Fixed Income
Credit Commentary

19 April 2023

CMBI Credit Commentary

Asian T2s: Lower beta plays in volatile times

Executive Summary

- We consider Asian T2s lower beta and yield pick-up trades over their seniors and global peers. In times of volatility when bonds and capital papers of European peers were hit by the woes of SVB and CS, Asian T2s have been performing resiliently with largely muted price actions (See table 4). Within the Asian T2s space, we prefer **ANZ 2.95 07/22/30, KBANK 3.343 10/02/31, SHINFN 3.34 02/05/30**, **WSTP 2.894 02/04/30** for their decent risk-return profiles. We believe the likelihood of non-viability event is low and the return predictability of these T2s are high given the issuers' solid capital adequacy, stable dividend policy and track records of calling their T2s on the first call dates (except for KBANK 3.343'31 which is Kasikornbank's first T2 issuance).

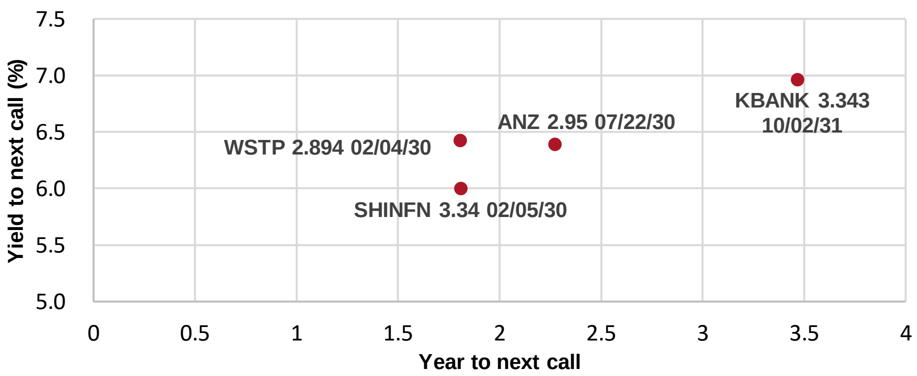
- As we discussed in our trilogy on Asian AT1s (Asian AT1s Part I – Our picks on Chinese G-SIBs AT1s, Asian AT1s Part II – Picks on DM AT1s, Asian AT1s Part III – Picks on EM AT1s), the return predictability of Asian bank papers has been higher compared with that of its EU peers in view of the sound track records of call on the first call dates and distributions. Indeed, we would argue that the return predictability of bank T2s would be even higher than that of AT1s given its higher seniority in the capital structure.

Table 1: Summary of our picks

	First call date	YTC	Px	Year to call	Amount o/s
KBANK 3.343 10/02/31	10/02/26	7.0	89.0	3.5	USD800mn
WSTP 2.894 02/04/30	02/04/25	6.4	94.1	1.8	USD1500mn
ANZ 2.95 07/22/30	07/22/25	6.4	92.8	2.3	USD1250mn
SHINFN 3.34 02/05/30	02/05/25	6.0	95.5	1.8	USD500mn

Source: Bloomberg.

Chart 1: YTC of our picks



Source: Bloomberg.

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Asian T2s: Lower beta plays in volatile times

Prefer ANZ 2.95’30, KBANK 3.343’31, SHINFN 3.34’30, WSTP 2.894’30

We consider Asian T2s lower beta and yield pick-up trades over their seniors and global peers. Amongst Asian T2s, we pick **ANZ 2.95’30, KBANK 3.343’31, SHINFN 3.34’30, WSTP 2.894’30** for their decent risk-return profiles. We believe the likelihood of non-viability event is low and the return predictability of these T2s are high given the issuers’ solid capital adequacy, stable dividend policy and track records of calling their T2s on the first call dates (except for KBANK 3.343’31 which is Kasikornbank’s first T2 issuance).

Strong fundamental with solid capital buffer and stable dividend payout

We have summarized the capital adequacy ratio of our selected banks as at Dec’22 in table 2 below. Based on the current capital buffer, and their systemic importance to their home countries, the chance of occurrence of non-viability event is remote, in our view.

In particular, the total capital ratios of these banks are well above the regulatory minimum with 3.7-6.0% buffer. We estimate that they will still be able to meet the capital requirements even after redemption of their T2s without issuing replacement capital papers.

Their dividend payout and profitability metrics (such as ROA and ROE) are largely stable in past 5 years, except in the year of 2020 when they were impacted by COVID-19 but has recovered since then. Their track records of sustainable profitability also help building up the core capital.

Table 2: Capital adequacy and liquidity

Dec’22	ANZ	KBANK	SHINFN	WSTP
Country	AU	TH	KR	AU
T2 bond rating (M/S/F)	Baa1/BBB+/A-	Ba1/-/BB+	Baa1/BBB+/BBB+	Baa1/BBB+/A-
Issuer rating outlook	Stable	Stable	Stable	Stable
CET1 ratio (%)	12.30	14.93	14.05	11.29
Regulatory requirement (%)	10.50	8.00	10.50	10.50
Tier 1 ratio (%)	14.00	15.96	14.99	13.39
Regulatory requirement (%)	12.00	9.50	12.00	12.00
Total capital ratio (%)	18.20	18.02	17.72	18.40
Regulatory requirement (%)	14.00	12.00	14.00	14.00
Liquidity coverage ratio (%)	131	188.6	98.8	132
Regulatory requirement (%)	100	100	90	100

Source: Companies’ filling, CMBI Research.

Table 3: Profitability and dividend payout

	FY18	FY19	FY20	FY21	FY22
ROAA/ROA (%)					
ANZ	0.70	0.60	0.30	0.60	0.70
KBANK	1.27	1.20	0.85	0.98	0.86
SHINFN	0.66	0.61	0.50	0.55	0.62
WSTP	0.93	0.76	0.25	0.60	0.58
ROAE/ROE (%)					
ANZ	10.90	10.00	5.90	9.90	11.40
KBANK	10.61	9.90	7.10	8.44	7.38
SHINFN	9.77	9.18	7.71	8.75	10.13
WSTP	13.05	10.64	3.36	7.70	8.10
Dividend payout (%)					
ANZ	72.10	76.20	47.60	65.30	59.30
KBANK	29.40	34.43	23.73	23.91	28.75
SHINFN*	23.90	25.00	22.70	25.20	23.50
WSTP	79.52	88.83	48.87	79.25	76.79

Note: Shinhan Financial Group's dividend payout ratio.
Source: Companies' filling, CMBI Research.

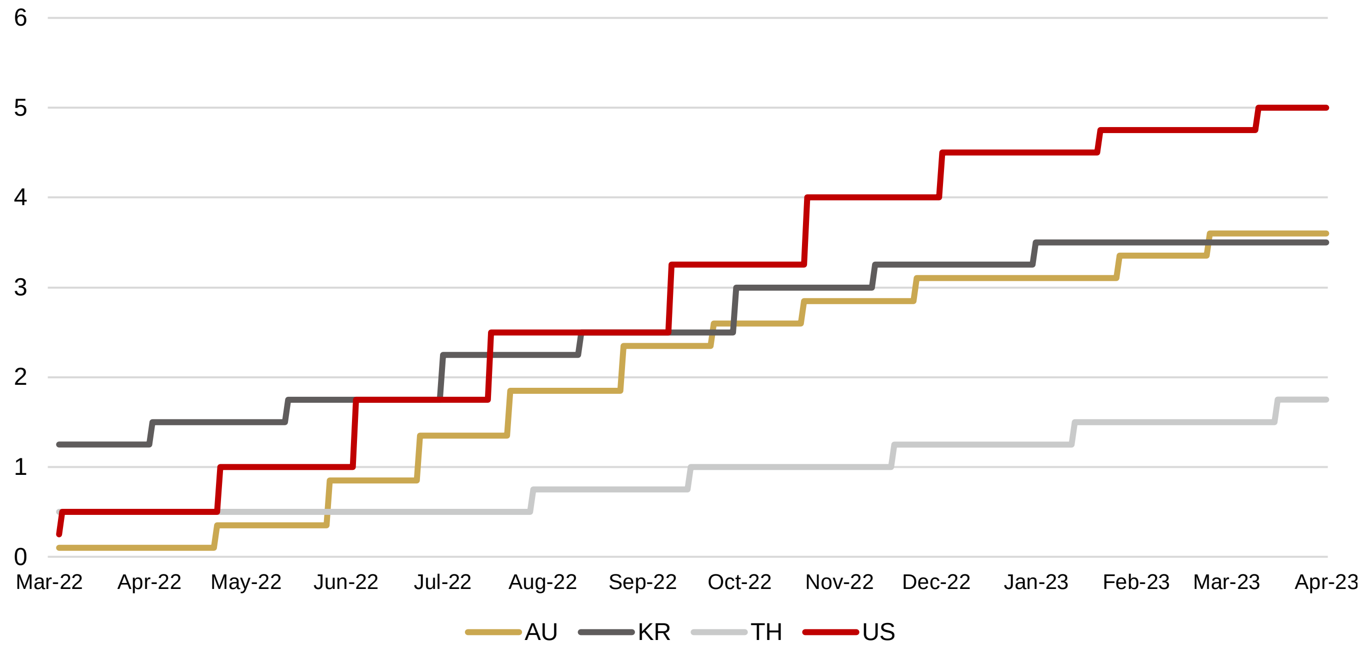
Limited spillover effect from SVB failure to Asia expected….

US regional bank Silicon Valley Bank (SVB) was taken over by the Federal Deposit Insurance on 10 Mar'23. This is the largest bank failure since 2008 financial crisis. Signature bank, another US regional bank, followed SVB's takeover two days after. The collapse of SVB was triggered by MTM losses resulting from Fed's rapid interest rate hikes, followed by the bank run. The contagion to Asian banks largely muted as the interest rate hikes by Asian central banks are in comparatively milder paces.

….while lower price fluctuation in Asian T2s impacted by UBS-CS merger

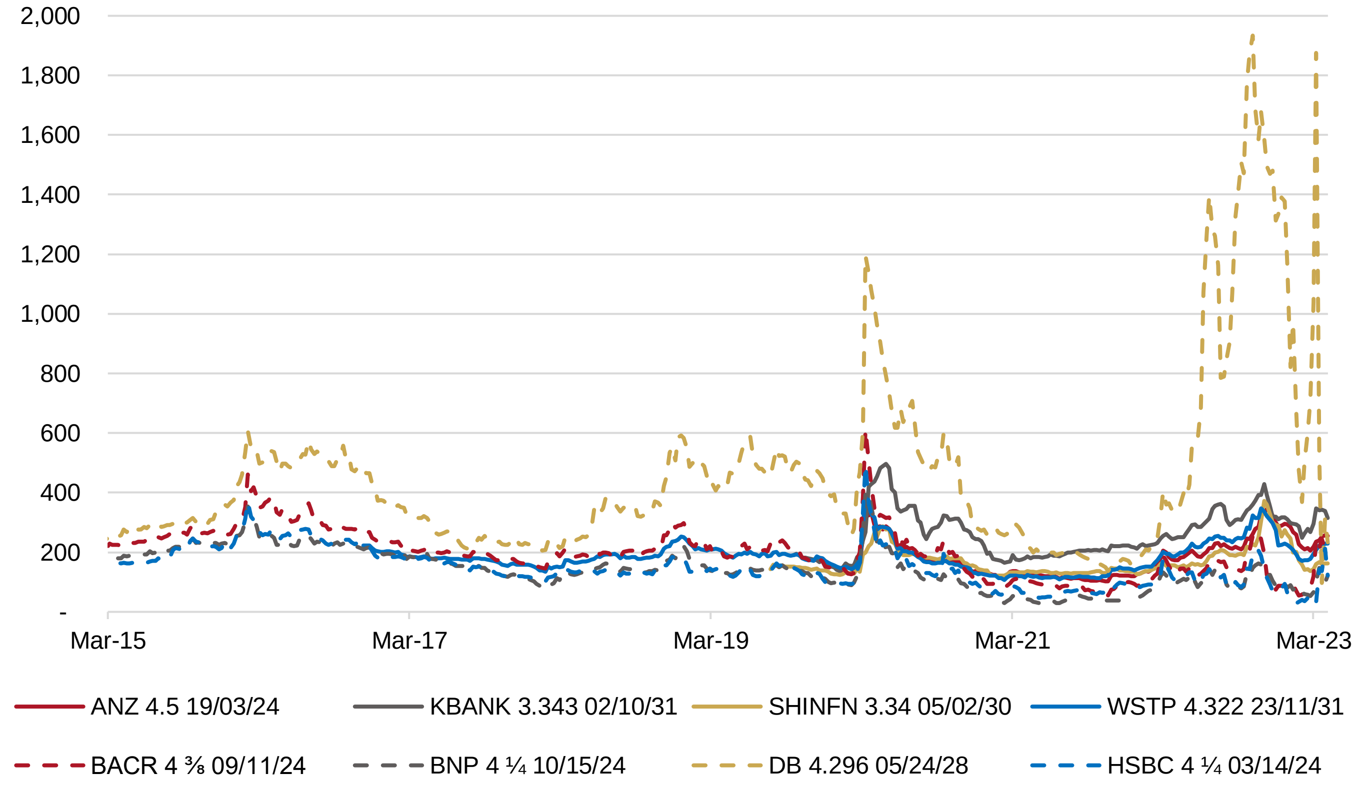
UBS and CS entered into a merger on 19 Mar'23 following the order by Swiss regulators. As instructed by FINMA, CS's USD17bn AT1s were fully written down in this non-viable event. The write-down of AT1 created turbulence in the global subordinated debt markets. The volatility of Asian T2s has been lower than that of EU peers (similarly rated G-SIBs) post the SVB and CS incidents. We view Asian T2s lower beta plays.

Chart 2: Policy interest rate movement comparison (%)



Source: Bloomberg.

Chart 3: Z-spread of our picks and EU GIBs peers (bps)



Source: Bloomberg.

Table 4: Z-Spread volatility of selected EU and Asian T2s from 1 Mar'23 to 18 Apr'23

Region	Bond	Price range	Max (bps)	Min (bps)	STD (bps)
Asia	ANZ 2.95 07/22/30	91.3-93.6	249.8	197.7	17.9
	KBANK 3.343 02/10/31	88.0-90.5	352.0	258.7	28.1
	SHINFN 3.34 05/02/30	94.5-96.3	168.9	122.9	12.8
	WSTP 4.322 23/11/31	93.8-96.3	235.2	166.0	20.1
Europe	BACR 4.375 09/11/24	96.2-97.9	289.4	65.3	54.3
	BNP 4.25 10/15/24	97.7-98.8	206.6	34.9	41.1
	DB 4.296 05/24/28	92.3-100.0	8,097.1	-452.1	1,777.7
	HSBC 4.25 03/14/24	96.5-98.7	357.4	14.3	76.7

Source: Bloomberg.

Higher predictability of return, Asian T2s non-calls are isolated events

The yield of similarly rated Asian and EU T2s are comparable but we consider the predictability of return of Asian T2s is higher, in view of Asian banks' more consistent track records of calling their capital papers on their first call dates.

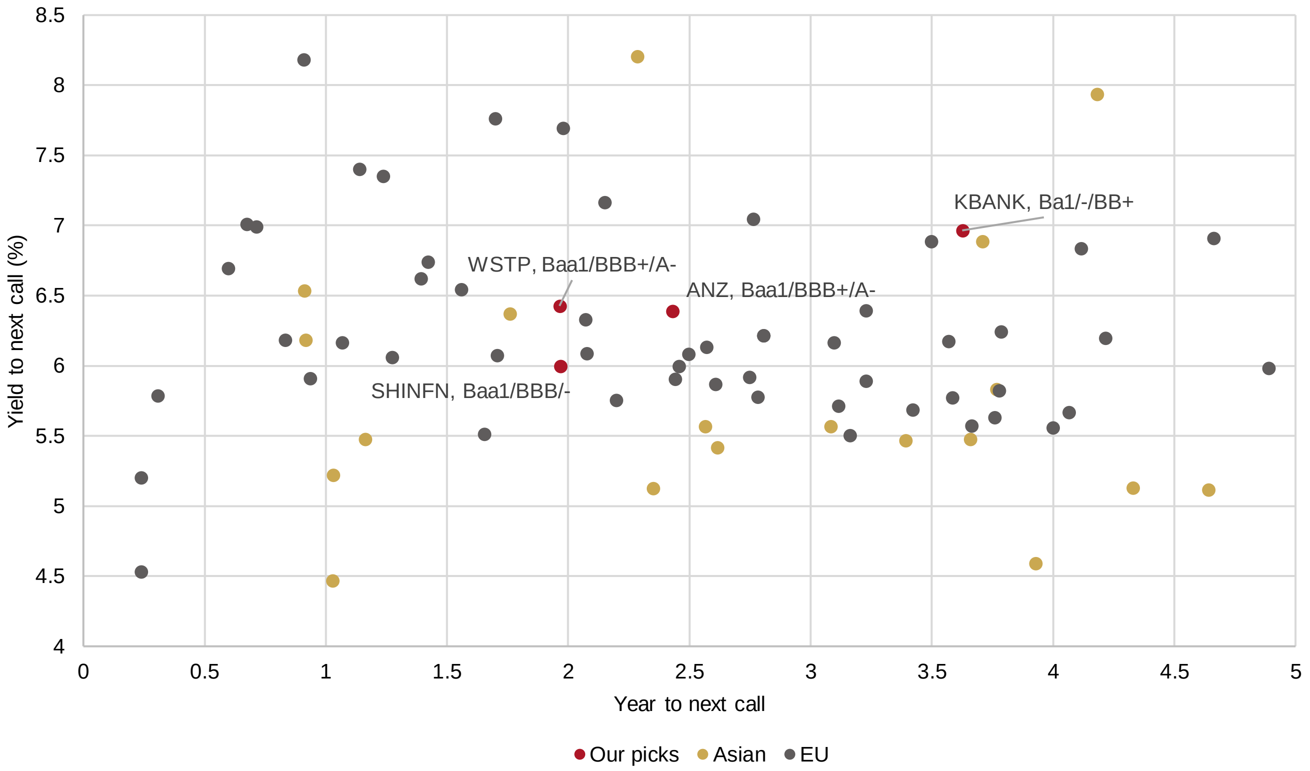
Non-calls in Asia were "rare". There are 2 incidents of non-call of T2 in Asia and the 2 T2s were subsequently redeemed shortly after their first call dates. The first non-call is Woori Bank's not-call of its T2 of USD400mn in Feb'09 amid global financial crisis. Woori Bank's T2 price plunged after the non-call decision. Concerning the negative market reaction, Woori subsequently issued new T2 to exchange the non-call T2 in Jul'09. Meanwhile in Hong Kong, CMB Wing Lung Bank did not call its T2 of USD200mn on the first call date in Nov'17 mainly due to the delay in issuing a replacing T2. CMB Wing Lung Bank subsequently issued a new T2 of USD400mn a week after the first call date, and eventually called the old T2 on next call date in May'18. Please see Table 5 for the summary of non-call of Asian and European banks.

Table 5: Example of T2 non-call and principal write down

Year	Country/region	Ticker	Bank	Treatment	Principal amount
2022	Germany	IKB	IKB Deutsche Industriebank	Principal non-call	EUR300mn
2022	Turkey	GARAN	Garanti BBVA	Principal non-call	USD750mn
2022	India	SIBIN	South Indian Bank	Principal non-call	INR4.9bn
2020	India	NLVBIN	Lakshmi Vilas Bank	Principal write down	INR3.18bn
2017	Hong Kong	CIMWLB	CMB Wing Lung Bank	Principal non-call	USD200mn
2009	Spain.	SANTAN	Banco Santander	Principal non-call	EUR500mn
2009	U.K.	NWG	Royal Bank of Scotland	Principal non-call	AUD1bn & EUR500mn
2009	Korea	WOORIB	Woori Bank	Principal non-call	USD400mn
2009	Spain	SABSM	Banco Sabadell	Principal non-call	EUR300mn
2009	Germany	DB	Deutsche Bank	Principal non-call	EUR1bn

Source: Bloomberg, CMBI Research.

Chart 4: YTC of BBB range Asian and EU USD T2s



Source: Bloomberg.

Higher than the historical average yield differential over senior/AT1

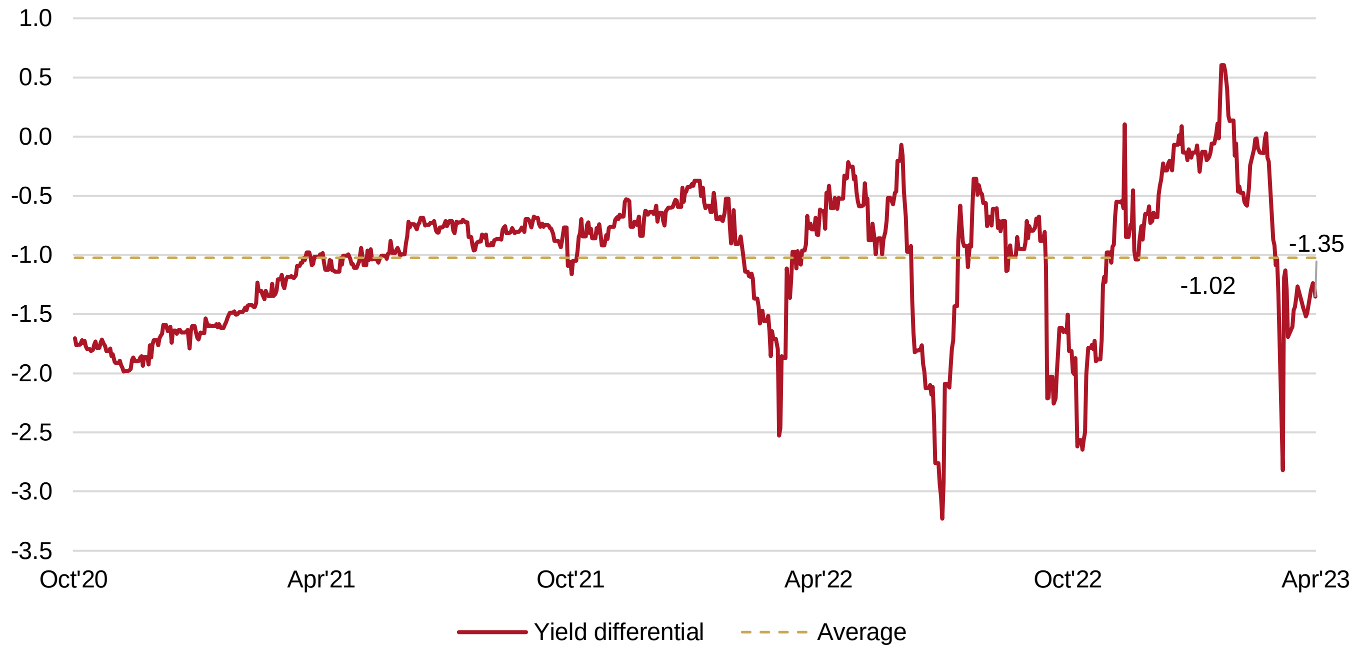
We have selected senior unsecured bonds issued by ANZ, SHINFN, and WSTP with similar maturity or first calls for comparison. The YTC of ANZ 2.95 07/22/30, WSTP 2.894 02/04/30 and SHINFN 3.34 02/05/30 are higher than their senior unsecured bonds by 1.84%, 1.80%, and 1.02%, respectively, albeit they have narrowed compared to the peak at Nov'22. For KBANK, we choose its AT1 for comparison given there is no outstanding senior unsecured bond with similar tenor as its T2; the YTC differential between KBANK 3.343 10/02/31 and its AT1 is 1.35%.

Table 6: Yield differential of our picks over comparable bonds since 2020

	Comparable bonds	Current YTC differential (%)	Average YTC differential (%)
KBANK 3.343 10/02/31	USD AT1	-1.35	-1.02
WSTP 2.894 02/04/30	Senior unsecured USD bonds	1.80	1.27
ANZ 2.95 07/22/30	Senior unsecured USD bonds	1.84	1.33
SHINFN 3.34 02/05/30	Senior unsecured USD bonds	1.02	0.84

Source: Bloomberg.

Chart 5: Spread of KBANK 3.343 10/02/31 over its AT1 (%)

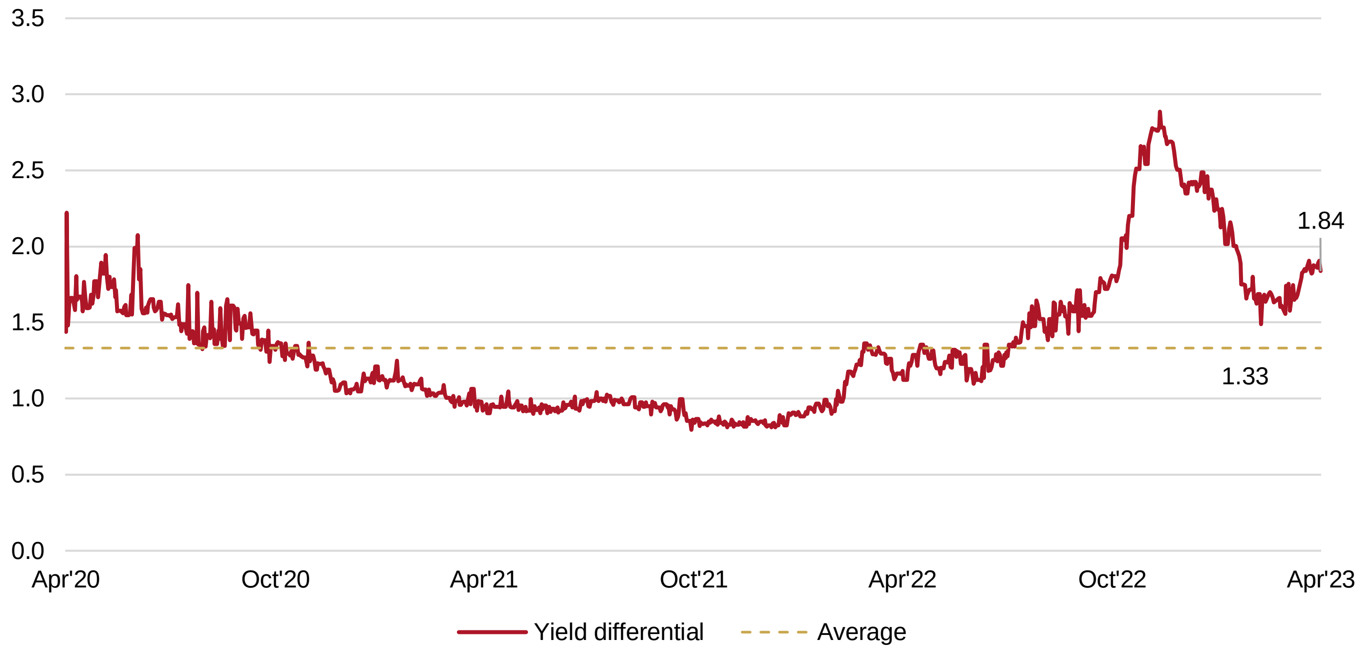


Source: Bloomberg.

Chart 6: Spread of WSTP 2.894 02/04/30 over its senior bonds (%)

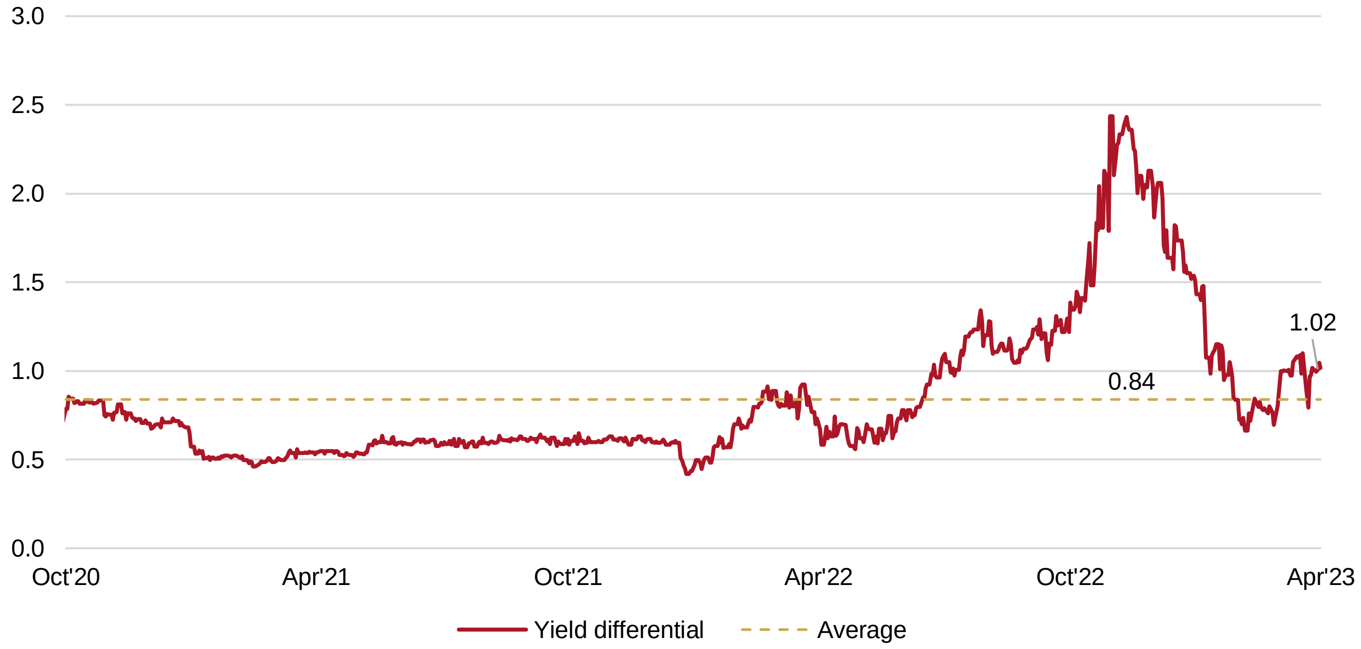
Source: Bloomberg.

Chart 7: Spread of ANZ 2.95 07/22/30 over its senior bonds (%)



Source: Bloomberg.

Chart 8: Spread of SHINFN 3.34 02/05/30 over its senior bonds (%)



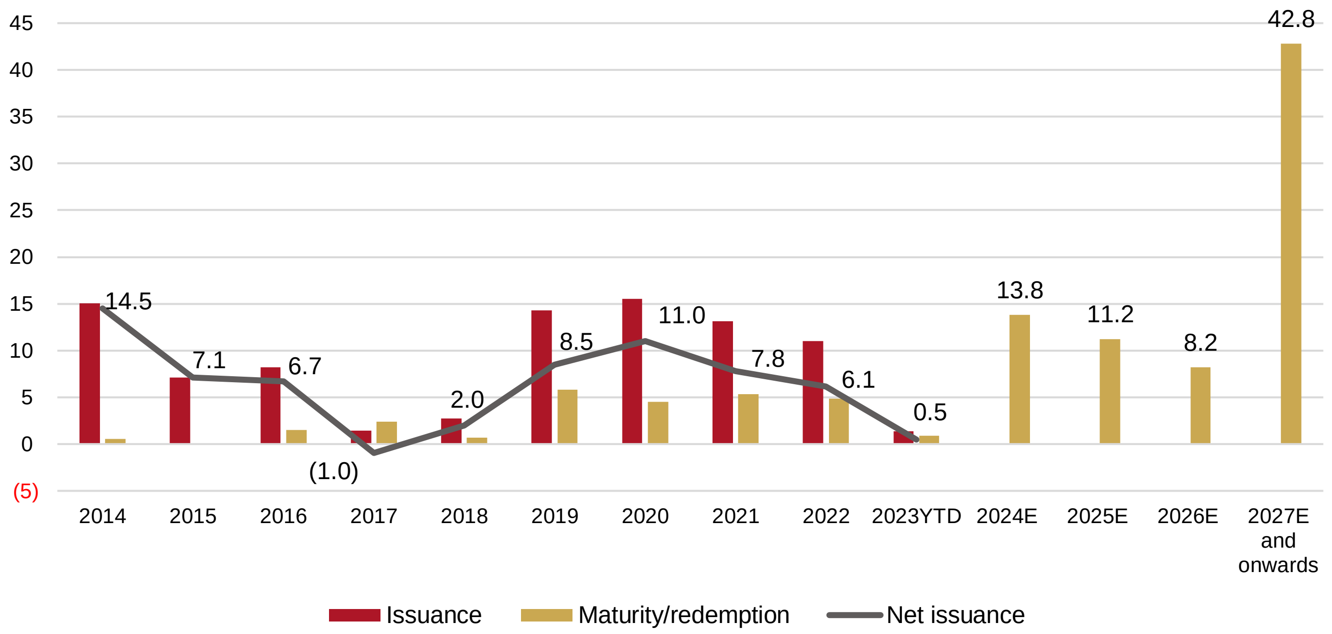
Source: Bloomberg.

USD T2 issuance and refinancing to be lower in 2023…

Since 2014, Australian and Chinese banks are the major issuers of USD T2, accounted for 40.2% and 17.1% of total USD T2 issuance respectively. Given the 10NC feature, the potential redemption requirements for Asian T2s are only USD0.9bn in 2023. We expect the gross issuance for T2 will continue the declining trend since 2021 in view of the lower refinancing requirements.

Concerning the economic recovery after reopening, we expect that there is faster loan growth in China in 2023. This could raise the need of capital replenishment to cope with the loan book expansion. However, given the higher cost of funding of USD issues, we expect Chinese banks to opt for RMB issues. Likewise, we also expect Australian banks to opt for AUD funding to reduce the funding costs.

Chart 9: APAC ex JP USD T2 issuance and redemption (USD bn)



Note: 2024 and onwards are estimated based on the first call date or the maturity date of the outstanding T2s, whichever is earlier.
Source: Bloomberg.

Comparisons of T2 regulatory regime in APAC

Under Basel III requirements, T2 is subordinated with a minimum tenor of at least 5 years. In terms of capital adequacy calculation, it is amortized at a rate of 20% per year in the last five years to maturity. In terms of priority of claims, T2 rank behind AT1 to absorb loss at the point of non-viability. Meanwhile, T2 does not contain the trigger of capital adequacy ratio that usually seen in AT1. We have detailed the T2 regulatory regime in table below.

Table 7: APAC T2 regulatory regime in APAC

	Australia	China	Hong Kong	Singapore	South Korea	Thailand
Non-viability trigger event	Occurs when APRA has provided a written determination to the bank that: (a) the conversion or write-off of hybrids is necessary because without the conversion or write-off, APRA considers that the Bank would become non-viable, or (b) without a public sector injection of capital into, or equivalent support with respect to, the bank, APRA considers that the bank would become non-viable.	Earlier of: (a) CBIRC having decided that a write-down is necessary, without which the bank would become non-viable; (b) any relevant authority having decided that a public sector injection of capital or equivalent support is necessary, without which the bank would become non-viable.	Earlier of the HKMA notifying the bank in writing that (a) the HKMA is of the opinion that a write-off or conversion is necessary, without which the bank would become non-viable; (b) the decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the bank would become non-viable.	Earlier of: (a) the MAS notifying the bank in writing that it is of the opinion that a write down or conversion is necessary, without which the bank would become non-viable; (b) the decision by MAS to make a public sector injection of capital, or equivalent support, without which the bank would have become non-viable, as determined by MAS.	Designation of the bank as an "insolvent financial institution" pursuant to the Act on the Structural Improvement of the Financial Industry of Korea	Emergency capital assistance from the central bank or any other empowered government agency
Step-up/ incentive to redeem	No	No	No	No	No	No
Dividend stopper	No	No	No	No	No	No
T2 non-call record	No	No	Yes	No	Yes	No

Source: Financial Services Commission (FSC), MAS, APRA, CBIRC, HKMA, CMBI Research.

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