Bank+InsuranceHybridCapital Briefing

Euro bank debt recovers strongly to reopen ahead of Easter, as rate outlook improves

The resumption of euro unsecured bank issuance today (Tuesday) comes on the back of a rapid recovery from post-SVB and Credit Suisse lows, with even AT1s having rebounded strongly. The ball is now in the court of central banks, whose balancing of inflation and financial stability missions could shape market dynamics. *Neil Day* reports, with insights from Crédit Agricole CIB syndicate and DCM Solutions.

BNP Paribas reopened unsecured bank issuance in euros today with a €1bn eight year non-call seven senior non-preferred (SNP) green bond, following a strong recovery in spreads, with an increasingly benign macroeconomic outlook combining with receding bank fears to spur activity.

The French bank's new issue is the first euro bank supply outside covered bonds since 9 March, just before the failure of Silicon Valley Bank. The new issue came at the same time that Axa reopened the euro subordinated FIG market with a €1bn 20.25 non-call 10.25 Tier 2 blowout this morning *(see article below)*.

After going out with initial price thoughts of the mid-swaps plus 140bp area for the eight non-call seven SNP benchmark, BNP Paribas priced its new issue at 137bp on the back of a book of more than €1.85bn, with orders having earlier surpassed €2bn.

The pricing was arguably as much as 10bp-15bp inside the issuer's conventional curve, although fair value based on its green secondaries was elsewhere seen at around 125bp, and hence 135bp for a new conventional issue, implying a new issue premium of a couple of basis points.

Price stability, or financial stability?

A successful reopening of the market had been anticipated early this week on the back of a dramatic improvement in sentiment.

"What we have seen in today's market is a 180 degree turnaround in risk appetite compared to where we were 10 days ago," said Vincent Hoarau, head of FI syndicate at Crédit Agricole CIB. "We had the feeling this morning that the cooling inflation figures and constructive rate outlook would be a strong factor for new bond issuance, and that is exactly what we saw today, particularly with Axa.

"In terms of quality and granularity, the book was exceptional and you can feel that investors don't want to miss out. They know that the bulk of the rate hikes are behind us and don't want to be in a position where they are chasing paper in the secondary market."

Already last week, the iTraxx Crossover had recovered more than 125bp of ground from its 20 March peak, and André Bonnal, FI syndicate at Crédit Agricole CIB, noted that buyside momentum continued into the start of this week.

"The market has been on a very good tightening trend," he said. "We have seen strong ETF flows pretty much buying indiscriminately on the lows, and even if these flows are small, this has helped bring pretty much everything tighter, especially with the lack of supply there's

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Axa €1bn Tier 2 restarts sub debt, after insurance outperforms

Axa issued the first euro subordinated FIG transaction in four weeks today (Tuesday), a €1bn 20.25 year non-call 10.25 Tier 2 that attracted some €4.6bn of demand and landed at a new issue premium of just 10bp, reflecting both the insurance sector's attractions and the broader recovery in FIG market sentiment.

The new issue is the first euro sub debt from an insurance company or bank since 7 March, after which the crises of Silicon Valley Bank and Credit Suisse put paid to issuance plans. The French insurer's deal is also the first subordinated insurance trade in euros since 11 January, when CNP Assurances sold a €500m 30.5 non-call 10.5 sustainable Tier 2 debut.

With a view to managing its call schedule over the coming years, Axa hit the market this morning with initial price thoughts of the mid-swaps plus 295bp area for the 20.25 non-call 10.25 benchmark, expected ratings A2/A- (Moody's/S&P). The size and spread were then set in one step at €1bn — the issuer's target size — and 260bp on the back of €3bn of demand, and the order book good at re-offer totalled €4.6bn.

André Bonnal, FI syndicate at joint bookrunner Crédit Agricole CIB, said the lack of insurance supply played in Axa's favour, in conjunction with an emergent duration bid and the issuer's strong profile.

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been — we've had three weeks of nothing but covered bonds and one funding agreement-backed note."

Candidates who could build on the reopening of unsecured issuance include those banks that have thus far this year been less active but are now keen not to fall behind in their funding, as well as second tier names who preferred to wait for national champions to restart supply.

"I expect such issuers will be prepared to pay the price for getting something done and also keen to take volume," said Hoarau. "It's clear from the past few weeks that the market can be quite volatile, if not shut completely.

"Had this been a normal week with four actionable days, we would have seen more follow-on issuance," he added, "but the long Easter weekend presents something of an obstacle, and some issuers will be happy to wait until afterwards."

Today's reopening came after market participants could last week refocus on fundamentals after a fortnight of firefighting.

"It was the first, so to speak, quiet week," said Hoarau. "The market turned back to the macroeconomic situation and inflation figures, while the absence of bad news fuelled a strong tone towards risk assets."

The sentiment was reflected in two year US Treasury yields backing up to around 4.20% last week after they had fallen from above 5% to below 3.80% amid the fallout from the demises of Silicon Valley Bank and Credit Suisse.

Yield curves in the US and Europe meanwhile became less inverted, and macroeconomic data released last week affirmed dovish hopes.

"In the US, inflation numbers remain fairly elevated, but the trend of cooling inflation has definitely been confirmed by the latest data," said Hoarau. "It's certainly still too high for many Fed officials, but at least it's going in the right direction and there is a consensus that the end of the tightening cycle is approaching."

The PCE index fell to 5.0% in February, coming in slightly lower than expected in Friday's release, while the previous month's figure was revised downwards. The market is now pricing in 50:50 chances of either no increase or a 25bp hike at the next FOMC meeting on 3 May, and then a pause, with rate cuts anticipated by year-end.

Eurozone figures released on Friday painted a more complicated picture, with headline CPI falling from 8.5% to 6.9% in March, but core inflation — the European Central Bank's main focus — accelerating from 7.4% in February to a historic high of 7.5%. The market is pricing in 75bp of rate hikes across May, June and July — possibly front-loaded — but a pause thereafter as the prevailing situation is considered.

"We've had some good numbers and some bad," said Bonnal, "but clearly it still remains at elevated levels. That's the inflation part of the story, but there is another force at play, namely financial stability.

"Will central banks have to take that into account in their overall monetary policy strategy? So the direction will obviously depend on forthcoming inflation numbers, but also the level of stress we may have in the financial system in the coming weeks and months."

In spite of the encouraging developments, last week remained another blank week for unsecured and subordinated FIG supply in euros. In the meantime, covered bonds again demonstrated their resilience, as CIBC on the Monday (27 March) restarted euro FIG supply after two blank weeks with a successful €1.5bn four year trade at mid-swaps plus 33bp, kickstarting €9.25bn of supply via four deals in the asset class, and a further €3bn via three deals followed today.

"Covered bonds are playing a key role and will continue to do so," said Hoarau. "We had close to €10bn of deals last week, with everything smoothly digested, strong oversubscription levels, and good granularity.

"NIPs have been fairly limited, in the context of the mid-single-digits, which is impressive given what has happened in the banking system in recent weeks," he added. "Don't forget that when we reopened after Covid, new issue concessions were in the high single-digits, if not 10bp, with spreads somewhere in the 40s for three to five years."

Euro benchmark covered bond issuance of some €86bn for the first quarter is the second highest ever (after 2011), and overall euro-denominated FIG supply still remains well above the run-rate of recent years, at more than €190bn for the first three months of the year *(see table over)*.

"That is despite three weeks of the primary market being starved of supply," said Hoarau, "which illustrates just how heavily FIG borrowers have been frontloading activity. That reflects the normalisation of funding programmes as we exit QE and loose monetary policies."

And in spite of the ongoing post mortem of Credit Suisse Additional Tier 1, the most deeply subordinated bank asset class has recovered strongly from its lows, raising the prospect of an AT1 reopening sooner rather than later. Bottom-fishing from UK and French accounts amid a favourable rate environment supplemented by Asian interest has seen many AT1s trading back at par.

"The tone has recovered swiftly," said Hoarau, "and it feels like primary market would be open for very strong names.

"Looking ahead, considering the strong capital metric, legal framework and support seen from regulators in Europe, we anticipate a constructive consolidation of the sector and a solid recovery."

But while the market may be normalising, the lessons of the Credit Suisse write-down will not be completely forgotten in a hurry. Greater discrimination is expected among investors towards jurisdictions, credits and structures, while issuers' attitudes towards calling or not calling AT1 will be critical.

"Some investors have left the asset class and will not come back, particularly if outright interest rates remain elevated," said Hoarau.

"There are enough alternatives around with a high coupon but where capital is less subject to destruction." ●

"The trade worked out beautifully," he said. "We had the feeling that the bid for duration would be very strong, given that the market now believes terminal rates are going to be reached sooner rather than later, and these kinds of yields are likely to disappear, so it makes sense for investors to load on duration. That really helped the transaction as well as the scarcity value that has been building alongside modest supply expectations in regards to insurance.

"We had all of the big asset managers that count in insurance sub in the book and could even have fully allocated the transaction with the top six counts alone."

The leads saw fair value at the mid-swaps plus 250bp area, citing Axa 4.25% 2043 non-call 2032s at 245bp and taking into account the short curve extension. The leads' fair value calculations were done on an i-spread basis to the reset date rather than the first call date, i.e. putting it at a tighter level than might otherwise have been seen.

"Ultimately, there was a strong consensus that this was going to be a successful and attractive trade even at 260bp," said Bonnal, "which is just 10bp of new issue premium — quite skinny, if you consider the turmoil we have seen in the market."

The performance of insurance debt since the failure of SVB and emergency takeover of Credit Suisse had earlier suggested investors were acknowledging the sector's differences to the banking industry. The iBoxx Insurance Subordinated index, for instance, outperformed the iBoxx Euro Banks Tier 2 index in the wake of the US bank's collapse, and went on to trade inside its bank counterpart as fears over the Swiss bank mounted *(see chart over)*.

"It makes sense that we've seen this outperformance," said Bonnal. "Just as the EU banking sector was never really in the same situation as the US banking sector, the insurance sector is clearly further away from being in a similar situation.

"The illiquidity of the insurance sector has also played a little bit in favour of insurers," he added.

Insurance paper could not, however, fully escape the market turmoil, with Tier 2 debt early this week still some 20bp-30bp wider than pre-SVB, while Restricted Tier 1 (RT1) were two to four points lower on a cash basis after a substantial rally since last week, having traded as much as eight to 10 points lower after news of the write-down of Credit Suisse AT1 emerged.

"Clearly the market was hurt," noted Bonnal, "but similarly to the rest of the financial sector, there hasn't been any panic-selling; this was a remarking exercise that has now stopped and we are already closing on the pre-SVB levels across the capital structure."

Euro FIG supply (EUR bn)

Seniority	YTD 2020	YTD 2021	YTD 2022	YTD 2023
Covered	48,300	22,700	72,000	89,325
FABS	800	500	500	2,250
SP/OpCo	14,000	18,800	19,200	44,050
SNP/HoldCo	39,750	36,800	34,850	40,850
Tier 3			500	
Tier 2	5,770	8,050	7,050	8,250
AT1	5,590	1,275	1,150	6,200
Grand Total	114,210	88,125	135,250	190,925

Source: Crédit Agricole CIB

Insurance differences supportive

The write-down of some $17bn of Credit Suisse Additional Tier 1 (AT1) has nevertheless led to increased scrutiny of not only deeply subordinated bank instruments, but also their insurance counterparts, namely RT1. Investors are keener than ever to understand the fine print of both the structural features of the instrument, and the resolution process issuers would face.

Furthermore, insurance companies are far from immune from the impact of the sharp increases in yields that were at the centre of the failure of Silicon Valley Bank (SVB).

According to Michael Benyaya, co-head of DCM solutions and advisory at Crédit Agricole CIB, the insurance sector offers comfort on all three fronts — rates, RT1, and resolution — even if there are risks that need to be understood.

"Rising interest rates are viewed as a positive for the insurance sector, especially the life insurance sector" he said. "But it's not 100% positive."

Life insurance companies are exposed to rising interest rates: on the asset side — e.g. unrealised losses on bonds; in their liabilities — the risk of policyholders trying to redeem policies early, i.e. "lapse" risk; and through derivatives exposures, via margin calls.

"We saw that as of year-end 2022, IFRS equity massively decreased last year due to increasing unrealised losses on bond investments," said Benyaya, "while Solvency 2 sensitivities show that a further increase in rates versus end-2022 levels would be

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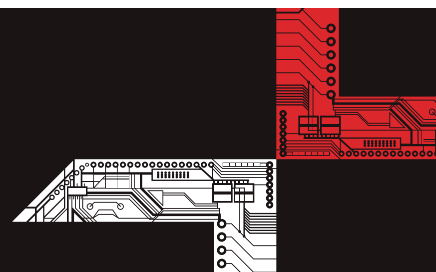

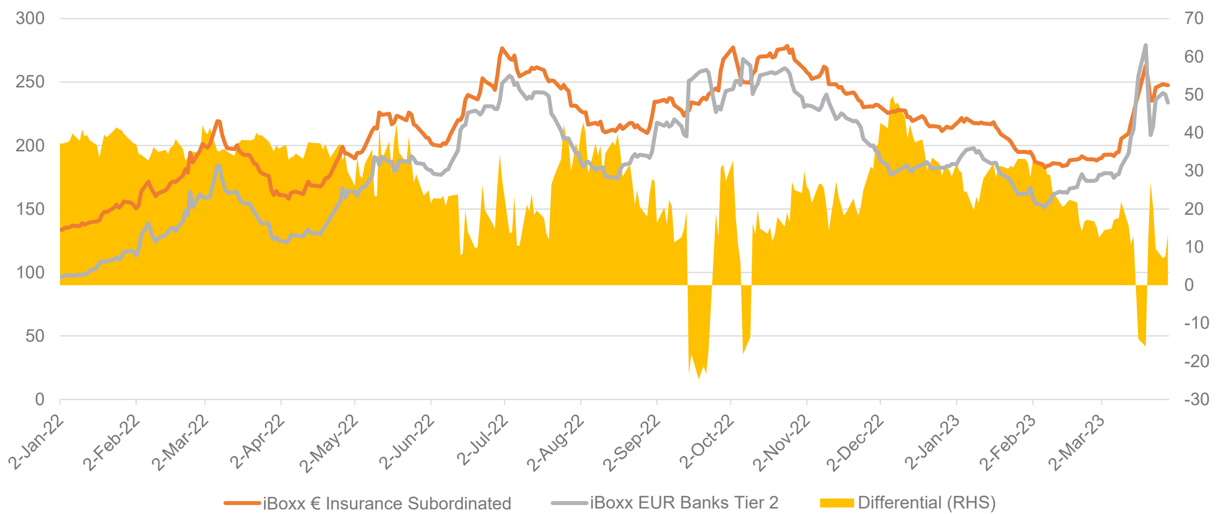

Source: Markit, Bloomberg, Crédit Agricole CIB

marginally positive or even negative for some insurance companies. So far, these are just accounting moves; the question is whether insurance companies would have to crystalise these losses and sell such bonds to meet policyholder redemptions.

"But lapse risk is generally very low and manageable — insurance liabilities, including life insurance policies, are not usually very liquid. It's not that straightforward to redeem early a life insurance policy and there could be penalties attached or a loss in the tax benefit. So the prospect of a bank run-type scenario for insurance companies is still pretty remote."

Italian life insurer Eurovita was nevertheless placed into extraordinary administration last week after Italian insurance regulator IVASS had in February placed it into temporary administration and suspended redemptions of its savings policies following a high volume of surrender requests. The company had also deferred interest payments on two Tier 2 bonds based on mandatory deferral clauses and its weak financial position.

Fitch said last month that Eurovita's fate highlights the risks that rapidly rising rates can pose to weaker insurers, but noted that its circumstances are different from those of other life companies, including its compatriots'.

Regarding resolution, a key difference between AT1 and RT1 is that the insurance instruments generally only contain a loss absorption trigger based on solvency requirement ratios (the Solvency Capital Requirement (SCR) and/or Minimum Capital Requirement (MCR)).

"With the exception of the Netherlands, there is no bail-in regime applicable to insurance companies," said Benyaya, "so there is no statutory loss absorption provision included in RT1 terms and conditions."

An Insurance Recovery & Resolution Directive (IRRD) akin to the Bank Recovery & Resolution Directive (BRRD) is in the making in the EU, which could be implemented in 2025-2026. This will introduce a bail-in power, amongst other resolution tools, for supervisors, who will hence have the power to impose losses on bondholders in the context of an insurance company resolution.

"However," noted Benyaya, "this clearly states that any bail-in will be subject to the 'no creditor worse off' (NCWO) principle and therefore applied as per the hierarchy of claims — as enshrined also in the BRRD."

RT1 or Tier 2?

Going forward, the insurance sector could draw support from its limited size and ongoing modest supply expectations. The circa €20bn-equivalent of outstandings in the RT1 sector, for instance, are dwarfed by the circa €250bn AT1 market, and in a first quarter when euro bank issuance has been breaking records, only two subordinated insurance euro deals have been launched before today — a €750m 10 year senior issue from Axa and CNP Assurances' €500m Tier 2 sustainability debut (joint bookrunner Crédit Agricole CIB), both in the opening fortnight of January.

Less than €15bn of insurance sub debt is coming up for redemption or call this year, but ahead of the market's recent disruption, a pick-up in RT1 supply had been deemed possible in light of an increase in redemptions and calls in 2024 and 2025, in particular related to legacy perpetual grandfathered Tier 1 debt issued in 2014 and early 2015.

"In an ideal scenario, a few insurers would have been looking to pre-finance these bonds early with RT1," said Bonnal. "But even if the RT1 market has outperformed AT1, overall levels are wider than a month ago, and issuers might want to wait a bit and potentially see AT1 supply before themselves testing appetite from investors in deeply subordinated bonds.

"The big question is what kind of split are we going to have between Tier 2 and RT1?"

Indeed, Benyaya expects that, with Tier 2 capacity available, a number of insurers could fall back on the less junior instrument for refinancing the legacy Tier 1 rather than seek to raise RT1, but that many will wait before taking a decision. ●

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