Bank+InsuranceHybridCapital Briefing

September sets AT1 record ahead of 2025 peak, bringing par call strategies to the fore

Record AT1 supply last month reflected not only demand- but also supply-side factors, notably 2025 having the busiest calendar for calls yet, thanks to the accumulation of issuance over the past decade. As such, the activity offered critical insights into investors' and issuers' stances vis-à-vis the instrument, especially the par call feature. *Neil Day* reports, with insights from Crédit Agricole CIB.

Additional Tier 1 issuance is nearing its biggest yearly total after a bumper 16 benchmark trades from European financial institutions in the space of a month, with issuers taking advantage of buoyant conditions to pre-empt upcoming calls and supply providing insights into behaviour around par call structures.

The 15 September benchmark AT1 deals for around €12.6bn-equivalent across euros, sterling and US dollars lifted year-to-date issuance to around €36.5bn, with Commerzbank adding $750m (€672m) on Tuesday of last week (1 October). This compares with around €26bn in the whole of 2023 and is only around 10% shy of the record set in 2014 when AT1 issuance was initially ramped up.

Momentum continued through September after a lightening start in the first week of the month *(see previous BIHC Briefing)*, the peak marked by a $800m perpetual non-call 7.5 trade from Nordea on 19 September — the day after the Federal Reserve delivered its first rate cut, and in size, cutting by 50bp rather than 25bp. The Scandinavian bank's deal was priced with a 6.3% coupon, some 20bp through fair value and tightened from initial price thoughts of the 7.125% area on the back of $11.5bn-plus peak and $6.8bn-plus final books.

Doncho Donchev, executive director, DCM Solutions, Crédit Agricole CIB, cites four factors as driving the financial institutions' AT1 issuance.

"Cash rich investors have been swarming new AT1 issues for the high coupons they offer in anticipation of falling rates," he said, "with the Fed delivering the big one after the ECB and Bank of England had taken their first steps.

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"Then there is the fear of the US election — not so much who wins, but what happens if it is a contested election that creates volatility and closes the market? And let's not forget residual fears of a recession — everyone is talking about a soft landing, but what if we have a hard landing?"

Finally, notes Donchev, some €36bn of AT1 call dates are scheduled in 2025 across euros, dollars and sterling, making it the biggest ever year in this respect, as calls under various perpetual non-call five, non-call seven and non-call 10 structures coincide for the first time. Institutions such as Deutsche Bank, Intesa Sanpaolo and UBS have as many as three AT1 call dates next year.

Too far, too fast for some

Nordea's AT1 transaction was one of eight new issues (nine tranches in total, with HSBC issuing dual-tranche) in US dollars from the beginning of September to Commerzbank's on 1 October, totalling $11bn.

The market's direction was evident from the Nordic perp non-call 7.5 deal's coupon of 6.30% being more than 1% inside that of an, admittedly longer dated, perp non-call 10 from BNP Paribas just 16 days earlier, on 3 September, with AT1 yields and spreads collapsing much faster than moves in underlying US Treasuries. The attrition evident in Nordea's book, with 40% of orders by volume dropping, suggested the market had moved too far, too fast for some accounts.

Conditions nevertheless remained ripe, with Crédit Agricole selling its first dollar AT1 since January 2022 on 24 September. The French bank approached the market on the back of consistent reverse enquiries and following a non-deal roadshow across the US and Asia, going out with IPTs of the 7.25% area for a perpetual non-call 10 trade. After the order book peaked at $9.1bn, the deal was sized at the maximum targeted

$1.25bn size on the back of a comfortable final oversubscription and priced at 6.70%, with a reset margin of SOFR plus 359.6bp, more than 50bp better than achieved on recent issuance from Crédit Agricole's peer group.

The issuer was nonetheless mindful of investor sentiment, according to Donchev.

"While it attracted some investors that many European issuers can only dream of, high quality buy-and-hold accounts including some insurance companies and pension and sovereign wealth funds," he said, "some investors were price sensitive from the start, while some classic AT1 investors simply dropped. In this market, you have to be aware that there can be some investor reticence and not squeeze too aggressively.

"We are seeing barbell distribution, with the top 10 to 20 accounts taking the lion's share of AT1s," added Donchev, "then hundreds of smaller investors with small allocations, and some trading accounts. Execution is still tied to the large specialist funds — issuers can afford to lose one or two, but beyond that a deal may come apart."

The book for a $1bn perp non-call seven issue for Lloyds Bank two days later peaked at some $5.25bn, with pricing tightened from the 7.125% area to 6.75%, while Commerzbank's $750m perp non-call 6.5 was tightened from the 8% area to 7.5% on the back of peak $5.25bn-plus and final $4.2bn-plus books.

The German bank's deal came amid takeover talk, with UniCredit eyeing Commerzbank, and after it had sold a €750m 7.875% perp non-call 2032 AT1 in June. Commerzbank noted that the pricing of the new dollar issue was substantially inside comparable euro funding levels.

Par calls: theory versus practice

As well as providing welcome opportunities for issuers and investors alike, the AT1 wave offered clues as to how so-called "par calls" are being viewed and used by each side of the market.

The par call feature of hybrids separates the first call date and first reset date — typically by six months for AT1s and three months for Tier 2s — with issuers able call the instrument at par at any time during the intervening period. Issuers thereby have additional flexibility on the replacement of capital instruments and it allows for a reduction in the potential cost of carry.

Doncho Donchev, Crédit Agricole CIB: 'You have to be aware that there can be some investor reticence'

But as par call periods approach, the difference in returns realised by investors if the bond is valued to the first or last possible call dates diverges greatly. Investors meanwhile have to track the varied documentation of different issuers, including coupon resets and call frequency after the first call date.

After being introduced and widely used in the corporate space, the par call feature began being used in the banking and insurance sectors in 2019, so — with the earliest par call date being five years — it is only now that evidence of how bank issuers would use them in practice and how investors would position themselves has been emerging.

With investors typically valuing AT1s to the first possible call date at the start of the par call period, their interest lies in issuers exercising calls at that point.

Among smaller or infrequent issuers with lower AT1 amounts outstanding, the question of how the par call feature would be used in practice has now been answered via a few concrete cases: Ireland's AIB and Bank of Ireland, as well as Iceland's Arion, launched new issues alongside tenders for their outstandings well in advance of the opening of their par call periods in late 2024 and 2025.

"The feature sounded nice in theory," said Donchev, "but in practice these banks have not used the feature so far. And not only did these banks not use it, but they gave a very clear feature to investors that they wanted to refinance their AT1 bonds in advance.

"This could have been simply a function of the very attractive market," he added, "but I expect investor pushback was a factor, too, with these banks requiring regular access to the capital markets, even if they are not the largest."

Among bigger players, the first issuers with par call periods approaching, in December, have also pre-empted par call periods: Nationwide Building Society issued a £750m (€890m) 7.5% perp non-call 6.75 on 9 September ahead of compatriot Lloyds' dollar AT1. This has heightened anticipation that the two will call their outstanding issues at the first opportunity, with Lloyds' action more eagerly awaited as it is one of the few banks not to have called an AT1, in May 2020 amid the impact of Covid.

When push comes to shove

With par calls having yet to serve their theoretical purpose — not to mention the complications of appropriately hedging AT1s incorporating the feature — some issuers have decided to dispense with them in their latest new issues.

Having previously included par calls in recent AT1 issuance, ING Groep and KBC dropped them from $1bn 7.25% perpetual non-call 10 and €750m 6.25% perp non-call seven trades on 5 and 10 September, respectively, as did Crédit Agricole and Lloyds from their new issues. Alpha Bank meanwhile reduced the par call period from six to three months as a mitigant to investor concerns. However, UBS introduced a six month par call for the first time, on a $1.5bn 6.85% perp non-call 5.5 on 5 September.

Other issuers to have previously included the feature retained it, while ABN Amro and BNP Paribas, in line with

Recent AT1 issuance including call features

Pricing Date	Issuer	Currency	Amount (m)	Tenor	Coupon	Reset spread	IPTs	NIP (bp)	Book (bn)	Cover ratio	Par call	Calls post first call/ reset date	Clean-up call
02 Sep	ABN Amro	EUR	750	PNC10	6.375%	+390.2bp	7.00%	6.25	4,750	6.3x	None and not used in any AT1	Every interest payment date (IPD), i.e. S/A	No
03 Sep	BNP Paribas	USD	1,000	PNC10	7.375%	+353.3bp	8.00%	0	10,000	10.0x	None and not used in any AT1	Every reset date, i.e. every 5 yrs	No
03 Sep	Bank of Ireland	EUR	600	PNC6	6.375%	+402.6bp	7.00%	-12.5	2,850	4.8x	6M par call	Every IPD, i.e. S/A	Yes (75%)
03 Sep	Alpha Bank	EUR	300	PNC6	7.50%	+517.8bp	8.00%	0	2,700	9.0x	3M par call	Every IPD, i.e. S/A	Yes (75%)
04 Sep	HSBC	USD	1,350	PNC5.5	6.875%	+329.8bp	7.625%	0	$20bn+ combined	8.0x	6M par call	6M par call prior to every reset date (every 5 yrs)	No
04 Sep	HSBC	USD	1,150	PNC10	6.95%	+319.1bp	7.625%	0					
05 Sep	ING Groep	USD	1,000	PNC10	7.25%	+408.4bp	7.875%	6.25	8,400	8.4x	No par call in this AT1 issue, used in previous recent AT1s	Every IPD, i.e. S/A	Yes (75%)
05 Sep	UBS	USD	1,500	PNC5.5	6.85%	+363.0bp	7.50%	0	9,900	6.6x	6M par call, new introduction (previously not used)	Every reset date, i.e. every 5 yrs	No.
09 Sep	UniCredit	EUR	1,000	PNC7.75	6.50%	+421.3bp	7.00%	0	2,800	2.8x	6M par call	Every IPD, i.e. S/A	Yes (75%)
09 Sep	Nationwide	GBP	750	PNC6.75	7.50%	+385.2bp	8.00%	0	3,500	4.7x	6M par call	Every reset date, i.e. every 5 yrs	No
10 Sep	BAWAG	EUR	500	PNC5.5	7.25%	+505.2bp	7.50%	0	1,050	2.1x	6M par call	Every IPD, i.e. S/A	Yes (75%)
10 Sep	KBC	EUR	750	PNC7	6.25%	+398.9bp	6.75%	0	1,400	1.87x	No par call in this AT1 issue, used in 2023 AT1	Every IPD, i.e. S/A	No
17 Sep	Arion	USD	125	PNC5.5	8.125%	+467.5bp	8.625%	0	350	2.80x	6M par call	Every IPD, i.e. S/A	Yes (75%)
19 Sep	Nordea	USD	800	PNC7.5	6.30%	+266bp	7.125%	-20	11,500	14.38x	6M par call	Every IPD, i.e. S/A	Yes (75%)
24 Sep	Crédit Agricole	USD	1,250	PNC10	6.70%	UST+302bp / Swap+ 359.6bp	7.25%	0	9,100	7.28x	No par call in this AT1 issue, used in previous AT1s	Every reset date, i.e. every 5 yrs	Yes (75%)
26 Sep	Lloyds	USD	1,000	PNC7	6.75%	UST+315bp / Swap+ 355bp	7.125%	0	5,250	5.25x	No par call in this AT1 issue, used in previous AT1s	Every reset date, i.e. every 5 yrs	No
01 Oct	Commerzbank	USD	750	PNC6.5	7.50%	+433.2bp	8.00%	12.5	5,250	7.00x	6M par call	Every IPD, i.e. annual	Yes (75%)

Source: Crédit Agricole CIB

their previous AT1s, continued without par calls in their euro and dollar deals that reopened the respective markets.

"Because of a combination of hedging issues and how the par call has developed in practice, some issuers have not included them," said Donchev, "and have used this as a marketing feature for their new issues, aware that there has been verbal pushback from some accounts. However, while investors may be happy with the lack of par calls, there has been no discernible impact on the outcome of the trades.

"Has it affected the book quality, oversubscription and the performance of deals? Absolutely not. When push comes to shove, demand is a function of where the market is, how investors see relative value, and how much money they can make."

However, Donchev notes that investor feedback suggests they may reassess the way they view and calculate returns for AT1s with par calls should a major bank decide to make use of the par call period.

The next test case on the horizon is Intesa Sanpaolo, which has a €400m 5.875% AT1 with a first call date of 20 January 2025 and first reset date of 20 June 2025.

Another technical development in AT1 supply has been the first Yankee issuance with SOFR-based resets, rather than US Treasury-based resets. UST-based resets had been the norm for dollar AT1s with the phasing-out of Libor, but the emergence of the reliable SOFR-based swaps curve in the past couple of years has allowed issuers such as Crédit Agricole, ING and UBS to use it as the basis for resets in their new transactions.

Having a SOFR-based reset avoids basis risk versus Treasuries for issuers using swaps to switch from fixed to floating coupons, while investors have cited easier comparisons of such dollar AT1 with euro equivalents as an advantage of the development. Recently the difference between SOFR-based resets and UST equivalents has been some 60bp. ●

Tier 2 dynamics mean proposed Australian phase-out of AT1 securities 'manageable'

Australia could become the first jurisdiction to phase out AT1 for banks, after the Australian Prudential Regulation Authority (APRA) on 10 September published a proposal to do so from 1 January 2027 to 2032 that could see some A$35bn of incremental Tier 2 issuance in the coming years.

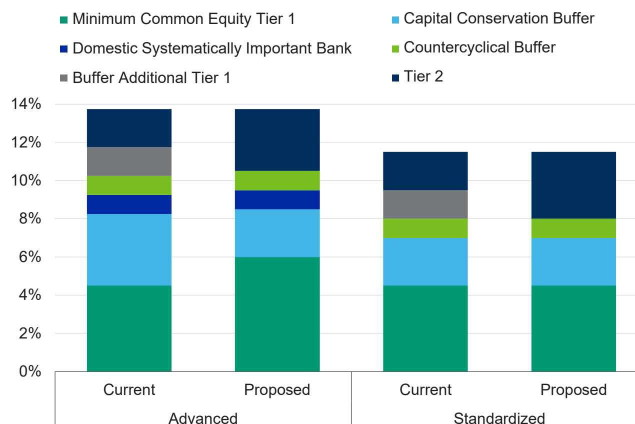
The move — which kicked off a two month consultation period — came after the Australian regulator in September 2023 floated a reduction in "reliance on AT1" or large scale modifications to the AT1 structure, including materially increasing the trigger levels. The country's four large banks have around A$39bn (€24bn, US$26bn) of such issuance outstanding.

"Unfortunately, international experience has shown that AT1 does not fulfil this function in a crisis situation due to the complexity of using it, the potential for legal challenges and the risk of causing contagion," said John Lonsdale, chair of APRA.

"These risks are heightened in the Australian context due to the unusually high proportion of AT1 held by retail investors."

While the total amount of regulatory capital banks would be required to hold

Current and proposed minimum bank regulatory capital frameworks



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Sources: APRA and Moody's Ratings

would remain unchanged under the proposed approach, large, internationally active banks would be able to replace the 1.5% AT1 bucket with 1.25% Tier 2 and 0.25% Common Equity Tier 1 capital.

Advanced bank requirements for CET1 would rise 0.25% to 10.5%, and Standardised banks' remain at 8.0%. Smaller banks would be able to fully replace AT1 with Tier 2, upon a reduction in Tier 1 requirements.

After 2027, existing AT1 instruments will be eligible as Tier 2 capital until their first scheduled call date.

APRA expects the volume of Tier 2 funding needed to replace AT1 over the next several years to be around A$35bn. Its base case puts the estimated funding cost — stemming from a potential repricing of Tier 2 instruments without AT1 in the capital structure — at A$70m for Advanced banks.

Although Australian Tier 2s widened on news of APRA's proposals, with some knee-jerk selling, they are only expected to be slightly negative for the asset class over the medium to long term, according to Daniel Dela Cruz, head of debt capital

markets, Australia and New Zealand for Crédit Agricole CIB, with the transition very manageable.

"It will be interesting to see where the circa A$40bn of AT1 liquidity goes once they are called," he said. "Most of the domestic investors in these securities consider them 'fixed income', as they are already exposed to bank equity, and so a good portion of it could well migrate to ETF funds that invest in Tier 2 bonds to continue to chase yield.

"Meanwhile, other domestic investors in these securities who take advantage of the 'franking credits' will move to other alternative products or buy more bank equity."

Dela Cruz notes that Australian banks enjoy healthy demand for their Tier 2 in offshore markets, particularly euros and US dollars, where they are appreciated as low beta, safe haven product and offer a pick-up over senior (non-preferred) paper. He points to a US$1.25bn 11 non-call 10 Tier 2 for ANZ on 23 September that was tightened from the US Treasuries plus 175bp area to 147bp after books peaked at around US$5.5bn — having been recently upgraded, the notes are rated single-A by all the bank's three rating agencies.

However, a conclusive verdict will only be possible once the new regime is finalised.

"Most investors are still comfortable with the instrument and see very minimal call risk in the new regime," added Dela Cruz, "although others warned of further price reaction if the proposal is confirmed with more details."

Outstanding AT1s have benefited from the news, while a A$800m floater perp for ANZ Holdings New Zealand printed the day after APRA's announcement traded up a point on the day of launch.

"The proposals are positive for AT1 from a technical perspective," said Dela Cruz, "and mean a much lower risk of non-call, even if this was already negligible."

Australian banks meanwhile generate very strong capital from their earnings and remain well above APRA minimum requirements, meaning the 0.25% increase in CET1 requirement should not be problematic, he notes.

The revised Australian capital framework also remains more conservative than Basel requirements.

Moody's said the proposals are neutral for bank capital adequacy but positive for banking system stability because they promote a simpler resolution regime that would limit the severity of losses for investors in a bank resolution.

"In APRA's discussion paper, it noted banks' potential reticence to suspend AT1 securities distributions and the complexity of multiple stakeholders as potential hurdles to the effectiveness and timeliness of bank resolution," the rating agency said.

"Additionally, contagion risk is heightened in Australia because these securities have a high volume of retail investors who may be less equipped to absorb losses."

Fitch said few countries are likely to follow the Australian example, unless the Basel Committee on Banking Supervision were to issue a recommendation. The committee is nonetheless just one of many looking into the role of AT1.

"While most investors do not expect other regions to follow with similar framework," said Dela Cruz, "one investor in particular noted that what APRA proposed was indeed a wake-up call — people need to take a step back and reevaluate AT1 as an effective loss absorption instrument."

Insurance companies and their AT1 instruments are not affected as their position in the capital regime will be retained, APRA confirmed.

Insurers' ability to continue to issue AT1, while banks cannot, should make them one of the biggest beneficiaries of the move, said Dela Cruz. ●

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HE HAS THE COURAGE TO LOSE SIGHT OF THE SHORE
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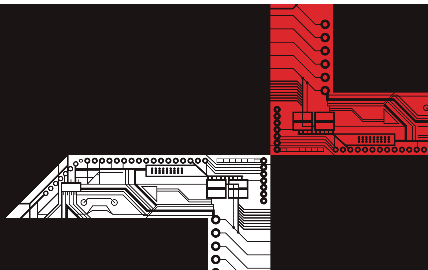

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