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Institutions line up for new-style sub debt

Last Monday Bendigo and Adelaide Bank launched a $200 million issue of subordinated debt. It priced the deal a day later below the price guidance and increased the size to $300 million.

The transaction is significant because it is the first of the Basel III-compliant issues by Australian banks to be targeted at institutional investors. Previous issues of Tier 2 capital and Additional Tier 1 capital that incorporated new features such as the 'non-viability' clause have been marketed to retail investors.

The transaction was launched as a $200 million issue with an indicative margin of 285 to 300 basis points (bp) over 90-day bank bills. It was priced on Tuesday at a margin of 280bp and increased to $300 million.

In a statement the bank said strong support from domestic and international institutional investors enabled it to close the book-build earlier than planned with the notes more than 2.5 times over-subscribed. More than 35 investors from Australia, Asia and parts of Europe took up the notes.

Bendigo and Adelaide Bank is rated A-/A2/A- by the three major ratings agencies. AMP, which is rated a notch higher, priced a similar Tier 2 capital transaction late last year at a margin of 265bp. It is now trading at a spread of 250bp, indicative of the general tightening in credit spreads.

Cheap capital: tomorrow's expensive debt

Andrew Papageorgiou, investment manager at Realm Investments, said the 280bp spread on the new issue was fair compensation. He views the non-viability clause, which allows the debt to be converted into equity if the Australian Prudential Regulation Authority (APRA) deems the bank to be non-viable, as a tail risk.

He is pricing the 10-year transaction on the basis that it will be called after five years, at which point "cheap capital becomes expensive debt." That's because after five years the securities no longer get 100 per cent credit as capital – the capital treatment is amortised at a rate of 20 per cent per annum - and are treated as a mix of capital and ordinary debt. In his opinion, spreads would need to be materially wider for extension risk to be a concern.

The fact that international investors participated is also interesting given European banks have priced similar transactions at much higher spreads. Late last year Barclays Bank priced an issue of Additional Tier 1 capital with a coupon of 8.25 per cent.

Comparisons between Australian bank transactions and European ones aren't valid because Europe has deflation and banks there are in a "generational debt crisis" with the asset quality not nearly as high as in Australia, said Papageorgiou.

The non-viability clause is the subject of much discussion because APRA hasn't defined it. However, Papageorgiou is less concerned about how it would be actioned and implemented. His interest is more in how the market would respond to deteriorating conditions in the banking sector.

Another investor, who didn't participate in the transaction because the bank isn't on his list of preferred

issuers, welcomed the introduction of the new Basel III instruments to institutional investors.

None of his mandates preclude him from holding debt that is convertible into equity. In any event there should be forewarning of that happening. “It may not be a price you like but you should be able to sell it down before it converts,” he said.

The new instruments with their more risky structures have to “become the market norm and the market comes to accept it and incorporate that risk into their thinking.”

One banker commented that he expects Tier 2 capital to be increasingly placed with institutional investors while the higher-margin, more deeply subordinated Additional Tier 1 securities would go to retail investors.

Rabo benchmark, CBA and NAB have it covered

Rabobank Nederland Australia Branch was the first bank to price a senior unsecured benchmark-sized deal of the year.

The five-year floating-rate notes were sold at a margin of 105bp over bank bills, with 75 per cent of the paper placed with domestic investors and the balance going offshore, predominantly to Asia.

Commonwealth Bank of Australia has completed three covered bond transactions so far this year.

It started with a €1 billion five-year transaction that was priced at 18bp over the mid-swap and most recently priced a £350 million four-year issue with a margin of 35bp over sterling Libor. It also privately placed a €45 million eight-year covered bond.

National Australia Bank was also in on the act, pricing a Swiss franc 200 million 10-year covered bond flat with the mid-swap rate.

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