Bank+InsuranceHybridCapital Briefing

Financial institutions find slimmer pickings in last minute pre-summer capital deals

The subordinated financial institutions market this week enjoyed a last hurrah ahead of the summer lull, with banks and insurers keen to take advantage of the levels on offer, even if they had to make do with smaller books and offer new issue premiums, as investors braced themselves for Q2 numbers. *Neil Day* reports, with insights from Crédit Agricole CIB's financial institutions team.

Banks and insurers took advantage of what is likely to prove to be the last pre-summer window to launch a series of successful subordinated trades this week, but the levels of oversubscription and new issue premiums showed the wind to have been taken out of the market ahead of critical Q2 figures.

While BBVA and Rabobank, for example, were able to get the week's benchmark AT1 issuance away, the reception was far less exuberant than witnessed in the last heady bout of bank capital issuance a month ago, when ABN Amro and Commerzbank attracted some €18bn of orders in aggregate to a combined €2.25bn of issuance. This Tuesday, Rabobank's final book was €2.5bn and BBVA's — for the first green AT1 — €1.8bn.

However, while the early June supply traded down as early as the next day, this week's issuance held relatively steady.

Crédit Agricole CIB (CACIB) AT1 trader Nigel Brady noted that the demand and performance dynamics reflected those in evidence on recent dollar AT1 supply from Royal Bank of Scotland and Standard Chartered. A $1bn (€883m) perpetual non-call five issue for Standard Chartered launched into a better market on 17 June was 5.5 times covered, while a $1.5bn perpetual non-call 5.5 for RBS launched into a weaker market on 24 June was four times covered but outperformed its peer's trade.

"With the RBS deal and the two euro AT1s on Tuesday, there was a lot less participation from retail, because the books weren't developing so well and the market was a little soft," said Brady. "But that had a converse effect on performance — the bonds are doing better because they have gone into safer hands.

"What that shows is that there is good underlying demand from real money, whereas the demand from retail-driven accounts is a bit more sporadic and market sensitive — if you have a weak market backdrop, the tone suddenly changes, and retail are heavily involved, then that can hit performance, as we saw in ABN and Commerzbank last month."

CACIB head of FIG syndicate Vincent Hoarau further noted that UK-based buyers have become particularly sensitive to the pricing and timing of new issues, with their diligence contributing to the reining-in of price moves, even if their continental European counterparts are less discriminating.

"Investors have cash to invest, but do not want to be caught long at current rich levels," he said. "Most recent AT1s are back below par."

While ABN Amro and Commerzbank were able to achieve pricing flat to through fair value on the back of their heavy oversubscription levels, issuers this week therefore had to offer new issue premiums or see demand fall away — BBVA achieved pricing close to fair value, but its order book fell from €2.75bn to €1.8bn upon the final spread revision, according to the leads.

"Everything in primary went relatively well this week," said Hoarau, "but while new issue premiums are still limited, issuers are having to leave something on the table. The exuberance we witnessed last month when everything was coming flat to or inside the curve is now behind us. We are coming to the end of a strong rally and are not necessarily going tighter from where we are — since valuations are stretched, investors are using any disappointing data point as an excuse to take profits.

"At the same time," he added, "we have a market that struggles to correct."

Although recent sharp downward moves on periodic panics have meant investors are still fearful of a correction, the market continues to be driven by liquidity and stimulus measures, and the fear of missing out on any new phase of the recovery rally persists, according to Hoarau.

Brady meanwhile sees the market as having become somewhat inured to bad headlines.

"Although we have had some intraday moves, volatility isn't that high," he said, "and what I expect in the near term is more of the same — we're probably going to have plenty of fluctuations plus or minus one or two points throughout the course of the next month, but are we going to get a move plus or minus five points in either direction? Probably not."

In spite of the increasing investor fatigue, the approach of the second quarter bank earnings season and summer holidays combined with still-attractive levels made the market one that issuers were keen to take advantage of.

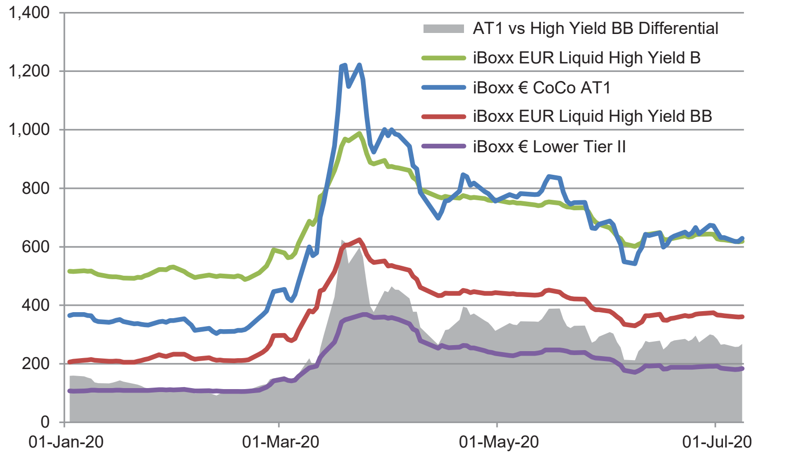
"This week really looked like the ultimate rush before the unknown, everyone with sub and high beta funding instruments," said Hoarau.

Although levels remain wide of those possible before the onset of the Covid-19 crisis — the 4.375% coupon on Rabobank's perpetual non-call 7.5 compares with 3.25% it achieved on a perpetual non-call seven in September 2019 — credit spreads in many capital instruments are approaching levels last possible towards the start of the year.

Since the beginning of July, European financials have focussed on capital trades, issuing only AT1 and Tier 2 this week, with just one senior preferred trade last week, thereby maintaining the unusually high bias seen in May and June, according to Neel Shah, financials credit analyst at CACIB.

"We haven't seen that kind of heavy skew for a long time," he said. "It just shows the strong appetite among issuers to issue at relatively attractive spreads into a constructive market where demand persists, before it effectively closes after next week due to blackouts."

Secondary market performance



Source: Markit, Crédit Agricole CIB

While a lack of supply and liquidity in the coming weeks could contribute to a squeeze on spreads, Hoarau warns that further ahead there is a real risk of a relapse.

"The upcoming earnings season and Q2 GDP are now set to move markets in one direction or the other," he said. "Markets have tended to price the upside scenario, counting on worldwide central bank intervention and balance sheet support to pare any disappointments."

AT1s, conventional and green

Unsurprisingly for a benchmark issuer such as Rabobank, its new AT1 on Tuesday exemplified the more sober dynamics of the primary market. After initial price thoughts of the 4.75% area, pricing was moved directly to the final coupon of 4.375% on the back of some €3bn of orders, with the final book standing at above €2.5bn. The pricing was seen as offering a new issue premium of around 15bp and the trade remained at its re-offer spread in the aftermarket.

"It was a very smooth process, with a very consensual approach," said CACIB's Hoarau.

BBVA also hit the market on Tuesday, going out with IPTs of the 6.5% area for its perpetual non-call 5.5 AT1, before revising guidance to the 6.125% area on the back of books above €3bn. The deal was then sized at €1bn and priced at 6% on the back of over €2.75bn of orders, pre-reconciliation, and the final order book was some €1.8bn.

The Spanish bank's deal is the first to have been marketed as a green AT1 and it said 44% of the paper was sold to investors with ESG-linked criteria.

While the issuer has a strong track record in the sustainability field, market participants raised questions over the green nature of the capital trade. The bank said the issuance is allocated towards refinancing the possible early repayment in April 2021 of an AT1 sold in 2016, leading to questions over the purported use of proceeds. Meanwhile, a long-standing question mark over possible green bank capital has been whether green bonds' use of proceeds model is appropriate for loss-absorbing instruments that not only provide funding for lending but support a proportionately larger amount of the balance sheet.

"We expect the deal will gather a lot of interest from the investment community, which will likely lead other banks to follow suit," said Charlene Malik in TwentyFour Asset Management's portfolio management team. "We will have wait to and see how the market develops, and if green AT1 deals can indeed lead banks to increase their sustainable lending.

"Ultimately, BBVA is a bank that we have long liked as a credit in general," she added, "and given the initial pricing thoughts, many investors may conclude that on a relative value basis the new bond looks an attractive one, with or without the green label."

However, the 50bp move from IPTs to re-offer was the equal-biggest of the week's supply and the ultimate new issue premium of around 5bp one of the lowest, and some market participants said the sharp fall in the size of the order book upon final pricing was due to the green tag helping BBVA squeeze the pricing, with the result being that the deal widened slightly in the secondary market, underperforming other new issues.

Compatriot Bankinter followed in BBVA's wake, selling its second AT1 on Wednesday, a €350m perpetual non-call six after having debuted in the format in 2016 with a €200m trade that is callable in May 2021. Following IPTs of the 6.5% area, guidance for the new issue was set at 6.25% plus or minus 0.125%, and the deal was ultimately priced at 6.25% on the back of over €800m of demand.

"We had a very strong reference from BBVA the previous day," said Hoarau at joint bookrunner CACIB. "We kicked off

marketing at 6.5% with a view to landing 0.125% to 0.25% back of BBVA, which made sense in terms of spread differentials and credit profile — Bankinter is not a frequent borrower, but a strong bank in terms of credit metrics. In light of the increasing spread sensitivity prevalent in the market, the issuer then wisely agreed to set the coupon at 6.25%.

"What was particularly pleasing," he added, "was the high level of granularity it achieved for an issuer of its size and standing, with quite well balanced distribution across the UK and continental Europe on top of the domestic take-up."

The UK was allocated 38%, Iberia 24%, France 16%, Germany and Austria 16%, Italy 2%, Asia 2%, and others 2%. Asset managers took 80%, hedge funds 11%, banks and private banks 4%, insurance companies and pension funds 4%, and others 1%.

Insurance trio hit targets

Generali opened the week's insurance supply, selling a second green Tier 2 issue after having become the first European insurer to sell green subordinated debt in September 2019. As with its debut, the new green Tier 2 was issued in conjunction with a tender offer it had launched for outstanding subordinated debt.

Investors tendered some €778m equivalent of three bonds in euros and sterling, callable in 2022, that were being targeted — approximately 50% of the aggregate outstandings — and Generali bought back around €600m, it announced on Tuesday.

This amount matched the size of the new Tier 2 issue launched on Monday, a 2031 non-call 2021 trade. Following IPTs of the 300bp area, guidance was set at 260bp plus or minus 5bp on the back of over €4.4bn of demand, and the deal was ultimately priced at 255bp over mid-swaps on the back of some €4.5bn of orders, which made it the most oversubscribed subordinated trade of the week and allowed for pricing around 10bp inside fair value — although, like BBVA's green trade, it widened slightly in the aftermarket.

André Bonnal, FIG syndicate at CACIB, said the combination of the tender — where participants receive priority allocation codes for the new issue — with the green nature of the deal had again provided for a strong result, backed up by Generali's lower issuance as it deleverages, and investors' like for the name.

Generali Group CFO Cristiano Borean said the two transactions further extend the average maturity of the company's debt, consistent with its proactive approach in shaping its debt maturity profile.

"Moreover, they will also lead to a further reduction in the annual gross interest expense," he said. "I am also pleased by the strong reception of our second green bond, which confirms our commitment to sustainability."

Crédit Agricole Assurances followed on Tuesday with a €1bn 10 year bullet Tier 2. Following initial guidance of the mid-swaps plus 250bp area, guidance was revised to 220bp-225bp and the size set at €1bn on the back of around €2.85bn of demand, and the new issue was ultimately priced at 220bp with the final order book €3.1bn.

The pricing reflected a new issue premium of around 10bp, according to CACIB's Bonnal, based on the trading level of CNP Assurances bullet 2029s, adjusting for the curve extension, and factoring in the spread differential between 2047 non-call 2027 CNP and 2048 non-call 2028 CAA issues.

"We left a little bit on the table, which we deemed appropriate for the size of €1bn, which is relatively large for the insurance space," he said, citing Generali's €600m size and recent €750m CNP Assurances and €500m La Mondiale trades. "But ultimately the NIP was the same as that paid by CNP or Hannover Re for smaller deals.

"The issuer has been absent from the market for two and a half years," added Bonnal, "so it was a really good comeback."

He noted that some investors saw the paper as offering value versus Crédit Agricole SA, with CAA offering a pick-up of some 30bp over where the bank issuer of the French group might price a new 10 year. The deal was also CAA's first subordinated deal with a bullet structure, which Bonnal said was possible thanks to headroom in relation to S&P's rating methodology and offered a saving of 60bp-70bp versus a callable structure.

'It's a very good first trade for the issuer'

CCR Re rounded off the week's subordinated supply with a debut subordinated trade, a €300m 20 non-call 10 Tier 2. The deal was announced last week and after investor calls from last Friday to this Tuesday had attracted some €350m of indications of interest for the €300m-maximum trade, on the back of positive discussions with investors, according to Bonnal at joint bookrunner CACIB.

The transaction was then launched on Wednesday, with IPTs of the mid-swaps plus 365bp area for the 20 non-call 10. Following book updates of €750m and then €1.5bn, the pricing was tightened some 55bp to 310bp over, with the deal remaining five times covered at re-offer. It went on to tighten 15bp in the aftermarket.

Bonnal said that finding fair value for the new name was difficult, but the process had been helped by the success of a €200m 15.25 non-call 5.25 green Tier 2 for Austria's Uniqa on Thursday of last week (2 July), after which the CCR Re mandate was announced.

"They had started at the 435bp area and tightened to 370bp with a book of €2bn," he said. "So although the two issuers have completely different profiles, they are both sub-benchmarks and hence more or less the same type of offer, and their success gave us further comfort that our trade would go well.

"It's a very good first trade for the issuer," added Bonnal, "and should stand them in good stead for further new issues in the years to come." ●

League tables

Bookrunners all European FI hybrids (euros and US dollars)
01/01/2020-30/06/2020

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	BNP Paribas	19	5,213	11.0
2	Deutsche Bank	11	3,671	7.8
3	Barclays	21	3,383	7.2
4	Crédit Agricole CIB	10	3,158	6.7
5	Morgan Stanley	18	3,095	6.6
6	HSBC	21	2,990	6.3
7	JP Morgan	23	2,927	6.2
8	BofA Merrill Lynch	18	2,605	5.5
9	NatWest Markets	9	2,577	5.5
10	Citi	16	2,391	5.1
11	Credit Suisse	12	2,367	5.0
12	Goldman Sachs	15	2,125	4.5
13	UBS	12	1,804	3.8
14	UniCredit	6	969	2.1
15	ING	4	832	1.8
	Total	73	47,251	

Source: Dealogic, Thomson One Banker, Crédit Agricole CIB

Bookrunners all investment grade financials (euros)
01/01/2020-30/06/2020

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	Crédit Agricole CIB	42	12,079	10.2
2	Société Générale CIB	30	9,023	7.6
3	JP Morgan	39	6,989	5.9
4	Natixis	22	6,904	5.8
5	Deutsche Bank	33	6,823	5.8
6	BNP Paribas	26	6,601	5.6
7	Barclays	28	6,599	5.6
8	UniCredit	26	4,760	4.0
9	HSBC	30	4,674	4.0
10	BofA Merrill Lynch	24	3,369	2.9
11	Santander CIB	21	3,361	2.8
12	ING	19	3,361	2.8
13	Lloyds Bank	5	3,240	2.7
14	Goldman Sachs	20	2,956	2.5
15	UBS	16	2,764	2.3
	Total	189	118,108	

Includes banks, insurance companies, finance companies. Excludes equity-related and covered bonds, and publicly-owned institutions.

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