

24 January 2021

Bank+InsuranceHybridCapital Briefing

Primary execution improves after subdued New Year start, as supply collapse hits home

The euro primary market last week recovered from a lacklustre opening, with financial institutions now able to take advantage of a severe supply-demand imbalance and benign conditions, and subordinated instruments finding most favour. *Neil Day* reports, with insights from Crédit Agricole CIB trading and syndicate in London and New York.

After an uncertain start to 2021 for the euro FIG market, the true extent of supply-demand dynamics hit home last week as issuance dried up, allowing for the new year's deals to perform and providing fertile ground for those banks approaching investors with trades.

From 13 January until Friday (22 January), only two new benchmark financial institutions issues hit the euro market, a €500m 10 year senior preferred issue for Erste Group Bank last Monday and a €1.75bn seven year senior HoldCo trade for Goldman Sachs on Thursday.

Supply of euro senior preferred/OpCo and senior non-preferred/HoldCo paper of €5bn and €10bn, respectively, is roughly half that of the first three weeks of January 2020. The contrast in more deeply subordinated instruments is even more stark, with year-to-date Tier 2 supply of €500m barely 10% of last year's €4.65bn, and AT1 issuance of €775m is down sharply from €2.8bn at the start of last year.

Although supply had been expected to be depressed, the first senior deals of the year achieved lower oversubscription levels — of around one and a half times — and slightly higher new issue premiums — around 5bp — than those typical of the second half of 2020.

"Despite the steady start to the year, pricing momentum was sometimes limited, and we did not see any proper blow-out in the euro senior unsecured segment," said Vincent Hoarau, head of FIG syndicate at Crédit Agricole CIB. "We need to bear in mind that we have come a very long way throughout the pandemic and valuation are extremely rich, and most of the time we are already back to pre-Covid levels."



Inside:

Dollars go from strength to strength despite USTs sell-off
— page 3

'Remarkable' result buoys early bird Abanca
— page 5

This was borne out by a €2bn dual-tranche senior preferred deal BPCE sold on 5 January, almost exactly a year on from a €2.25bn deal in 2020. A €750m six year tranche was priced at mid-swaps plus 48bp and a €1.25bn 10 year at plus 60bp, very close to January 2020's €1.5bn five year at 45bp and €750m 10 year at 55bp, while the re-offer yields were lower, at 0.032% and 0.325% versus 0.308% and 0.66%, respectively.

"Yields are negative in a big portion of the senior unsecured market," added Hoarau, "so it is not too big a surprise to acknowledge that books were slow to build in the lower beta end of the capital structure, with investors forced to buy in primary while lacking conviction."

"The higher beta the format and/

or credit, the bigger the order-book and the greater the price traction. Investor behaviour validates our belief that scope for performance and spread compression is only left in higher beta instruments."

Indeed, the highest oversubscription among 2021's year-to-date euro FIG supply was achieved on a €375m perpetual non-call 5.5 AT1 for Abanca on 7 January, whose €1.8bn book at re-offer was also larger than some of the senior benchmarks' on an absolute basis. The strong demand — above €2.1bn at its peak — allowed for pricing to be tightened from mid-to-high 6% down to 6%, with fair value put at around 6.25% by the leads, and for the size to be upped from an initially announced expected €350m.

André Bonnal, FIG syndicate at joint bookrunner CACIB, attributed part of the success of the trade to two days of premarketing before launch that encompassed around 40 accounts.

"It's a very good bank, but not the name you would expect to reopen the

subordinated space in euros,” he said. “It was really a question of considering the pros and cons of aiming for the first week versus waiting and risking more competing supply. While we were all expecting supply to be on the low side, it wasn’t apparent that we’d see as little as we got.

“In the end, it played out very well. Some parts of Europe were on holiday the day before launch, but it gave us another day to gather strong indication of interest from UK and French investors and we knew we would have a very well bid transaction the next day.”

See Abanca Q&A on page 5 for full coverage.

Banco Sabadell followed its compatriot into the market the next day (8 January) with the first euro Tier 2 of the year, a €500m 10 non-call five also jointly led by CACIB. Following initial price thoughts of the mid-swaps plus 330bp area, the deal was priced some 10bp inside fair value at 295bp on the back of a €1.4bn book, its 2.8 times coverage at the upper end of FIG supply.

“AT1 is the only part of the capital structure that still trades wide of pre-Covid levels,” said Bonnal, “and while Tier 2 may be flat to where it was, investors prefer it to the tight levels at which senior preferred and non-preferred trade — it’s the next best thing they can buy while retaining in many cases an investment grade rating.”

New issues rebound amid shortage
With equity markets weaker and government bond yields rising, the market entered the second week of the year on a softer note, and then Banco BPM approached the market on 12 January with a €400m perpetual non-call five AT1 just



Vincent Hoarau, CACIB:
‘The higher beta the format and/or credit, the bigger the order-book’

as the ruling Italian coalition government was threatening to fall apart. The transaction was priced in the middle of IPTs of the 6.5% area on the back of a €560m order book.

The underwhelming reception of new issues and their underperformance then contributed to the subsequent pause in euro primary market activity.

It just shows that the market is craving supply

“Issuers are in comfortable positions in terms of liquidity,” said Bonnal, “and they didn’t feel they needed to rush into primary in January, especially as some of the new issues were struggling in the secondary market.”

However, the subsequent pause in supply until last week and limited new issuance thereafter — with European banks entering blackout periods — only served to support the performance of the year’s early trades.

“As macro conditions turned, most of

those deals struggled quite badly, trading wide to re-offer,” said William Rabicano, director, credit trading, at CACIB. “But the expectations of additional supply simply didn’t materialise, and the new issues are now all trading back inside re-offer and outperforming.

“So there’s still cash to be put to work and the sheer lack of issuance means that any deals that come now will be well received and won’t have to pay much in the way of new issue premiums.”

This was evident in Goldman Sachs’s euro benchmark seven year senior Hold-Co on Thursday, where pricing was tightened from IPTs of the mid-swaps plus 90bp area to guidance of 70bp+/-2bp, WPIR, on the back of €3.75bn of orders, before the deal was sized at €1.75bn and priced at 68bp on the back of over €4bn of demand.

“They had a book above €2bn by around 9am UK time, whereas the earlier SNP trades were at around €1bn at the same stage of the process,” said Bonnal. “Everyone played in that trade and it’s the first proper big book we’ve seen year-to-date in seniors. It just shows that the market is craving supply.”

Rabicano nevertheless noted heightened price sensitivity among investors, highlighting that books on Erste’s €500m 10 year senior preferred benchmark last Monday fell from €1.7bn-plus at its 55bp-60bp over mid-swaps guidance to above €1.2bn at its 55bp re-offer.

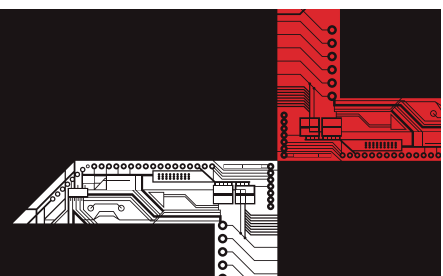
“It had a reasonable book, but this dropped dramatically on final terms,” he said, “so it seems that investors are going to be much stricter on where they are happy to own these new deals, and people are going to drop if they are tightened too much.”

(Article continues after US dollar box)



MAN CANNOT DISCOVER NEW OCEANS UNLESS HE HAS THE COURAGE TO LOSE SIGHT OF THE SHORE

Bloomberg: € = BGCS2 Global Directory = BGCP



Dollar market goes from strength to strength despite USTs sell-off

The US dollar market proved attractive for Yankee and US banks alike in the opening weeks of the year, with FIG issuance far exceeding supply in euros and funding levels proving more competitive across the capital structure.

On the first trading day of the year (4 January), Toronto-Dominion Bank kicked off senior preferred/OpCo supply and Sumitomo Mitsui Financial Group senior non-preferred/HoldCo with \$3bn (€2.46bn) and \$2.5bn of issuance, respectively. The Japanese issuer's TLAC-eligible deal was

split into four tranches, including a \$500m three year green bond jointly led by Crédit Agricole CIB, and attracted more than \$12.1bn of orders, allowing for pricing inside fair value.

AT1 and Tier 2 dollar issuance the next day alone exceeded such supply in euros across the first three weeks of the year, Standard Chartered selling a \$1.25bn AT1 on the second trading day of the year (5 January) and National Australia Bank and Crédit Agricole issuing \$1.25bn and \$1.5bn Tier 2s, respectively.

The French bank's 20 year bullet 144A/Reg S trade highlighted the savings available versus euros, coming some 20bp-25bp inside where a comparable euro trade might have been priced, after pricing was tightened from IPTs of the 140bp over Treasuries area to 110bp on the back of \$4.6bn of orders good at re-offer. While dollar AT1s have previously offered arbitrage versus euros, this has now spread to more senior parts of the capital structure.

"The Yankee bank space has been really active in dollars," said Fadi Attia, managing director, US dollar FIG, at Crédit Agricole CIB. "That's a function of significant buy-side liquidity and the fact that for much of last year the funding levels in euros for many of the Yankee banks were more competitive than in dollars, whereas this year there's a material funding cost saving that issuers can extract by taking funding out of dollars and swapping back to euros.

"This has been mainly driven by the strong relative out-performance of US dollar paper relative to euros on the secondary market coupled with the stable cross-currency basis."

The strong demand was most evident in Standard Chartered's \$1.25bn perpetual non-call 10 issue, which reopened



Fadi Attia, CACIB

the AT1 market for the year. It attracted some \$11.2bn of orders, allowing for pricing to be tightened from the 5.5% area to 4.75%.

"The deal was well received," said Attia, "and their ability to extend their non-call curve out to non-call 10 speaks to how robust the market is in that space."

While international banks approached the dollar market ahead of entering black-outs, US banks hit the market after the reporting season began on 15 January, with Wells Fargo kicking off supply on Tuesday

(19 January) with a \$3.51bn pref share issue. A book of some \$9.2bn allowed pricing to be tightened from the 4.375% area to 3.90% for the perpetual non-call five transaction.

"The Wells Fargo deal is another clear example that speaks to the fact that there's a wall of cash chasing subordinated product," said Attia. "You also see that in the Tier 2s, whether it's the 20 year Tier 2s that CASA and BNP Paribas have done or the NAB with an inverted credit spread curve."

As the cross-currency basis moves in favour of dollars, the attractions of the market for issuers will continue, particularly in the bank capital segment, according to Attia.

"Demand is holding up in spite of the sell-off in US Treasury rates," he said. "Whereas investors tend to shy away from adding AT1 during volatility in equities and rates, we haven't seen any signs of that so far. Real money investors have been either holding on to their positions or been net buyers on any movement wider in AT1. Capital is expected to be refinancing-driven as issuers look to optimize their existing stacks.

"And we haven't seen a panic sell-off — the migration of rates higher has been orderly, as the Fed is largely expected to step in and help create any excessive volatility. So the moves over the past couple of weeks have helped support the market compress spreads."

Overall supply meanwhile remains subdued on an historical basis, in spite of the relatively active start to the year.

"The market is expecting net supply this year to be a lot less than the last several years, including in the financial space," said Attia. "So it's certainly an area that continues to benefit from strong technicals." ●

Volatility low as risks take a backseat

The back-up in yields in US dollars across the first week of the year, with the 10 year Treasury rising from around 0.90% to above 1.10%, has meanwhile led to some selling of dollar AT1 by Asian investors, according to Nigel Brady, AT1 trader at CACIB.

"You are starting to look at a swing in the interest rate environment, with Asian retail tending to prefer equities over fixed income," he said. "They're very rate sensitive and also questioning whether 4.5% or 5% for AT1 makes sense when they were buying at 6% to 7% over the last couple of

years. They are taking profits where they can and my flows have been two to one in favour of sellers.

"But that's predominantly the Asian investor base," he added. "We've been able to recycle most of that because on the flipside we're seeing European and

US real money are still very much buyers. They're still constrained to fixed income and they still need to put money to work, and AT1s are still attractive versus IG and high yield."

While the euro market — with the exception of the Italian "wobble" — has outperformed the dollar market, Brady said AT1s in general have been very stable.

"Overall, we are in an environment of very low volatility," he said. "The year to date moves across the board have been very compressed, just plus or minus one point."

Brady sees a blow-out in rates as one of the only eventualities that could knock the market off course, alongside a correction in equities, but does not anticipate such a scenario.

"And I would expect it to be very short-lived," he added, "and any dip would be seen as a decent buying opportunity."

Like Brady, Hoarau sees markets' January resilience as reflective of their

focus on vaccination rates rather than infection rates when reflecting Covid-19 developments.

"Although lockdown is becoming the norm again," he said, "markets are focusing on the good news, as the reading of the first US non-farm payrolls of 2021 demonstrated: it was the ninth consecutive month of smaller payrolls, but investors focused on the signs of recovery in the readings, even if this is further away, somewhere in H2. Across the board, private sector demand is not there, but governments are doing the job with their budgetary weapons, and on top of that vaccination deployment brings positives into the room."

"There are some valuation concerns," added Hoarau, "but everyone is cognisant of the liquidity element and imbalance in the supply-demand dynamic, particularly in the FI world. With Biden in office, the political risk premium has disappeared, and more money is on the table with a

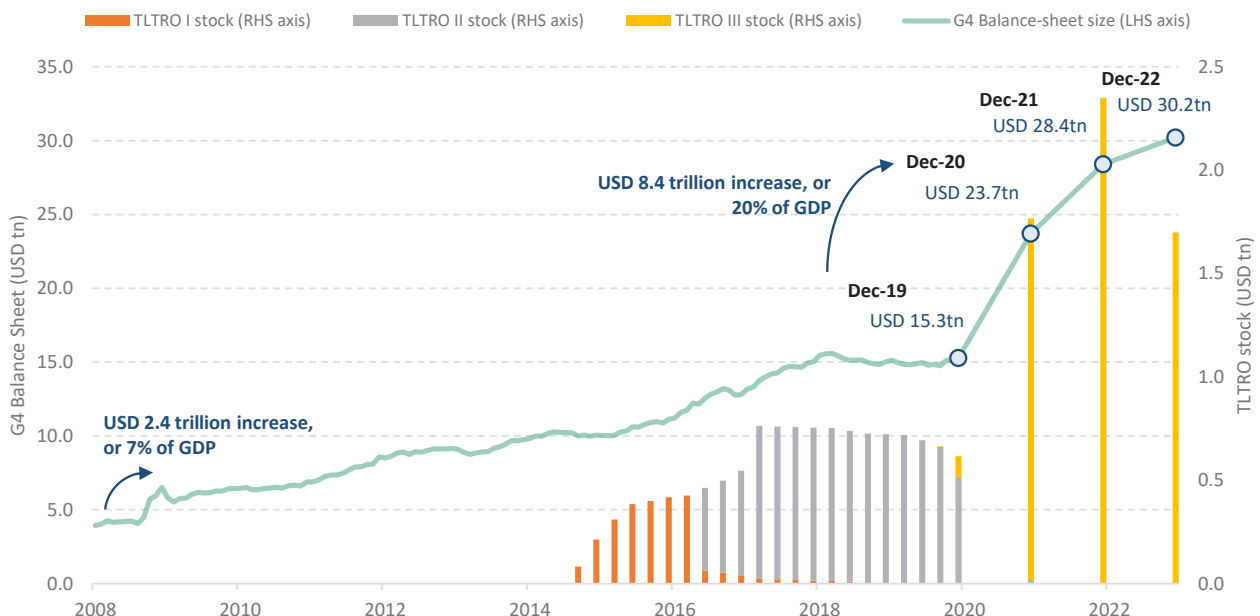
third stimulus package. And the earnings season should confirm that the micro economy is subsidised."

Regarding risk factors, Hoarau sees two that are not necessarily adequately priced into the market.

"The market isn't pricing in any probability of renewed tensions between the US and China, so this side of the equation could surprise at some point," he said. "Same for the German election and potential influence on ECB monetary policy: Germany — and its budget surplus — may not necessary be inclined to further support an expansionary policy."

"But again," he added, "neither of these are short term risks, and the powerful technical and liquidity supports currently in place are set to support further compression and tight spreads. Short term, we have a set of key inflation data coming out of Europe this coming week that will be scrutinised as it could move the direction of rates." ●

G4 Central Bank Balance Sheet Development & Forecast plus ECB TLTRO Facilities



Source: Bloomberg, Crédit Agricole CIB

**Why not visit us online at
bihcapital.com?**

'Remarkable' result buoys early bird Abanca

Abanca opened the euro subordinated space for 2021 with its second AT1 on 7 January, a €375m perpetual non-call 5.5 trade that attracted over 200 accounts and achieved pricing inside fair value. Alberto de Francisco Guisasola, CFO (pictured left), and Juan Luis Vargas-Zúñiga Mendoza, general manager, capital markets, institutional distribution and management, at Abanca, discussed the Spanish bank's approach to the new issue and broader strategy with *Bank+Insurance Hybrid Capital*.

Bank+Insurance Hybrid Capital:
What was the rationale behind your AT1 transaction?

Abanca: Abanca's objective in this transaction is to continue strengthening and diversifying its capital structure in order to comply with regulatory requirements. With this second AT1 debt issue, Abanca increases its capital ratio by 120bp and meets such debt buffer as is required by the authorities. In addition, the issuance allows the release of CET1 that the bank had been allocating to cover the part of the P2R that can be covered with AT1, increasing the buffer of the highest quality capital.

BIHC: You reopened the euro AT1 market for 2021. Did you have any hesitation about being first into an untested market? Why did you choose to come so early in the year rather than later?

Abanca: We felt comfortable with the market opening after the Christmas period and the read-outs it gave after Monday's session. Our joint lead managers proved paramount in assessing the risks and rewards of tapping the market so early in 2021. In our view, the risks of waiting further into a year so full of uncertainties outweighed those implicit in playing the role of early bird. And after seeing how the market received our bond, that proved to be the case.

BIHC: What were the key messages to investors during the marketing exercise in relation to your strategy, capital position or other topics? What did investors focus on?



Abanca: The issues discussed with investors during the marketing exercise were diverse and spanned all the major aspects of Abanca's business, governance and strategy. These would be the three main topics:

Strategy

The first thing to highlight is the execution record of accomplishments performed by the bank. Since 2014, it has consistently met the targets of its strategic plan and been able to generate 8%-9% returns.

The strategy has been based on three main points:

- Transformation towards a simpler, cooperative and innovative company
- Improvement of the customer experience through multi-channel management with best-in-class support.
- Generation of recurring profitability thanks to the: i) growth of the banking business (organically and inorganically), increasing its presence in business lines aimed at companies or means of payment; ii) the diversification of income sources (thanks to the development of insurance businesses and asset management); and iii) efficient use of capital when generating profitability.

Capital position

Sound capital ratios and ample buffers above regulatory requirements, as well as the bank's capability to generate recurrent capital.

Impact of Covid-19 on asset quality

Four points are important when it comes to understanding the good performance of Abanca in the first nine months of 2020 and the bank's soundness to face the uncertain recovery scenario:

- Differential entry point: Abanca faces this pandemic as one of the best entities in the Spanish financial system (NPL ratio of 2.6%, NPL coverage of 66%, and Texas ratio of 31%). Despite this, Abanca has made a significant effort in terms of credit provisions during the first nine months of the year (€210m allocated).
- Galicia, the core territory for Abanca due to its presence as a clear leader in the region, presents a better performance at the macroeconomic level than that presented by both Spain in general and other regions in particular.
- The exposure of Abanca's portfolio of companies and self-employed people to the most vulnerable sectors is lower than that of other competitors.
- Abanca has been very proactive in channelling the aid offered by the authorities to companies and households. These have helped and help Abanca customers to cope with this adverse transitory situation.

Examples of other aspects covered

during the marketing exercise are:

- M&A strategy and current vision on the latest movements in the system
- Update of the latest acquisition announced by Abanca (Bankoia)
- The funding plan of the bank
- ESG positioning and developments in this matter
- The bank's capability to maintain those profitability levels shown in recent years despite the adverse interest rate environment.



BIHC: How important was the marketing exercise to the overall process and result?

Abanca: Our marketing exercise has to be understood in light of our broad strategy of being as close to our investor base and as transparent as we can be. The roadshow of 5 and 6 January was just fine tuning of this long term commitment to our investor base, tailored towards an AT1 issue — we tried to a) address whatever doubt they might have about the issue or the bank at the time we decided to go to the market, and b) gather intel about their stance on an eventual AT1 Abanca bond.

BIHC: How do you feel about the outcome?

Abanca: We feel extremely happy, not only about the absolute figures, which speak for themselves, but also because it proves our approach to MREL issuance makes sense, in that we understand the whole process to be a long term — if not permanent — task, tackling the most junior instruments first and building from there upwards. The fact that we came from a book of 70 investors in our first AT1 to a 200+ book in this latest one, after issuing two Tier 2 in between, speaks loudly about the market liking this approach. And we feel this is very pertinent, because even after the tightening from IPTs, keeping over 180 individual orders in the book gave

us comfort about the final conditions, especially after printing a 6% bond, which is quite remarkable given the rest of our AT1 and Tier 2s' conditions. We feel it's worth noting that not only in terms of coupon — this AT1 is 150bp below the one we printed in February 2018 — but also the spread over swaps is substantially tighter — from 732.6bp to 657bp, reflecting what we feel is a better perception of our bank, and greater confidence in our long term business model.

BIHC: How did the level of demand and pricing compare with your hopes and expectations?

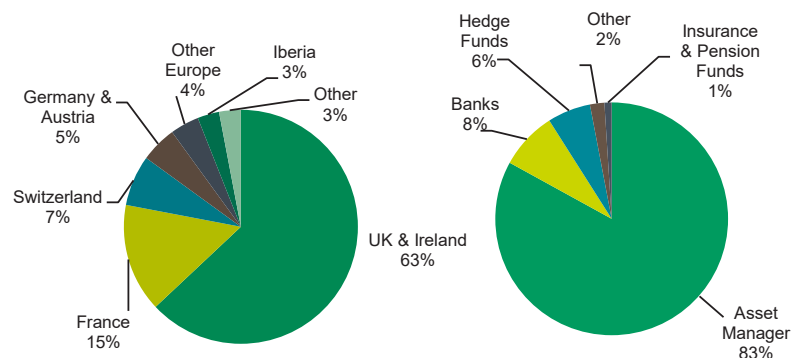
Abanca: Although we felt we had a good chance of hitting a sweet spot by launching so early in 2021, and that feeling was backed by very strong investor feedback from our roadshow,

we used a bit of caution at IPTs. But very soon the book showed its robustness, reaching two times oversubscription in approximately half an hour. The book grew steadily, giving a hint of a 6% landing zone, which was a bit better than expected. Anyway, the raw pricing is not as important on this occasion as the volume of demand and, perhaps even more importantly, the sheer number of individual investors that cared to show their interest in our paper. We are both delighted and grateful in equal measure about this.

BIHC: Can we expect to see any further issuance from Abanca in 2021?

Abanca: When we printed our first AT1 in 2018, we told investors that we will be a recurrent issuer. This is a commitment that we take very seriously and, within reason for our size and what market conditions dictate, we are committed to complying with it. We have filled our AT1 bucket with this last bond and we had already done the same with our Tier 2 bucket last year, so we anticipate no more issuance of these two particular MREL categories in the near future. We have yet to issue senior preferred/senior non-preferred paper, but we don't expect to do so within the first half of 2021. Maybe the latter half could see that, but we are definitely not in a hurry to issue anything at this point in time. ●

Distribution by geography and investor type



Source: Crédit Agricole CIB

Disclaimer

This material has been prepared by Crédit Agricole Corporate and Investment Bank or one of its affiliates (collectively "Crédit Agricole CIB"). It does not constitute "investment research" as defined by the Financial Conduct Authority and is provided for information purposes only. It is not to be construed as a solicitation or an offer to buy or sell any financial instruments and has no regard to the specific investment objectives, financial situation or particular needs of any recipient. Crédit Agricole CIB does not act as an advisor to any recipient of this material, nor owe any recipient any fiduciary duty and nothing in this material should be construed as financial, legal, tax, accounting or other advice. Recipients should make their own independent appraisal of this material and obtain independent professional advice from legal, tax, accounting or other appropriate professional advisers before embarking on any course of action. The information in this material is based on publicly available information and although it has been compiled or obtained from sources believed to be reliable, such information has not been independently verified and no guarantee, representation or warranty, express or implied, is made as to its accuracy, completeness or correctness. This material may contain information from third parties. Crédit Agricole CIB has not independently verified the accuracy of such third-party information and shall not be responsible or liable, directly or indirectly, for any damage or loss caused or alleged to be caused by or in connection with the use of or reliance on this information. Information in this material is subject to change without notice. Crédit Agricole CIB is under no obligation to update information previously provided to recipients. Crédit Agricole CIB is also under no obligation to continue to provide recipients with the information contained in this material and may at any time in its sole discretion stop providing such information. Investments in financial instruments carry significant risk, including the possible loss of the principal amount invested. This material may contain assumptions or include projections, forecasts, yields or returns, scenario analyses and proposed or expected portfolio compositions. Actual events or conditions may not be consistent with, and may differ materially from, those assumed. Past performance is not a guarantee or indication of future results. The price, value of or income from any of the financial products or services mentioned herein can fall as well as rise and investors may make losses. Any prices provided herein (other than those that are identified as being historical) are indicative only and do not represent firm quotes as to either price or size. Financial instruments denominated in a foreign currency are subject to exchange rate fluctuations, which may have an adverse effect on the price or value of an investment in such products. None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party without the prior express written permission of Crédit Agricole CIB. No liability is accepted by Crédit Agricole CIB for any damages, losses or costs (whether direct, indirect or consequential) that may arise from any use of, or reliance upon, this material. This material is not directed at, or intended for distribution to or use by, any person or entity domiciled or resident in any jurisdiction where such distribution, publication, availability or use would be contrary to applicable laws or regulations of such jurisdictions. Recipients of this material should inform themselves about and observe any applicable legal or regulatory requirements in relation to the distribution or possession of this document to or in that jurisdiction. In this respect, Crédit Agricole CIB does not accept any liability to any person in relation to the distribution or possession of this document to or in any jurisdiction.

United States of America: The delivery of this material to any person in the United States shall not be deemed a recommendation to effect any transactions in any security mentioned herein or an endorsement of any opinion expressed herein. Recipients of this material in the United States wishing to effect a transaction in any security mentioned herein should do so by contacting Crédit Agricole Securities (USA), Inc. United Kingdom: Crédit Agricole Corporate and Investment Bank is authorised by the Autorité de Contrôle Prudentiel et de Résolution (ACPR) and supervised by the ACPR and the Autorité des Marchés Financiers (AMF) in France and subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority. Details about the extent of our regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from us on request. Crédit Agricole Corporate and Investment Bank is incorporated in France and registered in England & Wales. Registered number: FC008194. Registered office: Broadwalk House, 5 Appold Street, London, EC2A 2DA.

© 2021, CRÉDIT AGRICOLE CORPORATE AND INVESTMENT BANK. All rights reserved.