Bank+InsuranceHybridCapital Briefing

AT1s take off after NFP shock, but credit markets quickly come back down to earth

The outlook for credit markets is finely balanced after a week in which exuberance gave way to anxiety — but not before ABN Amro, Commerzbank and Nationwide smartly walked away with Additional Tier 1 transactions that tapped into the flood of central bank-pumped liquidity. *Neil Day* reports, with insights from Crédit Agricole CIB's financial institutions team.

ABN Amro and Commerzbank took advantage of surging credit markets to generate multi-billion euro order books for benchmark AT1 on Monday, but the latest bout of exuberance proved short-lived as optimism sparked by astounding US employment numbers gave way to concerns over recovery prospects and markets fell sharply into the end of the week.

Having already recovered dramatically from their March wides, credit markets engaged in their latest surge after nonfarm payrolls (NFP) on Friday blew away forecasts by showing the US economy to have put on 2.5m jobs in May, implying a fall in unemployment to 13.3% rather than the increase towards 20% that had been expected — even if the surprise number was met with scepticism in some quarters.

The US news came just a day after the European Central Bank's latest stimulus measures had surprised to the upside, with an increase to its Pandemic Emergency Purchase Programme (PEPP) coming in above expectations, at €600bn, taking the overall amount to €1.35tr, plus an extension until at least the end of June 2021 and redemptions reinvested until at least the end of 2022.

Additional Tier 1 (AT1) issues from ABN Amro and Commerzbank were among a slew of deals from financial institutions that hit the market on Monday and Tuesday, as issuers sought to take advantage of spreads approaching pre-crisis levels.

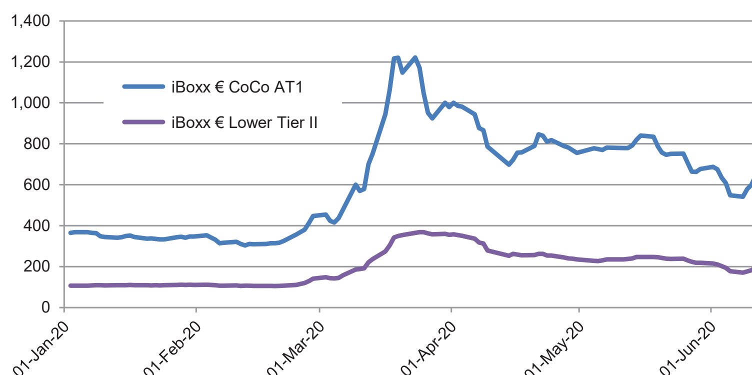
However, while the €2.25bn of AT1 issuance on Monday attracted some €18bn of orders in aggregate and the Dutch and German banks were able to tighten pricing as much as 1% to re-offer levels at or through fair value, demand subsided

on Tuesday and new issue premiums rose, as the market turned sharply. The downward move gained momentum on Wednesday as Federal Reserve chair Jerome Powell gave a downbeat assessment of recovery prospects and concerns over the number of coronavirus cases in the US rose.

"At least the week has demonstrated that in primary, deals can go extremely well, even if in the second half of the week things became more difficult," said Vincent Hoarau, head of FIG syndicate at Crédit Agricole. "Indeed, after the market rallied in the wake of the shocking NFP, the initial correction may have been healthy — in the eyes of many, we had come too far, too fast.

"But it is now clear that the overall backdrop is becoming more fragile, with the return of volatility. The reality is that many headlines are bad — GDP and unemployment forecasts released this week, in particular."

Secondary AT1 and Tier 2 performance



Source: Markit, Crédit Agricole CIB

Zurich rides out deteriorating market to score €750m success

Zurich Insurance launched a 30.25 year non-call 10.25 subordinated transaction into the toppish market on Tuesday, but was able to come away with an upsized €750m trade priced flat to fair value that held its own in the aftermarket.

The Swiss insurer entered the market on Tuesday morning alongside several other financial institutions, just as the strong rally that peaked amid Monday's AT1 frenzy *(see main article)* was fading, with ABN Amro's and Commerzbank's new issues soon trading below par.

"Essentially we had the first day of softness, with all the primary transactions taking that little bit more time to get done," said André Bonnal, FIG syndicate at Crédit Agricole CIB, joint bookrunner on Zurich's deal.

Initial price thoughts for the euro benchmark-sized 30.25 year non-call 10.25 year subordinated transaction were set at the mid-swaps plus 215bp area. Orders surpassed €1bn within around two hours, and after around three and a half hours guidance was revised to the 200bp area for an expected size of €500m on the back of over €1.5bn of demand. The books were closed less than half an hour later, with the spread set at 195bp for a €750m size, with around €1.2bn of orders good at re-offer.

The closest comparable for Zurich's new issue was a €500m February 2049 non-call February 2029 subordinated deal the insurer launched in February 2019, which was trading at 184bp over. That deal was launched by Zurich Insurance Company Ltd via a repackaging vehicle (Argentum Netherlands BV), whereas thanks to a change to Swiss tax law last year, it is now more efficient for Zurich to issue via Zurich Finance (Ireland) DAC, guaranteed by Zurich Insurance Company Ltd.

Based on Zurich's curve and also Allianz's — with the German having refreshed its curve with a €1bn 30 non-call 10 on 15 May — he said fair value was in the context of 195bp over.

"The 215bp IPTs were probably deemed aggressive," he added, "but — without having to tighten as much as some recent sub deals — they helped us achieve a successful outcome, particularly given the market backdrop.

"And the fact that we are still around re-offer when everything is wider today (Wednesday) is testament to the quality of the order book."

Asset managers were allocated 70% of the issue, insurance companies and pension funds 15%, central banks 9%, and banks 6%. France took 39%, the UK and Ireland 14%, Germany and Austria 11%, southern Europe 11%, the Nordics 9%, Switzerland 7%, the Netherlands 5%, and others 4%.

Bonnal said Zurich's new issue is in line with insurers proactively managing their solvency ratios in light of Covid-19 and taking advantage of the attractive levels available to them in the market. He noted that coupon and spread on the new €750m issue, at 1.875% and 195bp, were each lower than on Zurich's February 2019 €500m issue, which was priced at 2.75% and 220bp, respectively.

"Clearly a lot happened in the course of 2019 in terms of spread tightening," he said, "but this goes to show how much better levels are than at the beginning of 2019. This sub-2% coupon for the 30 non-call 10 structure is a very good level, all things considered." ●

The extent to which the latest leg of the recovery had swept all before it was borne out by the performance of higher beta peripherals, according to CACIB AT1 trader Nigel Brady, who noted that UniCredit 3.875% perpetual non-call 2027 paper, for example, had tightened some 20 points in the previous two weeks — before giving up around five points.

"That shows the extremeness of the moves that we've seen in many cases," he added.

While the upswing and subsequent downturn may have been based on low volumes by historical standards, recent performance has nevertheless been based on real money buying, said Brady.

"Across credit in general and particularly in the sub space, real money — many of whom were previously underinvested — has picked up the pace," he said. "It's quite clear that the stimulus money has fed through and the rally hasn't been led by the Asian private bank side, as is often the case, but by US real money in the dollar space and European real money buying euro deals."

Commerzbank's decision to come in euros rather than return to dollars, where it debuted last year, was a testament to this, he added.

Last Friday's nonfarm payrolls after the ECB's PEPP announcement were then the icing on the cake, according to Neel Shah, financial credit analyst at CACIB.

"Clients don't want to be behind the curve in terms of any rally," he said. "We saw this in Friday's move and the strength of issuance in the subordinated space on Monday."

With the correction earlier in the week having evolved into more of a rout yesterday (Thursday), the question now is whether investors view the latest move as a threat or an opportunity, according to Hoarau.

Crédit Agricole $1.5bn SNP hit a coda to tender, Tier 2

Crédit Agricole sold its first callable dollar senior non-preferred issue on Tuesday, a $1.5bn (€1.32bn) trade launched after it bought back some €3.3bn of senior preferred debt across euros, sterling and US dollars and issued a new €750m Tier 2, in an exercise aimed at rebalancing its liabilities in the context of surplus liquidity and growing TLAC/MREL needs.

On 30 May, the French bank opened US and European tenders targeting some €14.3bn-equivalent of senior preferred bonds and simultaneously launched the €750m 10 year non-call five Tier 2, offering European investors participating in the tender potential priority allocation. The liability management exercise is Crédit Agricole's largest ever.

(If reading electronically, click here for earlier coverage of the tender and Tier 2, and their rationale.)

When the tender concluded on Wednesday of last week (5 June), around $1.608bn nominal of the $3.650bn of dollar paper was bought back in the any-and-all US offer, giving a success rate of 44%, while €1.928bn-equivalent — 18% of the targeted euro and sterling paper, excluding a private placement — was bought back in the European offer, which was capped at €3.5bn.

Participation rates in the European offer were typically lower in the shorter dated targeted bonds, with the issuer attributing this to the market rallying strongly during the offer and making the offer less attractive for some investors. In the US offer, the highest coupon bond was the least tendered, with some large investors making an overall portfolio decision to retain it and tender the others, the bank said.

"This is the second liability management exercise done by Crédit Agricole this year and the largest ever, which has enabled the issuer to optimise its liability structure in an efficient way," said Véronique Diet Offner, in charge of liability management for EMEA and corporate hybrid structuring, DCM solutions and advisory, CACIB.

As well as offering investors liquidity, the tender for senior preferred debt allowed the French bank to reduce its excess liquidity, while the Tier 2 issue was the latest step in building up its TLAC/MREL-targeted buffers, which also included earlier senior non-preferred issuance in euros, yen and Australian dollars.

On Tuesday Crédit Agricole entered the dollar market with its latest senior non-preferred issue, a benchmark-sized six year non-call five fixed to floating note with a SOFR reset if not called. After being launched with IPTs of Treasuries plus 185bp, the deal had gathered strong momentum by mid-morning New York, with the book peaking at $5.5bn, allowing the issuer to revise pricing aggressively and launch the $1.5bn deal at plus 150bp.

Fadi Attia, managing director, US dollar FIG, at Crédit Agricole CIB, noted that the 35bp tightening compared with an average move of 27bp the same day, and that the issuer could hit the upper end of its size target and crystallise a negative 5bp new issue concession.

"The quality of the book was very high," he said, "incorporating most of the large US and London-based money managers. Despite announcing the deal NY hours, we were able to capture Asian buyers in the book."

Some 80% of the deal was sold into the US.

"The bonds traded at 145bp on the break," added Attia, "underscoring strong demand for the deal, which is a healthy yet modest rally relative to other Yankee bank supply priced over the past two weeks."

Market sentiment deteriorated later in the week, following the FOMC meeting *(see main article for more)*.

"The decision by CASA to access the market on Tuesday has proven to be well timed, given the significant market sell-off as the week came to a close," added Attia. "IG credit spreads traded 15bp-20bp wider on the weaker market sentiment." ●

"The level of cash is extremely high while many institutional investors did not benefit from the rally, particularly in equities," he said. "Are we moving towards a relapse where they get a second chance? If so, they are likely to again play the convergence and compression game — non-core tightening versus core, Tier 1 versus Tier 2, SNP versus senior preferred — given the relatively limited risk implied by bank subordinated instruments and the accommodating approach taken by the regulators.

"Still, the magnitude of the credit spread widening and equity losses on Thursday was impressive."

While acknowledging that calling the market's next move is tough, Hoarau argues that technical supports remain intact, with global central bank stimulus measures supporting economies and liquidity, and supply-demand dynamics helping.

"Behind the scenes, the EU news around the recovery fund continues to support valuations, while Powell's comments mean the 'lower for longer' rates mantra is now valid for the US," he said. "That should help even if he poured cold water on the prospect of a V-shape recovery — the global economy is in recession and entering into a new business era, and central banks and worldwide governments have never been so accommodating.

"However, there is room for disappointment at current valuation levels as the market was priced to perfection — at the beginning of the week, at least."

AT1 moves vindicated

Indeed, ABN Amro and Commerzbank could hardly have hoped for better outcomes when they approached the market on Monday.

"The deals were extremely well absorbed and multiple times oversubscribed," said Hoarau, "with issuers extracting zero or negative new issue concessions. The tightening of the AT1s by a full percentage point illustrated some of the signs of exuberance."

ABN Amro opened books with initial price thoughts (IPTs) of 5.25% to 5.5% for

its perpetual non-call 5.25 euro benchmark AT1, rated BBB- by Fitch. After an update putting orders above €5bn, guidance was set at 4.75% for a €1bn size. Books peaked above €10bn, with over €8bn of orders good at the final coupon of 4.375%.

Commerzbank went out with IPTs of the 7% area for its perpetual non-call six euro benchmark AT1, rated Ba2/BB- by Moody's and S&P. Guidance was later set at the 6.375% area on the back of more than €7bn of orders, and a €1.25bn deal was ultimately priced at 6.125% on the back of books above €9.5bn, pre-reconciliation.

Commerzbank's deal is the first off a €3bn AT1 issuance programme it established last month

"The first transaction under our new issuance programme has been met with great interest," said Commerzbank CFO Bettina Orlopp. "As a result, we were able to issue the bond with very good conditions.

"The further improved capital structure gives us additional leeway," she added.

The bank said the issuance strengthens and optimises its capital structure, and makes use of the recent regulatory changes whereby AT1 can now be used to a greater extent to meet capital requirements (SREP). Combined with Commerzbank's recent €750m Tier 2 issue, the AT1 reduces Commerzbank's CET1 requirement (MDA threshold) to 10.07% pro forma at the end of March 2020, it said.

Although the Dutch and German trades quickly fell below par on Tuesday, bankers said this was simply the result of them being caught up in the broad correction and the frothiness of order books in the toppy market, rather than reflective of their execution.

"The ABN Amro deal was priced at fair value and Commerzbank's slightly through value," said CACIB's Shah, "but even with a book eight times covered, there was little interest from investors to add in secondary, as the bonds fell from par to a cash price of 99.

"This just shows how quickly market sentiment changes and the quality of the order books."

The market nevertheless remained open through the first half of the week, and after La Banque Postale and Société Générale had sold senior non-preferred bonds on Monday, further financial institutions supply ensued on Tuesday, ranging from senior preferred — a €1.25bn six year non-call five UniCredit senior preferred issue at 160bp over mid-swaps and a €500m seven non-call six green bond from KBC (with CACIB as joint bookrunner) at 72bp — to an RBI €500m 12 non-call seven Tier 2 and a €750m 30.25 year non-call 10.25 subordinated trade from Zurich insurance *(see accompanying article for more)*.

By Wednesday, conditions had deteriorated to the extent that some issuers who had been eyeing the market decided to hold off.

However, Nationwide Building Society proceeded with a £750m (€836m) perpetual non-call 7.5 AT1 and was able to tighten pricing from IPTs of 6.25% to final pricing of 5.75% on the back of more than £4.5bn of demand, pre-reconciliation. Although the outcome was deemed wide of where the issuer might have priced at the start of the week, Nationwide said that it was worth going ahead given the risk of conditions deteriorating in the second half of the year, with Brexit an added concern for UK issuers.

"If you look at how markets have moved since ABN Amro, Commerzbank and Nationwide issued, their decision to pull the trigger has been vindicated," said CACIB's Hoarau. "They could have waited further in anticipation of a better funding level, but they were wise to adopt a realistic approach.

"They also enjoyed a bit of luck," he added. "Many issuers were in the pipeline and did not grab the window."

Should markets stabilise, financial institutions planning new issues are now expected to approach the market ahead of blackouts leading up to the second quarter reporting season from mid-July, which is viewed as the next potential risk to market sentiment in the calendar, alongside an EU summit where the bloc's resolve to tackle the Covid-19 crisis in cooperation will be tested.

The AT1 market meanwhile enjoyed some political relief early in the week, when it became clear that proposals by some Members of the European Parliament to subject AT1 coupons to similar prohibitions to bank bonuses and equity dividends came to nothing. ●

SpaceX photo credit: NASA/Bill Ingalls

League table: All financials (euros) 01/01/2020-05/06/2020

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	Crédit Agricole CIB	35	10,886	10.8
2	Société Générale CIB	24	7,405	7.4
3	Natixis	19	6,495	6.4
4	BNP Paribas	22	6,226	6.2
5	JP Morgan	31	5,993	6.0
6	Deutsche Bank	26	5,908	5.9
7	Barclays	23	5,831	5.8
8	HSBC	25	4,072	4.0
9	Lloyds Bank	5	3,240	3.2
10	Santander CIB	19	3,062	3.0
11	ING	17	3,036	3.0
12	UniCredit	20	2,734	2.7
13	BofA Merrill Lynch	19	2,680	2.7
14	UBS	14	2,603	2.6
15	NatWest Markets	15	2,568	2.5
	Total	153	100,723	

Includes banks, insurance and finance companies. Excludes equity-related and covered bonds, and publicly-owned institutions. Source: Thomson One Banker, Crédit Agricole CIB

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