Bank+InsuranceHybridCapital Briefing

Banks capitulate amid relentless volatility, but Handelsbanken Tier 2 reopens sub debt

Svenska Handelsbanken headlined brisk FIG supply in euros last week, with the first bank sub debt issue since early April, as investors showed themselves ready to engage at wider levels. Other issuers found their options more limited, but seized what was available in a bid to progress funding plans. *Neil Day* reports, with insights from Crédit Agricole CIB syndicate, trading and DCM solutions.

Svenska Handelsbanken issued the first euro subordinated bank debt in seven weeks on Tuesday, a €500m 11 year non-call six Tier 2 deal that, alongside a €1.25bn 20.8 non-call 10.8 Tier 2 for Axa, demonstrated strong execution to be available for the right names and instruments, even if others settled for more defensive trades in the face of stubbornly high volatility.

The two new issues — along with a €500m 10.25 non-call 5.25 Tier 2 from insurer Athora Netherlands on Tuesday — represent the first subordinated financial institutions issuance in euros since the first full week of April, when a Banco BPM €300m perpetual non-call five AT1 on April 5 was followed by a €500m six non-call five Tier 2 for Zürcher Kantonalbank the next day.

On Tuesday, Svenska Handelsbanken was able to tighten pricing from initial price thoughts of the mid-swaps plus 200bp area for its €500m expected size deal to a re-offer of 180bp on the back of some €1.25bn of demand, thereby limiting its new issue premium to around 10bp — at the lower end of that paid on preceding senior preferred and senior non-preferred supply.

"If you look at what has been working recently, clearly lower beta spread product — including core Eurozone covered bonds — has been a harder sell," said Vincent Hoarau, head of FI syndicate at Crédit Agricole CIB, "while subordinated debt from core names at post repricing wide levels has been very well received.

"When it comes to duration," he added, "sensitivity is very high, particularly in the senior space. Investors are increasingly selective, and we are seeing a more pronounced fragmentation, with the depth of some parts of the credit market questionable, even if the primary market continues to offer very good funding for national champions."

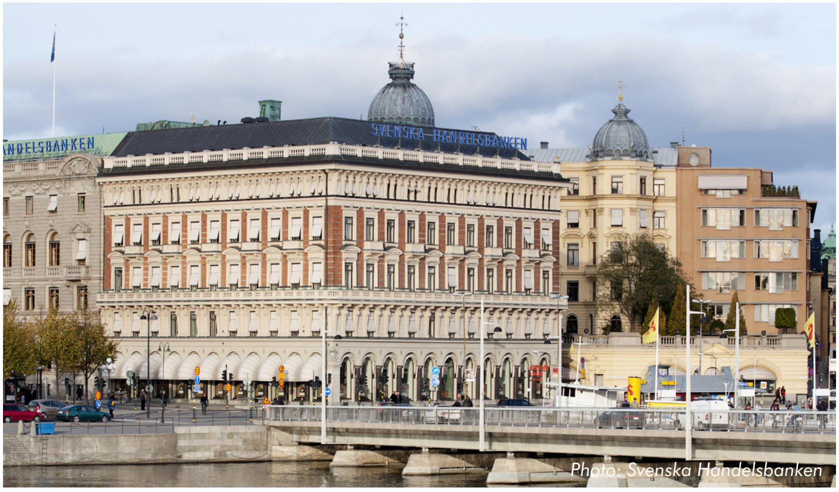


Photo: Svenska Handelsbanken

The less attractive options available to some were demonstrated by Credit Suisse on Monday, when it approached the market with a €1.75bn two year OpCo issue split into €1bn fixed and €750m floating rate tranches and paid triple-digit spreads. The Swiss bank tightened pricing 15bp during execution to mid-swaps plus 120bp and three month Euribor plus 123bp, respectively, and, on the back of a roughly 1.5 times covered book, paid new issue premiums of around 20bp on each — with the coupon on the two year fixed tranche relatively closed to where, less than two months ago, BNP Paribas set the re-offer yield for a 10 non-call five euro Tier 2.

Société Générale also tapped the short end on Monday, selling a €1bn three non-call two senior preferred issue at mid-swaps plus 60bp alongside a €1bn seven year tranche at 110bp. A €1.5bn dual-tranche green SNP issue from ABN Amro, incorporating five and 10 year tranches, and a €750m four non-call three senior preferred from DNB (Crédit Agricole CIB joint bookrunner) on Tuesday were able to resist the worst of the market's tendencies, but bankers noted that issuers in general need to be pragmatic in the face of prevailing dynamics.

"What we have seen even more this past fortnight is that more and more issuers are losing patience and just capitulating, printing at levels they would never have expected to accept a month ago," said Hoarau, "because they all realise that the wait-and-see mode doesn't pay off at all. Inflation may be getting out of control and the war in Ukraine is going on longer than anyone could have expected in February — nobody expects the situation to improve anytime soon.

"What we have seen for some weeks now is that markets are struggling to stabilise."

EU bank supply has at best achieved a run-rate only just commensurate with full-year forecasts from Crédit Agricole CIB, according to financials analyst Neel Shah. Year-to-date issuance of senior bail-in-able debt is 45% of that expected this year, while senior preferred is less than 41%, Tier 2 less than 33%, and AT1 less than 26% of forecasts for the full year.

"In any window of stability, issuers have come to the market but been largely focused on the senior side, with duration skewed towards the shorter end," said Shah, "with the cuspier names erring on the side of caution by issuing in senior preferred, and the stronger names more in SNP.

"Svenska Handelsbanken was a good test of the Tier 2 market after it was closed for a couple of months and that went fairly well," he added. "So the better banks can issue, but the weaker banks have to be cautious in terms of the tenor and where in the capital structure they're issuing."

The volatility that has infected the market has been exacerbated by a lack of liquidity, according to Jeremy Gardner, head of financials credit trading at Crédit Agricole CIB.

The yo-yo sentiment of 2022 continues

"Liquidity is the worst I've seen it in a very long time," he said. "Street positioning feels very, very light, and the market is very one way or the other — either you can't buy bonds, or you can't sell them.

"It's still functioning to a degree in senior preferreds and non-preferreds, but the AT1 market's completely broken — there's not an offer in sight today."

The most recent swings in sentiment have emanated from the US, where the previous week key retailers reported disappointing earnings, prompting a sell-off in equities amid recession fears, with Federal Reserve chair Jerome Powell and then Fed minutes reinforcing monetary tightening expectations. Sentiment nevertheless improved towards the end of last week, amid positive signs on the earnings and inflation fronts, causing a rebound in credit and equities, with US indices posting their first week's gain in six weeks — although the moves were seen as a bear market bounce in some quarters.

"The yo-yo sentiment of 2022 continues," said William Rabicano, director, credit trading, at Crédit Agricole CIB. "All one-way sellers Monday, Tuesday and Wednesday morning, but since Wednesday lunchtime, it appears someone hit a switch and it has been all back the other way in one straight line.

"Given the volatility," he added, "it is hard to see how things will change in the short term, with dealers still fearful of being caught out one way or the other." ●

Selected recent euro financial institutions issuance

Issue date	Issuer	Format	Size (m)	Coupon	Maturity	Re-offer spread	IPTs/ guidance	NIP	Books	Cover
04-May	SEB	SP/OpCo	1000	1.750%	Nov-26	42	60a	10	1400	1.4x
05-May	Morgan Stanley	SNP/HoldCo	1500	2.103%	05/26NC05/25	88	110a	13	2750	1.8x
05-May	Morgan Stanley	SNP/HoldCo	1500	2.950%	05/32NC05/31	123	145a	13	2600	1.7x
16-May	ING Groep NV	SNP/HoldCo	1500	2.125%	05/26NC05/25	110	135a	5	2680	1.8x
16-May	Nordea Bank Abp	SNP/HoldCo	1000	2.500%	May-29	105	125a	12	2300	2.3x
17-May	NAB	SP/OpCo	1000	2.125%	May-28	72	95a	7	2300	2.3x
17-May	Deutsche Bank	SNP/HoldCo	500	3.250%	05/28NC05/27	193	215a	13	3000	6.0x
18-May	BNP Paribas	SNP/HoldCo	1500	2.750%	07/28NC07/27	137	160a	15	3500	2.3x
18-May	BPER Banca	SP/OpCo	500	3.375%	06/25NC05/24	245	265a	27.5	850	1.7x
18-May	BBVA	SP/OpCo	1250	1.750%	Nov-25	60	80a	10	1850	1.5x
18-May	BBVA	SP/OpCo	500	FRN	Nov-25	64	84a	10	675	1.4x
18-May	Swedbank	SP/OpCo	1000	2.100%	May-27	70	90a	8	1550	1.6x
20-May	NatWest	SP/OpCo	750	2.000%	Aug-25	90	105a	17	900	1.2x
20-May	NatWest	SP/OpCo	500	FRN	Aug-25	94	109a	17	600	1.2x
23-May	Credit Suisse	SP/OpCo	750	FRN	May-24	123	138a	20	1000	1.3x
23-May	Credit Suisse	SP/OpCo	1000	2.125%	May-24	120	135a	20	1600	1.6x
23-May	Societe Generale	SP/OpCo	1000	1.500%	05/25NC05/24	60	80a	10	1500	1.5x
23-May	Societe Generale	SP/OpCo	1000	2.625%	May-29	110	125a	15	1600	1.6x
24-May	ABN Amro Bank NV	SNP/HoldCo	750	2.375%	Jun-27	110	120a	15	1000	1.3x
24-May	ABN Amro Bank NV	SNP/HoldCo	750	3.000%	Jun-32	135	150a	20	1200	1.6x
24-May	Axa SA	Tier 2	1250	4.250%	03/43NC09/32	260	285a	20	2250	1.8x
24-May	Athora Netherlands	Tier 2	500	5.375%	08/32NC05/27	5.375%/401	5.75%a	37.5	950	1.9x
24-May	DNB Bank ASA	SP/OpCo	750	1.625%	05/26NC05/25	58	75a	12	825	1.1x
24-May	Svenska Handelsbanken	Tier 2	500	3.250%	06/33NC06/28	180	200a	10	1250	2.5x
25-May	Allianz SE	Tier 2	1250	4.252%	07/52NC01/32	255	270a	27.5	1900	1.5x
25-May	Barclays	SNP/HoldCo	1000	2.885%	01/27NC01/26	168	190a	18	2300	2.3x

Source: Crédit Agricole CIB

Axa hits ‘entry point’ to sell €1.25bn Tier 2

Axa attracted some €2.25bn of orders to a €1.25bn 20.8 non-call 10.8 Tier 2 transaction on Tuesday, in the first sub insurance trade in euros since 6 April, as investors took the opportunity to pick up the top name at higher spreads and yields, with Athora and Allianz joining in the burst of insurance issuance.

The French company’s deal was only the second sub insurance trade in euros since Russia’s invasion of Ukraine, the prior having been a €500m eight year Tier 3 for Mapfre on 6 April, and Axa was joined by Athora Netherland with a €500m Tier 2 on Tuesday.

Axa approached the market on the back of upgrades to A+ from S&P and Fitch on 11 and 16 May, respectively, and after a €1.25bn 20.5 non-call 10.5 Tier 2 in January.

Following initial price thoughts of the mid-swaps plus 285bp area for the new March 2043 non-call March 2033 benchmark, expected ratings A3 (on review for upgrade)/A-/A-, the spread was set at 260bp with orders peaking above €2.55bn, pre-reconciliation, and the final demand was above €2.25bn — the biggest book amid a flurry of FIG issuance in the first half of the week.

“Given the widening of spreads and back-up in rates, we have very quickly gotten to an environment where investors really see value,” said André Bonnal, FIG syndicate at joint bookrunner Crédit Agricole CIB.

He noted that while Axa’s January transaction was issued at a coupon of 1.875%, the new issue just four months later was priced at 4.25%.

“And coming just after the upgrades,” said Bonnal, “it was particularly good timing from Axa — the combination of yield and rating here is really interesting for a lot of accounts. The fact that it was UK accounts that led the way with triple-digit tickets shows they see value at these levels.

“The only question mark was to what extent the lack of bid for duration would impact execution,” he added. “Some investors clearly preferred the shorter part of Axa’s curve, but we still got more than €2.5bn of demand at the peak, so enough accounts saw this as a good entry point to more than counterweight those who were less keen.”

With fair value at around 240bp, Axa was priced with a new issue premium of around 20bp following IPTs reflecting a pick-up of around 45bp.

“Investors realised that even if we tightened 20bp-25bp, there would still be a decent NIP attached to the deal in line with what we have been seeing on average in these volatile markets,” said Bonnal.

Axa’s outcome compared favourably with what Allianz achieved when following its peer into the market the next day — the German on Wednesday priced a €1.25bn 30.1 non-call 10.1, expected ratings A2/A+, at 255bp on the back of €1.9bn book, following IPTs of the 270bp area and with a NIP of around 27.5bp.

“On a curve-adjusted basis, Axa priced flat to Allianz, whereas normally you have a differential,” said Bonnal. “Allianz was a very good trade — they were pragmatic in acknowledging they were coming second, and with a strategy that seemed to focus on size rather than price.”

Athora Netherlands also took advantage of the window of opportunity, on Tuesday issuing its €500m 10.25 non-call 5.25 deal at a coupon of 5.375%, equivalent to mid-swaps plus 401bp, on the back of a book of some €950m, following IPTs of the 5.75% area and offering a NIP of around 37.5bp.

Bonnal noted that, being only rated by Fitch, Athora could opt for a shorter-dated structure — the deal has an expected rating of BBB-, while Athora was upgraded from BBB+ to A- on 9 May.

“The result is that they can offer investors what they want,” he said, “which is subordinated risk with less duration. That enabled a less well-followed name like Athora to get close to €1bn of orders for a €500m trade and move pricing significantly tighter, even if it still offers a chunky pick-up versus their curve.”

The deal was also supported by a tender for Athora’s $575m (€536m) 6.25% perpetual non-call November 2022 notes, which were issued under its previous Vivat name. ●

Groundhog market: Extension risk is back

Extension risk came into sharp focus in the subordinated debt market on Tuesday as investors witnessed a Tier 2 non-call as well as a consent solicitation seeking to ensure full AT1/MREL eligibility but perceived by the market community as potentially increasing non-call risk.

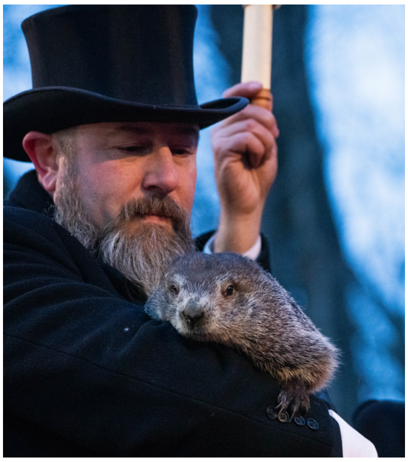
Deutsche Pfandbriefbank (pbb) announced it will not be calling a €300m Tier 2 issue next month, sparking recollections of Deutsche Bank's unprecedented decision not to call a Tier 2 back in December 2008, which at the time caused fallout for the wider sub debt market. Pbb's non-call is the first non-call of a Basel III Tier 2 instrument by a EU bank since the Great Financial Crisis — Turkey's Garanti Bank also recently did not call a $750m Tier 2 issue.

Germany's pbb had in the week of May 16 announced that it had mandated banks to arrange investor calls to explore a potential €300m no-grow 10.25 non-call 5.25 Tier 2 transaction. The announcement came ahead of the call date of 28 June for a €300m 2.875% Tier 2 issued in 2017. Last Tuesday (May 24) it then announced that it had decided not to pursue a new Tier 2 issue and that it will not call the outstanding issue.

"The decision not to refinance the bond with a new Tier 2 instrument has been taken after careful evaluation of various factors, including market conditions, economic costs, and the recognition of the bond in terms of Tier 2 capital as well as MREL," the bank said. "Further, the decision does not change the overall approach towards pbb's fixed income stakeholders.

"Pbb would like to thank all investors for their engagement and feedback during recent days."

Whereas calculating the economics of not calling an AT1 is relatively simple, given that the regulatory value of the instrument remains the same, it is less so for Tier 2 versus a new issue, given that a non-called issue counts less and less towards Tier 2, but will count as subordinated MREL for four years and then offer funding in the final year prior to maturity.



"Calculating this 'blended cost' of Tier 2, MREL and funding content is not necessarily a straightforward exercise," said Doncho Donchev, DCM solutions, Crédit Agricole CIB, "but understanding it is of critical importance for investors in order to anticipate potential Tier 2 call decisions."

Pbb's non-called Tier 2 issue will reset to a coupon of around 4.15% in June (reset of 2.75%). Following the non-call announcement, the pbb Tier 2's price settled at around 93.7, implying a secondary spread of around 420bp-425bp for a five year bullet Tier 2 and clearly a higher new issue price for a 10 non-call five.

The market's reaction to the non-call was more measured than when pbb's compatriot did likewise some 14 years ago.

"We've come to a stage where if you have to call an issue, whether that's an AT1 or Tier 2, the market is such that for some of these calls, the price you would have to pay for the replacement issue would be higher than the price attached to a non-call," said Donchev. "But whereas not calling was previously a bit of a taboo, the fact that some issuers have not called AT1 has helped it become to a certain extent an accepted feature of the market, which will perhaps encourage more issuers now to look at Tier 2 on a purely economic basis, too.

"I think the issuer went about it the right way," he added, "in dialogue with investors via the roadshow, exploring whether they could bridge the gap between the cost of refinancing and not calling."

Whereas for a bank a Tier 2 non-call results in having a Tier 2/MREL/funding hybrid, from an investor perspective, "a Tier 2 remains a Tier 2" in terms of risk profile and subordination, noted Donchev. However, he said that mitigating against a wider market impact was the sub-investment grade rating and smaller size of the non-called issue, meaning that it is not included in the major credit indices.

"The impact of a non-call of an investment grade, index-eligible, liquid Tier 2 by a large European bank would be much greater," he added.

As a single bond can cover an issuer's complete Tier 2 structural needs, the significance of the recent non-call may be most relevant for small to mid-sized banks across Europe, who may be tempted to tap material cost savings.

Italy's Intesa Sanpaolo meanwhile launched a consent solicitation seeking to make two AT1 instruments MREL and AT1-compliant after 28 June 2025, when their CRR2 grandfathering treatment would otherwise cease. The two issues are a €750m 6.25% perpetual non-call May 2024 and a €1.25bn 7.75% perpetual non-call January 2027.

The decision to seek investor approval to amend the terms of the issue callable in May 2024 raised eyebrows, since it could anyway be called ahead of the change in regulatory treatment. Indeed, the deal is among AT1 that have been bid up precisely because a call ahead of the end of grandfathering has been anticipated, with Intesa's issue also having a high reset spread, in line with earlier AT1 vintages.

"Given the heightened sensitivity around extension risk — particularly with a Tier 2 non-call the same day — investors may focus on the fact that this could now flip into a perpetual bond," said Donchev. "As for the longer-dated bond, investors may be additionally inclined to participate to avoid a possibility of being called at par while the bond may be trading above par closer to June 2025."

The consent solicitation exercises for the AT1 issues are separate, allowing the holders and economics of each to determine the respective outcome.

Donchev meanwhile noted that non-call exercises and potential funding cost savings banks can thereby gain are a reminder of the going concern value of AT1 instruments at a time when the Bank of England and European Central Bank have raised question marks over the prudential usefulness of the products. ●

Photo: Punxsutawney Phil, Groundhog Day 2022; Credit: Anthony Quintano/Flickr

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