Santander strategy pays off as blow-out €1.5bn AT1 reopener delivers refi savings

Santander on Thursday moved to refinance a €1.5bn 5.481% Additional Tier 1 issue and saw its strategy deliver big savings as clear and consensual execution helped it attract over €10bn of demand to a €1.5bn perpetual non-call six transaction, joint lead managed by Crédit Agricole CIB. The blow-out also reopened the AT1 market for 2020, as financial institutions issuance overall surprised to the upside both in terms of volume and performance.

Banco Santander reopened the Additional Tier 1 market on Thursday (9 January) with an acclaimed €1.5bn perpetual non-call six issue that attracted an unprecedented €10bn of orders to strongly reopen the AT1 market in the new year.

The new issue was launched with the intention of refinancing a €1.5bn 5.481% AT1 that was the first AT1 not to be called when the Spanish banking group on 12 February 2019 left it outstanding.

On Thursday morning, Santander teed up the announcement of the new €1.5bn AT1 with a statement of its intention to call the 5.481% issue on 12 March, subject to completing new AT1 issuance, while the new issue was being launched outside its communicated funding plans for 2019 and 2020 purely to refinance the 5.481%.

On the back of buoyant primary market conditions and thanks to consensual initial price thoughts, lead managers Barclays, BNP Paribas, Crédit Agricole CIB, HSBC, JP Morgan and Santander took more than €10bn of orders — making it what is understood to be the biggest book of any euro AT1 ever — with market participants complimenting Santander on its approach.

"I was pleasantly surprised with how the process went," said a fund manager who participated in the deal. "When they launched the 7.5% last year, it felt as though Santander were being very opportunistic, maybe slightly playing on the market's uncertainty over whether they were going to call the old 6.25%.

"The way Santander went about it this time was as you'd expect one of the largest banks in Europe to behave when it comes to calling and refinancing an AT1. The communication with regards to what they intended to do with the 5.481s was very clear from the outset, which is how it should be, and that gave me a lot more confidence when it came to placing orders."

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Some market participants had last February interpreted the issuance of the new $1.2bn (€1.06bn) 7.5% perpetual non-call five, which was launched the week ahead of the non-call decision, as suggesting that the then 6.25% €1.5bn issue might be called at its first call date on 12 March 2019, even though the issuer had indicated it would take any decision on a purely economic basis and the price of the euro AT1 had previously reflected this.

The new €1.5bn issue was on Thursday launched into a primary market that had seen record euro supply in the financial institutions space since its full reopening on Tuesday, with US-Iranian hostilities having failed to deter issuers or investors. A perceived de-escalation of geopolitical tensions on Wednesday, highlighted by a relatively measured statement from President Donald Trump around the European close, then provided renewed support going into Thursday.

After going out with IPTs of the 4.75% area for the Ba1 rated perpetual non-call six AT1 on Thursday morning, the leads reported books over €5bn after less than two hours, then moved directly to setting the pricing at 4.375% after an hour and 40 minutes with books in excess of €7.5bn, pre-reconciliation, and demand ultimately surpassed €10bn. It traded up in the aftermarket and was quoted at a cash price of 102 on Monday morning.

According to André Bonnal, FI syndicate, at joint bookrunner Crédit Agricole CIB (CACIB), fair value was in the context of 4%-4.125%, based on Santander's 4.75% non-call March 2025s, which have a reset of 410bp and were trading pre-announcement at 410bp on an i-spread basis.

"We did not have to engineer too much in terms of back-end adjustment, with the outstanding non-call 2025s trading on an i-

spread basis at reset level, and at 3.9% yield-to-call," he said.

"In the first book update within two hours we were able to communicate that orders were above €5bn, which is basically unheard of in euro AT1," added Bonnal. "The next step — going to final terms of €1.5bn at 4.375% — then made it quite clear to everyone that the issuer wasn't here for the last basis points; it wanted to refinance with a very successful trade that would perform well in the secondary market."

The fund manager said the pricing and sizing of the deal were as welcome as its handling.

"I was fully prepared to see two or maybe north of two yards being printed at 4.25% or even tighter," he said, "so to see Santander leaving some premium on the table and also not upsizing the deal horrendously was, again, a pleasant surprise and in line with how we'd expect a responsible issuer to behave."

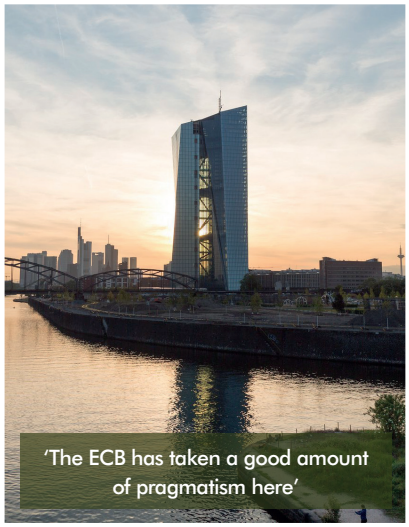
The bank was rewarded with some 490 investors contributing to the €10bn-plus final book, which CACIB's Bonnal said was a *Who's Who* of the AT1 market.

The UK and Ireland were allocated 44%, France 15%, Asia 11%, Switzerland 10%, the Nordics 5%, Germany and Austria 4%, southern Europe 4%, the Benelux 3%, and others 4%. Asset managers took 71%, banks and private banks 11%, hedge funds 11%, insurance companies and pension funds 6%, and others 1%.

"Naturally we had very strong interest from Asia, especially private banks," said Bonnal, "but more importantly, all the names you would want to see in terms of real money accounts in AT1 were involved."

The new 4.375% issue was priced with a reset of 453.4bp, which compares to 541bp on the 5.481% issue that it is refinancing.

"This is the beauty of the trade for Santander," said Vincent Hoarau, head of FI syndicate at CACIB. "The economics for the funding team are exceptional and the overall strategy paid off. The issuer deliberately took the decision not to call the 5.481% at the first call date and to



'The ECB has taken a good amount of pragmatism here'

wait for better market and liquidity conditions, and the savings are enormous.

"The issue vindicates last year's non-call decision in the best possible manner."

Breaking the deadlock

The Spanish bank was aided in its exercise by being able to take advantage of a more flexible stance on the part of the European supervisory authorities towards the refinancing of AT1 instruments, whereby regulators are willing to grant conditional authorisations for calls and still count the relevant instrument in

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capital ratios, as long as they are confident that it will be quickly refinanced.

Santander was the first issuer to take advantage of the new approach by issuing a public statement that it intended to call the 5.481% AT1 by replacing it with a new AT1 issue coming on 9 January, ahead of the window in which it can issue a formal call notice in the form of a material fact announcement from 12 January to 11 February, inclusive.

Sebastiano Pirro, portfolio manager, Algebris Investments, said the development is a positive one for Santander in particular and banks more generally.

"Previously people had to fund six months in advance and even then they couldn't say that they intended to call and redeem the outstanding bond until the formal notice period," he said.

"I think the ECB has taken a good amount of pragmatism here, saying, OK, you have the authorisation to redeem provided that you issue a new one, and that has broken the deadlock."

Primary performance surprises

Santander's blow-out also reopened the AT1 market, extending financial institutions issuance beyond the wave of covered bond to Tier 2 supply that had flooded the market in the first full week of the year. In spite of the volume of supply, the bulk of new issues performed, also riding out the geopolitical developments.

"Because 2019 was such a strong year of performance, particularly for sub financials, towards the end of last year a lot of people pared down their risk to some extent for whatever reason, like the UK election," said the fund manager. "So a lot of people came into the start of this year with cash to put to work and because of that — and in spite of the very heavy supply — the new issues have actually repriced secondaries tighter in many instances.

"A lot of market participants assumed that because of the heavy new issue calendar they'd have an opportunity to buy some cheap primary and then perhaps pick up some cheap risk in secondary. However, the really strong performance year-to-date has been aided by primary and not hindered by it, because it revealed that the clearing level for risk is a lot tighter than people thought it was."

Meanwhile, the medium term supply outlook for AT1 is relatively benign.

"As we have been highlighting for some time, the AT1 market has moved into its mature phase where there is largely only refinancing to come," said Nigel Brady, AT1 trader at CACIB. "In the last few years we've been consistently expecting net issuance in the region of €20bn-€30bn, but now we'll be lucky to get an extra €5bn of net issuance, and that is supportive of the overall sector because we don't see the demand side slowing down at all." ●

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