front-load borrowing as you come into the new year?

■ **KONTIO** MuniFin funds on an ongoing basis. So we don't have a strict internal guidance about what and how much we will issue on a quarter-by-quarter basis. For example, in 2011 we ended up in a situation where we had to close the doors after three months as we had funded 70 per cent of our needs in the first quarter. This year I think the situation is pretty good – we have funded 25-30 per cent of our €6 billion (US$7.9 billion) requirement. We wanted to avoid the situation we were in last year – which was difficult as we have always marketed ourselves as an investor-driven and flexible issuer.

■ **HOLMSTRÖM** Looking at agencies like those around this table, the lending for our institutions is very low-risk so there is no risk in our business operations. The risk lies in pre-funding liquidity portfolios – so in times of stress it is challenging to extensively add on to our liquidity. On top of this, regulations which dictate how much exposure we can have to counterparties also gives challenges for our asset managers to warehouse funds. The only solution if we do a lot of pre-funding – like we at MuniFin did in the first quarter of 2011 – is to try to lend out of the excess liquidity.

> "The numbers of municipalities in the Nordic region – between 300 and 400 – shows the difference in scale between the Nordic agencies and New Zealand's LGFA."
>
> **NICK HOWELL** WESTPAC INSTITUTIONAL BANK NEW ZEALAND

NORDIC LOVE AFFAIR WITH JAPAN

High-grade issuers from the Nordic region have long been able to source substantial volumes of cost-effective funding from Japan, primarily in the form of Uridashi transactions. They do not think there is any sign of a reduction in appetite from Japanese investors.

HOWELL **Do you get the sense that Uridashi appetite might drop off, and is this a risk for the Nordic agencies considering the quite substantial volumes issued to Japanese retail?**

AROSENIUS We are asked this from time to time – for example last year after the tsunami and earthquake. At that time we saw the opposite trend, with appetite growing. Each country or region has unique characteristics and the Nordic agencies have a long love affair with Japan. Those investors appreciate stability and good credit, so all of our agencies have been issuing a lot there for a long time. It's like a machine – deals just keep being printed. It is also our only retail market at Kommuninvest. But I do not think appetite will drop off any time soon.

ALESTRÖM We have noticed a trend of lower volumes in the Uridashi market in 2012. The market has been very resilient and increasing for us over the last several years and became a major pillar in our funding programme. We still expect to do large Uridashi volumes, but probably off the high of 2011. We are not, however, concerned about finding alternative funding in other markets where short- to medium-term funding is readily available.

HOLMSTRÖM I think one of the biggest reasons behind our success in that market is that as issuers we are all very flexible. We can look at almost any currency and any structure and you will see that we have issued a range of structures, currencies and maturities in the Japanese retail market. Not every issuer can do that – and that's why our proportion of funding sourced in Japan is quite high.

STOBO We have received feedback that there is interest in the Local Government Funding Agency (LGFA) from Japanese investors. This was demonstrated by the only other semi-government issuer in New Zealand that can issue in foreign currencies, Auckland Council. In March, Auckland Council issued a 10-year private placement to a Japanese buyer. We are definitely interested in hearing more about how that market works.

COMBES As you know, some of the very popular Uridashi currencies are AUD and NZD. Over the last several years we found that, instead of issuing in the Uridashi market, there has been a trend in Japan for retail investors to participate in managed trusts and for those fund managers to purchase bonds directly. So rather than going via a broker in the Uridashi market it has been possible for Australasian high-grade issuers to access Japanese retail investors by issuing government bonds directly to Japanese financial institutions. This has particularly been the case for Australian and New Zealand sovereign bonds.

For example, since the New Zealand Debt Management Office (NZDMO) last issued a Uridashi deal in 2003, the Uridashi market hasn't generated cheap enough pricing for it to issue in that format. So the NZDMO now sells its bonds, via tender counterparties, directly to financial institutions in Japan that manage various retail trusts. The LGFA will likely issue in that way first – whether in Aussie or Kiwi dollars.

"WE SAW A LARGER PROPORTION OF STRUCTURED PRIVATE PLACEMENTS IN JAPAN A FEW YEARS AGO, WHICH HAVE SINCE DISAPPEARED. BUT AFTER THIS THE RETAIL MARKET TOOK OVER ALL OF OUR FUNDING FROM JAPAN."

ANDREAS ALESTRÖM KOMMUNALBANKEN NORWAY

■ **LANDSTRÖM** Our funding target for this year is US$17-20 billion and so far we have issued 20-25 per cent of that. Like MuniFin, we try to fund throughout the year. However, we do limit tenors, especially on the short-dated three-month non-call structures, and we sometimes also limit the size of deals.

We cannot pre-fund very much as we have a liquidity reserve which is limited to 20-40 per cent of our lending. We invest this liquidity portfolio in very short-dated products from the sovereign, so having too much in this portfolio would result in a big negative carry – which we would like to avoid.

■ **ALESTRÖM** At KBN we have done about US$5 billion of our US$20 billion funding volume for 2012. We are quite liquid, to the point that we have to turn down funding enquiries on a daily basis – especially in the shorter range of the curve. We also cannot front-load funding too much and there are limitations on how liquid we can be. Like MuniFin and Kommuninvest we have also seen the increasing challenge to find sufficient high-quality short-term assets or banks to store liquidity.

In the last couple of months of 2011 there was a short period when we were not too active in the public space as the markets in general slowed down or shut. Also, after the Eksportfinans story we felt we needed to update investors before returning to benchmark markets. So we decided not to issue our planned third benchmark for the year. We returned to the USD benchmark market in February and I think the strategy to wait was the correct one. Spreads came in massively in the two weeks before launching the three-year at 48 basis points over mid-swaps, and it is now trading in the mid 20s. •