Helaba

Focus on: Credits
2 August 2021

Regulatory call option for non-preferred bonds becoming standard

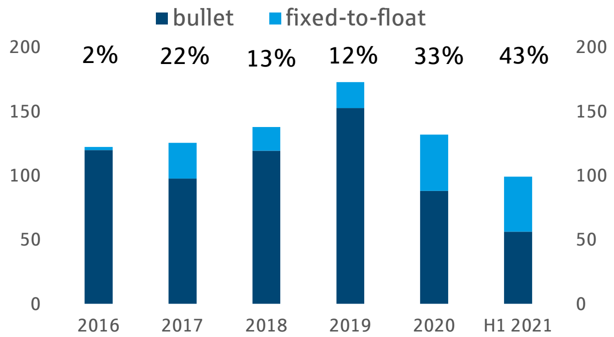
sk/ The fixed-to-float option for euro-denominated, non-preferred senior bonds, which can be called one year prior to final maturity, is becoming increasingly popular. This trend is being spurred on by the latest minimum requirements for own funds and eligible liabilities (MREL). A number of fixed-to-float instruments offer attractive spreads, both on the primary as well as the secondary markets.

Call option one year before final maturity motivated by regulatory considerations

The share of non-preferred senior unsecured issues with a call option one year before final maturity is steadily increasing (fixed to floating rate notes, see also **"Primary Market Update EUR Benchmark Bank Bonds"** of 7 July 2021). The underlying reason for this trend is that any instruments held as eligible liabilities by large and systemically relevant banks that count towards the minimum MREL requirement must have a residual maturity of at least one year (Article 72c CRR 2). Issuers grant themselves an early termination right in order to avoid non-eligible maturities during the year. Minimum requirements for own funds and eligible liabilities (MREL) generally apply to all institutions that fall within the scope of the European single resolution mechanism as defined by the Bank Recovery and Resolution Directive 2014/59/EUR (BRRD).

Growing prominence of fixed-to-floaters

EUR benchmark issuance volume (in EUR billions)



Sources: Bloomberg, Helaba Research & Advisory

Statutory minimum ratios for entire MREL requirement applicable to large banks

The respective resolution authorities are responsible for determining the minimum requirement level on an individual basis. In addition, statutory minimum ratios also apply to certain groups of institutions: for global systemically important institutions (G-SIIs)[1], statutory minimum MREL ratios have been in force since as early as the end of June 2019[2]. Statutory minimum MREL ratios will also apply to top tier banks from 1 January 2022, including banks with total assets in excess of EUR 100 billion[3]. Furthermore, the resolution authority may classify institutions with total assets of less than EUR 100 billion as top-tier banks if it deems, with sufficient probability, that their failure poses a systemic risk (fishing option)[4]. It is also likely that minimum MREL requirements will be imposed on banks supervised by the ECB (with total assets of EUR 30 billion or more).[5]

[1] Art. 131 CRD. Once a year, the Basel-based Financial Stability Board identifies 30 institutions among G20 countries considered to be systemically important on a global level. According to the G20 Term Sheet, they are subject to particularly stringent TLAC - total loss absorbing capacity - requirements
[2] Art. 92a CRR
[3] Art. 45c (5) BRRD 2
[4] Art. 45c (6) BRRD 2
[5] The MREL requirements according to BRRD 2 had to be implemented nationally by 28 December 2020 (in Germany via the so-called Risk Reduction Act). The previous catalogue of MREL criteria according to Article 45 BRRD 1 was transposed into the CRR (Articles 72a to 72c CRR 2), including the criterion that liabilities may only count towards MREL requirements if they have a residual maturity of at

MREL at a glance
Positions and rules

	G-SIIs	Top tier banks (> EUR 100 bn total assets and fishing option)	Other banks (subject to resolution)
Since banking package came into force (28 June 2019)	16 % RWA 6 % LRE Higher institution-specific requirement, if applicable	Institution-specific requirement	Institution-specific requirement
From 2022	18 % RWA 6,75 % LEA* Higher institution-specific requirement, if applicable	13,5 % RWA 5 % LEA Higher institution-specific requirement, if applicable	Institution-specific requirement
From 2024	See above, additionally 8 % TLOF**	See above, additionally 8 % TLOF** (but max. 27% RWA)	Institution-specific requirement; additionally 8 % TLOF** at discretion of resolution authority
Subordinated liability	Discretionary subordinated liability		Case-by-case decision (NCWO*** assessment)

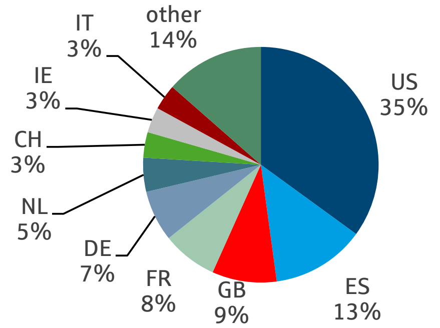
* LEA: Leverage Exposure Amount ** TLOF: Total Liabilities and Own Funds *** No Creditor Worse Off, creditors cannot incur greater losses than those they would have incurred if the institution had been liquidated
Sources: Deutsche Bundesbank, BaFin, Helaba Research & Advisory

Fixed-to-float option meanwhile established format

While fixed-to-floaters played a relatively insignificant role in the euro area back in 2016, their volume had risen to around EUR 44 billion by 2020. In the first half of 2021, as much as EUR 43 billion had already been placed on the market. In addition to US banks, institutions from Spain have recently made particular use of the regulatory call option one year before final maturity. Moreover, banks from other European countries, especially France, have already had extensive recourse to this funding instrument in the scope of their refinancing activities and, in this way, have aligned themselves with the relevant statutory MREL requirements.

Fixed-to-float: generous supply from US banks in H1 2021

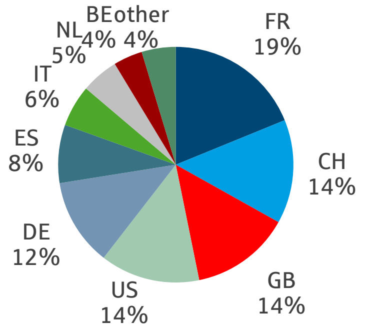
Issuance of fixed-to-floaters in H1 2021 (total of 43 EUR bn)



Sources: Bloomberg, Helaba Research & Advisory

Broadly diversified by region

Fixed to floating rate issues in whole of 2020 (total of EUR 44 bn)



Sources: Bloomberg, Helaba Research & Advisory

From 19 transactions in 2017, the number of issues had risen to 43 by 2020 and as many as 43 bonds were placed in the first half of 2021 alone. At the same time, the average transaction size declined from EUR 1.5 billion in 2017 to EUR 1.0 billion in H1 2021 - a reflection of the fact that, in addition to global systemically important banks, the regulatory requirements for total liable capital are increasingly being applied to top tier banks as well.

least one year (Article 72c CRR 2). Regarding the banking package, see also Credit Special "**Riskier credit growth with meagre margins**", of 22 January 2020

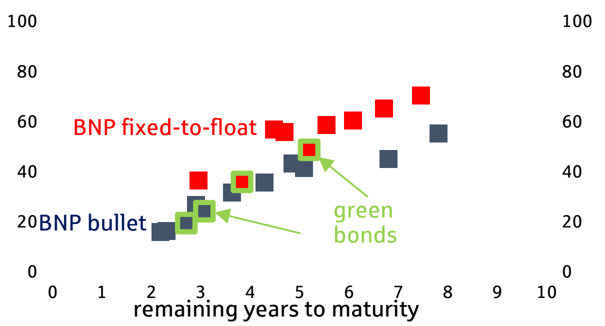
Fixed-to-float bonds offering attractive spread premiums

For senior non-preferred notes with a fixed to floating rate structure, the rates of oversubscription have been noticeably higher since 2019 than for senior non-preferred bullet notes without a call option. In 2020, the median oversubscription rate for fixed-to-floaters was 2.9 times, compared to 2.4 times for bullet bonds. Therefore, it appears that demand for this category of bond is rather buoyant and driven by investors' search for higher yields.

In our view, it is possible to find rather attractive spread premiums for fixed to floating rate notes. For instance, it is not uncommon to see spread premiums on the secondary market of up to 15 basis points over comparable bonds. Our analysis has shown that, on the primary market, so far these bonds have been priced with a median spread premium of around 10 basis points higher than comparable bullet issues in 2021.

BNP Paribas: Fixed-to-floaters with attractive spreads on both secondary ...

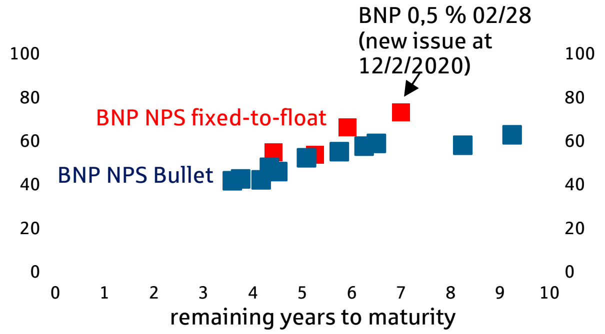
Current Z-spread in bps*



* Non-preferred EUR benchmark format, fixed coupon, 2.8.2021
Sources: Bloomberg, Helaba Research & Advisory

... and primary markets

Z-spread in bps on 12 February 2020*

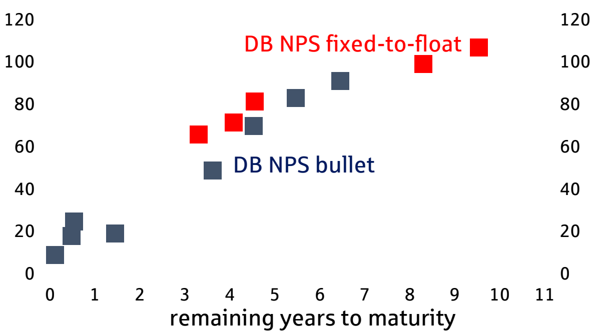


* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

This analysis assumes that issuers will call the bond one year prior to final maturity. We believe that this comparatively expensive funding instrument will generally lose its appeal for them as soon as the advantage of its eligibility for MREL in the final year no longer applies. However, there is an element of risk that the principal will not be paid back until a later maturity date. However, issuers will consider damage to their reputation when weighing up the positives and negatives. In our view, this would only be a feasible option in a crisis scenario in which access to the money markets is severely disrupted. Those who would like to minimise this residual risk further should focus on issuers with stronger credit ratings and substantial capital market refinancing activities.

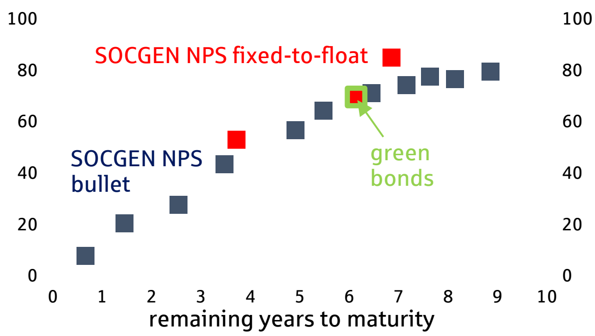
ATTACHMENT:
Selected fixed-to-float issuers
(as of 2 August 2021 in each case, term to maturity assumes bonds called before final maturity)

Deutsche Bank NPS notes*
Current Z-spread in bps



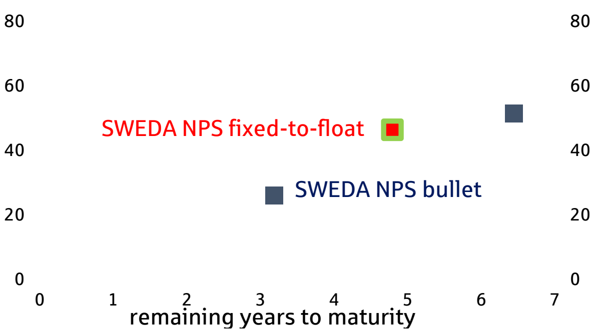
* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

Société Générale NPS notes*
Current Z-spread in bps



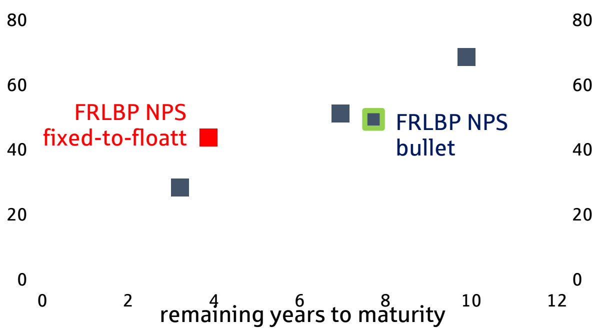
* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

Swedbank NPS notes *
Current Z-spread in bps



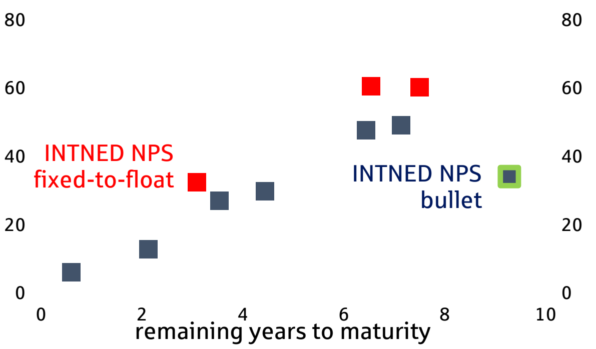
* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

La Banque Postale NPS notes*
Current Z-spread in bps



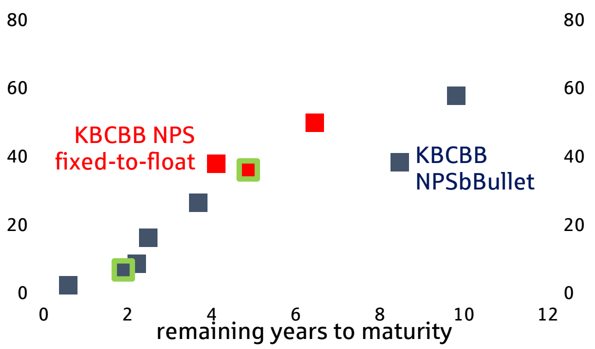
* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

ING Group NPS notes
Current Z-spread in bps



* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

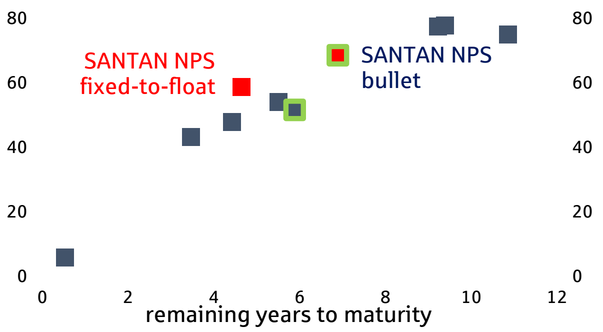
KBC Group NPS notes
Current Z-spread in bps



* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

Banco Santander NPS notes

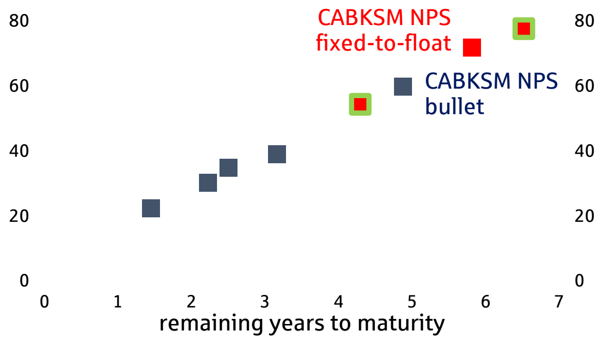
Current Z-spread in bps



* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

CaixaBank NPS notes

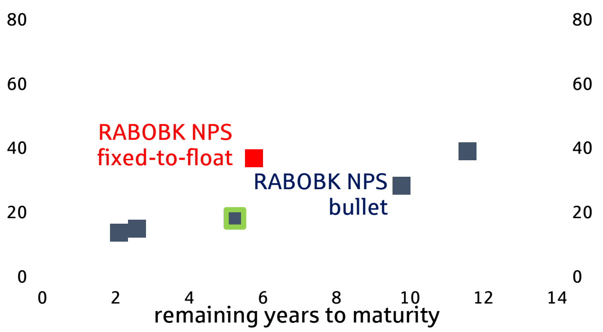
Current Z-spread in bps



* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

Rabobank NPS notes

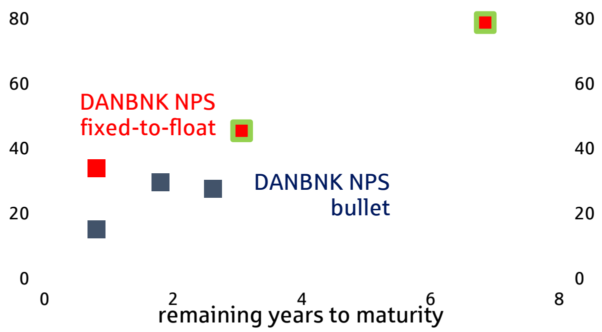
Current Z-spread in bps



* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

Danke Bank NPS notes

Current Z-spread in bps



* Non-preferred EUR benchmark format, fixed coupon
Sources: Bloomberg, Helaba Research & Advisory

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