In association with CRÉDIT AGRICOLE CORPORATE & INVESTMENT BANK

1 June 2021

Bank+InsuranceHybridCapital Briefing

Dollar bank capital hits new highs as rates stabilise, overshadowing cautious euro mart

With rates markets having stabilised after a bout of uncertainty, the US credit market last week experienced renewed momentum, allowing an array of European banks to achieve stronger outcomes than available in a more hesitant euro market. *Neil Day* reports, with insights from Crédit Agricole CIB trading and syndicate in London and New York.

European financial institutions experienced strong outcomes across the capital stack in dollars last week, as the US credit market went from strength to strength, overshadowing the euro FIG sector, where issuers had to account for heightened sensitivity among investors.

The exceptional conditions in the US were demonstrated by UBS Group on Tuesday achieving the lowest ever coupon on a dollar AT1 from a European issuer, 3.875% on its $750m (€615m) perpetual non-call five deal. Pricing was tightened from initial price thoughts (IPTs) of the 4.5%-4.625% area on the back of some $4.4bn of demand, with the final level flat to slightly through fair value.

Connor Prochnow, US debt syndicate, Crédit Agricole CIB, said the pricing represented a breakthrough that demonstrated the rude health of the sector.

"Four percent had been something of an unofficial floor for that market for some time," he said, "so when you see them being able to print at 3.875%, that speaks to the pent-up demand for that segment of the capital stack."

He noted that the potential for such successful issuance had been suggested by the recent performance of a $2bn dual-tranche AT1 issued by HSBC Holdings at the beginning of March. After struggling to perform amid the rates volatility that afflicted the market from mid-February onwards, the $1bn perpetual non-call five and perpetual non-call 10 tranches had now recovered to trade above par.

"Over the beginning of Q2, when the market was trying to adjust to the new rate dynamic and its uncertain trajectory, it was a little tough for capital deals to get done," said Prochnow. "But now that we have settled into a comfortable trading range, and with the risk tone on the dollar side still very robust, that is allowing for deals on both the high quality side and for some of the higher beta names."

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Intesa Sanpaolo had on Monday opened dollar subordinated issuance for the week with a $1.5bn dual-tranche Tier 2 trade, its first in the dollar market since 2016. The Italian issuer launched $750m 11 non-call 10 and 21 non-call 20 tranches, and was able to tighten pricing from IPTs of the 300bp area and 305bp area over Treasuries, respectively, to 260bp and 275bp.

"They paid a healthy concession," said Prochnow, "but traded meaningfully tighter, around 15bp-20bp, on the break, which is indicative of the state of the market.

"In this environment, where both rates and spread product are trending towards historical tights, anything like this which comes with a pick-up is going to attract investors' attention and catch a strong bid."

Deutsche Bank and UniCredit were similarly able to benefit from the trend last week. Deutsche achieved levels flat to marginally through fair value for $1bn three year senior preferred and $1.5bn 11 non-call 10 senior non-preferred tranches, tightening pricing from Treasuries plus 80bp-85bp and the 180bp area, respectively, to 60bp and 148bp on the back of a combined $13bn-plus of orders.

UniCredit attracted an aggregate $6bn-plus of orders to a $2bn dual-tranche senior non-preferred deal, split into $1bn six non-call five and 11 non-call 10 trades. Pricing was tightened from the Treasuries plus 145bp area to 120bp for the shorter tranche, and from the 180bp area to 155bp for the longer.

The Yankee issuance came despite the euro/dollar cross-currency basis swap

being at its lowest level since 2015, with the outperformance of US credit markets more than compensating for that.

Euro NIPs edge higher

Indeed, dollar issuance far exceeded financial institutions activity in euros, which was more tentative last week, with a lack of hybrid issuance, save for a €200m (DKK1.5bn) perpetual non-call eight AT1 for Jyske Bank on Wednesday. Only four benchmark trades hit the market, three senior non-preferred and one senior preferred.

In spite of the easing of rates volatility, investors remain watchful for renewed inflation warnings, according to Vincent Hoarau, head of FI syndicate at CACIB, and with credit spreads at or near historic tights, this has pushed new issue premiums higher.

"A couple of weeks ago, before the latest NFP and CPI data, everything was coming bang on the curve," he said, "but the dynamic has changed a little, and if you want to deliver a reasonable outcome you have to pay up a bit."

This was borne out by senior non-preferred trades for ABN Amro and Banque Fédérative du Crédit Mutuel (BFCM) this week.

BFCM went out with IPTs of the 100bp over mid-swaps area for a €1.5bn seven and a half year SNP and was able to tighten pricing 23bp to 77bp on the back of an order book of some €2.4bn, ending with a new issue premium of around 3bp. ABN Amro paid a new issue premium of around 5bp after attracting around €1.6bn of demand to a €1bn 12 year SNP issue and tightening pricing from 100bp-105bp to 83bp.

"Even taking into account the size they were seeking, they came with quite generous levels, and delivered outstanding results in terms of subscription ratio and secondary market performance," said Hoarau.

Landesbank Hessen-Thüringen (Helaba) was able to take a different tack when coming with a €500m eight year trade that was its first green bond and first senior non-preferred issue, with Hoarau at joint bookrunner CACIB highlighting the limited deal size and green nature of the deal as key to the outcome. Following initial guidance of 70bp-75bp, the German bank could tighten to 53bp on the back of some €970m of orders and achieve pricing around 2bp inside fair value.

"In line with the bank's sustainability strategy, we want to position Helaba as a fully sustainable issuer across all funding instruments on the refinancing side, too," said Helaba treasurer Dirk Mewesen. "Strong demand from investors for our green bond indicates that we are on the right track with our approach."

A €500m 10 year senior preferred issue for KBC found the going tougher. Although the Belgian bank could tighten pricing from 80bp-85bp to 65bp on the back of a €800m book, the new issue widened 3bp-4bp in the secondary market.

Caution, but no fear

William Rabicano, director, credit trading, at CACIB, said that although investors are proving more selective and stricter on price, the resultant order books can nevertheless be higher quality.

"Books may be smaller than we're used to, but one of the reasons is that you're seeing less fast money because they're not comfortable with how deals are breaking," he said. "This means the final books are real and the bonds are in strong hands. That may be why most of this week's deals have performed so well — we've seen very little selling and, if anything, there's been top-up buying.

"There's a bit more nervousness around AT1s, given how susceptible that sector is to large moves in rates, but even there we still see this buy-the-dip mentality."

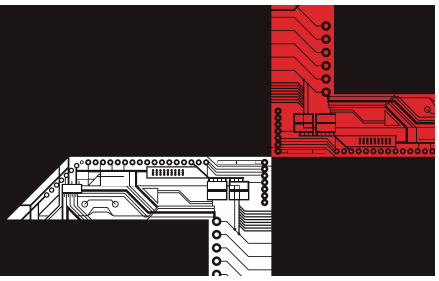
Neel Shah, financials credit analyst at CACIB, noted that investors' concerns on rates and preference for shorter maturities have been reflected in issuance, with the longest AT1 benchmark in any currency since March being a non-call seven, for example, whereas most supply in the first two months of the year was focused on non-call 10 structures.

"There's definitely more sensitivity among investors in terms of the duration risk they are taking," he said, "and I expect more appetite for short duration in the primary market and also the secondary market."

Hoarau expects the market to become increasingly focused on economic datapoints, with US rather than Eurozone numbers the more likely to cause any disruption, given the more advanced stage it is at in the recovery than Europe. However, he expects conditions to remain benign going into the summer break.

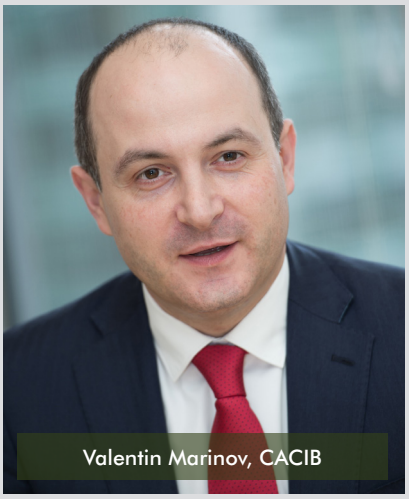
"No one feels the rush to issue now ahead of the June ECB or Fed meetings," he said. "Everyone is pretty relaxed at the moment, with no concern whatsoever towards market evolution in the coming weeks or month."

As this report was going to press this (Tuesday) morning, Belfius Bank entered the market with its inaugural green bond, a €500m no-grow six year senior non-preferred deal with IPTs of the mid-swaps plus 80bp area, with CACIB green structurer alongside Belfius and a joint bookrunner. MUFG was also in the market, with a six year non-call five euro benchmark HoldCo transaction at IPTs of 80bp-85bp. ●



Managed taper anticipated from September, wider EUR/USD XCCY

Persistent signs of a burgeoning US recovery over the summer could lead to the FOMC signalling its tapering strategy as early as the August Jackson Hole central bank symposium or the September policy meeting, according to Valentin Marinov, head of G10 FX research and strategy at Crédit Agricole CIB, with growing divergence between dollar and euro rates putting widening pressure on the cross-currency basis swap.


Valentin Marinov, CACIB

Although markets have reined in earlier expectations of Fed action since the March meeting, US CPI jumped to 4.2% in April and inflation figures are expected to continue to overshoot in the coming months. Marinov says this could prompt FOMC members to adopt a more hawkish stance at the September meetings, while bringing forward their expectations of future rate hikes from 2024 to 2023 as described in the so-called dot plot.

"By September, the Fed will have an updated set of forecasts with a sufficient number of data points on growth, inflation and labour markets to potentially conclude that less monetary stimulus is needed, and then proceed towards tapering by the end of Q1 next year," he says.

However, he expects the process to play out differently to the "taper tantrum" in 2013 that preceded the announcement of tapering in December that year. Then, Treasury yields backed up ahead of the official announcement, before gradually falling over the next three years.

The Fed will try to avoid taper tantrum as much as possible

Marinov expects 10 year Treasury yields to head towards 2% in early 2022 from around 1.6% today, and remain around that level for some time.

"In the current conditions, the Fed will try to avoid taper tantrum as much as possible," he says. "I expect some adjustment in rates, but I wouldn't think it's going to be as aggressive as what you've seen in the past, because since last August the Fed has adopted the average inflation targeting framework, which is by definition more dovish compared to their previous policy stance.

"They could announce that from January they are going to gradually cut the pace of purchases, but remain vigilant and maintain a fairly stable rates outlook, albeit with the new start of the tightening cycle in 2023."

With Eurozone rates expected to be kept at "rock bottom", such US developments could lead to a widening of the euro/dollar cross-currency basis swap, which has recently hit historic lows, according to Marinov, after it widened into March upon earlier inflation fears.

"Global liquidity conditions have warranted very tight spreads," he says, "but growing divergence in the policy outlook will essentially mean that we could see a renewed rewidening of those spreads."

Contributing to the recent retightening has been an overhang of liquidity deriving from a $1tr reduction in the Treasury General Account, announced in February, which has kept US money market rates depressed, according to Marinov. He expects the downward pressure exerted by this to ease once the reduction is completed this month.

Meanwhile, a successful extension to the debt ceiling next month and renewed spending by the Biden administration and Treasury borrowing could absorb more liquidity — with the Fed otherwise potentially acting to put a floor under money market rates, if necessary, by hiking the interest rate on excess reserves or signalling a willingness to increase the repo rate, for example.

Higher Treasury yields could also encourage greater foreign demand, which Marinov notes has remained below recent highs despite the return on hedged purchases having improved significantly for Eurozone and Japanese investors this year. The very tight euro/dollar cross-currency basis swap spread at present may nevertheless partly reflect growing demand for short-dollar hedges by Eurozone investors in Treasuries. That said, a potential bear flattening of the Treasury yield curve in the wake of the QE taper announcement could make a significant increase in the demand for short-dollar hedges less likely in the coming months.

Meanwhile, tighter funding conditions in the US could encourage renewed reverse Yankee issuance from US corporates and this could boost demand for dollars in the forward market.

While such factors will put widening pressure on the euro/dollar cross-currency basis swap, Marinov sees potential pressure in the opposite direction from Eurozone corporates selling dollar forwards and buying euro forwards, particularly as the global economy recovers from the pandemic and their export revenues increase — even if this activity has recently come in well below expectations in the first months of the region's recovery. ●

Crédit Agricole £500m AT1 exchange tackles Libor, CRR issues

Crédit Agricole SA (CASA) on 20 May launched a novel one-for-one exchange offer for holders of its £500m (€582m) perpetual non-call June 2026 grandfathered Additional Tier 1 instrument, seeking to replace it with a fully CRR-compliant, state of the art AT1 incorporating Sonia language.

Financial institutions have been managing the transition from Libor to Sonia of outstanding sterling instruments since 2019, but only began tackling more complex AT1 structures later last year, with Santander UK being the first to gain bondholder approval to amend the terms of its outstanding sterling AT1 accordingly.

Further progress in the transition has meanwhile been made by, for example, the launch of the GBP Sonia ICE Swap Rate in December 2020, while the buyside has called for issuers to step up their efforts.

"The Investment Association's members are reaching out to issuers to encourage them to put into effect plans to transition these instruments as quickly as possible," said the industry body in an open letter in February. "This is critical if a broad-based market transition is to be achieved by the deadline outlined by the authorities."

On top of transitioning the reference rate of capital securities, Eurozone issuers with sterling AT1s are faced with the simultaneous task of tackling non-CRR compliance, since — following the end of the Brexit transition period at the turn of the year — they require contractual bail-in recognition.

CASA's £500m AT1, for instance, only remains eligible as AT1 thanks to grandfathering treatment, but this will

expire from 28 June 2025, a year earlier than its first call date. This change in treatment would constitute a capital event and the issue could then be called at par.

Being CRR-compliant, the French bank's new fully compliant AT1 offered via the exchange will address this, as well as incorporating language for any reset period.

"Now that an established Sonia methodology is in place, and following the end of the transition period, the issuer is addressing these key issues," said Doncho Donchev, DCM Solutions, Crédit Agricole CIB, "while taking the opportunity to make other technical amendments to align it with AT1 best practices."

UK issuers have addressed the reference rate issue via consent solicitations, but the mechanic process was not feasible under the transaction's documentation, leading Crédit Agricole to come up with the unusual one-for-one exchange.

Holders can exchange their grandfathered AT1 for new CRR-compliant AT1 securities with substantially similar terms and conditions — such as the coupon to the first call (7.5%), call dates, margin at reset (4.535%) — save for the aforementioned technical updates and substitution of Sonia for Libor with the relevant standard spread adjustment of 0.2766%.

The exchange runs until 18 June, although holders can benefit from an early participation amount of 10 cents for instructions received by Friday (4 June). The offer is contingent upon CASA achieving a £250m participation amount, although it has reserved the right to waive this minimum exchange condition.

"The early bird fee compensates investors for the time spent on the analysis, since it is not just the Libor transition we are managing, but also ensuring the new instrument is fully CRR-eligible," said Véronique Diet Offner, co-head, DCM solutions and advisory, CACIB.

"Early participation will also give the issuer maximum visibility as to the progress of the exchange." ●

CASA sees efficiencies in Origin auto-docs

Origin Documentation, soft-launched in July 2020, automates the production of transaction documentation pre- and post-bond issuance. Origin worked with Crédit Agricole's treasury and Crédit Agricole CIB's Debt Capital Markets teams to completely streamline their issuance process for self-led transactions. Since implementation, Crédit Agricole SA (CASA) has issued five transactions via Origin across senior preferred and senior non-preferred (SNP), including two €1bn-plus syndicated benchmarks.

The platform automates all necessary transaction documentation, including bond and swap term sheets, final terms, subscription agreements, paying agent letters and more. According to CACIB's legal teams, the tool has reduced the time for drafting and processing documentation by 90%.

Bank+Insurance Hybrid Capital (BIHC): What did your issuance process look like previously? What problems were you trying to solve?

Guillaume Corral, medium and long term funding, London desk, CASA: We have complex bespoke term sheets for each of our asset classes (covered, senior preferred, SNP) and we spend a lot of time pre-trade getting the term sheet right. Our funding strategy involves a mix of benchmarks and private placements, but the private placement flow involves the same number of documents as a benchmark, both pre-and post-trade.

The main hurdles are:

- The significant time and cost of all the documentation that is produced;
- Multiple back and forth between issuer, dealer and their respective counsels;
- The risk of divergence between term sheet and final terms;
- The burden of manually producing the multiple documents, agreements and notices related to each issuance.

BIHC: How long would it take to process a new issuance from start to finish? How did that differ between a private placement and syndicated transaction?

Romain Beillard, director, DCM FIG, Crédit Agricole CIB (CACIB): Depending on the asset class, the new issuance process can be time-consuming, and is still very much manually executed. From the pre-trade to post-trade documents, a number of emails and documents are produced and exchanged.

When we do private placements, we regularly need to produce post-trade documents, such as a subscription agreement, signing and closing agenda, etc. External counsels are appointed in the case of public/syndicated trades, while for private placements our internal counsel will usually draft all post-trade documents, which can take almost a day to expedite.

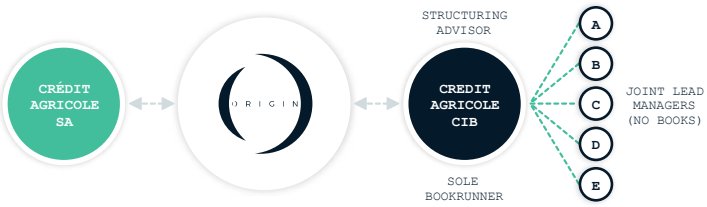
BIHC: How does the Origin platform solve these problems?

Raja Palaniappan, CEO and co-founder, Origin Markets: Origin's Documentation tool automates the production of all the necessary documentation that accompanies a bond transaction, including term sheets, final terms, ancillary letters, etc. We can take any document template and make it machine-readable — we then upload it to the platform and the platform creates a dynamic wizard, which guides a user towards populating all the necessary terms.

This documentation engine is overlaid with a bespoke workflow platform that is specifically designed around the debt issuance process. We have different user types (e.g. "DCM", "dealer legal", "funding manager", "issuer legal", etc), and the workflow tool guides each user in completing the tasks they need to do. DCM can quickly draft a term sheet, the funding manager can approve it and grant a mandate, and the legal teams can pick the trade up and draft final terms — all within minutes.

Case Study: Origin Documentation facilitates CASA's inaugural €1bn social bond

Bespoke issuer-defined templates enabled the various parties to streamline the entire documentation process from pre-trade to post-trade



CACIB DCM drafted four pre-trade documents electronically and received the approvals through Origin:

- Indicative bond term sheet
- Indicative BBG Termsheet
- IIIA message
- Final bond term sheet

CACIB legal drafted eight post-trade documents simultaneously through Origin:

- Final terms
- Subscription agreement
- Payment instructions
- Décision d'emission
- Expense Side Letter
- Accounting Letter
- Signing and Closing Agenda
- Certificate of No Material Adverse Change

Source: Origin Markets

BIHC: Are there any limitations to what the platform can do?

Palaniappan, Origin: The platform is built specifically around issuance off programmes (i.e. EMTN/GMTN, etc). This is because the documentation required for that type of issuance lends itself nicely to templating. There is a clear one-to-one relationship between the economic terms in the term sheet and how those terms are represented in the final terms. So for now, standalone issuance is outside the scope of the platform.

Additionally, for now the platform supports interactions between only one dealer and issuer on a transaction. However, over the course of the next few months, we will be releasing functionality to allow multiple counterparties such as other dealers within a syndicate, or even external law firms, to be able to connect and collaborate on a set of docs.

BIHC: How does the issuance process look like now that you are using Origin? How is it better?

Beillard, CACIB: The Origin platform makes the term sheet creation, including BBG TS and the IIIA process, much easier — it now takes us two or three minutes, since the bespoke templates have already been reviewed and validated by all parties.

Once the mandate is granted, there is no unnecessary back and forth emailing between all internal parties (legal teams, capital solutions team when necessary, syndicate) — everything is done faster and is more accurate, while all live modifications can be followed on the platform.

Another important element that could definitely bring value would be to plug internal tools into the Origin platform to avoid multiple entry of the same data.

BIHC: What was the hardest part of getting the product right for CASA/CACIB?

Palaniappan, Origin: The "magic" of the tool — automatically creating documents based on templates — was actually the easy part. What was harder was getting the user experience and workflow right.

Because there are so many participants and stakeholders in each transaction, there are so many different permutations of how a trade could progress, and so many edge cases and exceptions to account for. We spent a lot of time with the teams doing dry-runs and test trades, trying to iron out all the bottlenecks for users as they were working through a transaction. We hold ourselves to a very high bar when it comes to the UX (user experience) of the app — it needs to be incredibly intuitive for each user to know exactly what to do next. If anything, we believe that is one of our strongest USPs, as we have been co-developing the tool with our many dealer and issuer users for quite some time now, so we're very confident in the flow.

BIHC: What are your ambitions for using the Origin platform in the future?

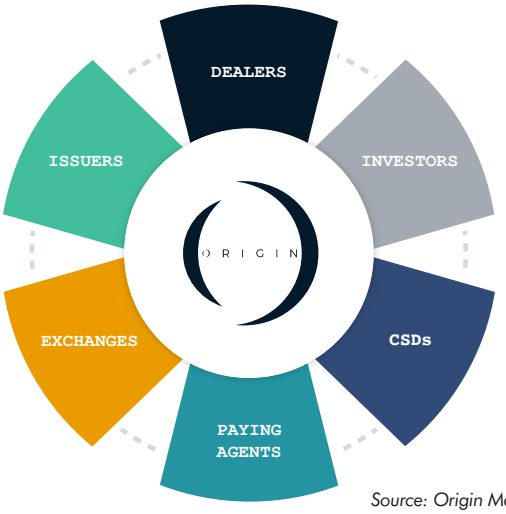
Corral, CASA: We have already used this for private placements in senior preferred and in benchmark issuances in SNP format. We are considering extending the scope of products that we would run on the platform across the capital structure, including, for instance, covered bonds and subordinated instruments, and also non-euro EMTN issuances.

We would like to be able to use this platform to connect different teams involved in the process of our primary issuances. We expect the use of the platform to save time (allowing for a shorter settlement period, potentially), reduce expenses, decrease operational risk, and increase control over structuring and documentation processes.

BIHC: What is the long term vision for future issuance on the platform?

Palaniappan, Origin: The ultimate benefit of Origin is the ability for us to structure transaction data so that we can automate settlement. We have integrations with many post-trade infrastructure entities already — such as our partners Luxembourg Stock Exchange and Clearstream — and we are building more every day. This allows us to feed transaction data down to their systems in a straight-through process that eliminates the need for lengthy emails and manual steps.

We view Origin as the "application layer" that brings together market participants and helps them originate, negotiate, and create new securities. This application layer sits on top of, and can interface with, whatever "infrastructure layer" participants choose to use. Today it may be the existing CSD (central securities depository) network; tomorrow, it may be on the Ethereum blockchain. Our vision is to ensure Origin is built to bring value to our customers today, while also planning ahead to ensure it continues to bring value to them as the market and infrastructure evolve in the coming years. ●



Source: Origin Markets

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