Bank+InsuranceHybridCapital Briefing

Euro investors buy into AIA's distinctive story as €750m T2 debut beats expectations

AIA entered the euro market on 2 September with a €750m 12 non-call Tier 2 deal that attracted a peak €4.4bn book and beat spread expectations. Ethan Farbman, head of external capital and liquidity, group treasury, AIA Group, discussed how the debut transaction fits into the insurer's strategy with BIHC, in association with joint bookrunner Crédit Agricole CIB.

Bank+Insurance Hybrid Capital: Since your new issue may have represented many European fixed income investors' first encounter with AIA Group Ltd as an issuer, perhaps you could start by providing a brief portrait of the group?

Ethan Farbman, AIA *(pictured)*: First, I want to thank you for the opportunity to discuss our profile and particularly the recent transaction.

AIA Group Limited is a pan-Asian life and health insurance company with a platform that has been built for over a century. Our market capitalisation is approximately $136bn, making us the largest life and health-focused insurance company in the world by market capitalisation. The business was founded in Shanghai in 1919. We became an independent and publicly traded company in 2010, listed and headquartered in Hong Kong, ticker 1299 HK.

The group is entirely focused on the Asia-Pacific region and has 100% ownership in 17 of our 18 markets. Notably, in 2020 we became the first and only company to be granted a wholly-owned foreign life insurance subsidiary in Mainland China. Since IPO, the focus on Asia and our financial discipline have been the foundation of the group's extremely strong balance sheet and our consistent delivery of profitable growth. Our profitable growth is illustrated through an increase in both the group's embedded value (EV) equity and shareholders' allocated equity of more than three times since IPO.

BIHC: Why have you decided to enter the euro market, debuting with this subordinated trade, and how does it fit with your overall issuance strategy, notably your dollar presence?

Farbman, AIA: We have been a fairly regular issuer in the US dollar market since 2013, active in both the 144A/Reg S market and the Reg S-only market. Previously, we had been exclusively issuing senior debt, but last year we shifted to issuing subordinated debt. That shift was driven by regulatory change in Hong Kong, with the introduction of the group-wide supervision (GWS) framework. This was enacted in March this year, but it had been in the works for some time and the rules for debt capital instruments were near final in summer 2020, which allowed us to begin issuing subordinated debt from last September onwards. Our issuances since then have all been subordinated, and we expect our issuance going forward to consist largely of subordinated debt.

The euro market is of course a large international investment grade debt market, and one where many financial institutions — whether they be banks or insurance companies — issue sub debt. In light of our shift towards subordinated debt, and being a fairly regular issuer, and a large cap company by international and not just Asian standards, issuing into the euro market is something that we feel adds financial flexibility through opening up for us a new deep market.

We have close relationships with a number of European banks who have been informing us about the euro market and updating us on market opportunities. We also have some very large investors — whether they be asset managers, insurers or sovereign wealth funds — that are global institutions who manage across different currencies, including dollars and euros, and some of those had in the past expressed an interest in seeing us in euros. Entering this market was something that we had been thinking about for some time. We felt confident that there would be a large number of new high quality investors that we would be able access in euros.

From a timing standpoint, it seemed right, with markets being very constructive. This was the case globally, but particularly in Europe. The rate and spread environment is obviously very low, and we thought that it was the right time for a new name to be well received by investors and achieve an attractive cost of subordinated debt funding.

BIHC: The structure of your Tier 2 instrument has been viewed as more akin to a European bank Tier 2 than insurance Tier 2 — what are the relevant elements and why is it structured this way?

Farbman, AIA: This is more driven by AIA's capital structure and current levels of leverage, which provide us with a degree of flexibility. In terms of the Hong Kong regulatory framework, the requirements for regulatory capital are more debt-like than what rating agencies require to get equity content and capital credit. Most insurers tend to structure regulatory capital instruments that also achieve rating agency benefits, such as equity content for managing leverage, or more capital credit if the rating agency has a capital model. We have done that in the past, and we will do it in the future, but we also have the flexibility to be able to issue structures that only receive regulatory capital credit, like a 12 non-call seven. We only have 13% leverage — that's total leverage, not financial leverage and we have very strong credit ratings, with our capital adequacy scores from all three credit rating agencies at the highest end of the spectrum.

We chose to issue the 12 non-call seven because we we have the flexibility to be able to, and because we felt like that was the more appropriate instrument to lead with in a new market, as people could really focus on the credit. While it's a subordinated instrument, there was no requirement from any price discovery around structural features such as coupon deferral, ultra-long maturities or extension risk.

BIHC: What were the key messages you wanted to convey during pre-marketing about AIA and the issuance (beyond anything already mentioned)? What did investors focus on?

Farbman, AIA: We had a mix of investors that were familiar with us and many that were new. One thing we needed to make sure of on this marketing exercise, unlike past ones, was to take a step back and introduce the company, introduce our strategy, the fact that we are pan-Asian, and exclusively focused on Asia, which is the most attractive region in the world for life insurance, with substantial amounts of growth.

We did receive a number of questions on the deal structure, similar to what you just asked before — why can we issue this type of instrument that is so infrequently issued by insurers? We addressed these questions largely in relation to our conservative capital structure with low leverage, extremely high interest coverage, and very strong financial strength ratings. The discussion naturally led to questions around our solvency capital

Execution highlights

- Books opened with IPTs of the mid-swaps+140bp area
- Orders in excess of €1.5bn in one hour and 45 minutes
- Size fixed at €750m and spread at 110bp after three and a half hours on the back of books above €3.75bn, pre-reconciliation
- Final order book €4.4bn with 196 accounts

Issuer:	AIA Group Limited
Issuer ratings:	A1 (Stable)/A+ (Stable)/AA-(Stable) (Moody's/S&P/Fitch)
Issue ratings:	A2/A/A (Moody's/S&P/Fitch)
Status of the securities:	Subordinated notes, expected to be treated as Tier 2 capital under the HKIA's Insurance (Group Capital) Rules
Format:	Regulation S, Category 2, Registered
Amount:	€750m
Maturity date:	9 September 2033 (12 years)
Reset date:	9 September 2028 (7 years)
Re-offer price/yield:	99.980/0.883%
Swap/benchmark spread:	Mid-swaps plus 110bp/Bund plus 149.1bp
Coupon:	0.88% per annum until the reset date, payable annually. Reset at the reset date at the 5 year EUR mid-swap rate plus the initial margin
Optional Redemption:	3 months par call prior to reset date subject to redemption conditions; make whole redemption subject to redemption conditions (to the extent required by the applicable supervisory rules)
Selected structural characteristics:	No step-up; no optional/mandatory coupon deferral; no contractual loss absorption feature
Pricing date:	2 September 2021 (settlement T+5)

levels, which was 412% as of 30 June 2021, and the Local Capital Summation Method, or LCSM approach, that has been adopted under Hong Kong's new GWS framework.

BIHC: How do you feel the transaction went? How did the execution, pricing and distribution compare with your hopes and expectations?

Farbman, AIA: The process went very smoothly. One thing that we were aware of going into the trade was how busy the calendar was going to be — there was a lot of competing supply, a lot of other issuers in the market — so we did have to take into account that we were going to be asking people to join a series of calls and that it was going to take up more than just one day of their time. The announcement went out on Tuesday morning, European time, and we managed to get together a schedule that was very good, we did a couple of calls that day in the afternoon, and then a number of calls the following day. On the Wednesday we had close to 40 investors sign up for the various calls, and the banks and ourselves were also engaging with a lot of others who were providing feedback and considering the deal. So the marketing process was very smooth.

On Thursday morning we went out with initial price guidance of 140bp. We knew the final level would be tighter, but we didn't know by exactly how much — our expectations were for perhaps 20bp-25bp — so the final outcome of 110bp may have surprised us a bit to the upside, but that was entirely supported by a book that at peak was about €4.4bn, with numerous triple-digit orders. We were expecting the reception to be good, but we were pleasantly surprised at just how big the book was and how many high quality investors came in. We were very happy with the level of demand and the final pricing, and we've been very pleased that the bonds have continued to trade well in the secondary market, which is good for us and good for investors.

BIHC: What can investors expect to see from AIA in terms of capital instruments going forward? Will you be a regular visitor to euros?

Farbman, AIA: Perhaps it's helpful if I answer that in the context of our key goals for the transaction. One was to reach an efficient and good pricing outcome, which we arrived at, as we just discussed. The other thing was to make sure that we brought in new investors and established our credit in the euro market, so that we would have the ability to come back to this market in the future, and I think the quality and the size of the book indicated that we were successful with respect to that goal, as well. So, yes, the intention is for us — alongside the various dollar markets that we access — to be able to consider the euro market for future issuance. This may be for a range of different structures — the bank-style Tier 2 that we issued, but it can also be hybrid debt going forward. Indeed, an important aim we had was to issue a bond that would be relevant for some time as a reference point, so that we can more easily return to the euro market quickly or when the opportunity arises in the future.

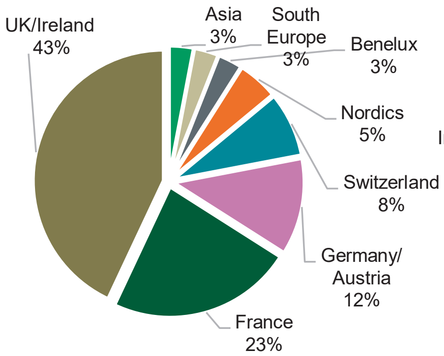
BIHC: What are the prospects for Tier 1 Limited issuance, as permitted under the HK GWS framework?

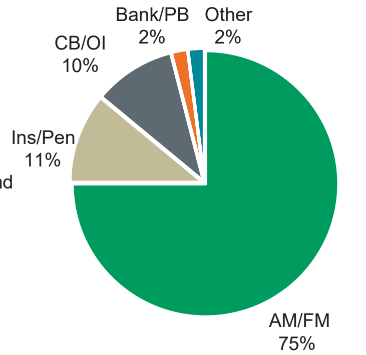
Farbman, AIA: Under the Hong Kong rules, Tier 1 Limited could make up 10% of our minimum required capital (which has to be met entirely by Tier 1), so it's something that is available. However, given our levels of solvency capital, and the way that we manage our various businesses, we are pretty strongly capitalised from a Tier 1 perspective. So our expectation would be to focus more on the various types of Tier 2, because that's the lower cost form of debt capital. But if there were opportunities in the future where Tier 1 Limited was competitive or compelling relative to the cost of Tier 2, it's certainly something we could consider.

BIHC: Is there anything else you would like to highlight about your overall strategy in this area?

Farbman, AIA: It's worth emphasising that AIA is a profitable growth company. While debt can be used for regulatory and ratings capital and capital structure optimisation, the primary driver behind our debt issuance has been to fund strategic growth — through bancassurance agreements, acquisitions, and so on — and that's how we would expect to continue to fund a portion of our growth in the future. This approach drives the slightly different composition of our issuance. We can look at senior debt, we can look at bank-style Tier 2, and we can look at hybrids — but it doesn't all have to be one or the other, because we are not in a position where we're entirely solving for regulatory or ratings outcomes. ●

Distribution by geography and investor type





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