

ISSUANCE REPORT:
A RESHAPED BUT
REVIVED H1 MARKET

NEW ZEALAND: HOPES
AND FEARS AS CRISIS
MANAGEMENT BITES

IBOR TRANSITION:
NO SLOWING DOWN IN
AUSTRALIA OR OFFSHORE

KangaNews

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AUSTRALASIAN FIXED INCOME: GLOBAL REACH, LOCAL EXPERTISE

GAP IN THE MARKET

AUSTRALIA'S BIG-FOUR BANKS HAVE NOT BEEN ACTIVE
IN SENIOR BOND MARKETS SINCE THE ONSET OF
THE COVID-19 CRISIS. THEIR ABSENCE IS ALMOST
AS SIGNIFICANT AS THEIR ACTIVITY.

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Australian corporate market poised and hopeful for a smoother second half

Corporate originators do not expect the floodgates of issuance to open in the second half but say conditions should be supportive of active issuers.

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BNP Paribas's debut as a Kangaroo green-bond issuer also introduced a globally innovative structure to the local market.

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Issuance keeps pace despite disrupted H1

The COVID-19 crisis effectively closed Australasian debt capital markets in March but KangaNews transaction data show volume recovered well to produce a solid H1 outcome.

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COPUBLISHED ROUNDTABLE NEXT STEPS FOR AUSTRALIAN ARR ADOPTION

While Australia is not facing the same compulsion as other global markets to drop its credit reference rate, there is still growing reason for market participants to understand, and start using, alternative reference rates. **Commonwealth Bank of Australia** convened a roundtable with *KangaNews* to discuss the next phase.

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New Zealand market participants gathered virtually on 20 August for the **ANZ-KangaNews New Zealand Capital Markets Forum**.

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Five Australian issuers executed tier-two deals in mid-August, reviving a subordinated debt market that had largely lain dormant since the onset of the COVID-19 crisis.

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Q+A

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ANZ's return marked the first major-bank domestic tier-two deal since late 2019 and the sector's first Australian vanilla GSS bond since 2017.

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Asian demand – to the surprise of some – has emerged from the first phase of the COVID-19 crisis as a still-reliable bid for Australian credit.

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KangaNews hosted an exclusive webinar briefing with the Reserve Bank of Australia as part of the **KangaNews Debt Capital Markets Summit 2020** online agenda.

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The process of adapting to the demise of IBORs, for which a hard deadline continues to loom, is not on hold – despite the challenges of 2020.

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KANGANEWS FIXED-INCOME RESEARCH POLL 2020

Though the usual suspects dominate a suite of categories in the **KangaNews Fixed-Income Research Poll 2020**, there is change at the very top.

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KangaNews is a one-stop information source on all issues relevant to **Australian and New Zealand debt markets** – including in- and outbound issuance.

Each issue provides all the information market participants need to keep up to date with the deals and trends making headlines in the markets, as well as in-depth issuer and investor insights

KangaNews is published six times a year, with regular reports and yearbooks adding to the suite of printed offerings. Subscribers also have access to email updates on breaking deals and news from the **KangaNewsAlert service** as well as full access to the website www.kanganews.com.

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MARKET ANALYSIS

Demand holds up as Australasian sovereigns ramp up syndication volume

The Australian Office of Financial Management (AOFM) and New Zealand Debt Management (NZDM) made inroads into substantially increased funding tasks via record-volume syndications in July (see table). The sovereign issuers say demand is holding up well despite the new supply paradigm.



Issuer: **New Zealand Debt Management**
 Issuer rating: **AA+/Aaa/AA+**
 Pricing date: **16 June 2020**
 Maturity date: **15 May 2024**
 Volume: **NZ\$7 billion (US\$4.6 billion)**
 Volume at launch: **NZ\$2 billion**
 Book volume at pricing: **NZ\$14 billion**
 Margin: **9bp/April 2023 NZGB**
 Indicative margin: **9-12bp/April 2023 NZGB**
 Geographic distribution: **see chart 1**
 Lead managers: **ANZ, Deutsche Bank, J.P. Morgan, Westpac Banking Corporation New Zealand Branch**



Issuer: **New Zealand Debt Management**
 Issuer rating: **AA+/Aaa/AA+**
 Pricing date: **14 July 2020**
 Maturity date: **15 May 2041**
 Volume: **NZ\$4.5 billion**
 Volume at launch: **NZ\$2 billion**
 Book volume at pricing: **NZ\$8.5 billion**
 Margin: **31bp/April 2037 NZGB**
 Indicative margin: **29-36bp/April 2037 NZGB**
 Geographic distribution: **see chart 1**
 Lead managers: **BNZ, J.P. Morgan, UBS, Westpac**



Issuer: **Australian Office of Financial Management**
 Issuer rating: **AAA/Aaa/AAA**
 Pricing date: **14 July 2020**
 Maturity date: **21 November 2025**
 Volume: **A\$17 billion (US\$12.2 billion)**
 Book volume at pricing: **A\$50.6 billion**
 Margin: **18.5bp/EFP**
 Indicative margin: **17-20bp/EFP**
 Geographic distribution: **see chart 2**
 Distribution by investor type: **see chart 3**
 Lead managers: **BofA Securities, J.P. Morgan, UBS, Westpac Institutional Bank**



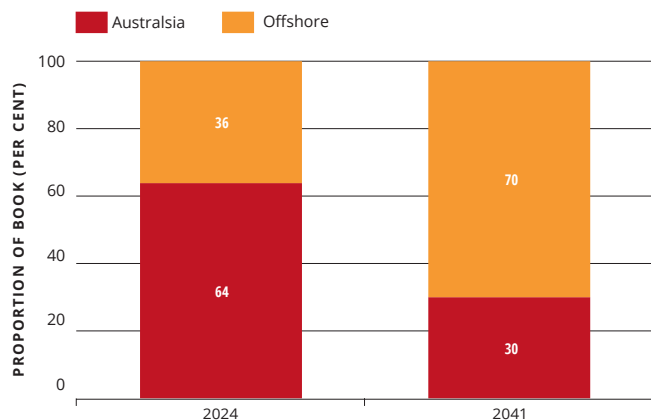
Issuer: **Australian Office of Financial Management**
 Issuer rating: **AAA/Aaa/AAA**
 Pricing date: **28 July 2020**
 Maturity date: **21 June 2051**
 Volume: **A\$15 billion**
 Book volume at pricing: **A\$36.8 billion**
 Margin: **98bp/EFP**
 Indicative margin: **98-105bp/EFP**
 Geographic distribution: **see chart 2**
 Distribution by investor type: **see chart 3**
 Lead managers: **ANZ, Commonwealth Bank of Australia, Deutsche Bank, J.P. Morgan, UBS**

AOFM AND NZDM LARGEST SYNDICATIONS

ISSUER	PRICING DATE	TENOR AT ISSUE (YEARS)	VOLUME (A\$BN/ NZ\$BN)
New Zealand Debt Management	24 Oct 12	13	2,500
New Zealand Debt Management	9 Oct 13	17	2,500
Australian Office of Financial Management	22 Feb 17	11	11,000
New Zealand Debt Management	7 Apr 20	11	3,500
Australian Office of Financial Management	15 Apr 20	4	13,000
Australian Office of Financial Management	13 May 20	10	19,000
New Zealand Debt Management	16 Jun 20	4	7,000
New Zealand Debt Management	14 Jul 20	21	4,500
Australian Office of Financial Management	14 Jul 20	5	17,000
Australian Office of Financial Management	28 Jul 20	31	15,000

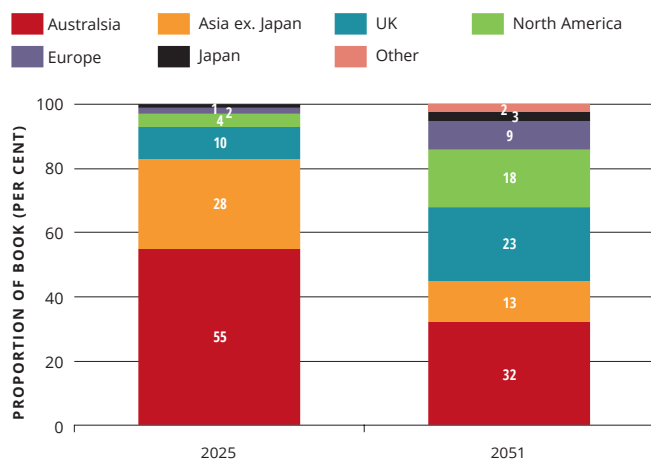
SOURCE: KANGANEWS 15 AUGUST 2020

CHART 1. NZDM SYNDICATIONS GEOGRAPHIC DISTRIBUTION



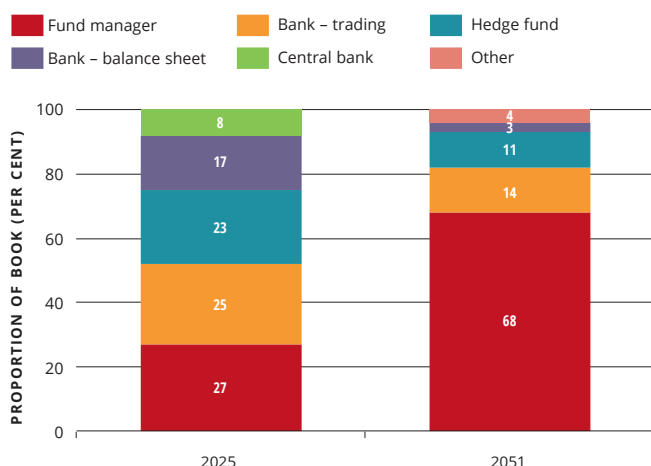
SOURCE: NEW ZEALAND DEBT MANAGEMENT JUNE-JULY 2020

CHART 2. AOFM SYNDICATIONS GEOGRAPHIC DISTRIBUTION



SOURCE: AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT JULY 2020

CHART 3. AOFM SYNDICATIONS DISTRIBUTION BY INVESTOR TYPE



SOURCE: AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT JULY 2020

ISSUER INSIGHTS



MATTHEW COLLIN
HEAD OF PORTFOLIO MANAGEMENT
NEW ZEALAND DEBT MANAGEMENT

"We had always targeted this timing for the [2024] transaction and would have had to see a significant amount of market disruption to

delay it, particularly given the shorter tenor. All the feedback we are receiving suggests liquidity in our market is strong and the RBNZ's LSAP programme is providing good support."

"The prudent thing to do at the moment is to manage the heightened risk around cash requirements by undertaking borrowing when it is available and economic. We also think it is vitally important for our actions to be consistent, predictable and to provide as much transparency and certainty around coming supply as possible."



ROB NICHOLL
CHIEF EXECUTIVE
AUSTRALIAN OFFICE OF FINANCIAL
MANAGEMENT

"Despite the signals we sent to the market, expectations that we would soon bring the [2051] deal hung around. So we thought

we should get on with it and get it out of the way, which is why we announced it back in early July as part of our issuance guidance for the 2020/21 financial year."

"Now the 2051 deal is behind us it means it is not hanging over the market any more and, hopefully, we will get the opportunity to respond to long-end demand where market participants are not holding off because they think a major deal is coming."

TRANSACTION ANALYSIS

NHFIC lands its largest deal yet

Growing subscription from community housing providers (CHPs) to National Housing Finance and Investment Corporation (NHFIC)'s programme led to the agency's largest social bond to date.



Issuer: **National Housing Finance and Investment Corporation**

Issuer rating: **AAA (S&P)**

Pricing date: **24 June 2020**

Maturity date: **29 June 2032**

Format: **social bond**

Volume: **A\$562 million**
(US\$402.3 million)

Book volume at pricing: **"circa three times" final volume**

Margin: **47bp/EFP**

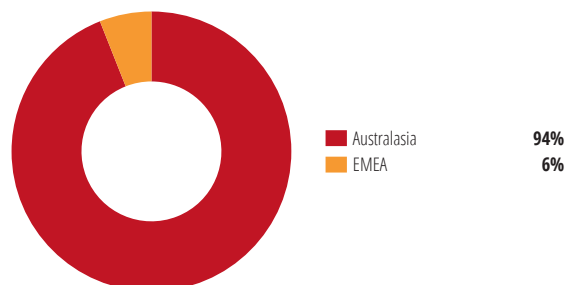
Indicative margin: **55bp/EFP**

Geographic distribution: **see chart 1**

Distribution by investor type: **see chart 2**

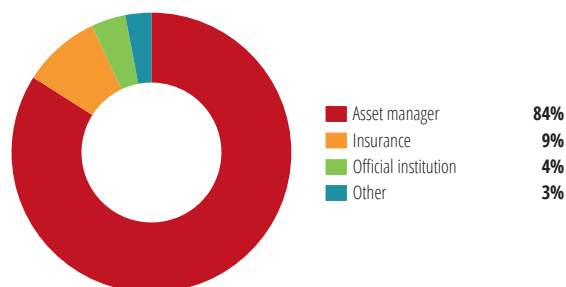
Lead managers: **ANZ, UBS, Westpac Institutional Bank**

CHART 1. NHFIC DEAL GEOGRAPHIC DISTRIBUTION



SOURCE: NATIONAL HOUSING FINANCE AND INVESTMENT CORPORATION 25 JUNE 2020

CHART 2. NHFIC DEAL DISTRIBUTION BY INVESTOR TYPE



SOURCE: NATIONAL HOUSING FINANCE AND INVESTMENT CORPORATION 25 JUNE 2020

ISSUER INSIGHTS



NATHAN DAL BON
CHIEF EXECUTIVE
NATIONAL HOUSING FINANCE AND
INVESTMENT CORPORATION

"Many of the transactions we were working on with CHPs pre-dated the COVID-19 crisis. Our second transaction, in November

last year, incentivised a lot of CHPs to come forward and take advantage of the low interest-rate environment."

"We adopted a wait-and-see approach in March and April in response to COVID-19, but we were

always targeting a June execution window. We were on track to reach a threshold of more than A\$500 million worth of transactions, which opens up a new class of investors, and the way markets unfolded confirmed it was the right time to issue."

"Given how the unemployment rate and economy are tracking as a result of COVID-19, it is possible we are going to see higher demand for community housing. It is a really important time for investors to support the sector and to support Australians in need."

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MARKET ANALYSIS

Securitisation market builds momentum through July and into August

The return of market stability and the ongoing support of the Australian Office of Financial Management (AOFM) allowed more than A\$5 billion (US\$3.6 billion) of new securitisation issuance to print in Australia between the start of July and mid-August. The requirement for AOFM support appears to have declined, at least for the time being, as the agency's role in transactions – even via secondary switches – has declined, to zero in some cases.

AUSTRALIAN SECURITISATION PRIMARY ISSUANCE (EXCLUDING REFINANCING), 1 JULY – 12 AUGUST 2020

PRICING DATE	POOL NAME	ISSUER	TYPE	TOTAL VOLUME (A\$M)	LARGEST TERM TRANCHE MARGIN (BP/1M BBSW)	LEAD MANAGER(S)
2 Jul 20	Metro Finance 2020-1 Trust	Metro Finance	Auto ABS	300	170	Deutsche, NAB
9 Jul 20	Firstmac Mortgage Funding Trust No.4 Series 2-2020	Firstmac	Prime RMBS	1,300	145	ANZ, JPM, NAB, StanChar, Westpac
15 Jul 20	Triton SMSF Bond Trust 2020 – Series 1	Columbus Capital	SMSF RMBS	400	165	Credit Suisse, NAB, Natixis, StanChar, Westpac
22 Jul 20	AFG 2020-1 Trust	Australian Finance Group	Prime RMBS	700	145	ANZ, NAB
23 Jul 20	Bastille Trust Series 2020-1NC	Resimac	Nonconforming RMBS	1,000	165	CBA, Deutsche, Macquarie, NAB, Wells Fargo
12 Aug 20	CNH Industrial Capital Australia Receivables Trust Series 2020-1	CNH Capital	Agricultural and construction ABS	435	110	ANZ
12 Aug 20	PRS No.27	Pepper Group	Nonconforming RMBS	1,000	165	CBA, NAB, Macquarie, Westpac

SOURCE: KANGANEWS 15 AUGUST 2020

MARKET INSIGHTS



DAVID BAILEY
CHIEF EXECUTIVE
AUSTRALIAN FINANCE GROUP

"We have a great understanding of the sectors and regions of the economy where new business is being written, as well as those with higher levels of COVID-

19-related hardship. We are able to apply this to our own lending book and we are seeing improvement in this data – which we have been able to provide to investors."

"AFG's lending portfolio is generally distributed in line with Australia's population bases so it has some exposure to Melbourne's second

lockdown. This was raised in investor meetings prior to launch but concerns were assuaged by the transaction's conservative mortgage pool, relatively high credit enhancement and shorter tenor."



ANDREW MARSDEN
GENERAL MANAGER, TREASURY
AND SECURITISATION
RESIMAC

"Notwithstanding challenges in Victoria and, potentially, New South Wales, there is growing awareness among offshore investors of Australia's largely successful

response to COVID-19 – both at health level and economic and government policy level."

Distribution statistics suggest real-money demand and the offshore bid remain in place for prime and nonconforming residential mortgage-backed securities (RMBS) transactions (see charts 1 & 2).

There are also signs of returning investor breadth: Firstmac's most recent RMBS, for instance, attracted a total of 31 investors compared with a more typical book of 10-12 accounts, the issuer says.

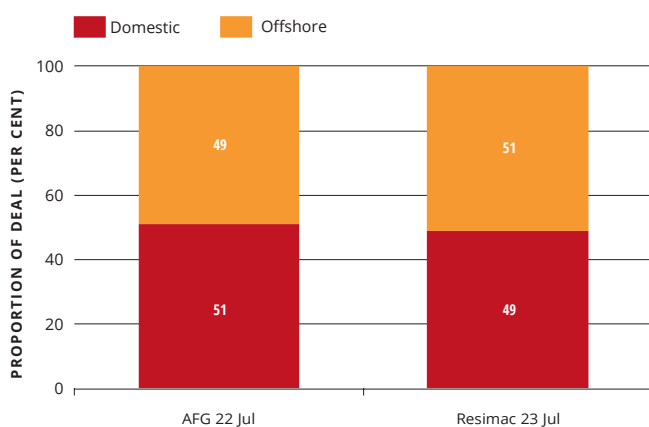
The market also demonstrated the ability to print large deals with little or no AOFM support in the July-August period. By 12 August, Pepper says it was able to price a A\$1 billion RMBS deal without AOFM support. Firstmac says the government

debt-management agency did not participate in its 9 July deal at all and it provided secondary switches behind less than 1 per cent of investor bids.

There are also signs of an improving path for pricing. For instance, Firstmac completed a refinancing transaction in May with a margin of 165 basis points over bank bills. The same issuer's new deal in July posted a 20 basis points pricing improvement for the senior tranche.

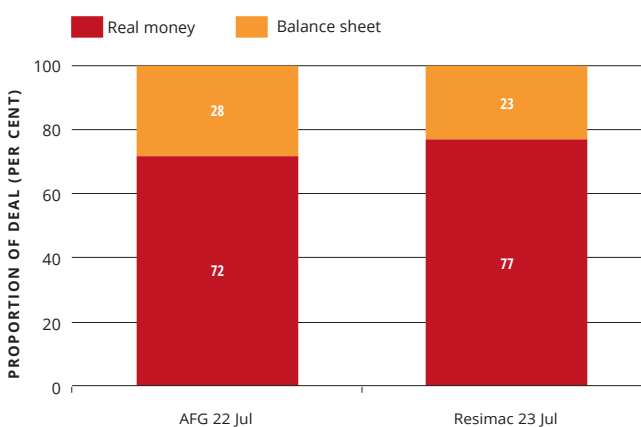
Pepper, meanwhile, saw the margin on its top-rated term RMBS tranche improve to 165 basis points over bank bills in PRS 27 from 180 basis points over bills in PRS 26 barely two months previously.

CHART 1. SELECTED RMBS DEALS GEOGRAPHIC DISTRIBUTION



SOURCE: NATIONAL AUSTRALIA BANK JULY 2020

CHART 2. SELECTED RMBS DEALS DISTRIBUTION BY INVESTOR TYPE



SOURCE: NATIONAL AUSTRALIA BANK JULY 2020

"Our prime offering has seen us attract a lot of typical major-bank customers. Given the uncertainty around the market backdrop, this provides quite a lot of confidence to investors."



JAMES AUSTIN
CHIEF FINANCIAL OFFICER
FIRSTMAC

"Our prepayment rates have risen month-on-month to nearly 30 per cent in July from 20 per cent in April. This is partly due to the low rates being offered by major

banks. It shows competition is alive and well in the lending sector and that there is confidence in the lending and housing markets."



ANDREW TWYFORD
TREASURER
PEPPER GROUP

"At the time of Pepper's PRS 26 RMBS deal, some of our offshore investors were not yet back being active in Australian RMBS. We kept in contact with these after PRS

26, though, with a view to roll forward onto a fast follow-up transaction."

"There was strong appetite across the capital stack. What led to the price tightening from PRS 26 to PRS 27 – even though only eight weeks had passed – was improved market conditions and the re-engagement of offshore investors."

TRANSACTION ANALYSIS

SMBC Sydney breaks offshore-bank volume record with Australian dollar print

Sumitomo Mitsui Banking Corporation Sydney Branch (SMBC Sydney)'s latest transaction was at the time of pricing the largest-ever Australian dollar deal from a bank with offshore parentage. It was also the largest credit deal since the onset of the COVID-19 crisis.

Issuer: **Sumitomo Mitsui Banking Corporation Sydney Branch**

Issuer rating: **A/A1/A**

Pricing date: **2 June 2020**

Maturity dates: **5 June 2023 & 5 June 2025**

Volume: **A\$1.2 billion* (US\$859 million) & A\$1.2 billion**

Margin: **95bp/swap & 115bp/3mBBSW**

Indicative margin: **100bb/3m swap & 120bp/3m BBSW**

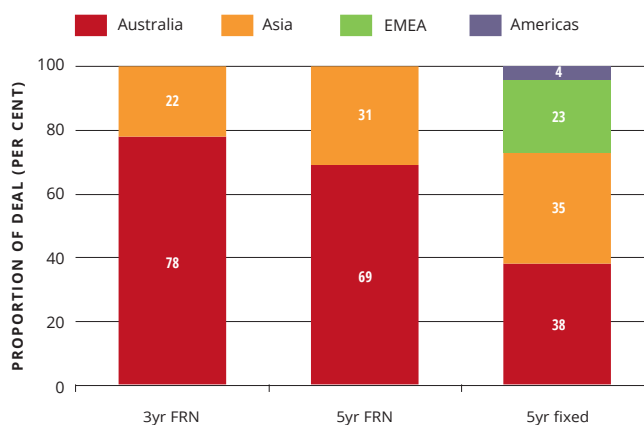
Geographic distribution: **see chart 1**

Distribution by investor type: **see chart 2**

Lead managers: **Commonwealth Bank of Australia, Macquarie Bank, SMBC Nikko, TD Securities, Westpac Institutional Bank**

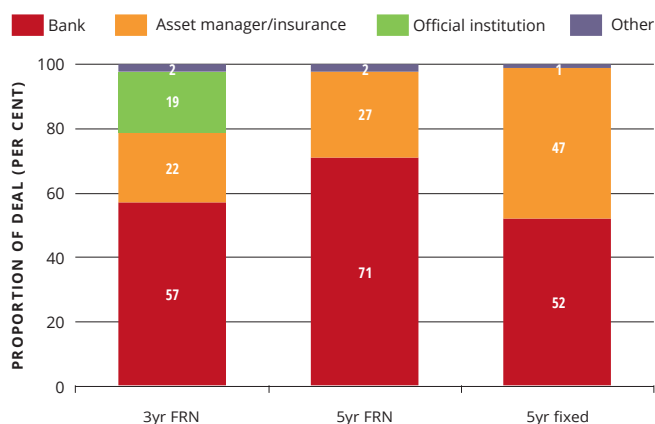
* Comprising A\$1.025 billion floating-rate and A\$175 million fixed-rate notes.

CHART 1. SMBC SYDNEY DEAL GEOGRAPHIC DISTRIBUTION



SOURCE: SMBC NIKKO, TD SECURITIES 11 JUNE 2020

CHART 2. SMBC SYDNEY DEAL DISTRIBUTION BY INVESTOR TYPE



SOURCE: SMBC NIKKO, TD SECURITIES 11 JUNE 2020

ISSUER INSIGHTS



MATTHEW HEDDOU
HEAD OF FUNDING AND ALM
SUMITOMO MITSUI BANKING
CORPORATION SYDNEY BRANCH

"During the COVID-19 crisis, we have undertaken a considerable amount of work to support the borrowing and liquidity

requirements of our long-term clients. This increase in loans gave us the opportunity to come to the Australian debt market to raise sustainable term funding from our investors."

"We have seen increased demand from our customers in recent months. SMBC Sydney takes a long-term view of its relationships and expects this to continue. This is the first public debt issuance for the SMBC Group since the COVID-19 crisis began, which shows its importance. The success will lead to more issuance from SMBC in other markets."

TRANSACTION ANALYSIS

Ausgrid sees, and exploits, window of opportunity

Ausgrid Finance returned to the Australian dollar market for only its second domestic transaction, on 29 July. The issuer says it saw a window of opportunity to refinance debt ahead of schedule and moved quickly to take advantage of conducive issuance conditions.

Issuer: **Ausgrid Finance**

Issuer rating: **BBB/Baa1**

Pricing date: **29 July 2020**

Maturity date: **5 February 2024
& 5 February 2027**

Volume: **A\$250 million (US\$179 million)
& A\$750 million**

Book volume at pricing: **More than A\$2 billion**

Margin: **110bp/s-q swap
& 135bp/s-q swap**

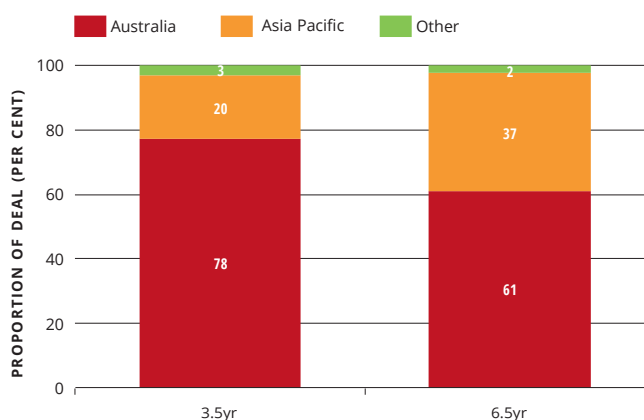
Indicative margin: **115-120bp/s-q swap
& 145bp/s-q swap**

Geographic distribution: **see chart 1**

Distribution by investor type: **see chart 2**

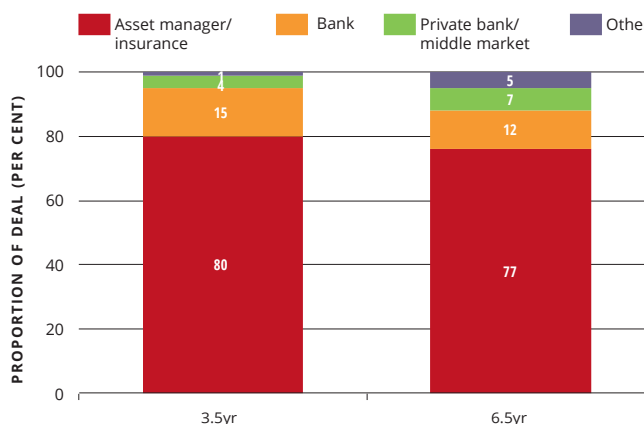
Lead managers: **MUFG Securities,
National Australia Bank, UBS**

CHART 1. AUSGRID DEAL GEOGRAPHIC DISTRIBUTION



SOURCE: NATIONAL AUSTRALIA BANK 30 JULY 2020

CHART 2. AUSGRID DEAL DISTRIBUTION BY INVESTOR TYPE



SOURCE: NATIONAL AUSTRALIA BANK 30 JULY 2020

ISSUER INSIGHTS



ED WATERS
GROUP TREASURER
AUSGRID

"Our deal process was seven days from start to finish, which is very fast for a company the size of Ausgrid and for a A\$1 billion deal."

"Port of Brisbane's deal [see p12] was a very strong transaction, well oversubscribed, and there seemed to be a lot of momentum from it. There appeared to be no other issuance following it in the late July to early August period ahead of corporate reporting season in Australia."

"What changed with COVID-19, because we have a sizeable debt book, is that we think it is responsible to refinance well ahead of maturities given the uncertainty ahead and the potential for volatility."



MICHAEL BRADBURN
CHIEF FINANCIAL OFFICER
AUSGRID

"The result reflects the quality of the joint-lead-manager group to have this turned around in such a short period of time, as well as the continuing support of the Australian dollar investor base."

TRANSACTION ANALYSIS

Port of Brisbane provides a safe harbour for investors

Port of Brisbane is the latest in a clutch of corporate borrowers to bring a deal initially mandated prior to the COVID-19 crisis. As a defensive credit, deal sources say the transaction – issued out of QPH Finance – met demand sufficient to facilitate substantial price tightening.

Issuer: **QPH Finance**

Issuer rating: **BBB (S&P)**

Pricing date: **22 July 2020**

Maturity date: **29 July 2027**

& 29 January 2031

Volume: **A\$200 million (US\$143.2 million) & A\$300 million**

Book volume at pricing: **A\$2.75 billion**

Margin: **180bp/s-q swap & 205bp/s-q swap**

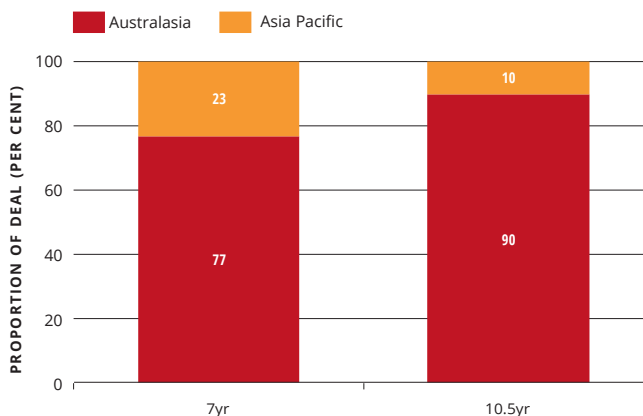
Indicative margin: **210bp/s-q swap & 240bp/s-q swap**

Geographic distribution: **see chart 1**

Distribution by investor type: **see chart 2**

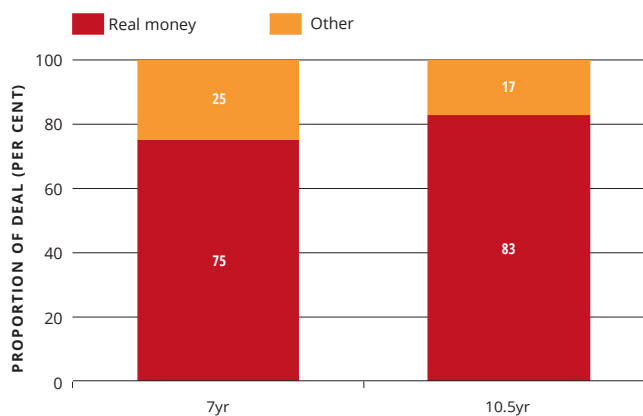
Lead managers: **ANZ, MUFG Securities, Westpac Institutional Bank**

CHART 1. PORT OF BRISBANE DEAL GEOGRAPHIC DISTRIBUTION



SOURCE: WESTPAC INSTITUTIONAL BANK 27 JULY 2020

CHART 2. PORT OF BRISBANE DEAL DISTRIBUTION BY INVESTOR TYPE



SOURCE: WESTPAC INSTITUTIONAL BANK 27 JULY 2020

ISSUER INSIGHTS



NEIL STEPHENS
CHIEF FINANCIAL OFFICER
PORT OF BRISBANE

"The port's property is industrial, which means we have not had the level of assistance requests that have perhaps been seen in other sectors. Trade was

uncertain at first and has varied by sector, but overall is only slightly down on pre-crisis levels and has proved more resilient than was initially feared."



DARREN TRIGGELL
CORPORATE FINANCE MANAGER
PORT OF BRISBANE

"Other recent corporate deals gave us further confidence to proceed and we were able to achieve the price and tenor we wanted. We feel we received

excellent support from the Australian market and our joint lead managers."

"The bank debt Port of Brisbane took on at the beginning of the crisis was a mix of short- and long-term borrowing, and the bond deal was undertaken partially to term out short-term facilities."

SEEK supplements liability-management objective with sub notes tap

SEEK says it is pleased with the outcome of a recent liability-management exercise, despite a tap to its 2026 subordinated bond coming up short of launch volume. The issuer says it is in a comfortable liquidity position even with a challenging operating environment and has been able to complete the redemption of its 2022 maturity bonds.

Issuer: **SEEK**

Issuer rating: **NR**

Pricing date: **7 July 2020**

Maturity date: **20 June 2026**

Format: **Subordinated 6.5NC3.5 bond**

Volume: **A\$75 million (US\$53.7 million)**

Volume at launch: **A\$100 million**

Margin: **550bp/BBSW**

Indicative margin: **550bp/BBSW**

Geographic distribution: **96% Australasia, 4% Asia**

Distribution by investor type: **90% asset manager, 10% middle market**

Lead managers: **HSBC, MUFG Securities, Westpac Institutional Bank**

The A\$75 million tap of SEEK's existing 2026 subordinated bond takes total outstanding in the line to A\$225 million. The subordinated bond was first issued on 11 December 2019 and this is its first tap.

SEEK revealed plans to repurchase its A\$175 million April 2022 senior-unsecured floating-rate notes on 22 June. At the time, the borrower also flagged it was considering tapping the 2026 maturity or issuing new subordinated notes to create further senior debt headroom and increase operating flexibility.

Ed Collis, treasurer at SEEK in Melbourne, tells *KangaNews* the tap was always intended to be an add-on to the liability-management objective. "The main purpose for us was to optimise our capital stack and maintain our maturity profile," he says.

Collis says the April 2022 maturity came into the borrower's sights after it refinanced a syndicated-loan facility at the start of this year. "In this environment, we wanted to keep our balance sheet clean. While COVID-19 has put pressure on our earnings in the short term, we have plenty of liquidity so we figured we would manage our liabilities," he says.

COVID-19 has significantly affected SEEK's core business in the job market. In a 22 June Australian Securities Exchange announcement, however, SEEK revealed that since early May it has experienced a consistent trend of improving weekly billings for its operations in Australasia and Asia.

In June, it observed a weekly billing decline of 40-50 per cent versus the previous corresponding period, which marks an improvement on the 65-70 per cent decline versus the previous corresponding period in April.

SEEK obtained a temporary increase to key covenant limits in its senior syndicated-debt facility through to 30 June 2021, to create balance-sheet flexibility. At 31 May, the SEEK group had A\$1.1 billion in net debt, A\$246 million in cash on hand and A\$363 million of its bank facility undrawn.

Joel Morton, Melbourne-based director, debt capital markets at Westpac Institutional Bank, tells *KangaNews* the initiative of the liability-management transaction was well received by investors. "It is quite rare for issuers in the domestic market, and in the corporate asset class, actively to manage their maturity profile by providing liquidity events for investors well ahead of maturity."

Collis adds: "We are an unrated credit and investors need to spend more time assessing us as a consequence. We thought it made sense that we would test investor appetite with a tap of our subordinated notes while we had investors engaged around the redemption of our April 2022 maturity."

Investors preferred a tap of SEEK's existing 2026 line over a new issue of subordinated notes as this should facilitate extra liquidity if required, Morton reveals.

It was not until investment-grade credit market functionality returned, with the first primary corporate transaction from Woolworths issued on 13 May, that the opportunity to contemplate a tap of the 2026 maturity presented itself, Andrew Duncan, Sydney-based head of capital markets at HSBC Australia, tells *KangaNews*.

Despite the deal falling short of the stipulated A\$100 million minimum at launch, Collis says the issuer is not disappointed. "We went with A\$100 million because we thought it was a good minimum size but we would have been prepared to tap anything north of A\$50 million. It was always going to be an additional feature to the liability management," he explains.

Duncan adds: "We had seen IOIs [indications of interest] during the early stages of the liability management process suggesting an opportunistic tap for A\$100 million was possible. But as we moved through the 10-day long process a few interested investors fell away for various reasons." •

TRANSACTION ANALYSIS

LGFA uses sovereign slipstream to extend its curve

Following the pricing of its longest-dated syndicated transaction, on 30 July, New Zealand Local Government Funding Agency (LGFA) says the deal harnessed momentum generated in the long end by recent syndications from the Australian and New Zealand sovereign borrowers.

Issuer: **New Zealand Local Government Funding Agency**

Issuer rating: **AA+/AA+**

Pricing date: **30 July 2020**

Maturity date: **14 April 2022 & 15 April 2037**

Volume: **NZ\$400 million (US\$264.2 million) & NZ\$600 million**

Volume at launch: **NZ\$200 million & NZ\$300 million**

Margin: **21bp/mid-swap & 97bp/mid-swap**

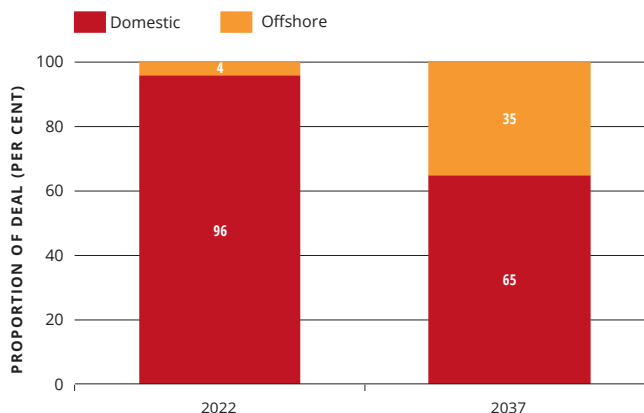
Indicative margin: **20-23bp/mid-swap & 97-104bp/mid-swap**

Geographic distribution: **see chart 1**

Distribution by investor type: **see chart 2**

Lead managers: **ANZ, BNZ, Commonwealth Bank, Westpac Banking Corporation New Zealand Branch**

CHART 1. LGFA DEAL GEOGRAPHIC DISTRIBUTION



SOURCE: NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY 3 AUGUST 2020

CHART 2. LGFA DEAL DISTRIBUTION BY INVESTOR TYPE



SOURCE: NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY 3 AUGUST 2020

ISSUER INSIGHTS



MARK BUTCHER
CHIEF EXECUTIVE
NEW ZEALAND LOCAL GOVERNMENT
FUNDING AGENCY

"The deal required a much lower new-issue premium than other New Zealand dollar high-grade deals priced since April: a 3 basis

points concession on the 2022 tap and similar for the 2037 line. This is evidence of the market being much more stable than it was in April."

"We chose the 2022 line for a syndicated tap in order to build volume close to our line limit of

NZ\$1.75 billion. The 2022 now has volume of NZ\$1.7 billion but the ability to tap would have declined as the bond's maturity date draws closer."

"We remain hopeful that, over time, councils will borrow at longer tenors. Now was the right time to establish [the 2037] benchmark as we are just beginning a new funding year with a large requirement. Furthermore, the two recent long-end sovereign deals, as well as the general lift in sovereign issuance, have brought greater attention from offshore investors."

Wellington Airport well-placed to manage latest COVID-19 outbreak

Wellington International Airport issued New Zealand's first public domestic corporate bond since the COVID-19 crisis began, just days before new local cases were detected on 11 August. Lack of supply helped the airport complete the early refinancing of a May 2021 maturity.

Issuer: **Wellington International Airport**

Issuer rating: **BBB (S&P)**

Pricing date: **7 August 2020**

Maturity date: **14 August 2026**

Volume: **NZ\$100 million (US\$66 million)**

Volume at launch: **NZ\$75-100 million**

Margin: **210bp/mid-swap**

Indicative margin: **220-245bp/mid-swap**

Lead managers: **ANZ, Forsyth Barr**

This is the first public corporate deal in the New Zealand market since December 2019. The interest-rate environment has changed further in 2020, resulting in Wellington Airport's transaction printing with the lowest-ever coupon in the New Zealand corporate market.

After 102 days of no COVID-19 community transmission, four new cases emerged in New Zealand on 11 August. The country was forced to re-enact social-distancing measures, focused on the epicentre of the new cluster in Auckland. Despite this – and the ongoing absence of international travel – Wellington Airport says its long-term business fundamentals remain strong.

Approximately 85 per cent of Wellington Airport's passenger market was domestic prior to the pandemic. Domestic passenger traffic bounced back strongly in June and July with passenger levels in early August operating at 70-75 per cent of pre-COVID-19 levels, Martin Harrington, the airport's chief financial officer, tells *KangaNews*. The airport is forecasting overall passenger traffic to return to pre-COVID-19 levels in the 2023 financial year.

In the meantime, the airport has undertaken several measures to manage the disruption caused by COVID-19. In the months since March, Wellington Airport has cut 25 per cent of its operational expenditure.

The airport has increased its bank facilities to NZ\$170 million from NZ\$100 million, with extended duration – to 2022/23. In the debt capital market space, it has also negotiated covenant waivers with its US private placement (USPP) investors.

In addition, shareholders Infratil and Wellington City Council have put in place NZ\$75.8 million of support, in the form of redeemable preference shares.

These measures have improved Wellington Airport's short-term balance-sheet obligations and allowed the airport to focus its attention on refinancing a NZ\$75 million May 2021 retail bond, Harrington says. While the maturity is still a fair way off, he says the airport considered it prudent to refinance now given stable market conditions.

Over recent months, secondary-market pricing has tightened including for airports, thanks in part to an unprecedented lack of corporate primary supply in New Zealand, according to Jason Green, director, debt capital markets at ANZ in Wellington.

Wellington Airport is the first New Zealand corporate bond issuer to have a proximate reason to come back to market in 2020. Most local corporates were well placed coming into COVID-19 and continue to monitor capital markets conditions rather than having near-term needs, Green explains.

Harrington says the issuer considered alternatives including wholesale bonds and a USPP transaction but settled on the approach it took because of a desire to minimise execution risk. "The feedback we received from our lead managers was that there was likely to be strong demand from retail investors in the first corporate bond issue in New Zealand since COVID-19. A minimum 2.5 per cent coupon was seen as important," he says.

He adds that credit margins at the time of execution were higher in the USPP market than could be sourced domestically.

Leads say Brisbane Airport Corporation's A\$850 million (US\$608.4 million) transaction in late June – A\$250 million of six-year and A\$600 million of 10.5-year notes – guided the price discovery process ahead of launch. Wellington Airport shares a sector and a rating – BBB with a negative outlook from S&P Global Ratings – and was offering the same tenor.

Shaun Roberts, Wellington-based head of debt capital markets at Forsyth Barr, says term-deposit rates have dropped to a typical 1.4-1.7 per cent from pre-COVID-19 levels of more than 2 per cent, making Wellington Airport's 2.5 per cent coupon attractive on a relative basis.

Roberts comments: "Wellington Airport's coupon was the lowest-ever for a triple-B rated transaction in the domestic market by nearly 1 per cent, and well inside Brisbane Airport's recent pricing for the same rating and tenor. Importantly, the deal demonstrated that the market is willing to engage at the mid-two per cent level, representing a significant coupon paradigm shift from previous higher levels." •



Silver linings

There can't be many people who would put 2020 down as a vintage year. In fact, I think most of us would probably have rather gone to sleep in late February and not woken up until Christmas. While we might not be enjoying much of what 2020 has thrown at us, unique circumstances have given the Australian debt market a chance to demonstrate a new level of maturity and resilience.

In the rates space, the Australian dollar market has demonstrated capacity orders of magnitude greater than it has required in the past. A comparison with the financial crisis puts this in perspective. In the 12 months from September 2008 – the peak of the financial crisis – the Australian Office of Financial Management (AOFM) conducted gross Treasury bond issuance of A\$31.2 billion (US\$22.3 billion). In Q2 2020 alone, gross T-bond issuance was A\$85.6 billion (see chart 1).

Counting from the start of the new millennium, it took until a couple of weeks before Christmas 2009 for the AOFM to match the A\$144.1 billion of gross T-bond issuance it placed from 1 April to 21 August this year.

This exponential growth in issuance – which has been supplemented by substantially increased volume of semi-government issuance – has been absorbed without a collapse in market functionality.

It is true that the Reserve Bank of Australia (RBA) stepped in to calm conditions in March, but central-bank

intervention is hardly unique to Australia. And the fact is the bulk of issuance has come since the RBA scaled back its purchases – a clear sign the market can absorb this volume of issuance, even at yield close to zero in the short end.

Government-sector issuers say that after a shaky period in March they have seen liquidity return to their market, including interest and participation from offshore investors and at the long end of the curve. AOFM syndications have been two or three times oversubscribed even when printing A\$20 billion of volume or more in a single shot.

Perhaps the clearest indicator of the Australian dollar market's capacity is that state treasury corporations appear no closer to printing benchmark volume in foreign currencies than they did under benevolent market conditions and with the smaller funding tasks of 2019.

Meanwhile, the Australian dollar credit sector has also shown a degree of robustness in challenging conditions that it may not previously have been given credit for. Here, the biggest moving part

is undoubtedly the near-absence of the domestic big-four banks.

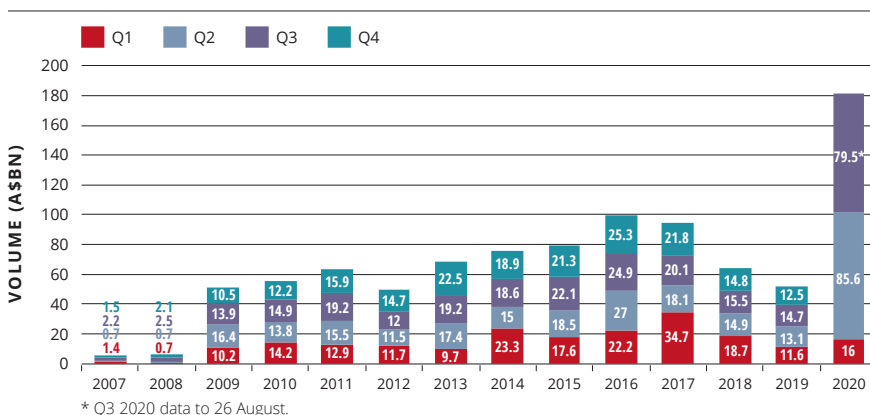
The disappearance of major-bank senior supply since the end of February means Australian dollar credit issuance volume has fallen significantly in 2020 (see chart 2). But this is not a demand story. Some really quite remarkable deals have been done, their visibility lost to some extent in the focus on crisis management.

Two high-profile global banks have visited Australia for transactions of more than A\$2 billion, the first time ever that such volume has been available to offshore financial institutions. True corporate issuance volume is unlikely to set a record in 2020, but deal books reflect an abundance of demand. Oversubscription levels suggest investment-grade, defensive corporate credits should comfortably be able to print deals in the billions of dollars should they have the need.

Again, the comparison with the financial crisis is stark. Corporate issuance effectively disappeared from the Australian dollar market between the demise of credit-wrapped deals in 2007 and a cautious return in 2009. At the time, the idea that Australia could be hit by a major global crisis of the magnitude of COVID-19 and yet be printing massively oversubscribed corporate bond transactions within weeks would have been borderline laughable.

Slowly and without a big-bang moment, credit seems to have established a niche in the Australian dollar market. In 2008-9, redemptions from fixed-income funds created a secondary-market overhang that poisoned the new-issuance well for months. The same outcome seems to have been avoided in 2020, despite a background in the

CHART 1. AUSTRALIAN GOVERNMENT TREASURY BOND GROSS ISSUANCE



* Q3 2020 data to 26 August.

SOURCE: AUSTRALIAN OFFICE OF FINANCIAL MANAGEMENT, KANGANEWS 26 AUGUST 2020

superannuation sector that has been arguably even less favourable.

According to Australian Prudential Regulation Authority (APRA) data, Q2 2020 was the first time since the inception of Australia's mandatory superannuation regime in the early 1990s that the sector's net outflows exceeded inflows. The cause is unprecedented: the federal government's decision to allow superannuation members to draw down funds early to support income in the near term.

The Australian savings pool is significantly larger than it was a decade ago. Superannuation assets under management totalled A\$2.9 trillion at the end of June, APRA says – representing growth of more than A\$1 trillion since the onset of the financial crisis. A bigger system and, perhaps, the need to find consistent income in a low-rates environment seems to have made credit allocations at least somewhat stickier over the past decade.

The fact that redemptions did not spark a protracted liquidity panic may also speak to a more mature secondary market. Forced selling did not break out in a big way even in the depths of the crisis in March, while at least some intermediaries have worked their way through regulatory constraints to offer more reliable secondary coverage to investors.

Finally, there can be little doubt that Australian dollar credit has followed the government sector in becoming a much more international market since the financial crisis. The Asian bid may not be in full voice in mid-2020, but deal sources say regional investors have remained engaged with Australian credit throughout the year and this liquidity pool continues to contribute to deal books.

SUPPLY SIDE

If the Q3 issuance renaissance in the Australian dollar debt market demonstrates anything conclusively, it is that the size of the local credit market is a product of constraints on supply rather than demand. Investors have proved themselves willing to engage with high-quality credit of all types. In the absence of the major banks, however, there simply is not enough supply.

This is hardly likely to change in the current economic environment. Elsewhere in this magazine you can read bank funders talking about why ultra-low rates may not be enough to stimulate credit growth – because households and small businesses dealing with an almost unprecedented level of fear and uncertainty are hardly likely to see borrowing more as their path out of trouble (see p38). Neither is this an environment in which one expects to see an uptick in corporate capex, to say the least.

On the other hand, the word on the street is that Australian corporates emerging from their reporting season are tending to coalesce around the domestic market as the most likely option for whatever near-term funding needs they have to address. Again, it is hard to imagine this being the case in the immediate wake of past crises: the old line was that the Australian market was the first to close and the last to reopen around any major risk event.

The other factor to throw into the mix is investor relations. Almost universally, borrowers that have been active since March have commented on how manageable deal execution proved to be even with investors and deal teams scattered across home offices globally. As one issuer remarked to me the other day, it's all done on the phone anyway – so what's the real difference?

This might suggest there will be little change in global market-selection inputs. I am not so sure. Absence may make the

heart grow fonder but it is hard to imagine it increases the focus of international investors – especially those with plenty of competing supply like the US and European public markets.

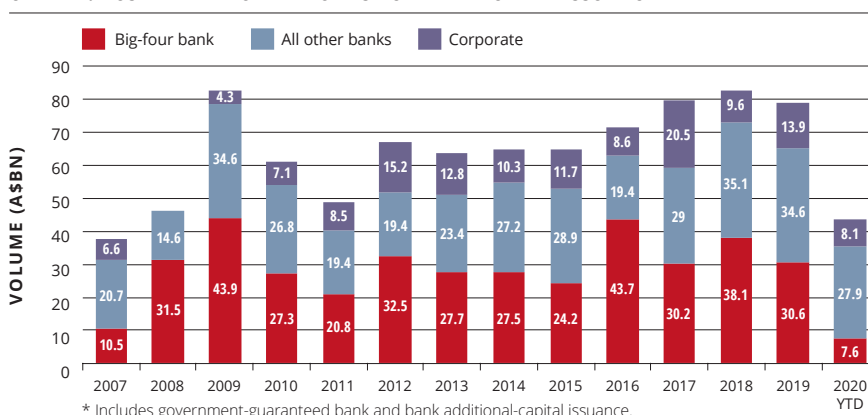
I am certainly not prepared to predict that Australian issuers will start to be disadvantaged in global markets if the inability to conduct in-person roadshows is protracted. But equally it is hard to see how not being able to sit down with major global investors is going to help the deal marketing process.

There has been plenty of talk about COVID-19 being a powerful antiglobalisation force, and I wonder if what we are seeing in the Australian issuance space is an early sign of an at least somewhat more domestic issuance bias in future. If the domestic market offers more reliable liquidity and pricing than has been the case historically – and especially if a decent weight of international investors remains willing to buy in the currency – there is every reason for more issuance to be directed there.

Other than the big-four banks, few borrowers will be facing limit issues in Australian dollars. If the majors have structurally less issuance in the years ahead they leave a vacuum that could be filled by global names and domestic borrowers from other sectors.

It will certainly be interesting to see what supply emerges. I will be keeping an eye on domestic issuance and popular alternatives, like the US private placement market, to see if there has really been a fundamental shift in preferences. •

CHART 2. AUSTRALIAN DOLLAR DOMESTIC MARKET CREDIT ISSUANCE*



* Includes government-guaranteed bank and bank additional-capital issuance.

SOURCE: KANGANEWS 26 AUGUST 2020

No obvious circuit breaker for Kangaroo SSA supply

Pricing in the Australian dollar supranational, sovereign and agency (SSA) market remains dislocated, intermediaries say, based on lack of alignment between domestic investor and offshore borrower pricing expectations. A number of factors are at play, not least among them the record support SSA borrowers are receiving in global markets.

BY MATT ZAUNMAYR

By the end of July 2020, SSA Kangaroo issuance was well down on previous years (see chart 1). Supply is typically muted during the northern hemisphere summer, but intermediaries have limited hopes for a revival later in the year.

As COVID-19 continues wreaking havoc on global economic conditions, there is every chance that SSAs may need to access global markets for far more volume than they have required in recent years, including in the second half of the calendar year. But compelling price drivers in the Australian dollar and offshore markets mean incremental issuance appears more likely to go to the latter.

Pricing is the main obstacle for SSA Kangaroo supply. Oliver Holt, head of Australian dollar syndicate at Nomura in Singapore, says Australian dollar pricing has been 10-15 basis points wide of US dollars, euros and sterling for SSAs across the curve. SSA issuers have in the past been willing to pay up to some extent to maintain a presence in the Australian dollar market but pricing elsewhere has been too compelling in 2020 to justify the diversity premium.

There has been sporadic benchmark supply from some smaller SSA borrowers – including some record volume-by-issuer transactions – facilitated by the void of other supply. But the

largest SSA names have been notably absent even as maturities have rolled off (see chart 2).

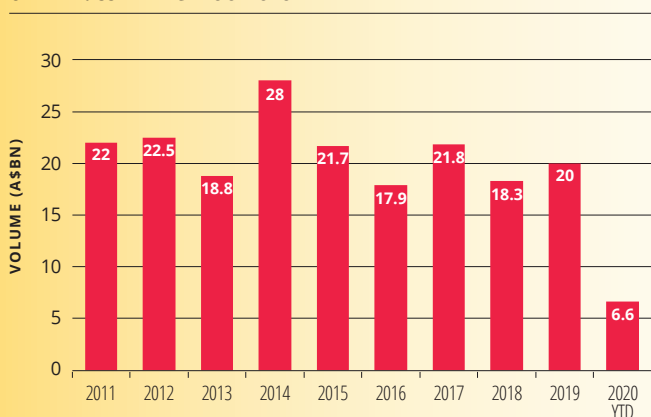
SSA pricing in Australian dollars has rallied with the rest of the local market on an absolute and relative basis. For example, by the end of July the yield on World Bank's 2025 Kangaroo had tightened by around 70 basis points from its March peak and was virtually the same as that for similar-maturity issuance by New South Wales Treasury Corporation (see chart 3).

The key issue is that this rally has not been as big as the global equivalent, where market intervention has been greater and investors more willing to buy SSA bonds at a lower price.

Investors in Europe and the US have been much more willing to chase SSA yield. Daniel Wilson, DCM and syndicate at RBC Capital Markets in Sydney, points to a recent US dollar KfW Bankengruppe deal launched shortly after the borrower revised down its borrowing requirement for 2020. He says investors, faced with the prospect of scarcer supply from a borrower that had only completed one US dollar deal in the first half, supported the US\$5 billion transaction with a record US dollar SSA orderbook of more than US\$15 billion.

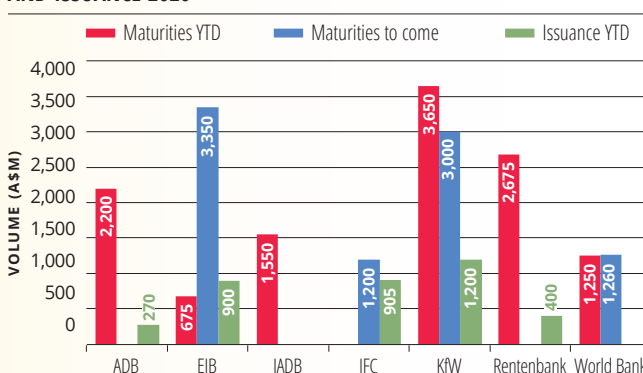
The disconnect between Australia and global markets is replicated in domestic investor views towards SSA pricing, which intermediaries confirm tend to be based more on relative-value

CHART 1. SSA KANGAROO VOLUME



SOURCE: KANGANEWS 31 JULY 2020

CHART 2. SELECTED SSA ISSUER KANGAROO MATURITIES AND ISSUANCE 2020



SOURCE: KANGANEWS 31 JULY 2020

assessment. Borrowers see the Australian market as expensive compared with global levels but at the same time domestic investors view SSA pricing as expensive relative to local semi-government issuers in particular.

Holt says the prevailing assumptions of domestic investors on where SSA pricing should sit relative to local and global marks could be a side effect of Australia still being relatively new to a near-zero interest rate environment.

“Most other global markets have the best part of a decade of experience of how pricing in various sectors responds to QE and, as a result, are much more willing to invest in SSA bonds at their current levels,” Holt explains. “Global investors know these borrowers have access to multiple markets and will not necessarily need to pay a premium for access to funding.”

So far, a relatively sluggish domestic SSA Kangaroo bid has not yet created a buying opportunity for offshore investors of sufficient scale to promote an issuance uptick. Yuri Popovych, director at TD Securities in Singapore, says this demand should eventuate in time. So far, though, the lingering effects of March volatility remain in place. Specifically, this means a global investor retreat to the largest, most liquid markets including the liquidation of significant volume of foreign-currency assets.

Wilson says offshore investors have started taking advantage of relative value to buy Australian dollar assets at the short end. This has yet to provide an opportunity for SSA names, though, as short-tenor pricing in euros and US dollars remains too compelling for borrowers to consider Australian dollars.

CIRCUIT BREAKER NEEDED

The factors conspiring to constrain Australian dollar supply do not seem likely to reverse. In fact, there are good reasons to suspect they may be exacerbated in the second half of the year.

The Australian dollar basis swap was too tight in early 2020 to support the usual burst of early-year SSA supply – and it remains contained at tight levels, according to Popovych. Australia’s major banks seem unlikely to make large offshore funding forays while they can draw cheap funding from the Reserve Bank of Australia’s

term funding facility, which takes one obvious driver of basis-swap reversion out of the equation.

Furthermore, except for the Washington names that have just begun new financial years, the majority of SSAs have completed large portions of their funding requirements for 2020. Wilson says most European SSAs have completed 70-90 per cent of their funding requirement.

On the other hand, the economic environment means supply shocks are possible. A surge in funding requirements from SSAs could see spreads in offshore markets widen and currencies like Australian dollars become more competitive. However, offshore markets have intervening forces that directly support the SSA sector and should keep yield contained – such as the European Central Bank’s targeted longer-term refinancing operations.

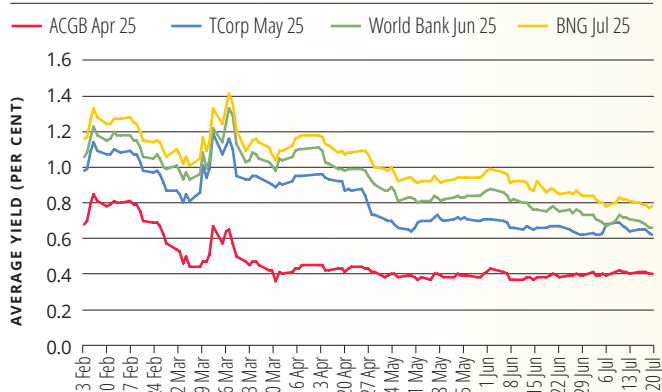
In Australia, the large increase in supply of government and semi-government bonds appears so far to have been counterproductive to SSA demand, as local investors are proving extremely supportive of domestic high-grade borrowers. The perception of greater liquidity in these bonds has only been enhanced by government support for the sector.

Popovych points to an increase in Australian dollar SSA redemptions in August as a potential demand driver for the sector. He says this could see further buying in the front end and at 10-year tenor where some smaller deals have been possible on the back of targeted offshore demand.

KangaNews data show August to be the largest volume of SSA Kangaroo maturities for 2020 before a drop off through to year end (see chart 4). It appears, though, that only a change in investor focus will open the door for more Kangaroo SSA issuance in 2020. This would mean domestic investors reassessing the level at which they see value in SSAs or offshore accounts increasing the Australian dollar bandwidth lost over the last few months.

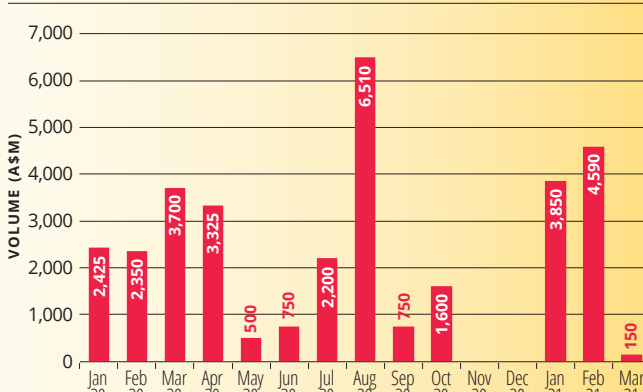
There are valid arguments for Australian dollar investors to consider SSAs, Holt claims. “The major banks are not issuing and the semi-governments are mostly looking to issue in the long end. This leaves the SSA sector as the only other potential source of consistent, high-grade supply – so local and offshore asset managers should have demand at some point.” •

CHART 3. VARIOUS AUSTRALIAN DOLLAR HIGH-GRADE YIELDS



SOURCE: KANGANEWS 31 JULY 2020

CHART 4. AUSTRALIAN DOLLAR SSA REDEMPTIONS



SOURCE: KANGANEWS 31 JULY 2020

Australian corporate market poised and hopeful for a smoother second half

The Australian dollar corporate bond market finished the first half of 2020 with a flurry of deals and greatly improved sentiment. Corporate originators do not expect the floodgates of issuance to open in the second half but say conditions should be supportive of active issuers.

BY MATT ZAUNMAYR

Australian dollar corporate supply in the first half of 2020 was A\$4.4 billion (US\$3.2 billion). More than A\$1.8 billion of this came in the final week of June. This clutch of deals brought first-half corporate issuance to around the long-run average despite the freeze on new issuance during March and April, while a solid issuance month in July saw the annual running total pop above that of most recent years (see chart 1).

The shape of the market in 2020 has tended to be a smaller number of generally somewhat larger deals. According to KangaNews data, in the first half of 2018 there was A\$4 billion of supply from 16 individual corporate issuers. In 2019 it was A\$5.4 billion from 17 issuers. This year's first-half volume came from just 11 borrowers.

IMPROVING CONDITIONS

Credit market conditions have improved markedly from the March-April period. Market sources point to maturities outstripping supply across the credit market and support from the Reserve Bank of Australia (RBA) as drivers of much tighter pricing and ample liquidity.

Desmond Fennell, head of global syndicate at Commonwealth Bank of Australia (CBA) in Sydney, tells *KangaNews* the turning point was smaller-than-expected use of the government's early access to superannuation scheme.

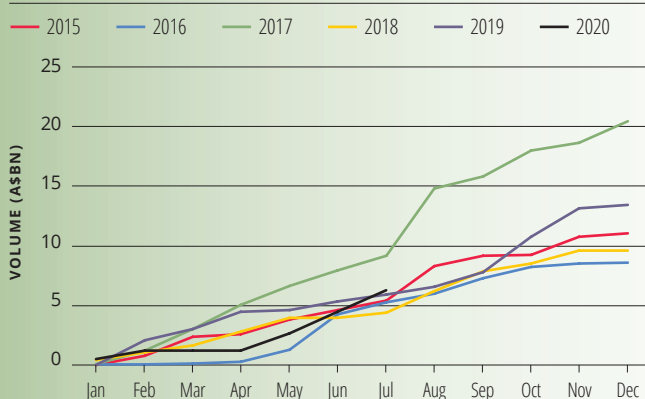
In March, uncertainty around the scale of uptake forced much of the Australian asset-management community to carry high levels of liquidity in advance of potential redemption requests. But corporate borrowers are now able to term out bank liquidity in the public market.

Westpac Institutional Bank's Sydney-based head of corporate and nonfrequent borrower origination, Peter Block, adds: "The deals that have come since Woolworths reopened the market in May have been defensive names and we are very constructive on the market for borrowers of that ilk. Investors recognise critical infrastructure, defensive assets and nondiscretionary consumer companies, and can see through this crisis."

Even so, corporate spread tightening has lagged parts of the Australian dollar market with more explicit government and central-bank intervention. Financials in particular have rallied on the back of lack of supply from the domestic big-four banks.

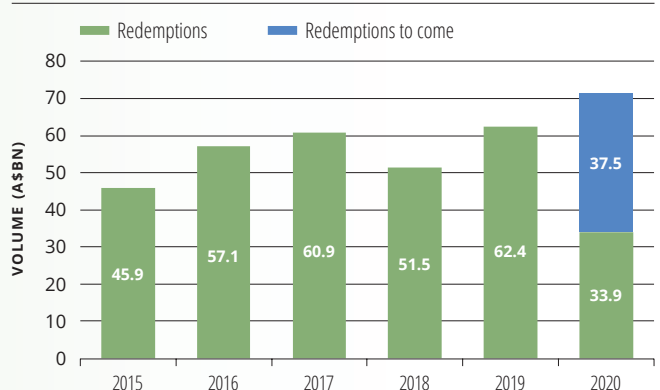
The technical factors driving the wider market are now also supporting corporate spreads, though. One of the main ones is

CHART 1. CUMULATIVE AUSTRALIAN DOLLAR CORPORATE ISSUANCE



SOURCE: KANGANEWS 11 AUGUST 2020

CHART 2. AUSTRALIAN DOLLAR CREDIT REDEMPTIONS



SOURCE: KANGANEWS 6 JULY 2020

undersupply. Australian dollar credit redemptions in 2020 are greater than in previous years (see chart 2).

Gwen Greenberg, head of corporate debt capital markets at ANZ in Sydney, says lack of supply is creating a strong tailwind for corporate issuance. “A lot of corporates accessed bank debt in March and April as spreads in debt capital markets were volatile and moved significantly wider. This has flipped, and pricing currently favours debt capital markets for corporate borrowers across the curve,” she adds.

Demand for corporate deals appears to have returned from all corners and is indicative of Australian market developments in recent years. Tabitha Chang, director, debt capital markets origination at National Australia Bank in Sydney, tells *KangaNews* recent deal books are larger than 2019 outcomes. This may be a function of limited supply, but Chang says the amount of cash in the system and inflows to credit funds are also contributing.

International investors generally pulled back from allocations to Australia during the peak of the market crisis, but now offshore investor demand for Australian corporate deals has also come back strongly. Penny Schubach, director, debt capital markets origination at CBA in Sydney, says bids from Asia and Europe have been particularly strong but have not necessarily been reflected in deal distribution statistics thanks to the activity level of local real-money accounts.

Bids from Asia have been particularly important in the development of the Australian dollar corporate market in recent years. Chang says NAB research into corporate book dynamics between 2015 and 2020 show the average number of investors in corporate deals has risen to 63 from 38. Meanwhile, participation from offshore accounts has risen to an average of 40 per cent of orderbooks compared with around 25 per cent in 2015.

Brad Peel, Sydney-based director, capital markets origination at NAB, says: “Having more investors in the mix means more price certainty, as borrowers are less likely to need to move pricing to get every bid available and achieve their desired volume.”

Demand appears to be particularly robust at 10-year tenor, another part of the market that has been building in recent years and now appears entrenched due to ultra-low front-end rates. The

make-up of corporate supply in 2020 so far has, for the first time, been weighted to 10-year maturity and longer (see chart 3).

Greenberg says the technical drivers of demand have brought secondary market performance across the curve but have been particularly strong for 10-year deals as investors seek higher-yielding assets.

Long-end demand at the beginning of 2020 facilitated two 12-year transactions – for Dexus Finance and GPT RE. Block says several points on the curve are open and he is confident of support if the right issuer tested the market for 12-year tenor.

POTENTIAL SUPPLY

Demand has clearly returned to the Australian dollar corporate market and conditions are conducive to issuance. However, the supply picture remains unclear given many corporate borrowers sought increases and extensions to bank facilities in March and April.

Peel explains that some corporates accessed short-term liquidity or drew on existing facilities in the bank market, either of which they may look to term out in the coming 6-12 months. However, others were able to secure medium-term loan liquidity and may be happy to stay out of capital markets for the time being.

He adds, though, that many corporates, either through maturing debt or establishing new bank lines, will have shortened their portfolio maturity profile. The opportunity to re-lengthen with public deals could prove attractive.

After Brisbane Airport priced its deal on 23 June, the issuer told *KangaNews* it had already raised short-term liquidity to deal with COVID-19-related funding needs. Its deal was the fulfillment of a commitment to come to debt capital markets, made prior to the crisis unfolding, to refinance a local bond line.

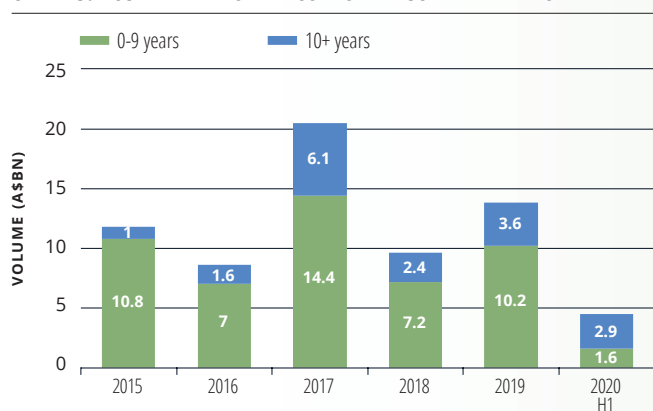
Westlink Motorway Group's deal was also the return of a mandate from earlier in the year. These transactions have offered some catharsis and confidence to market participants, particularly given both issuers' businesses have been severely affected by the crisis. Fennell says the ability of the market to support such names is indicative of the appetite for credit.

Originators remain cognisant of risks on the horizon, though. Block says borrowers should consider taking advantage of positive conditions while they last. “There is strong demand at the moment, but this is a new environment and the goalposts have shifted. The extraordinary overall government support and the RBA's interventions have been very supportive and helped the market improve since March, but we know we are not yet at the end of this crisis.”

Domestic and global headline risk events appear to be accumulating in the fourth quarter of the year, when much of the government stimulus is scheduled to be unwound and the US presidential election takes place. Meanwhile, markets are likely to remain susceptible to outbreaks of COVID-19.

Greenberg expects Australian dollar supply may be weighted to the third quarter after corporate reporting season. “Investors may want to tackle any potential supply sooner rather than later, and issuers may be inclined to do so as well.” •

CHART 3. AUSTRALIAN DOLLAR CORPORATE SUPPLY BY TENOR



SOURCE: KANGANEWS 30 JUNE 2020

BNP Paribas touts double impact of new green structure

BNP Paribas's debut as a Kangaroo green-bond issuer also introduced a globally innovative structure to the local market. The transaction is a standard use-of-proceeds green bond that also rewards investors for the outperformance of a new forward-looking climate-transition equity index.

BY LAURENCE DAVISON

The eight-year bond's A\$140 million (US\$100.2 million) volume was subscribed by Clean Energy Finance Corporation, First State Super and QBE Insurance at pricing on 3 August. Each investor bought a unique tranche.

Proceeds will be used to fund qualifying projects in BNP Paribas's global green-bond pool, while the bonds are also and separately linked to the new Australian Climate Transition (ACT) Index. The bond embeds a call option on the constituent companies in the ACT index. The bank funds the purchase of shares of index constituents to hedge its option exposure. In a forward-looking index, these companies should be environmental outperformers over the bond's life.

Mike Watanabe, managing director and head of equity derivatives, Australia at BNP Paribas in Sydney, explains: "This means the bond has a dual impact: from the green projects funded by BNP Paribas and additionally from the performance of the companies in the index."

The provision of equity-index upside reduced the bond's cost to the issuer. BNP Paribas has not disclosed full pricing details but says the bond coupon is "well below 1 per cent [in order] to purchase participation in upside index performance". By comparison, UBS Australia Branch issued five-year fixed-rate bonds in Australia in late July with a coupon of 1.2 per cent.

ACT INDEX

This is not the first time a bond and an equity-index call option have been combined – indeed, BNP Paribas has used such a structure several times in Europe and the

US. For instance, the bank arranged the inaugural Tera Neva transaction in November 2015. This €500 million (US\$588.7 million) deal combined a European Investment Bank (EIB) climate-awareness bond with a payoff at maturity linked to the performance of the Ethical Europe Climate Care Index.

However, the Australian deal marks the first time BNP Paribas has deployed a forward-looking index in this type of structure – and may be the first time ever.

The index associated with the Tera Neva transaction comprises 30 companies selected on present financial and sustainability criteria, reviewed on a quarterly basis. The ACT index is more ambitious. It seeks to project how businesses will perform under five climate-transition scenarios and thus identify companies in three categories it expects to outperform.

The first category is "enablers": firms selling products and services needed to support climate transition. Second is the "least affected" companies that will be able to cope with climate change because their existing technologies and services are compatible with the future environment. The third category is "adaptors", meaning companies that are well-placed to adapt to climate change despite operating in affected sectors.

The ACT index's universe is firms in the Australian Securities Exchange (ASX) 300 with activities primarily in Australia, with a liquidity filter that left 100 qualified candidates. BNP Paribas applies its own corporate social responsibility filter as an initial negative screen, though Watanabe says this did not disqualify any further companies as of the date of bond issuance.

Companies in the index are assessed according to five climate-transition scenarios, all of which facilitate an outcome of 2 degrees



"In essence, we are trying to focus on what the ASX will look like in future – it is, in effect, stock picking based on environmental scenario analysis. The companies that are best at adapting to environmental transition or are least affected by it should outperform in future."

MIKE WATANABE BNP PARIBAS

or less of overall climate change. These scenarios take account of the pace of policy, social and technological change to assess not just companies' current environmental footprints but how they will change as Australia responds to the reality of climate change. They were co-developed by ClimateWorks Australia and CSIRO under the Decarbonization Futures project.

ClimateWorks Australia and ISS ESG designed a process to score each company under each scenario, every six months. This is converted into a single company score, based on relative weighting of the five scenarios. This weighting is initially equal but will be updated annually to reflect the real-world trajectory of Australia's policy, technology and social response to climate change.

Watanabe tells *KangaNews*: "In essence, we are trying to focus on what the ASX will look like in future – it is, in effect, stock picking based on environmental scenario analysis. The companies that are best at adapting to environmental transition or are least affected by it should outperform in future."

ALIGNMENT OF EXPERTISE

Developing an investable product with this type of structure requires a deep alignment of purpose.

Investors are delegating a stock-picking function to the index methodology. BNP Paribas as the instrument issuer is also relying on the expertise of the index provider for its integrity and performance.

"Climate is a complex, interconnected issue for the investment world and we are seeking to partner with experts that have academic, forward-looking knowledge we do not – this is what attracted us to this project in the first place," says James Pearson, head of impact and responsible investments at QBE in Sydney.

For a firm like QBE – an asset owner – Pearson compares the use of external expertise to the selection of external fund managers for specific asset classes. The company manages fixed-income investments in-house but conducts investment in equities and other risk assets via exchange-traded funds and third-party fund managers. "Finding managers with expertise in asset classes we are not resourced for is part of our normal process – this is just a different specific area of expertise," Pearson explains.

The arranger experience was similar. "The project was only possible thanks to deep collaboration," Watanabe confirms. "The forward-looking aspect is an area of scientific research, not an investment bank capability. We had to work with two different entities on the scientific and data sides of this issue, while the three initial investors also contributed a lot here and elsewhere."

Deal participants leaned on established relationships to help navigate what became a two-year process. For instance, Watanabe says BNP Paribas has a longstanding partnership with Monash University's Centre for Quantitative Finance and Investment Strategies, which acted as adviser to the overall index construction and implementation process, and as academic observer to the index on an ongoing basis. The university also part funds ClimateWorks.

Pearson, meanwhile, says QBE's own ESG policies were considered in the development process. "We advised BNP Paribas on our ESG processes and exclusions and it built a product based on a comparable level of screening. For instance, we have a comprehensive exclusion of thermal coal and would not have invested in a product that did not pass this type of screen."

Achieving alignment between as many parties as a transaction of this nature requires may predicate against its wide-scale deployment in the Australian debt market. For one thing, the combination of a vanilla green bond and an equity-index call option may be disqualifying for many fixed-income mandates.

"We have a fixed-income portfolio that includes fixed- and variable-return bond product, and we were able to classify this instrument as the latter," Pearson reveals. "But it likely helps in this regard that we are investing for QBE, where we have built an impact investment initiative for which we want to be actively seeking opportunities."

He describes the BNP Paribas product as a positive component of the evolution of impact investment rather than something that needs widespread takeup to be regarded as a success. "Five years ago, finding a product that ticked the right boxes on impact and financial return was sometimes like finding a unicorn. This is much less the case nowadays – the mindset has changed and we are seeing a proliferation of structures and products that answer the questions we are asking."

Structures linked to equity indices also have a limited breadth of issuer applicability. Watanabe says the issuer has to be able to fund the equity hedge economically over the extended tenor of a bond transaction. This restricts usage to credits with a sufficiently low cost of funds.

BNP Paribas wants to issue at least a few more transactions in this format to demonstrate investor commitment and demand, Watanabe says. But in the longer term it plans to roll out a global equivalent of the ACT index that it may open to licensing agreements. It has committed to disclosing the makeup of the Australian index a year after launch. •

"Five years ago, finding a product that ticked the right boxes on impact and financial return was sometimes like finding a unicorn. This is much less the case nowadays – the mindset has changed, and we are seeing a proliferation of structures and products that answer the questions we are asking."

JAMES PEARSON QBE INSURANCE



Issuance keeps pace despite disrupted H1

The COVID-19 crisis effectively closed Australasian debt capital markets in March. But KangaNews transaction data show volume levels recovered to produce a solid H1 outcome, driven by the government sector. Major-bank supply has all but ceased and Kangaroo supply is down, while nonbanks provided the lion's share of securitisation volume.

BY CHRIS RICH

Australian syndicated issuance in H1 2020 does not look too dissimilar to previous years when sovereign syndications are excluded. The A\$62.5 billion (US\$44.7 billion) of combined credit and non-sovereign rates issuance is close to the total from 2019 and is the third highest in the last 10 years (see chart 1).

The biggest driver of the issuance total this year is the increased borrowing requirements of semi-government issuers to address the costs of COVID-19 on state economies. In fact, the relatively consistent year-on-year total masks what could be a bigger shift in local issuance patterns than took place even during and after the financial crisis.

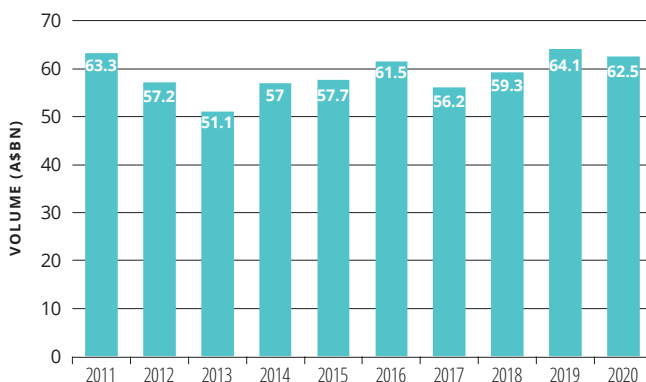
While it is true that credit issuance all but ceased late in 2008, it was not long before bank issuers returned to the market in significant volume – albeit initially with the wrap of a sovereign guarantee. In 2020, by contrast, Australia's major banks simply

did not need to issue in the second quarter of the year. Even into the second half of Q3, their only benchmark domestic activity since the onset of the COVID-19 crisis has been a single tier-two transaction. Subordinated debt, the major banks say, is likely to remain their only call on benchmark debt markets for the foreseeable future (see p38).

The government sector, meanwhile, exploded into life in Q2 after a torrid period in March. The flurry of private-placement and reverse-enquiry activity in the sector early in Q2 is not included in KangaNews data, but even so syndicated, public semi-government issuance in H1 2020 totalled A\$22.9 billion – almost equalling the record full-year issuance of 2019, A\$24.7 billion (see chart 2).

Meanwhile, in two transactions Australian Office of Financial Management (AOFM) issuance for H1 2020, at A\$34 billion, surpassed 2017's standout volume of A\$28.4 billion. The AOFM is expected to release its 2020/21 borrowing requirement in

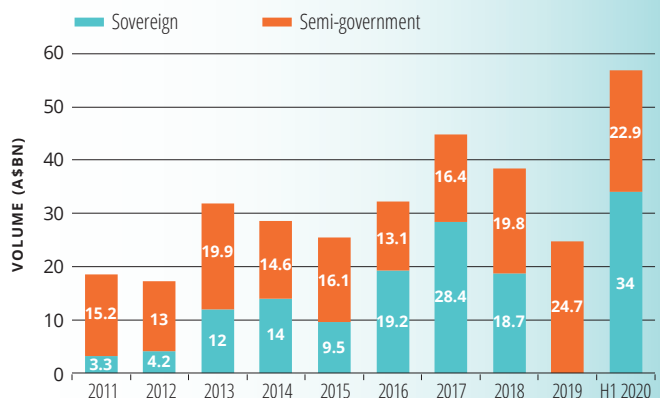
CHART 1. H1 AUSTRALIAN MARKET SYNDICATED ISSUANCE*



* Excludes Australian Office of Financial Management syndications

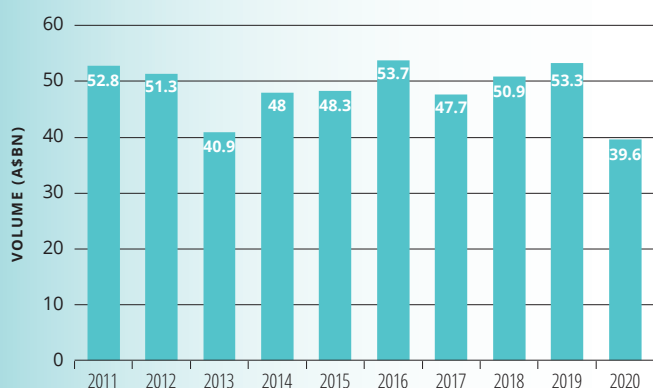
SOURCE: KANGANEWS 1 JULY 2020

CHART 2. AUSTRALIAN MARKET SOVEREIGN AND SEMI-GOVERNMENT SYNDICATED ISSUANCE



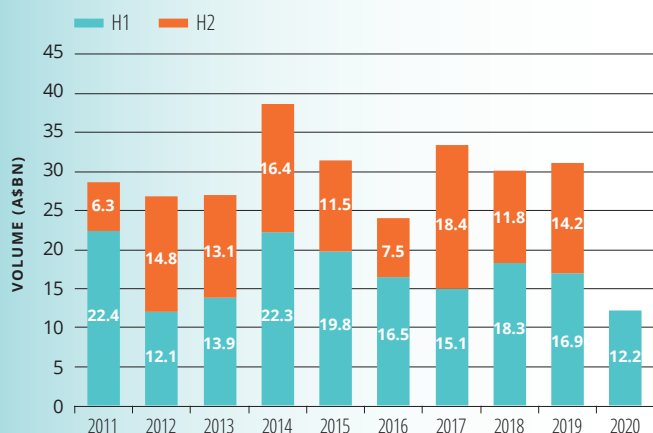
SOURCE: KANGANEWS 1 JULY 2020

CHART 3. H1 AUSTRALIAN DOLLAR ISSUANCE (EXCLUDING AOFM AND SEMI-GOVERNMENT ISSUERS)



SOURCE: KANGANEWS 1 JULY 2020

CHART 4. KANGAROO ISSUANCE



SOURCE: KANGANEWS 1 JULY 2020

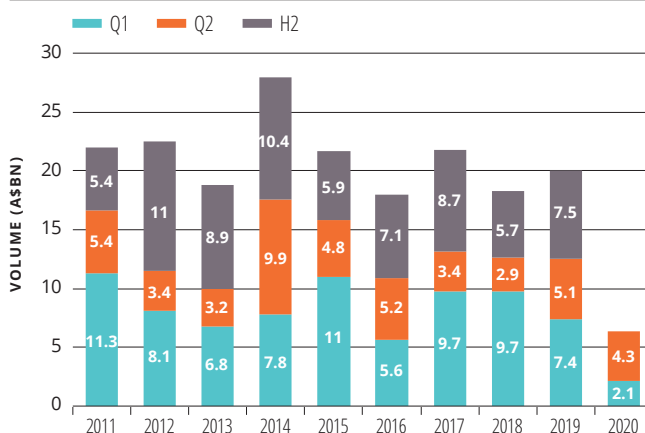
conjunction with the federal government's budget in October but H2 syndicated issuance got off to a flying start with two transactions executed in July totalling A\$32 billion (see p4).

Excluding sovereign and semi-government syndicated deals, however, the picture is dramatically different. Other Australian dollar volume in H1 2020 was down significantly, to A\$39.6 billion from A\$53.3 billion in 2019, and at its lowest ebb for the past 10 years (see chart 3).

This can in part be explained by the slow Kangaroo market, especially for supranational, sovereign and agency (SSA) issuers (see p18). First-half Kangaroo issuance fell to A\$12.2 billion from A\$16.9 billion (see chart 4) in 2019 despite a slight increase in supply from international banks. SSA supply dropped significantly to A\$6.4 billion from A\$12.5 billion last year (see chart 5).

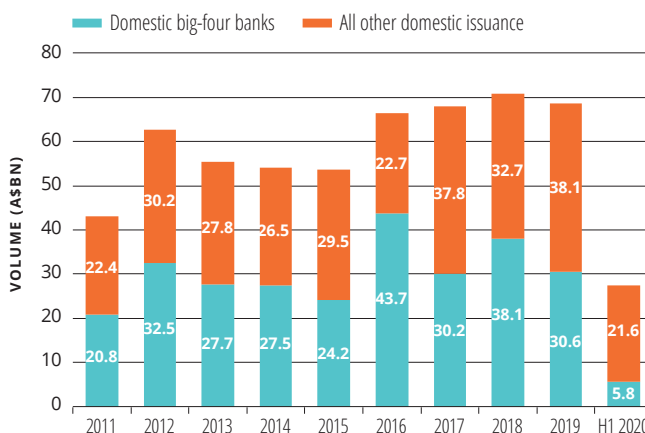
However, the biggest volume drop by sector across the Australian dollar market came from major-bank issuance (see chart 6). The A\$5.8 billion of supply came from just two of the majors – ANZ Banking Group and National Australia Bank –

CHART 5. SSA KANGAROO ISSUANCE



SOURCE: KANGANEWS 1 JULY 2020

CHART 6. COMPOSITION OF AUSTRALIAN DOMESTIC CREDIT ISSUANCE

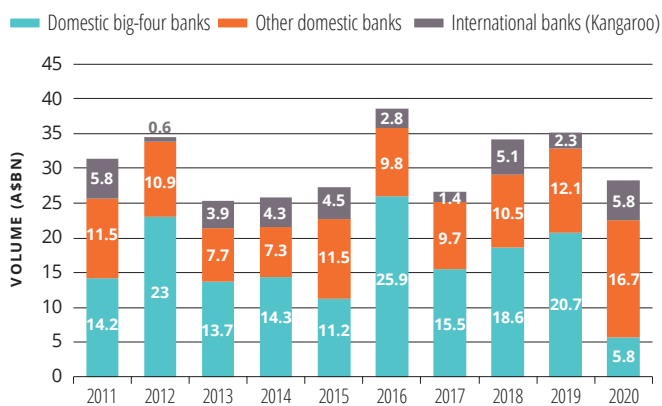


SOURCE: KANGANEWS 1 JULY 2020

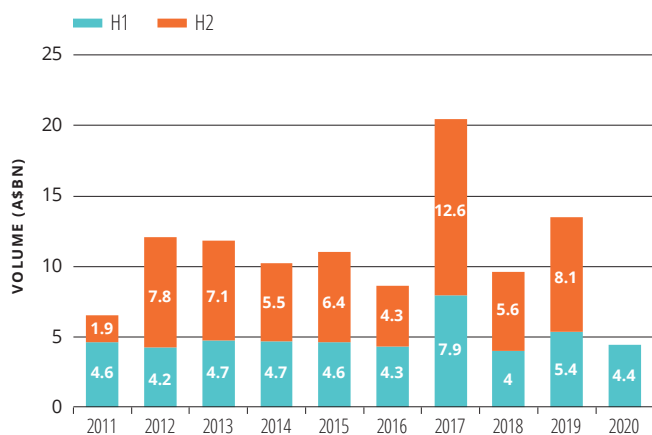
and the sector as a whole has been all but silent since the onset of the COVID-19 crisis in Australia.

The Reserve Bank of Australia (RBA)'s term-funding facility (TFF) – introduced at the beginning of the crisis – offers authorised deposit-taking institutions (ADIs) access to three-year funding with an interest rate of 0.25 per cent. This funding is capped at 3 per cent of outstanding credit but access to further volume is available if banks increase lending to businesses, particularly SMEs. The total funding allowance ballooned to A\$150.9 billion as of 1 July from an initial total of A\$84 billion – although only A\$14.4 billion had been drawn down by the end of H1.

Many analysts expect the major banks will draw on the TFF in H2 to refinance outstanding maturities rather than execute senior-unsecured deals in the Australian dollar market. At the same time, the majors have benefited from significant deposit inflows in an environment of depressed demand for credit. Taken together, their call on wholesale debt markets has evaporated apart from the ongoing need gradually to build the tier-two stack.

CHART 7. H1 AUSTRALIAN DOMESTIC MARKET FINANCIAL INSTITUTION ISSUANCE

SOURCE: KANGANEWS 1 JULY 2020

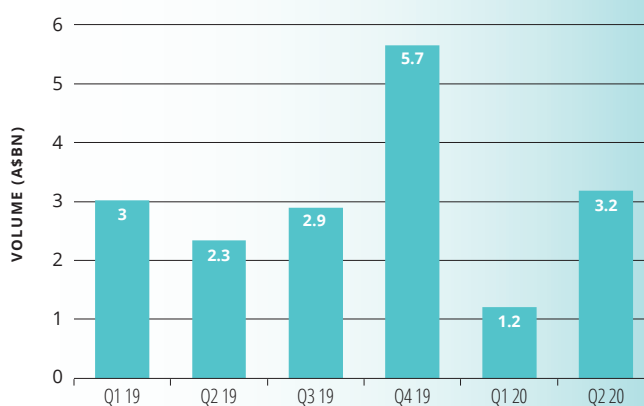
CHART 8. AUSTRALIAN MARKET TRUE CORPORATE ISSUANCE

SOURCE: KANGANEWS 1 JULY 2020

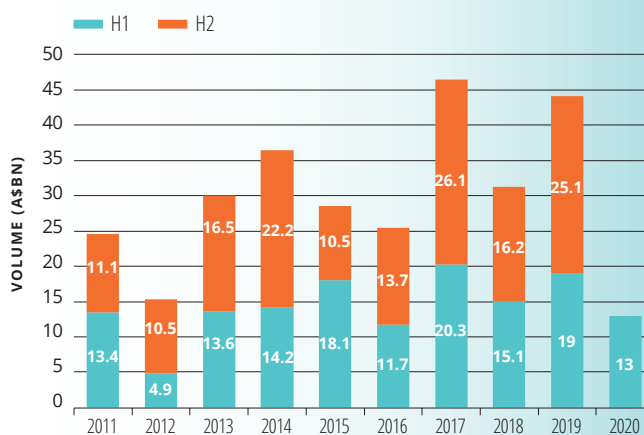
In the majors' absence, a clutch of Canadian banks reopened the Australian dollar financial institution (FI) market in April with covered-bond deals, quickly followed by Suncorp and Bank of Queensland. The major-bank supply void also provided an opportunity for benchmark senior-unsecured issuance from global banks – either through local entities or in Kangaroo format. Accordingly, H1 2020 volume in the FI sector outside the big-four banks held up well (see chart 7).

While the Australian corporate sector has been severely disrupted by COVID-19, debt capital market issuance remained largely consistent with previous years in the first half of the year (see chart 8). In this case, the contrast with the financial-crisis era is more positive. The demise of credit wraps put the Australian corporate bond market on ice in this period and there was virtually no issuance from mid-2007 until 2009. By contrast, issuance rebounded relatively quickly in 2020 after the turbulence of March.

This is in large part due to the final full week of June, which saw just less than A\$1.9 billion printed in transactions from

CHART 9. AUSTRALIAN MARKET TRUE CORPORATE ISSUANCE BY QUARTER

SOURCE: KANGANEWS 1 JULY 2020

CHART 10. AUSTRALIAN DOLLAR SECURITISATION ISSUANCE

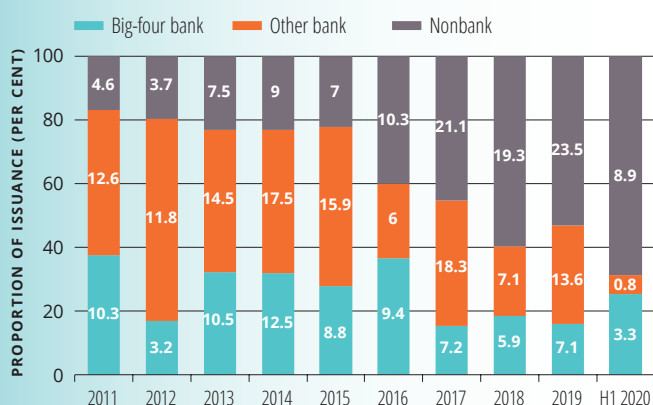
SOURCE: KANGANEWS 1 JULY 2020

Brisbane Airport Corporation, Optus Finance and Westlink Motorway Group. The second quarter of 2020 actually saw more corporate issuance in Australian dollars than the same period last year (see chart 9). This does not look like a flash in the pan, either, as an issuance pipeline started to build after corporate reporting season in August and the first clutch of deals featured eye-catching levels of oversubscription.

Australia's securitisation sector, meanwhile, also saw a large drop-off in issuance in H1 thanks to COVID-19 uncertainty halting deal flow for a time and the ongoing absence of major banks. By the end of June, volume was at its lowest since 2016 (see chart 10) though issuance rebounded significantly later in Q2.

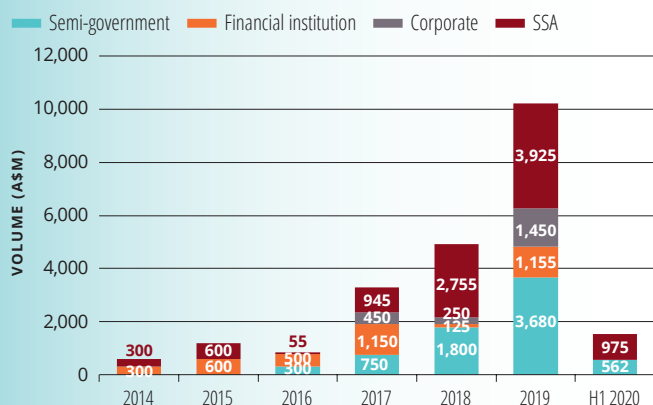
After a month-long primary-market issuance hiatus caused by COVID-19, securitisation deal flow resumed in early May. The initial catalyst was the introduction of the AOFM's Structured Finance Support Fund (SFSF) – which helped clear a secondary market overhang and, at times, stepped up to support new deals with direct investment.

CHART 11. COMPOSITION OF AUSTRALIAN DOLLAR SECURITISATION ISSUANCE



SOURCE: KANGANEWS 1 JULY 2020

CHART 12. AUSTRALIAN DOLLAR GSS BOND ISSUANCE (EXCLUDING SECURITISATION)



SOURCE: KANGANEWS 1 JULY 2020

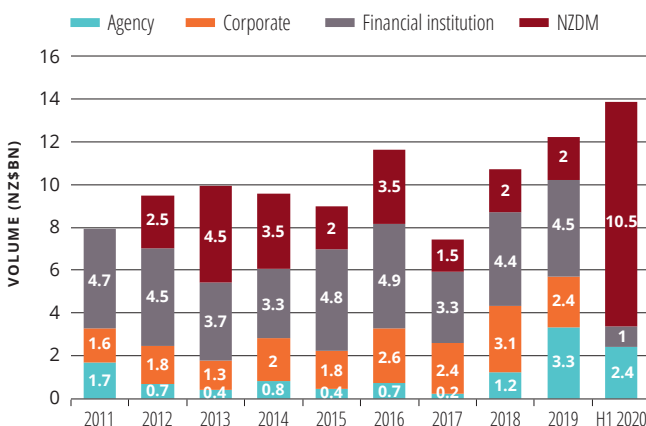
The SFSF is only available to nonbanks and to banks that are unable to access the RBA's TFF. While this dynamic does not necessarily preclude securitised issuance from the bank sector, nonbanks have been the only issuers in this new environment. The composition of H1 2020 volume thus skews toward nonbanks – which account for A\$8.9 billion out of A\$13 billion issued (see chart 11).

As of 30 June, the AOFM had invested A\$394.6 million in the primary market, A\$848.5 million in the secondary market and A\$1.7 billion in warehouses. The SFSF has A\$15 billion to invest over its lifetime.

Green, social and sustainability (GSS) issuance stalled in the first half of 2020. Total issuance was A\$1.5 billion and has some catching up to do if it is to eclipse last year's record A\$10.2 billion of labelled supply (see chart 12). All the GSS issuance in the first half of 2020 came from government-sector names including global SSAs.

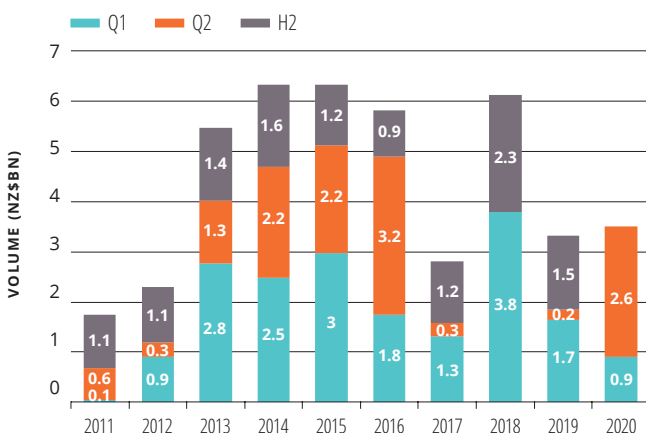
The New Zealand domestic market, meanwhile, has had a somewhat different experience with COVID-19. Issuance volume

CHART 13. COMPOSITION OF NEW ZEALAND DOMESTIC ISSUANCE



SOURCE: KANGANEWS 1 JULY 2020

CHART 14. KAURI ISSUANCE



SOURCE: KANGANEWS 1 JULY 2020

for H1 has never been higher at NZ\$13.9 billion in 2020 – surpassing last year's record NZ\$12.2 billion (see chart 13). But from issuing NZ\$1.5-4.5 billion each year, New Zealand Debt Management (NZDM) printed NZ\$10.5 billion in H1 2020 alone with more to come.

There was minimal corporate volume in H1 and only two FI transactions – from BNZ and Westpac New Zealand – both of which occurred before March. Between then and the end of the first half, only three borrowers accessed the domestic market for benchmark deals: NZDM, Kāinga Ora – Homes and Communities and New Zealand Local Government Funding Agency.

Kauri issuance, on the other hand, recovered well in the first half 2020 after failing to live up to the expectations set by 2018's bumper year. The NZ\$3.5 billion of Kauri volume has already passed 2019's NZ\$3.4 billion total (see chart 14). After a disappointing Q1, Q2 supply shot up due largely to technical factors supporting Kauri spreads including a redemption-supply gap and a proliferation of bank balance-sheet demand. •

On the – virtual – ground with **Kāinga Ora**

Kāinga Ora – Homes and Communities (Kāinga Ora) held its inaugural virtual investor day on 19 August to showcase its role as a world-class public-housing landlord and leader in delivering urban-development projects. The goal was to explain the agency's role to debt investors beyond the normal tenets of its funding programme.

Close to a hundred attendees participated in the event, on which KangaNews partnered with Kāinga Ora. The investor day was originally planned as an in-person event but took place on the KangaNews virtual event hub, a decision made by Kāinga Ora several months ago in order to become comfortable with this delivery mechanism and mitigate the risks of an in-person event.

Kāinga Ora is the New Zealand government's key delivery agency for public, affordable and market housing. It combines Housing New Zealand, and its development subsidiary HLC, with KiwiBuild Unit, and is 100 per cent Crown-owned.

Kāinga Ora prides itself on being a world-class public-housing landlord, partnering with the development community, Māori, local and central governments, and others on urban development.

More than 189,000 people live in Kāinga Ora properties across 62,400 tenancies, which equates to 4 per cent of New Zealand's population of five million. Kāinga Ora's focus is prioritising its tenants' wellbeing and providing them with good quality, warm, dry and healthy homes.

In March 2019, Kāinga Ora developed a sustainability financing framework and brought all bonds into it as labelled "wellbeing bonds" around a year ago. Wellbeing bonds are sustainability bonds with the additional feature of aligning with the New Zealand Treasury's living-standards framework after

the government directed the public sector to embed a wellbeing approach into operations.

OPERATING CONTEXT

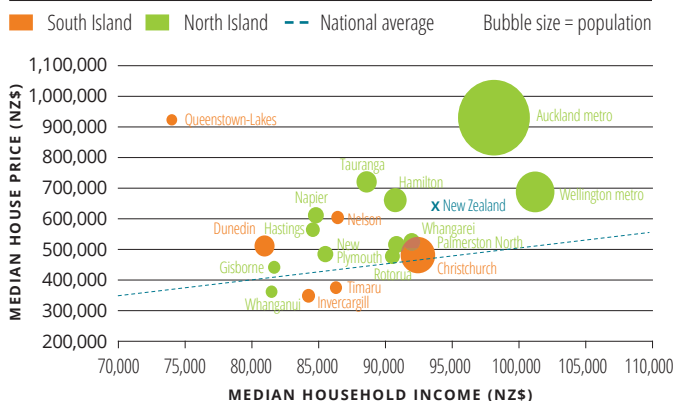
The New Zealand housing market has been under pressure for a number of years. Not enough houses are being built in high-growth urban centres around New Zealand to meet the demand from strong population growth.

The undersupply of housing, alongside constrained land availability and high infrastructure, development and building costs, is contributing to high house prices relative to income and thus a housing affordability crisis (see chart 1). In conjunction with this, there has been an almost sixfold increase of the public housing register over the past five years (see chart 2).

While Māori make up 16.5 per cent of New Zealand's population, according to the 2018 census, they are disproportionately represented among Kāinga Ora's customers at 37 per cent. Similarly, Pacific peoples account for 27 per cent of residents despite making up 8.1 per cent of the population.

Te Ariki Pihama, Kāinga Ora's chief adviser – Māori, explained that one of the agency's six strategic outcomes is partnering with Māori to ensure their interests are protected and their needs and aspirations met, allowing Kāinga Ora to fulfil its obligations in respect of the Treaty of Waitangi.

CHART 1. HOUSING AFFORDABILITY ACROSS REGIONS, JUNE 2020



SOURCE: KĀINGA ORA – HOMES AND COMMUNITIES 19 AUGUST 2020

CHART 2. NEW ZEALAND PUBLIC-HOUSING REGISTER



SOURCE: MINISTRY OF SOCIAL DEVELOPMENT 21 AUGUST 2020

He continued: “My position and team was brought into being to empower a more overt involvement of Māori in the development and decision-making process of housing-related policy, to shape the direction of Kāinga Ora and better position ourselves to meet treaty obligations.”

URGENT NEED

Kāinga Ora believes quality of life is intimately tied to the condition of a home, with poor-quality housing having ongoing impacts on physical and mental health for whānau and individuals.

Many of Kāinga Ora’s old premises experience problems of damp and lack appropriate insulation. The average age of homes in its portfolio is 45 years, with 39 per cent of homes constructed before 1965. Only 15.1 per cent of Kāinga Ora’s homes were built after 2000 and meet modern building codes and specifications. The agency expects 80 per cent of its properties will reach the end of their life in the next 20 years.

Replacement and new-build needs mean Kāinga Ora will have to bring new homes into use more quickly than its current rate, explained Matthew Needham, deputy chief executive – finance. “We need to catch up to a backlog of 10,000 houses. Houses will also require a significant amount of investment in order to continue to be occupied through to their end of life,” he said.

Kāinga Ora is very aware the of the impact COVID-19 has on its customers. The pandemic brings the agency’s supportive role into sharper focus as it provides homes for New Zealand’s most vulnerable people with challenges in income, health, relationships and sense of belonging.

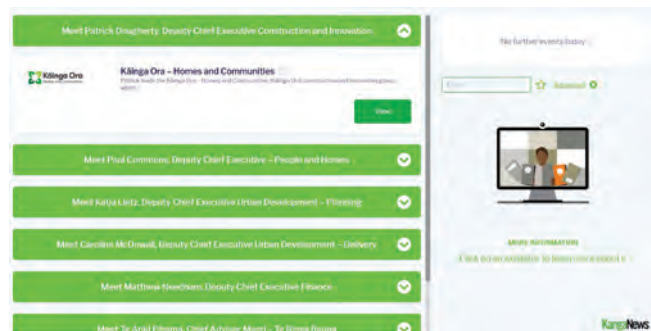
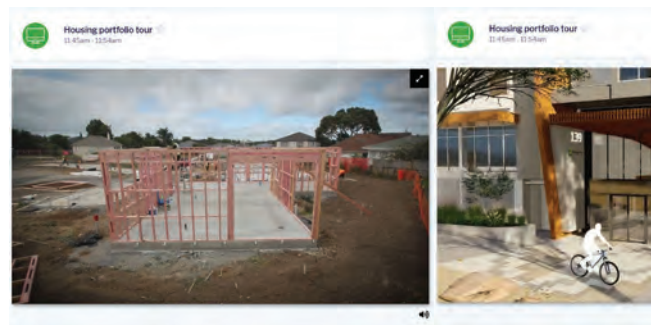
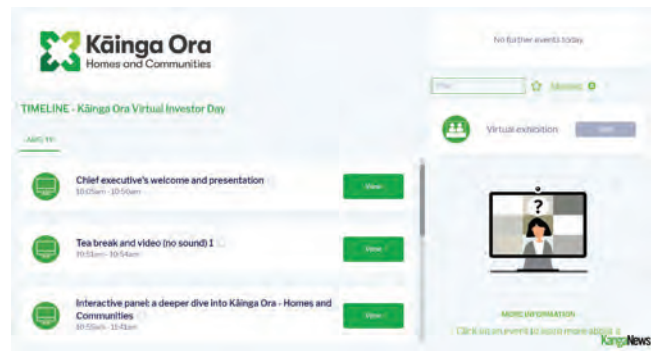
Paul Commons, deputy chief executive – people and homes, said: “COVID-19 hits everyone hard, but your ability to recover and withstand it is very much a reflection of where you are in your life and health, and where you draw your support from.”

Another of Kāinga Ora’s responsibilities is delivery of large-scale development projects. Seven projects are currently underway, over 600,000 hectares of developable land, that will deliver an initial 25,000 and an eventual 50,000 homes over the next 5-10 years.

Key to the success of these projects is establishing a sense of community through urban design, explained Katja Lietz, deputy chief executive – urban development planning.

“We undertake a comprehensive master planning exercise where we look at issues that are much wider than our land holdings and urban housing, such as the amenities already in place and those that are needed,” she said. “We work in partnership with stakeholders to tease out what we can do to improve that particular place in the community.”

Partnering with private-sector developers to provide more market homes, including KiwiBuild and other affordable options, is also a key outcome from Kāinga Ora’s large-scale developments, explained Caroline McDowall, acting deputy chief executive – urban development delivery. “Our commitment to ensuring there is a good mix of public, market and affordable homes means the



housing we’re supplying meets the needs of a wide range of New Zealanders, with a mix of typologies contributing to sustainable, well-designed and thriving neighbourhoods,” she added.

Importantly, all Kāinga Ora’s new homes are built with a 6 Homestar rating. Not only does this take into account Kāinga Ora’s environmental footprint but it is also the best solution for its customers.

“Costs of paying for electricity and heating for low-income households can be high so it is important to ensure our homes are cost-efficient to operate and maintain. We can do this through our climate- and energy-efficient modern homes,” Needham said. •

Flux capacity

New Zealand market participants gathered virtually on 20 August for the **ANZ-KangaNews New Zealand Capital Markets Forum** (NZCMF). New Zealand's economy, politics and COVID-19 response are setting the market's parameters, and discussion focused on managing through and beyond the current rocky patch.

BY MATT ZAUNMAYR

The 11th NZCMF was originally due to take place in March. The onset of COVID-19 meant it was rescheduled to August, when the country's successful elimination of COVID-19 would have enabled the market's first chance to gather in person since the crisis began. However, days out from the event a new, locally transmitted, outbreak of COVID-19 emerged in Auckland. This threw New Zealand back into lockdown mode and the conference into the virtual sphere.

Organisers, participants and delegates manoeuvred quickly to deliver the agenda as planned via the KangaNews virtual event hub. The conversation remained unchanged, with the focus on the post-COVID-19 economic outlook, fiscal policy heading into an imminent election, and the Reserve Bank of New Zealand (RBNZ)'s ever-expanding market intervention. The new outbreak of COVID-19 in the country and its return to lockdown measures added a further layer of uncertainty to the mix.

Despite acknowledgement of the obvious challenges, a consistent theme running through the panels and presentations was the possibilities New Zealand's capital markets and economy have in front of them.

In his opening address, Andrew Allan, head of global markets, New Zealand at ANZ, told the audience at the online event: "The impact of the pandemic is a recurring theme, as is the impact of the unprecedented policy response of the government and the RBNZ. However, we also want to highlight innovation and

the ways in which New Zealand companies can continue to be successful in global markets."

SETTING THE SCENE

New Zealand's economic situation is inextricable from its COVID-19 response. New Zealand is one of only a couple of countries around the world pursuing outright elimination of the virus instead of suppression. Until mid-August, this was going well as the country recorded more than 100 days without local transmission.

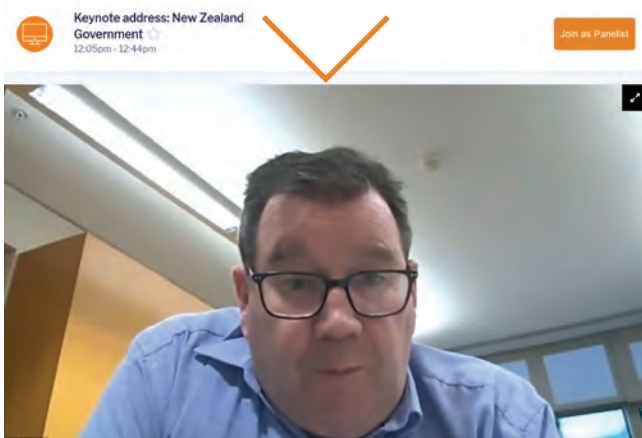
Sharon Zollner, chief economist at ANZ in Auckland, said at NZCMF that countries which have successfully controlled the virus have shown a better rebound in economic activity. This still means less bad, rather than outright good, performance: Zollner said the only reward for dealing well with the health crisis is a recession.

"The economy had a surge immediately after the first lockdown ended as there was pent up spending capacity," she added. "But we are going into a recession due to the loss of tourism. Although this will not be fully felt until the end of the year, businesses know it is coming and are reflecting it in their intentions and expectations for investment, employment and profits."

The response of the RBNZ and central government has been unprecedented stimulus. The former expanded its large-scale asset purchase programme (LSAP) to NZ\$100 billion (US\$66 billion) from NZ\$60 billion in the week prior to NZCMF.

GRANT ROBERTSON GOVERNMENT OF NEW ZEALAND

“Over time, we need a way to ensure our borders are open. This will rely as much on what is happening in other countries as here. We will be following progress on vaccines and continue to explore the possibility of travel bubbles. However, our border policy has been crucial to our COVID-19 control.”



The latter's fiscal response has seen New Zealand Debt Management's 2021 financial-year borrowing requirement rise to NZ\$60 billion with more expected in the government's delayed pre-election fiscal update, due on 16 September. The election itself has been postponed by four weeks to 17 October.

New Zealand's minister of finance, Grant Robertson, told conference delegates New Zealand's finances remain relatively stable despite the record spending. “New Zealand is in a strong position with a robust balance sheet, which means we can manage higher levels of debt. We will bring this down over time but at the moment the spending is important to manage the crisis.”

The New Zealand government bond (NZGB) market has functioned well so far during the crisis, with significant support from the RBNZ's LSAP programme. At the time of the conference the central bank had bought more than NZ\$25 billion of NZGBs as well as New Zealand Local Government Funding Agency bonds in the secondary market.

RBNZ assistant governor, Christian Hawkesby, said in the opening keynote: “We are not using the reserve-bank balance sheet to maximise profit or minimise risk. We are using it to achieve our policy objectives.”

The central bank has flagged further measures to help buttress the economy against imminent recession, including telling banks to prepare operationally for the possibility of negative interest rates in 2021 and contemplating the purchase of foreign assets to push down the New Zealand dollar exchange rate.

Hawkesby reiterated in his NZCMF speech that the RBNZ is preparing the market for further policy measures. He responded frankly to questioning on whether the RBNZ would specifically seek to influence the exchange rate more than other monetary policy channels with its policies.

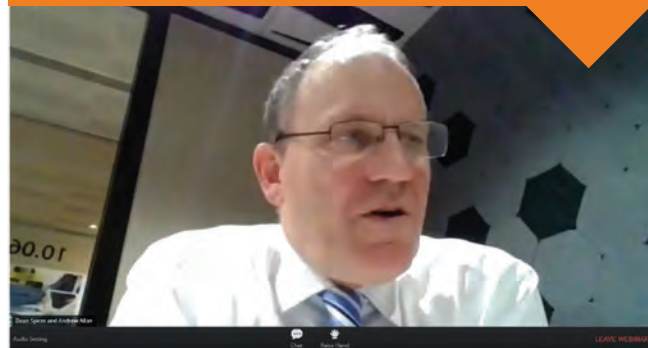
CHRISTIAN HAWKESBY RESERVE BANK OF NEW ZEALAND

“In April, we judged that a programme that included a wide range of corporate issuers could potentially do more harm than good, by removing scarce supply and distorting conditions when normal activity resumed as market calm was restored.”



DEAN SPICER ANZ

“Markets were very dislocated in March and liquidity was very challenging. Those of us that went through the financial crisis in 2008 thought we had seen the worst markets could throw at us, but this period was reminiscent of that – although with a different cause.”



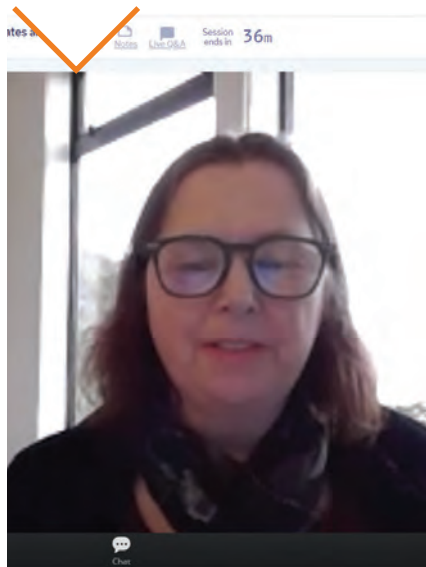
“The New Zealand dollar fits into the picture as it always does. We assess all the moving parts in the New Zealand economy including the exchange rate and its implications for inflation,” he replied. “It is an important channel and interest-rate differentials matter, but no more or less than before the crisis.”

PARSING THE MESSAGE

New Zealand rates have been on a rollercoaster ride since April, as market participants digest the various interventions and messaging from the central bank and

DIANA GORDON KIWI INVEST

"We will be fighting for every basis point. But neither of the two levers we can pull to get greater returns in fixed income – increasing credit risk or extending duration – are necessarily great ideas as we bridge ourselves, hopefully, to a vaccine and the end of this crisis."



PAUL CABLE ANZ

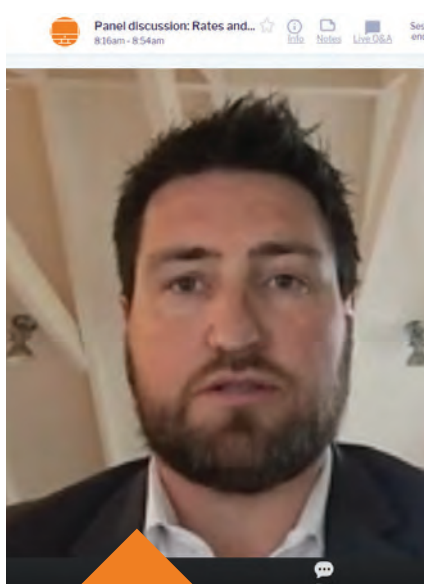
"It is hard to see yield rising in the near term, but for the first time in a while we have procyclical fiscal and monetary policy at the same time. At some point this should lead to a meaningful steepening of yield curves as issuers extend duration. This is more likely in five years than one, though."

government. The RBNZ's recent LSAP expansion and more emphatic language around negative rates has seen NZGBs rally to new lows, well inside the Australian sovereign curve.

David Croy, senior interest rate strategist at ANZ, pointed out that the rally is not new. "New Zealand 10-year bond yields have fallen every year since 2013. What is new is the synchronous nature of global policy easing and the strength of forward guidance here and abroad. And, of course, QE is now a key feature of the New Zealand bond market."

New Zealand seems set for low interest rates for many years. Diana Gordon, head of fixed income at Kiwi Invest, said this has significant implications for Kiwisaver and for local fund managers. Investors will not be able to rely on the same assets they have historically used to provide their clients with acceptable retirement income.

"The Kiwisaver mix has to change to provide the retirements people want," Gordon said. "We as an industry need to be looking at private debt, venture capital, forestry finance and other



TONY ALLEN ANZ

"All G10 countries are in the same boat but the US dollar is under pressure due to the quantity of printing from the US Federal Reserve. This money flows into the 2041 New Zealand government bond as well as other long-dated sovereign bonds."

avenues of risk, but they all should of course be looked at on their individual merits. Mandates have been slow to change in the past, but I expect they will change much faster to adapt to this world."

So far, demand for government bonds and recent corporate deals in New Zealand has remained robust as bank balance sheets and fund managers are extremely liquid but face limited supply. The RBNZ's backup bid is undoubtedly helping support market confidence especially in the rates sector.

Dean Spicer, ANZ's head of capital markets New Zealand, cautioned that while the turbulence of March and April is past it would be premature to suggest the worst is behind markets given prevailing uncertainty around the virus and the economy.

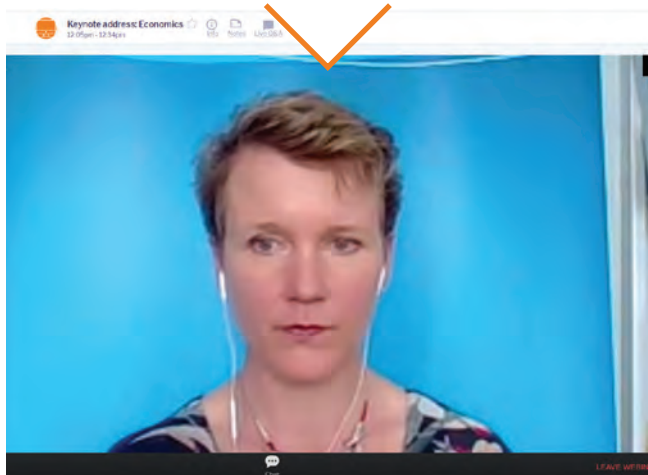
Jared Barton-Hills, head of credit trading Australasia at ANZ, added that lack of issuance is likely to become an issue for the New Zealand market. Negative rates will not influence this story; as rates go lower, Barton-Hills continued, offshore selling can be expected though it should be offset by RBNZ intervention.

By the time of NZCMF, there appears to have been negligible impact from the crisis on offshore demand for NZGBs, according to Kim Martin, acting director, capital markets at New Zealand



SHARON ZOLLNER ANZ

"One cannot put an economy in stasis for three years and expect to be able to wheel all the businesses out again. The unfortunate reality is that some business models are not viable in this period and they cannot be supported forever. The focus needs to shift to retraining for industries that can successfully operate in this environment."



Treasury. In fact, the sovereign borrower's increased borrowing requirement may even see increased interest from offshore investors.

"Previously, some offshore investors told us they liked New Zealand's sovereign fundamentals but considered our bond market just too small to invest in. This may be changing. We have seen a wider range of offshore investors participating in our recent syndicated deals," Martin said.

On the other hand, low rates are already causing a shift for some domestic institutional investors. Gordon said: "We are going further out on the curve right now. We think these are 'fictitious markets', in that central banks are dictating the curves they want in New Zealand and will crush the long end of curves overseas if they see long rates rise. While we are happy to play into this, we know it may not hold forever."

Meanwhile, Vicky Hyde-Smith, head of New Zealand fixed income at AMP Capital, said her firm was underweight credit before the crisis due to tight valuations but is now more comfortable adding credit because of the RBNZ's effective underwriting of liquidity premia.

New Zealand dollar corporate bonds have historically competed with stubbornly high term-deposit rates for retail investors. Deposit rates are now tumbling and retail investors too are having to adjust their return expectations. Andrew Parsonage, head of debt capital markets at Jarden Securities, told conference delegates retail investors are becoming used to low rates and are typically adjusting their maturity spectrum to find higher-yielding assets.

PAUL DALEY ANZ

"Wholesale funding is far more expensive than deposits at the moment so it has been crowded out. This is similar to what has happened in Europe in recent years, meaning some banks have been using markets for capital transactions and to keep their name fresh rather than for funding. The same may happen in New Zealand."



SIR PETER GLUCKMAN

"We have been slow to address digital governance and ethics, while focusing mostly on productivity. As a result, we are now in the misinformation age rather than the information age."

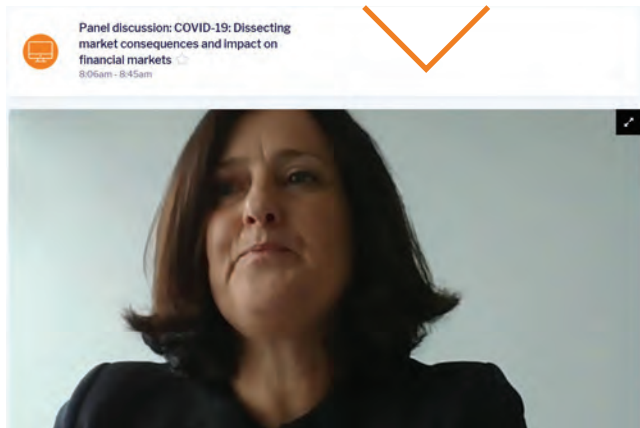


TIM MAIN KIWIBANK

"Capital is not static. We need more capital to fund growth and to help meet new requirements when they come in from 1 July 2021. The market for redeemable perpetual preference shares in New Zealand will need to develop and we look forward to issuing these in the future."

VICKY HYDE-SMITH AMP CAPITAL

"Duration benefit is reducing at pace so our focus is increasingly on absolute yield and taking advantage of the credit curve. We need to ensure we have some buffer for the case of negative rates without taking on default risk."



MARK BROWN HARBOUR ASSET MANAGEMENT

"The medium term is very uncertain. Possible scenarios include an inflationary or disinflationary environment. We think linkers are an undervalued asset and that a subset of global investors will manage medium-term inflation risk through buying them."



EYES ON THE FUTURE

Market participants have tended to focus on the near term since the start of the crisis. However, there is also a sense that the events of 2020 offer a once-in-a-lifetime opportunity to reset the New Zealand economy to be more innovative, sustainable and inclusive, and that capital markets have a role to play. With so much change afoot, it may be possible to reimagine the economy in a more sustainable fashion.



SUE TINDAL INDEPENDENT DIRECTOR

"We should be concerned as much with the potential loss of skills from New Zealand as we are the financial situation, because we do not have the talent pool to fill some of the specialised roles that will be necessary for economic recovery. We also need to have a greater focus on self-sufficiency."

In an NZCMF keynote address, New Zealand's former chief science adviser, Sir Peter Gluckman, said: "COVID-19 does not change the range of issues we are facing but it does offer an inflection point that we must not squander. This is a chance for deep discussion and engagement to shape the future of the economy and society."

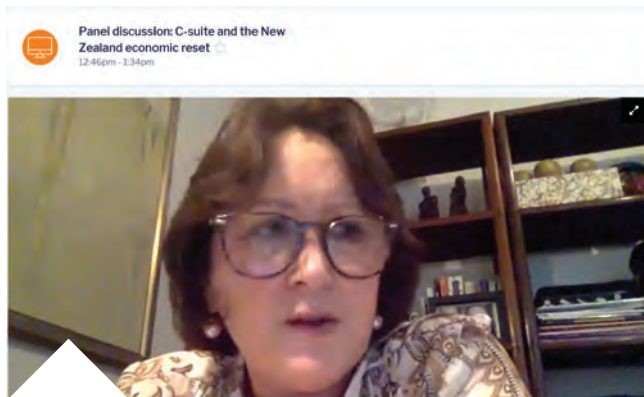
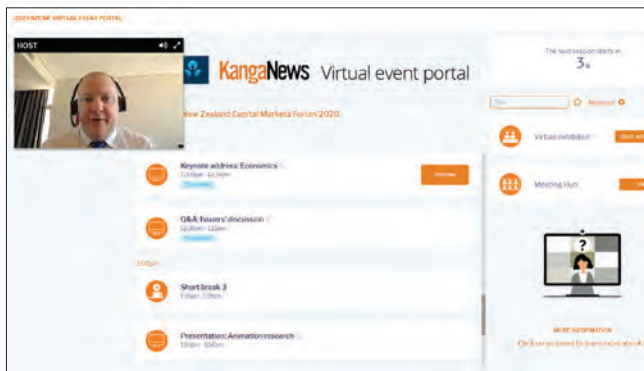
New Zealand's international borders will remain closed for the foreseeable future, so the immediate viability of some of its companies may rest on their ability to operate and thrive domestically. Conference delegates heard from Ian Taylor, founder of Animation Research, which had its entire pipeline of sports-graphics projects scrapped at the beginning of the pandemic.

"We began looking at what we needed to do to keep the day-to-day business running. This was essentially what we could do in New Zealand to keep money coming in. Meanwhile, we also began planning for what would happen as the crisis unfolded and for a scenario where life begins to return to normal but New Zealand's borders remain closed," Taylor said.

Live sport has returned much quicker than Animation Research initially predicted and Taylor told attendees of the company's pivot to deliver its contracts, which are mostly for coverage of sporting events in the US, remotely from its headquarters in Dunedin.

New Zealand's business leaders see capacity for domestic improvement and innovation in developing a sustainable, low-carbon economy. Jane Taylor is a director of entities including Port Otago and Orion New Zealand, and a guardian of Aotearoa Circle. She told delegates this may be the only chance left to address the risks posed by climate change.

Ensuring a sustainable economic recovery is an area in which capital markets can have an immediate impact. At NZCMF,



DEBBIE BIRCH DIRECTOR

"A lot of the focus is on a sustainable reset but it is important also to think about embedding the culture of caring for people in business, and using the balance sheet to do so if necessary, during the recovery."

Auckland Council's treasurer, John Bishop, said the council still hopes the majority of its future borrowing will be in green format. "Our issuance of green bonds has been well received by investors and councillors alike. Investors are engaging with the topic more than they ever have, and investors that are not holders of our green bonds are asking questions on sustainability."

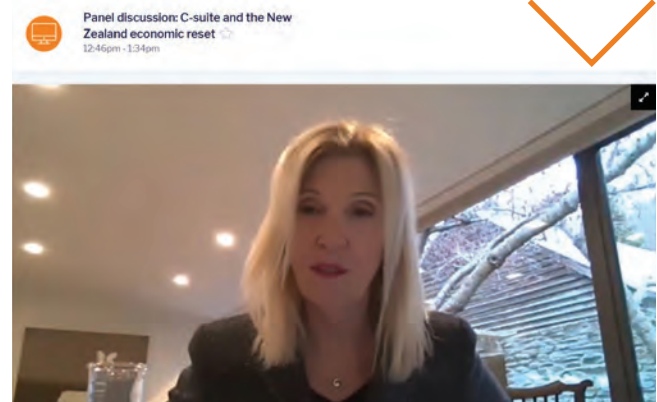
Conference speakers insisted there is much more interest in the market than the range of current green, social and sustainability bond issuers in New Zealand indicates, though this number is also rising. Mercury mandated a debut green bond on 21 August, for example.

At NZCME, Craig Weise, chief executive of New Zealand Green Investment Finance (NZGIF), a new publicly owned green bank, told delegates NZGIF's mandate already includes the development of products that are investable by the wider market, which includes debt capital market issuance.

Meanwhile, David Hall, co-director of Mōhio's climate innovation lab, briefed the online audience on the development of forest-finance instruments, designed to channel investment funds into projects that would increase New Zealand's forest cover. "The key question in climate finance is how exposed New Zealand is to

JANE TAYLOR DIRECTOR

"We need to redefine value to include impact beyond financial value, in order to rebuild businesses for a sustainable future. There are significant gains to be made from continuing post-COVID-19 investment in people and communities, and to develop resilience and adaptability."



SAM DIREEN KĀINGA ORA - HOMES AND COMMUNITIES

"Sustainability always comes up in our investor engagement and views are changing rapidly. Investors see our debt as low risk but sometimes have specific and challenging questions, particularly on reporting benchmarks, which help focus our attention on how we can improve our efforts."



the risks and opportunities of the low-emissions transition. The financial system has a role in directing capital towards novel and innovative solutions," he said.

The New Zealand government, with its increase in fiscal spending, is also exploring investment opportunities to scale up its renewable-energy capacity, potentially to 100 per cent of output by 2035. However, some in the business community say the government's fiscal-policy approach may run the risk of crowding out private investment.

IAN TAYLOR ANIMATION RESEARCH

"Last year was the first in which we made a profit, which came in handy because it became our reserve and allowed us to ensure no-one would lose their job this year. We wanted to ensure staff knew that part of their new job description was to look after themselves and their families. It has been an incredible journey, and we have seen productivity go through the roof."



ALASTAIR WHITE SPARK NEW ZEALAND

"The New Zealand and Australian markets are key investor bases for us and we will aggressively support both over the next few years. This is not to say we would not consider opportunistic issuance in other markets where it makes sense."

However, investment is on hold in areas such as electricity and airports because of a combination of weak demand and uncertainties resulting from government policies. "Sustainable economic growth requires investment by private enterprise in productive assets and, in general, this is not getting a lot of encouragement from either the market or the government," Brown said.

Taylor added: "A lot of the excess capacity and unemployment in the economy is in the private sector and it is very important that the private sector is included in any reforms for the recovery. Stimulus must be boosted by private investment and the most obvious places are in energy, transport and food production. This should be underpinned by increased investment in science and technology."

New Zealand's relatively low sovereign debt coming into the crisis allowed the government to provide massive levels of fiscal support, but Zollner made the point that this cannot continue forever. If there is no vaccine or other fix that allows a rapid return to normality, at some point the focus must turn to reskilling the workforce rather than propping up nonviable businesses, she argued.

Robertson said the government is investing significant amounts in job creation and this is already producing results – for example a doubling of the number of construction industry apprentices.

The business leaders' panel discussed New Zealand's labour market self-sufficiency as an issue for the present and future of the economy. Debbie Birch, director of New Zealand businesses including Fonterra Co-operative Group and IWIinvestor, emphasised the need for a nimble labour market. "We need to be prepared for continuous change because businesses will need to be ready to scale up immediately with skilled staff as and when borders open." •

STUART MCKINNON ANZ

"This is a chance to think differently about our economy and look at new areas we can explore, and identify levers we should pull so we have a sustainable and sustained recovery."



Panel discussion: C-suite and the New Zealand economic reset
12:46pm - 1:34pm



Tim Brown, a member of the Infratil management team and chair of Wellington Airport, told conference delegates Infratil's New Zealand investment plans remain in place for areas that have continued to experience demand growth through the COVID-19 period. These tend to be technology projects like data centres and 5G infrastructure.



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BANK FUNDERS AND **THE FUTURE OF THE MARKET GAP**

Every year, *KangaNews* and **RBC Capital Markets** host the heads of funding from Australia's big-four banks to discuss market conditions and the outlook for their sector. In 2020, the COVID-19 crisis has reshaped the landscape completely – most notably by almost completely eliminating the majors' funding gap and thus removing them from public senior debt markets since the first months of the year.

The funders discuss their reshaped issuance need, the Reserve Bank of Australia (RBA)'s term funding facility (TFF), the ongoing need to accumulate additional-capital issuance, Australian lending-book quality and credit growth, and global investor relations in an era of social distancing.

PARTICIPANTS

- **Alex Bischoff** Head of Global Funding and Balance Sheet Management WESTPAC BANKING CORPORATION
- **Fergus Blackstock** Head of Term Funding COMMONWEALTH BANK OF AUSTRALIA
- **Mostyn Kau** Head of Group Funding ANZ
- **Scott Mitchell** Head of Funding NATIONAL AUSTRALIA BANK

MODERATORS

- **Laurence Davison** Head of Content and Editor KANGANEWS
- **Gerard Perrignon** Managing Director, Debt Capital Markets RBC CAPITAL MARKETS



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FUNDING ABSENCE

Perrignon We usually start this discussion with a funding conditions update, but this year it seems more like a 'not funding' conditions update. What is the background to the majors' absence from capital markets for several months, what dynamics are at play and what is the outlook for their call on capital markets in the medium term?

■ **KAU** The TFF has been a near-term game-changer. It is one of a few liquidity provisions the RBA has implemented and it is perhaps the one with the biggest impact. Purely from a funding perspective, it has changed the dynamic a lot – but we still have a reasonably sized tier-two requirement given our total loss-absorbing capital (TLAC) obligations under local regulations.

It is certainly the case that there has been a big short-term change in our draw on funding markets. The TFF is only available until the end of March 2021, though – and then only for additional funding for credit growth.

■ **BISCHOFF** Among the range of decisions the RBA made on 19 March, the government bond-buying programme and the TFF have had a meaningful impact on funding and liquidity. As it has for ANZ, these measures have shifted the way we think about funding in the near term.

But I would say just as much of an impact was derived from the early stages of market volatility and some of the headline risk around drawdowns, and what this meant for bank liquidity.

Ultimately, the outcome for banks was very different from what might have been feared. There were immediate cash-rate cuts, QE and funding facilities in different forms. We also saw corporates, SMEs and retail customers pre-emptively drawing down on cash and, in some circumstances, taking deferral packages as a precaution rather than as a need.

But all this saw liquidity come back onto the bank balance sheet. This has been reflected in the magnitude of deposit growth we have seen. This is a unique event, resulting in the structural rebalancing of our funding gaps.

What is difficult to assess, though – and this can be seen in the different stressed scenarios the banks and regulators are running – is what the shape of recovery is going to be, the timeline of that recovery and what further actions may be taken by governments and central banks. While we may not return

to the same issuance volume in the near term, we expect to be active in funding markets over time.

■ **BLACKSTOCK** The increase in deposits has certainly driven our strong liquidity position. In the results we released in mid-August, we pointed to a A\$43 billion (US\$30.8 billion) negative core-funding gap. In our case it has nothing to do with the TFF – it is purely the liquidity point that Alex Bischoff just described.

Having said this, we have drawn down some of the TFF available to us and we intend to draw down further. When we have access to this type of funding, which we are being encouraged to take, the reality is that it is available at a very competitive cost while being *pari passu* to senior or other forms of funding that is not regulatory-capital driven.

The reason we have not yet drawn down all the TFF on offer to us relates solely to the increased volume of deposits in the system. The big question for us is whether this phenomenon is structural or temporary. It is something we will have to watch very closely going forward.

■ **MITCHELL** We are talking about funding gaps for the banking system. Taking a very basic look at the initial TFF allowance and banks' funding profiles up until the point when the first TFF tranche expires, it is almost a one-for-one replacement. We have been explicit, in our disclosures and results announcements, in suggesting the initial allowance covers the run-off of our term-funding portfolio over this period.

At the same time, benign credit growth means the asset side has not been coming on to the extent forecasters might have expected. This is separate from the deposit or liability side. We were reframing our funding task lower through the year as we were not seeing lending match up with forecasts.

In saying this, the TFF has replaced term funding we otherwise may have done. In effect, there is a narrowing of the funding gap to begin with and the RBA injecting more cash to the system via the purchase of government debt is only going to increase liquidity in the Australian system. It should see funding gaps shrink further as QE recycles through the system and ends up back on banks' balance sheet as deposits.

An important distinction is the cash component versus the liquidity value of the TFF. One very effective decision APRA [the Australian Prudential Regulatory Authority] took through the peak of COVID-19 was to allow the TFF, as a committed facility, to be counted as an inflow toward our LCR [liquidity-coverage ratio] metric.



"One could argue the design of the TFF was an attempt to transmit a low cost of funding in a way that stimulates lending in the real economy. Looking at the levered component of the TFF and the amount drawn down from it, though, it suggests there is just not a lot of credit growth."

GERARD PERRIGNON RBC CAPITAL MARKETS

A NEW WORLD FOR INVESTOR RELATIONS

Before COVID-19 hit, the big-four banks were among the most visible Australian bond issuers on the world stage, with frequent deals and in-person investor updates in every major jurisdiction. Not only has their issuance need all but disappeared but the nature of the crisis has forced them to re-imagine how investor relations works.

DAVISON What have the banks been doing on the investor-relations side during the COVID-19 period, when they have not been issuing and cannot maintain their usual extensive calendar of global updates? Is it harder to get air time with global investors in particular under these circumstances?

■ **KAU** The calls we have had with investors following our results have been well-received. Investors have appreciated that we have stayed in touch in what are certainly very trying circumstances. It is not the same as face-to-face meetings but, generally speaking, investors are very appreciative. We have not been involved in any deals, of course, so I cannot comment there.

■ **MITCHELL** I concur. We received a similar positive reception as we tried to get across as many accounts as we could in group and one-on-one settings. There has been a lot of conjecture

on whether this approach will replace face-to-face nondeal roadshows or general investor engagement in the future. My view is that virtual updates will be a complement to in-person engagement, but will not replace it.

It is challenging for us to do our day jobs in between taking calls from 5am to late in the evening and working at all hours, given the time zones our investor base covers. It is clearly less glamorous working from home in our closets or laundries, or wherever our home-office set up may be, during periods of lockdown.

Investors will continue to see engagement on an in-person level because I think typically this is where conversation is far more flowing and candid. At the same time, VC tools may complement this type of engagement from time to time. When there is something topical or a particular area of focus investors want to get in front of us, they can do so at the touch of a button.

DAVISON National Australia Bank (NAB) is in the market with a tier-two deal right now. Based on this experience have things changed around deal execution, too?

■ **MITCHELL** Being in lockdown again in Melbourne, I am obviously working from home rather than the office. It is quite remarkable to be able to run a transaction like this remotely but it has become business as usual now.

Six months ago, I would have scoffed at the infrastructure and personal ability required to interact and communicate remotely as opposed to being in the office. I might not have said it was impossible, but the idea of execution from osmosis and dividing tasks virtually would not have appealed to me back then. But it has worked well and it is part of our operating rhythm now.

DAVISON Have jurisdictions varied when it comes to the uptake of VC?

■ **BLACKSTOCK** Across the globe, people have become comfortable with working remotely – it has become the new business as usual. Following our annual results announcement in mid-August, we started engaging with investors and we have not experienced any resistance to having these meetings virtually.

While the exercise is not yet complete, the uptake has been very good. I agree that, when the time is right, there will still be a role to play for face-to-face meetings as well as VC discussions for the sake of efficiency.

DAVISON Is the base case that, when and if conditions return to something closer to normal, the value of in-person meetings will snap back fast? Or, as with what we are seeing with the funding gap, will there be a structural shift including less flying and more VC on an ongoing basis?

■ **BLACKSTOCK** I think the trend has already started. The US seems to have become used to doing VC, particularly in execution mode, and I think COVID-19 has accelerated this. I expect there will be physical roadshows again – as they tend to achieve good engagement – but they are likely to be less frequent in the future.

“THE US SEEMS TO HAVE BECOME USED TO DOING VC, PARTICULARLY IN EXECUTION MODE, AND I THINK COVID-19 HAS ACCELERATED THIS. I EXPECT THERE WILL BE PHYSICAL ROADSHOWS AGAIN – AS THEY TEND TO ACHIEVE GOOD ENGAGEMENT – BUT THEY ARE LIKELY TO BE LESS FREQUENT IN THE FUTURE.”

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This is another factor relating to what we have seen with ESA [exchange settlement account] balances growing so much. The reality is that there is clearly a surplus of cash in the system, and this is causing a number of unusual outcomes. There is no specific requirement for this cash, but the liquidity component of the TFF is still very valid and relevant. When the TFF runs off and we lose this benefit, we will likely see the majority of the funds taken down.

Davison Is the disappearance of funding gaps a uniquely Australian phenomenon?

■ **PERRIGNON** I do not think it is. We have seen a global funding drawback and government support measures in a variety of jurisdictions, which are designed effectively to create the endpoint of supporting banks through what are clearly unprecedented times and to allow a broader transmission of credit into global economies.



"We do not have a supply of credit issue – we have a demand issue. Until we see a clearer, positive outlook with a stable platform for economic growth and the reopening of the economy, it is hard to see appetite for credit returning."

SCOTT MITCHELL NATIONAL AUSTRALIA BANK

On the other hand, the way the regulator and the RBA have designed the framework for funding in Australia is unique. Looking back to the financial crisis, the government at the time overlaid a guarantee structure to allow Australian banks to borrow externally in what was essentially a liquidity and funding crisis. Clearly, things are very different this time around.

Australian banks are in extremely good shape from a liquidity, funding and capital perspective thanks to the repair they affected after the financial crisis.

One could argue the design of the TFF was an attempt to transmit a low cost of funding in a way that stimulates lending in the real economy. Looking at the levered component of the TFF and the amount drawn down from it, though, it suggests there is just not a lot of credit growth in a system that remains extremely anaemic.

Davison What is the banks' read on demand for credit in global capital markets and the behaviour of credit spreads over the last six months?

■ **BISCHOFF** There is no doubt credit has reacted as one would expect it to in an environment of mass global policy easing via the range of different measures we have touched on already.

Everybody here has talked about the outlook and what their funding gaps look like in future. Structurally, it is difficult to say what the supply side will look like when the current situation normalises. On spreads, I suspect credit is in some ways at an artificially tight point, locally at least, because of the lack of supply from the major banks.

The spread story is similar offshore, but it is not so much down to lack of supply. US year-to-date issuance is at a record level but it is being underpinned by a massive QE programme. At some point this will normalise, just like every cycle we have

been through over the past 10-15 years. We have seen the highs and lows of credit and we are certainly at a lower point for senior-paper pricing.

I think all of us would argue tier-two still looks relatively expensive to where senior paper is today, albeit on an historical basis. We are not back to where we were in January this year and it will be interesting to see what happens in the tier-two space over the coming year as markets perhaps start to function more normally.

The reality is that it is a pretty good environment if you want to issue. The only problem is that we don't need to.

■ **KAU** It is a good point about the sheer volume of QE that has been prevalent around the globe. There was an initial shock, as there is in any crisis, but the actions of central banks have insulated markets.

One almost has to question whether this can be sustained going forward. I read recently that after the 20-plus per cent fall in US stocks in March this would be the first time a bear market has never retested the lows, after an initial bounce, before making new highs.

Of course we are not out of this crisis yet, but if this comes to pass it can only really be put down to the volume of QE. We all benefit from it, but we have to wonder where it leads us to in the future.

CREDIT BOOKS

Perrignon How have loan books performed through the COVID-19 crisis so far? Have hardship requests and performance been on the up- or downside of expectations, and how has the picture changed since March?

■ **BLACKSTOCK** Our loan book has performed well so far, which has been assisted by the allowance of loan deferrals. There are

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MOSTYN KAU ANZ

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ALEX BISCHOFF WESTPAC BANKING CORPORATION



areas of emerging stress in the industries that are most exposed to COVID-19, though – and I would be cautious about making statements on the outlook for financial-year 2021 beyond saying that we are actively modelling and stress testing.

■ **MITCHELL** The COVID-19 situation in Victoria has clouded the outlook. We are working through what this might mean for the trajectory of the recovery and, indeed, how much slower and shallower it may be.

Looking at risk-weighted assets (RWA), we did not see anything particularly significant on the risk-migration side. Again, it probably speaks to the significant scale of federal-government support that the activity of exposures in deferral remains uncertain.

On the deferral piece, pleasingly we have seen a portion of our deferral customers roll back into payments. Meanwhile, only 2 per cent of current deferrals have been turned over to our NAB Assist team, which undertakes product reviews and hardship.

It is very difficult to forecast, at this stage, what the ultimate deferral outcomes may be. In fact, the outlook is potentially more nuanced now than it was in the early days of the crisis, especially if we end up confronting a bifurcation of economic activity across the two major states – New South Wales and Victoria. It may not be until 2021 that we will be able to say it has played out.

■ **BLACKSTOCK** The outlook outlined in our results on 12 August had a central case very close to the RBA's view on where unemployment and GDP are going. It is difficult to be clear on the outlook for RWA given there is a lot of uncertainty about timing of any potential vaccine and coming out of the current situation.

Mortgage and loan deferrals have been very helpful in supporting customers so far. There are signs of stress in some areas but, outside of the scenario analysis and the stress testing we continue to do, it is tricky to be definitive.

■ **BISCHOFF** It is hard to say anything beyond the fact that we have not experienced anything much different from what our peers have reported.

TFF TRANSMISSION

Davison How do the banks see the TFF panning out as a catalyst for a higher credit-growth trajectory?

■ **MITCHELL** In the first instance, it was probably overplayed – certainly for the major banks – how impactful the TFF would be on portfolio cost of funds. The TFF accounts for 3 per cent of liabilities – it is small.

To be clear, it is very economic and inside where term-funding levels were at the time in an absolute sense – but for a specified quantum of funding. Despite the rally we have seen since April, and the technical compression in major-bank funding spreads domestically and globally, the TFF is still economic. But the fact remains it is just one input into the banks' cost of funds – and a relatively minor one at that.

The TFF is there to assist banks in supporting their customers and the broader economy, which in turn is designed to reinforce the financial system's ability to get the transmission of price and availability of credit working. But with the uncertain outlook we have at the moment, we do not have a supply of credit issue – we have a demand issue. Until we see a clearer, positive outlook with a stable platform for economic growth and the reopening of the economy, it is hard to see appetite for credit returning.

It is currently very much a state of maintenance. Hopefully, we will start to see some credit appetite toward the end of this year and into next. The additional allowance of the TFF will come into play then and potentially support banks being able to finance growth out of this period.

■ **BLACKSTOCK** I agree with all these points. The factors are there to support supply of credit once demand picks up. But, with business confidence low and the outlook uncertain, it is difficult to say when that is likely to be.

I would add, though, that we are very much there to support our customers. There are lots of examples I am sure we could all point to that demonstrate how we have helped customers through this difficult period, be it through restructuring loans or alternative mechanisms depending on customers' situations. It will take time for credit demand to pick up and, in the meantime, it appears we will be in a period of high liquidity – and certainly limited funding – for some time.

■ **BISCHOFF** The only other piece I would touch on is that, while not directly beneficial for the major banks, the other benefit the TFF has had relates to where relative capital-market pricing lands. It has allowed corporate borrowers to term out drawdowns over the last several months at far more efficient levels than they otherwise would have been able to achieve, and therefore has enabled them also to recoup some

AT1 OUTLOOK

Tier-two issuance will likely get most attention but the major banks will still be looking at periodic additional tier-one (AT1) refinancing transactions. A recent foray into the wholesale market by National Australia Bank (NAB) suggests banks may be open to exploring diverse issuance.

DAVISON NAB recently came to market with a wholesale AT1 deal. Why did it choose this option rather than doing a traditional retail deal? Do the banks in general expect wholesale markets – including offshore wholesale – to be a more significant component of their AT1 funding going forward?

■ **MITCHELL** I wish I could take a little more credit on this, but Will Nigro, our acting head of capital, went down the path of creating the wholesale AT1 programme in 2019. The genesis of it was around adding flexibility to issue AT1 product.

This came into the spotlight in February this year when we were in the market with a retail transaction. It's not that the market wasn't supportive but that retail transactions have such a long open period between pricing and settlement.

Ultimately, market conditions had changed significantly

and in the best interest of stakeholders we decided to pull the transaction, which was subsequently followed by Macquarie Bank pulling a similar deal it had in the market. This shows the constraint of only having one market – domestic retail – in which to raise AT1 capital.

The flexibility of being able to access a new set of investors for the AT1 product, and the ability to access the market with a far shorter lead time than retail transactions require, is what we are after.

There is still an impediment to broad participation by investors in the wholesale programme in the form of the franking-credit piece, and there is still a way to go in achieving broad acceptance of frankable fixed-income product. But the direction of traffic seems pretty clear to us.

Wholesale AT1 will not be a replacement of our retail programme, even so. It is complementary to our

ability to raise this form of supplementary capital.

■ **BLACKSTOCK** We have only issued in the Australian dollar listed market and we have always found it to be well-received. It has enabled our customers to roll over their AT1 holdings, which they have told us is important to them. We note the success of other banks' offshore transactions and NAB's wholesale AT1 programme. I can see the rationale for having this product available and there is now a clear precedent for it.

■ **KAU** The AT1 market has traditionally been underdiversified by Australian banks. This is due to a number of impediments, especially the tax and regulatory laws related to it. Any diversification we can get should be welcomed.

DAVISON ANZ completed an AT1 deal in the US market in the not-too-distant past. Is a return to offshore issuance likely in the foreseeable future?

■ **KAU** Sadly not. We would love to be back in the US market but the constraints around tax law and other legislation make it impossible. The transaction we completed was always going to be a one-off deal and we were always very open about this. We would love to go into other markets as well, but we just don't have the specific balance-sheet capacity.

■ **BISCHOFF** I agree with this. We would love to issue offshore but it is much more challenging now for a predominately domestic-focused bank to find the capacity to get an offshore AT1 deal done given some of the cross-border impediments and tax rules.

What NAB has done has certainly been positive for the market. To echo some of the other comments, the retail market is likely to continue to be the one that offers the most depth. But having the flexibility to look at both wholesale and retail investors is a positive development for the market.

If we look at where tier-two trades were not even five years ago, deal sizes of A\$600 million (US\$429.5 million) were not out of place. This is what NAB printed and it should not be regarded as a negative. The market will likely evolve if we see more regular issuance.

“THERE IS STILL AN IMPEDIMENT TO BROAD PARTICIPATION BY INVESTORS IN THE WHOLESALE PROGRAMME IN THE FORM OF THE FRANKING-CREDIT PIECE, AND THERE IS STILL A WAY TO GO IN ACHIEVING A BROAD ACCEPTANCE OF FRANKABLE FIXED-INCOME PRODUCT. BUT THE DIRECTION OF TRAFFIC SEEMS PRETTY CLEAR TO US.”

SCOTT MITCHELL NATIONAL AUSTRALIA BANK

of the capacity they have with banks to deal with future shocks that may come through.

This is a pretty efficient tool when you think of what major-bank senior paper has come to represent as a benchmark in the domestic market. By this I mean it is more or less possible to read through the data on TFF allocations to see where large corporate exposures, represented by the additional TFF allowance, are starting to reduce. It seems to be the most logical scenario that these exposures should continue to come down as we go forward.

■ **KAU** Although the TFF is significant, I do not think it has changed our behaviour collectively as a banking system across the crisis. By this I mean, specifically, that it is unlikely we would have entered capital markets even without the TFF.

This is a significant contrast with, for instance, the Canadian and US banks. It was extraordinary to see the sheer amount of issuance they executed during the very worst of conditions. I guess this was largely for TLAC [total loss-absorbing capacity] reasons because it is unlikely to have been for demand reasons.

I suspect this is due to different ways of managing TLAC, but I'm not sure you would have seen us scrambling to access wholesale capital-market funds at the widest of levels at the worst point of the crisis. I think this is worth noting.

■ **BISCHOFF** I agree. It has definitely been the case that this has not been a liquidity-led crisis.

■ **KAU** It goes back to the point Scott Mitchell raised: this is very much a demand-led recession rather than a supply one.

Davison A number of analysts expect the banks to pick up their TFF usage towards the end of the facility's window, to lock in term funds for the longest possible duration. What are the banks' own expectations?

■ **BISCHOFF** From a Westpac Banking Corporation perspective, we have said we expect to draw down our full TFF initial allowance and our expectation is that the remaining industry-wide A\$50-60 billion of initial TFF allowance will be fully drawn. The relative value of TFF cost of funds is still far better than what is on offer in capital markets.

This means close to A\$90 billion, in total, that needs to be drawn down by the end of September given drawdowns have been limited to date.

■ **KAU** The RBA has said the same thing. Its expectation is that the TFF will be fully drawn within the allocated period. I agree, and in fact I would not say it is necessarily dependent on credit growth. The banks have let a lot of term funding mature because the TFF is there in the background and because we have had a bunch of deposit inflows. The economics behind the TFF remain pretty attractive, which is a key point.

Perrignon To what extent, if at all, are the banks concerned about a maturity spike in 2023 on the basis that the TFF offers only three-year funds? Has, or will, this reduce usage at the margin?

■ **BLACKSTOCK** The maturity profile should be manageable. While on paper it looks like it will cause a maturity spike, there is no impediment or penalty to early repayment. It is quite well designed to allow us to manage the maturity profile fairly smoothly.

■ **MITCHELL** We wouldn't normally see this scale of maturity concentration in the system, or for banks individually, if we were purely talking about external term wholesale transactions

that needed to be refinanced. There is not an issue around market capacity in the context of what the TFF is – which essentially is funding from an entirely new source.

This said, while it appears large from a forward-looking maturity-tower standpoint it is actually not that significant on the basis of the banks' cyclical 30-, 60-, 90- and 270-day refinancing. It fits in reasonably well, or at least would not otherwise cause any particular focus if it was just part of the typical refinancing profile for any of our numerous other liability products.

Provided we have the tools and the flexibility to construct other forms of funding around it, and we absorb the TFF part of our liability base as it rolls in, it can be managed. I also echo the point about the prepayment feature. This provides maximum flexibility to manage the maturity profile. All in all, how significant the maturity spike will prove to be might be a little overplayed.

■ **PERRIGNON** There seems to be a consensus that the base TFF as it is designed as a source of funding remains competitive enough for all the majors to use it in full, and it sounds as if the ongoing question is really around the efficacy of the supplementary facilities.

How much credit growth there is in the system and how much animal spirit there is to borrow money going forward is the difficult question. That is, the key question seems to be what the usage rate of the supplementary facilities, whether it be the large corporate facility or the SME facility, will be.

TLAC PROSPECTS

Davison We have just passed the one-year anniversary of the RBA's TLAC-equivalence regime and all the major banks have made significant headway on what is effectively a four-year ramp-up. How has this first year been?

■ **KAU** We were fortuitous in the sense that we had strong markets in the first six months of the regime being introduced. This underlines the importance of taking advantage of good market conditions when they present themselves. We all did multiple billions of dollars of tier-two issuance across all the different markets in that six-month period.

With the benefit of hindsight, this is the reason why we haven't had to do the same level of issuance some other global banks did at the height of the crisis and over the past

"The reason we have not drawn down all the TFF on offer to us yet relates solely to the increased volume of deposits in the system. The big question for us is whether this phenomenon is structural or temporary. It is something we will have to watch very closely going forward."

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"Collectively, as a jurisdiction, the Australian banks had a great experience across all tier-two markets and investors. It is always easier at the start of the process, though. The rest of the four-year transition period will most definitely be more difficult, even in favourable conditions."

MOSTYN KAU ANZ

six months – being ahead of the run rate buys time to ride out difficult periods. It is the only really good way to manage through the cycle.

Collectively, as a jurisdiction, the Australian banks had a great experience across all tier-two markets and investors. It is always easier at the start of the process, though. The rest of the four-year transition period will most definitely be more difficult, even in favourable conditions. The outstanding volume we will be looking at is going to be a lot higher.

We need to be cognisant of this but it is certainly a case of so far, so good. If markets keep presenting themselves as they are at the moment, it is likely we will issue in the near-to-medium term.

■ **MITCHELL** I agree. The whole banking system was pretty active after the APRA framework came into place and we were quite fortunate with the conditions from then until the start of this year.

The market conditions we experienced were the most conducive we had seen in years, particularly for higher-beta spread product. The transactions we all printed went well, which was a good demonstration to investors.

It is an exploratory transition with the chosen product of tier-two but, as Mortyn Kau says, the outlook is pretty positive in the near-to-medium term. This is especially true in the current rate environment where almost the entire coupon being received by fixed-income investors comprises the spread over the benchmark they are receiving rather than the base rate or yield. This should be supportive of capital products.

Even so, thanks to the exploratory nature of the transition we really do not know the depth of tier-two demand out there. I'm sure there will be a challenging market at some point in the next three years. To avoid this we need to have thoughtful and creative strategies in place to achieve the quantum of funds that will be required.

Hopefully, we will continue the current cadence of issuance and deals will be received warmly and at a cost that is not too burdensome. At the same time, we want transactions to perform well for investors so they continue to participate in the primary market. But I think there is some exploration to be conducted over the transition period, which highlights the importance of being active when the market is supportive.

■ **BISCHOFF** The way the banks have engaged with markets to date has been very targeted and measured, which is in line with what we have seen in market conditions.

The depth of the US market has come to the forefront for tier-two deals in the context of available duration, the demand for US dollars and the search for yield. This focus certainly doesn't seem likely to abate in the near term.

Importantly, banks are taking a pragmatic approach to duration. Ultimately, this is capital and we have to consider it in a different way from how we consider senior funding through the cycle. It has been encouraging to see trades with long tenors, and it's clear that issuers are regarding duration as a key element of how they manage the future refinancing risk. This can only help with investor comfort.

In addition, most of the banks are around or slightly above 3 per cent tier-two ratios, just six months into the task – which is a positive message for investors to be seeing this quickly. I think there was an expectation of an endless wall of supply but certainly to date this has not occurred.

Davison What are the prospects for tier-two deals with long tenor compared with the situation just ahead of the current crisis?

■ **BISCHOFF** Scott Mitchell made the point that where base rates are means most of the yield on products is now from spread. Taking euros as an example, this has been a negative rates environment since 2014 and investors are still looking

"Where base rates are means most of the yield on products is now from spread. Taking euros as an example, this has been a negative rates environment since 2014 and investors are still looking at duration. Markets believe rates are going to stay lower for longer and thus investors are willing to go further out the curve to pick up yield."

ALEX BISCHOFF WESTPAC BANKING CORPORATION

at duration. Markets believe rates are going to stay lower for longer and thus investors are willing to go further out the curve to pick up yield.

The example for Australian banks is the euro 15- and 20-year covered-bond private placements we have done. Covered-bond margins offer little spread and yet the banks have been able to access a regular stream of demand for these deals since 2014, despite the rates environment. Unless there was a near-term view that rates and inflation were going to return, the demand for duration is likely to continue.

■ **PERRIGNON** This is certainly what I see from a dealer perspective. There was probably a degree of circumspection leading into the TLAC regime implementation about the prospect of Australian banks bumping up against each other given the ramp-up in tier-two issuance requirement. Clearly, market conditions have helped this situation over the past year.

With base rates and spread product where they are, we have been surprised on the upside in regard to investor reception for Australian tier-two product over a very wide range of transactions and markets.

■ **MITCHELL** I think the point around different structures and tenors is underappreciated. As issuers, we are somewhat fortunate that we get to see the level of enquiry and appetite out there across the globe in various currencies, structures and jurisdictions.

The diversity and breadth of appetite is often underappreciated. It is always going to be at various levels of economics and we will move in reference to our own requirements and the way we choose to approach the transition. But I think it is very easy to underappreciate how significant the appetite is if you are not sitting in our chairs and getting the breadth of interest shown to us. •

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Tier-two tee-off

Four Australian issuers executed tier-two deals in the week of 17 August, reviving a subordinated debt market that had largely lain dormant since the onset of the COVID-19 crisis. Deal sources say demand for Australian tier-two is strong at home and abroad.

BY CHRIS RICH AND MATT ZAUNMAYR

Insurance Australia Group (IAG) was first out of the gate with a domestic deal priced on 17 August. National Australia Bank (NAB) followed in US hours on the same day, then QBE Insurance Group (QBE) and ANZ Banking Group (ANZ) printed Australian dollars on the following two days, followed a week later by Suncorp (see table).

Prior to these deals, public supply of Australian-origin tier-two debt had been minimal since well before the COVID-19 crisis began. NAB's tier-two deal was the first from a major bank since January, although it executed a handful of privately placed deals in June and July.

All the most recent issuing entities released results in the days preceding their transactions, allowing investors a fresh read on their position in the wake of the crisis.

The US dollar market has been the most popular destination for global banks executing capital transactions in recent months. Ian Campbell, managing director and head of debt capital markets Australia and New Zealand at Citi in Sydney, says the US Federal Reserve's market interventions and support mechanisms have assisted spread contraction to levels in line with or better than historical averages.

Scott Mitchell, head of group funding at NAB in Melbourne, tells *KangaNews* the bank returned to the US due to these favourable market conditions. He adds that scarce outbound issuance from Australian borrowers in recent months has also created a favourable cross-currency dynamic.

Tom Irving, Auckland-based managing director, debt capital markets at TD Securities, says the US market is likely to remain core to the majors' funding and capital plans despite their lower aggregate issuance task. "The tier-two requirement is still

meaningful and the term funding facility will not be in place forever. US dollars is still the market with the greatest depth and often the most competitive pricing so it will remain important in the major banks' strategies."

Meanwhile, the Australian dollar market has had limited subordinated supply but pricing and demand conditions have also been moving favourably for issuers primarily due to the evaporation of major-bank senior supply. Adrian Went, group treasurer at ANZ in Melbourne, says the bank considered the US and other markets for its transaction.

But he adds: "We weighed various factors, such as pricing and the demand we could expect from domestic investors, and decided that an Australian dollar deal would best serve our needs."

IAG has historically focused on Australian and New Zealand dollar issuance to match its business footprint. Mark Gold, IAG's Sydney-based head of treasury, says the company explored the possibility of long-dated US dollar issuance but ultimately was eager to take advantage of its familiarity to local investors.

QBE had already issued in US dollars in 2020, in the form of a 144A additional tier-one deal in March. Sources familiar with its deal tell *KangaNews* the issuer was keen to engage the domestic investor base, having not issued locally since 2015.

PRICE DISCOVERY

The absence of Australian-origin tier-two debt in recent months meant an enhanced price-discovery process was necessary for each of the transactions. Duncan Beattie, Sydney-based managing director, debt capital markets at J.P. Morgan in Sydney, says NAB faced the added complexity of deciding between a bullet and a callable structure.

AUSTRALIAN-ORIGIN TIER-TWO DEALS PRICED 17-25 AUGUST 2020

PRICING DATE	ISSUER	VOLUME (M)	MATURITY PROFILE	PRICE GUIDANCE AT LAUNCH (BP)	FINAL MARGIN (BP)	LEAD(S)
17 Aug 20	Insurance Australia Group	A\$450	16.25NC6.25	270/3m BBSW	245/3m BBSW	ANZ, HSBC, JPM
17 Aug 20	National Australia Bank	US\$1,500	10-year bullet	185-190/UST	165/UST	Citi, HSBC, JPM, TD
18 Aug 20	QBE Insurance Group	A\$500	16NC6	300/3m BBSW	275/3m BBSW	ANZ, Barclays, Citi, CBA, HSBC, NAB
19 Aug 20	ANZ Banking Group	A\$1,250	10.5NC5.5	200/3m BBSW	185/3m BBSW	ANZ
25 Aug 20	Suncorp Group	A\$250	15.25NC5.25	250/3m BBSW	225/3m BBSW	Citi, NAB, UBS, Westpac

SOURCE: KANGANEWS 20 AUGUST 2020

Australian banks have typically opted for callable tier-two deals in the US dollar market but NAB opted for a 10-year bullet. Mitchell says this was an attractive differentiating factor for investors. “Not only does the structure used offer NAB a small increase in investor diversity but the economics of the bullet structure were more balanced than what a callable transaction would have achieved.”

Beattie adds that the tenor call was vindicated in pricing. “We thought the bullet structure would give more ability to push on pricing and in the end the deal priced 30 basis points inside what secondary marks for a 15-year non-call 10-year deal indicated.”

According to Andrew Duncan, managing director and head of debt capital markets Australia at HSBC in Sydney, not having fresh pricing points is not necessarily an impediment, particularly given the imbalance between ample buy-side liquidity and emaciated major-bank supply. “Pricing for new transactions becomes more of a conversation around value relative to comparable supply from US and Asian banks,” he explains.

Meanwhile, the deluge of tier-two issuance brought by the major banks in the second half of 2019 provided adequate pricing reference for ANZ’s domestic deal, according to Paul White, global head of capital markets at ANZ in Melbourne. NAB’s US dollar transaction was also relevant.

“The pricing process was straightforward despite the lack of recent issuance,” White says. “There was plenty of deal flow and issuance in the market during 2019, from ANZ and the other major banks, which provided pricing points.”

Tightening was also in evidence. White points out that ANZ priced a 10NC5 tier-two deal at 200 basis points over three-month bank bills (BBSW) last July and this line was marked at around 165 basis points over BBSW ahead of the new issue.

The reference points for the insurer deals were also primarily domestic even though there has been such scarce supply. IAG has two outstanding Australian dollar tier-two lines, which Beattie says provided good reference points.

QBE had not been in the Australian dollar market for some time, but Campbell says coming to market a day after IAG made the point of reference to the preceding transaction fairly clear.

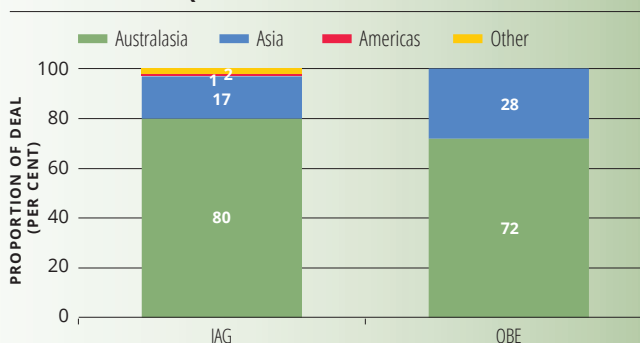
The maturity structures opted for by IAG and QBE, 16.25NC6.25 and 16NC6, reflect recent changes to S&P Global Ratings’ rules for capital instruments to allow a legal maturity date of 10 years after the call date rather than 20 years.

DEMAND RESPONSE

Intermediaries expected strong support for the transactions given the supply and demand backdrop that characterises global markets in the COVID-19 era. Duncan says scarce opportunities to gain exposure to Australian major-bank credit and Australia’s relatively favourable economic position for recovery from the pandemic meant demand was always likely to be high for higher-yielding financial-institution and insurance-company subordinated debt.

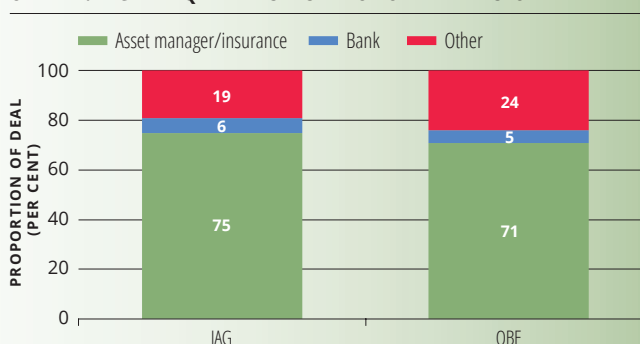
Still, he says, the quantum and quality of orders in NAB’s book was pleasing to see – particularly the contingent of demand

CHART 1. IAG AND QBE TIER-TWO DEALS GEOGRAPHIC DISTRIBUTION



SOURCE: HSBC, J.P. MORGAN 21 AUGUST 2020

CHART 2. IAG AND QBE DEALS DISTRIBUTION BY INVESTOR TYPE



SOURCE: HSBC, J.P. MORGAN 21 AUGUST 2020

from Asia, which accounted for 26 per cent of the book, compared with 62 per cent from the Americas and 12 per cent from EMEA.

White says ANZ’s deal had similar allocation to its July 2019 tier-two transaction, meaning just shy of 90 per cent was allocated to domestic real-money accounts. He adds that there was also strong demand from investors in Asia and New Zealand, as well as a strong contingent of repeat investors from ANZ’s 2015 Australian dollar green-bond debut.

IAG and QBE both attracted strong orderbooks from domestic and regional investors, while real-money accounts were the predominant buyers by investor type (see charts 1 and 2).

Beattie says IAG’s book peaked at around A\$2.5 billion, allowing for a price revision of 25 basis points. Meanwhile, QBE achieved its aims of engaging the Australian dollar investor base. Campbell tells *KangaNews* more than 100 accounts participated in the deal compared with 30 in QBE’s last domestic tier-two deal in 2015.

Irving says yields are continuing to trend lower and he has no doubt the major banks would again find strong demand at long tenor in the US. “NAB hit the deepest US dollar demand base with a 10-year bullet deal, but with yields going lower investors are increasingly eager to go out on the curve. As a result, the investor bases at different tenors – for example 15 and 20 years – have become more diffuse than they were before the COVID-19 crisis,” he explains. •

ANZ'S MARKET RETURN FROM ALL ANGLES

ANZ's capital-market return, on 19 August, marked the first major-bank domestic tier-two deal since late 2019 and the sector's first Australian dollar green, social and sustainability (GSS) bond since 2017, excluding securitisation and other nonvanilla instruments. It is ANZ's third transaction under its SDG [UN Sustainable Development Goals] framework, though previously it had only issued in the euro market.

ANZ's group treasurer, **Adrian Went**, global head of capital markets, **Paul White**, head of sustainable finance, **Katharine Tapley**, and head of debt investor relations, **Scott Gifford**, discuss the deal with *KangaNews*.

Issuer: **ANZ Banking Group**

Issuer rating: **AA-/Aa3/A+**

Issue rating: **BBB+/Baa1/A-**

Format: **SDG tier-two**

Pricing date: **19 August 2020**

Maturity date:

26 February 2031

Call date: **26 February 2026**

Volume: **A\$1.25 billion**

(US\$900.1 million)

Margin: **185bp/3m BBSW**

Indicative margin:

200bp/3m BBSW

Lead manager: **ANZ**

The deal came on the same day as ANZ's third-quarter results. What were the main messages the issuer wanted to communicate to investors ahead of pricing?

■ **WENT** There is naturally a lot of interest around our financial results due to the COVID-19 pandemic and related economic stress. One of the main points worth highlighting is the strength of our capital position. We increased our capital ratio by around 37 basis points over the quarter. This increases to 47 basis points including the sale of UDC Finance in New Zealand, which is expected to settle shortly.

The other key piece of our results is the dividend for shareholders. [ANZ

chief executive] Shayne Elliott spoke about the need to keep equilibrium between a strong balance sheet and delivering some return to shareholders. The dividend is smaller than it was pre-crisis, but we considered this a very important message that speaks to the confidence we have in our balance sheet and our ongoing performance.

All indications are that additional capital is likely to be the only substantial call on capital markets from major banks in the near term. What plans do you have for this type of issuance and has the strategy changed since last year given the lack of need for senior-unsecured funding?

■ **WENT** Our plans regarding the capital raise have not changed from last year, but it is correct that our need for capital markets is quite different from what it was pre-COVID-19. The Reserve Bank of Australia (RBA)'s term funding facility is obviously a big driver of this as a substantial provider of funding to the banks. We have begun drawing on this for term funding.

The other big factor is the deposit flow we have seen. We think this will continue as the amount of money in the system increases with various actions from the RBA and the federal government.

We have reiterated that our approach to TLAC [total loss-absorbing capacity]

and tier-two issuance is unchanged from what it was 12 months ago. We still need to get to 5 per cent of risk-weighted assets by January 2024 and the Australian major banks will need to do a significant amount of issuance to get there. We need to diversify across markets, tenors and currencies and we will be looking at private placements and public transactions.

What was the rationale for coming to the Australian dollar market for this deal?

■ **WENT** The domestic market remains important to us. We executed a tier-two deal in July 2019 and we expect to come to the market once or twice per year. Different tenors may develop over time, but the 10NC5 [10-year non-call five] structure remains dominant in the domestic market.

Excluding securitisation and nonvanilla debt, this is the first domestic labelled GSS bond issued by a major bank since 2017. It is also the first time ANZ has used its SDG framework for a transaction in Australia. What were the factors behind this decision?

■ **TAPLEY** We have been a GSS bond issuer since 2015 when we did our first green bond and have been a prolific arranger since then. The motivation behind the SDG label comes from our

commitment to the SDGs, to which we have been a signatory since 2016.

Creating a framework that links to the SDGs allows us to demonstrate to investors how our lending activities are deriving impact. They can then demonstrate this to their constituents.

We had not been in the local GSS bond market since our inaugural green bond in 2015 so we felt it was time to return. The transaction was well received, with crossover interest into this deal from our green-bond transaction.

The support for what we are doing was very evident in the investor call where most of the questions were focused on the format of the deal rather than ANZ's trading update, which had only been delivered an hour before.

There were many detailed questions around our framework, what we are doing and how we retain a robust approach through impact reporting and independent reviews. The call definitely demonstrated to us a maturing of ESG [environmental, social and governance] approach among domestic investors since our first GSS deal in 2015.

Exactly what sort of information did investors request when it came to the SDG framework and the use of proceeds?

■ **TAPLEY** Our approach to independent review was a focus. For this transaction, we had an opinion from Sustainalytics on our refreshed SDG bond framework. We also had assurance given by EY on the underlying asset pool.

There were also questions on our approach to reporting. We explained that we are not only focused on how we use proceeds but also how we measure impact. One of the benefits of issuing an SDG bond is that the SDGs provide a framework for measuring impact.

Investors are traditionally focused on issues such as reducing emissions intensity and other environmental outcomes, because these are measurable. However, we also explained how we are measuring impact in socially-oriented asset classes such as healthcare, for

example beds provided in hospitals and availability of aged care to vulnerable cohorts.

This feeds into the narrative of a sustainable recovery from COVID-19. Do you get a sense the pandemic has provided an inflection point for investors looking at GSS issuance, and is the domestic market catching up to Europe?

■ **TAPLEY** I think the Australian market has been endeavouring to catch up for some time now. When I was in London last year an investor commented on the sophistication and granular ESG requirements of their investor clients in Australia, for instance.

COVID-19 is certainly an inflection point, though. Coupled with the extensive bushfires and flooding we saw in Australia last summer, I think we will only see greater focus on environmental and social issues.

One of the motivations we had for refreshing our SDG bond framework was to add two more SDGs that have become increasingly relevant as a result of these events. These are SDG8 – decent work and economic growth, and SDG15 – life on land.

We are very focused on supporting our customer base through recovery from the pandemic and the economic fallout as well as investing in resilience and adaptation activities in anticipation of further extreme weather events caused by climate change.

What is the outlook for ANZ's SDG issuance in this new environment of reduced wholesale funding requirement? Can the bank maintain supply even though overall issuance is subdued?

■ **WENT** I hope so. Our capital raise will be our primary focus in capital markets and we would like to apply the framework to as much capital issuance as the asset pool allows.

■ **GIFFORD** One thing we are outlining with investors is that there is strong alignment between ANZ's A\$50 billion

sustainable financing target and its funding. SDG alignment is in the target so, as those assets are generated between now and 2025, they will map with our SDG funding and capital platform. There is tremendous opportunity for investors to partner with ANZ in driving positive impact in Australia and New Zealand.

We are committed to being a regular and leading issuer in SDG format. We have now executed SDG transactions in 2018, 2019 and 2020, and there is no reason this frequency could not continue.

Until the week the deal priced, there had been very little tier-two issuance in Australian dollars since the start of the COVID-19 crisis. How did this affect the execution process?

■ **WHITE** There was a lot of supply in the domestic market concurrent to ANZ's deal and a lot of information to digest with it being results season. Bringing in the SDG overlay and executing the deal on the same day as ANZ's results made it a busy process of investor engagement, but it was smooth.

What is the background for supply and demand drivers for major banks at the moment, and how do these affect the wider market?

■ **WHITE** There is obviously a lack of issuance, as Adrian Went outlined. This will not change in the near term. The domestic major-bank senior market is very technical and trading at historically tight levels, although spread tightening has slowed recently.

We are seeing a general shift into higher-yielding assets. This means other financial institutions and corporates are benefiting from the lack of major-bank supply. For example, Goldman's A\$400 million deal on 19 August saw more than A\$2 billion of demand and Coles saw more than A\$3 billion of demand for its deal on the following day.

Investors are looking to invest in a range of different asset classes, longer tenor and lower credit ratings to get yield in this environment. ■

Rapid renaissance

Asian demand has been a consistent component of the Australian dollar credit market in recent years and – to the surprise of some – has emerged from the first phase of the COVID-19 crisis as a still-reliable bid. Yield and credit quality factors are crucial, as the relative stability Australian credit offers attracts consistent demand.

BY MATT ZAUNMAYR

Demand for Australian dollar credit assets in Asia has been driven over the past decade by the Australian market's combination of relatively high yields and high credit quality, as well as by growth in the volume of Australian dollar savings being accumulated by Asian fund managers, banks and insurance companies.

The relative yield story has eroded significantly since 2018 and this has caused some challenges to Australian dollar demand. But the other drivers of Asian investor interest were strong enough for this bid to remain a consistent component of the Australian dollar credit market until the COVID-19 crisis struck.

When the crisis hit, intermediaries say most international investors' focus turned primarily to liquidity. This meant net selling for most markets around the world, including Australian dollars. In fact, even those regional investors that maintained significant Australian dollar risk in March-April may have done so due to inability to sell at cost-effective levels rather than preference for these assets.

On the up side, according to Owen Gallimore, Singapore-based head of credit strategy at ANZ, there was relatively limited panic selling from the Asian investor base during the crisis. In fact, he says demand from Asia – which often fluctuates in line with yield differentials – has been reassuring in its consistency throughout 2020.

Nervousness about the possible liquidity and price performance of the Australian dollar market that flared in the brief period of market dislocation appears to have dissipated by early August. Investors in Asia have been contributing a consistent portion of the books of corporate and financial-institution (FI) transactions, and intermediaries say their representation in deals continues to outstrip final allocation.

Most credit deals have tapped an excess of Australian domestic liquidity but offshore demand, made up mostly of Asian accounts, has also been a consistent feature since the market's restart (see charts 1 and 2).

MARKET RELATIVITY

Part of the motivation for Asian investors re-engaging with the Australian dollar market may be necessity. Like investors in most regions, whether they are banks, asset managers or insurance funds, those in Asia have seen cash inflows resume in force since the depths of the COVID-19 market crisis.

Unlike buy-side counterparts in the US and Europe, Asian investors do not have a booming local market to invest in. Supply from Asia-Pacific borrowers in the Asia-focused US dollar Reg S market is down compared with 2019, while there has been a small increase in issuance in combined Reg S and US 144A format.

Lorna Greene, director, debt syndicate and origination, Asia at National Australia Bank (NAB) in Hong Kong, says Reg S pricing continues to be favourable. But she adds: "Execution certainty has been a key determining factor for issuers amid the backdrop of heightened volatility in the post-COVID-19 environment and this has led some Asia-Pacific borrowers to issue in Reg S and 144A combined format to maximise their potential investor base."

Issuance in local currency markets such as Singapore and Hong Kong dollars is also down in 2020. Carman Lau, director and head of fixed income, North Asia, at HSBC Private Bank in Hong Kong, confirms that the US dollar market has been the main recipient of demand since the COVID-19 crisis. The challenge is that US investors are typically given preferential treatment in transactions with US domestic documentation – leaving a supply shortage for accounts in Asia.



"There are fewer options than before the crisis while liquidity remains strong. This is compelling investors to be open to doing credit work on more borrowers and to be active across more regional currency markets as they look to put money to work."

LORNA GREENE NATIONAL AUSTRALIA BANK

Greene explains: “There are fewer options than before the crisis while liquidity remains strong. This is compelling investors to be open to doing credit work on more borrowers and to be active across more regional currency markets as they look to put money to work.”

In another sign of how readily markets have adapted to a socially distanced world, intermediaries in Asia report that the demise of in-person investor updates has been little or no impediment to the process of spreading the net (see box on p54).

Even so, dealers say the fact that many regional investors are already familiar with the Australian dollar market can only be positive for demand in these unusual conditions.

The biggest challenge is the same as it has always been. The opportunity set in Australian dollars is limited compared with US dollars in particular. Daniel Leong, director, debt syndicate at Mizuho Securities in Hong Kong, says it is likely most investors in Asia will continue to favour US dollars as their economies are more tied to the currency, as well as for liquidity reasons.

DUST SETTLES

Rates and credit spreads have rallied around the world in response to monetary and fiscal stimulus. Australia’s cash rate and three-year Australian Commonwealth government bond (ACGB) yield target of 0.25 per cent make it one of the few places where positive yield is still on offer in the short end for high-grade product. Meanwhile, the Reserve Bank of Australia (RBA)’s light touch in the long end of the ACGB market has meant a relatively steep sovereign curve.

Still, global investors hunting for yield had reason to turn away from the Australian dollar market in 2018 and 2019 as Australian dollar yields went below those of US dollars.

Lau tells *KangaNews* the effect has been a 90 per cent decline in HSBC Private Bank’s Australian dollar investment base over the past year. She adds that the Australian dollar performing well provides further impetus for offshore investors to exit the currency and she expects investable Australian dollar funds to continue declining in the near term.

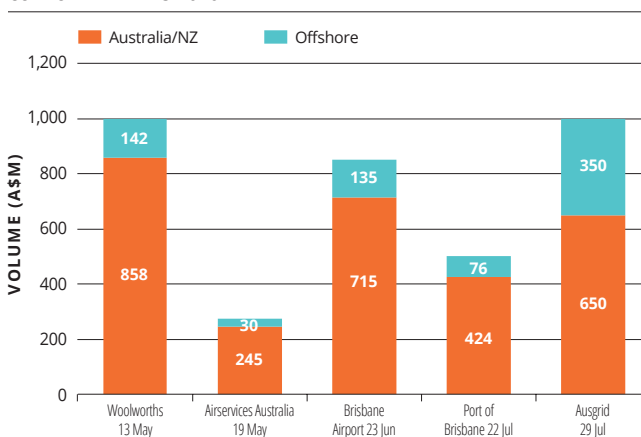
Intermediaries believe this view is not widespread, however. Leong says: “The proportion of Australian dollars held in Asia continues to increase so natural demand for the currency is still there. Investment in the Australian dollar market will be determined by investor comfort on the economy, rates, liquidity and currency. At the moment these are proving resilient.”

Meanwhile, the credit quality of borrowers coming to the Australian dollar market has remained strong. For instance, with notable exceptions the bulk of corporate issuers in 2020 have been credits experiencing limited impact from the pandemic.

Gallimore says: “Marketing Australian dollar corporate deals to offshore investors has always been a case of pointing to ratings arbitrage. Not only are Australian borrowers often conservatively rated but they also usually offer a greater spread than international comparisons with similar ratings.”

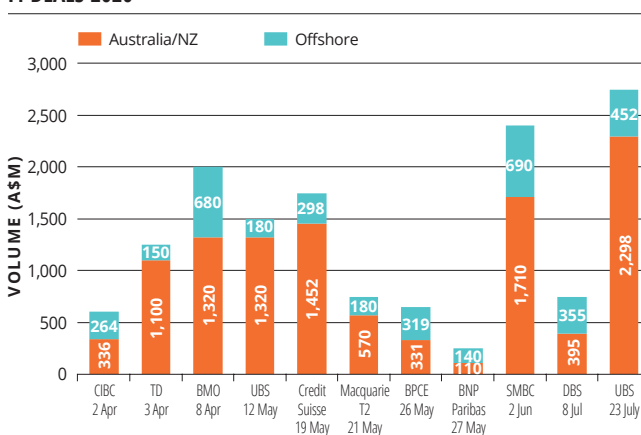
The supply backdrop should see Australian dollar credit continue to perform. A confluence of factors has essentially

CHART 1. GEOGRAPHIC DISTRIBUTION OF AUSTRALIAN DOLLAR CORPORATE DEALS 2020



SOURCE: KANGANEWS 3 AUGUST 2020

CHART 2. GEOGRAPHIC DISTRIBUTION OF AUSTRALIAN DOLLAR FI DEALS 2020



SOURCE: KANGANEWS 3 AUGUST 2020

eliminated major-bank supply since Q1, creating a technical tailwind for price tightening.

This could have positive and negative consequences for regional demand. Near-term performance may make the assets attractive, but Lau tells *KangaNews* the absence of major-bank supply, usually by far the largest source of Australian dollar credit, has further limited HSBC Private Bank’s participation in the market as it means a shortage of substantially sized primary-market opportunities.

The supply void has resulted in opportunities for global bank primary issuance in Australian dollars. Global bank spreads have rallied to levels competitive with offshore markets, while the spread offered to major banks means they are still relatively attractive to the Australian dollar investor base.

Global banks have taken advantage of this pricing sweet spot. Nonmajor bank Australian dollar issuance is up this year – though not to the extent that it fully replaces major-bank supply – and some banks have been able to issue in greater volume. Examples are Sumitomo Mitsui Banking Corporation Sydney Branch, which priced A\$2.4 billion (US\$1.7 billion) of three- and five-

ENGAGING THE REGION

Closed international borders have not been an impossible obstacle for investor relations as markets have further embraced technology to stay in touch. However, in a maturing region such as Asia there is likely to be impetus for issuers to hit the road again once it is possible to do so.

There have been two key tenets for Australian issuers seeking liquidity from investors in Asia: patience and presence. The oft-repeated mantra has been that investors in the region may require several in-person meetings over multiple years before finally engaging in a deal. Once they do, though, they tend to be loyal and consistent buyers.

Australian companies undertaking extensive deal and nondeal roadshows in Asia and further afield may be off the table for the foreseeable future. But the buy and sell side have embraced virtual methods of engagement.

With ample liquidity in the Australian dollar market, for

some issuers the need to continue intensive investor relations may have declined.

Similarly, for investors with less interest in the currency the impetus may not be there to focus on Australian dollar issuers. Carman Lau, director, head of fixed income at HSBC Private Bank, says interaction is often a casualty of lower issuance.

Will Gillespie, director, frequent issuer coverage and syndicate, Asia at National Australia Bank, says those corporate issuers that are keen to maintain or grow their regional investor base have typically been very deliberate in their regional engagement. This has resulted in high

attendance rates for investor update and pre-deal calls.

For Australian issuers, engaging with investors in the region early may be key to ensuring participation given the deal execution window is now typically compressed to minimise risk. In the past, it could be expected that intraday deal execution would preclude some investors in Asia.

Daniel Leong, director, debt syndication at Mizuho Securities, says the world has moved on from preferring physical meetings. "In-person roadshows are a powerful tool for engagement and once it is possible again they should return to a degree. But virtual

meetings do work and it seems likely that these will be incorporated into many issuers' standard investor relations."

Investors familiar with Australian borrowers are less likely to need ongoing physical meetings and should be comfortable conducting most meetings with potential issuers virtually. Owen Gallimore, head of credit strategy at ANZ, points out, however, that it is more difficult to engage new investors without the face-to-face contact.

"Asia remains a developing economic region with new pockets of investable funds emerging. There is always new money for issuers to meet," Gallimore explains.

year notes in June (see p10), and UBS Australia Branch, which printed A\$2.75 billion at the same maturity points in July.

Such names tend to be familiar to Asian investors, which can allow for greater regional investor participation in their Australian dollar deals – particularly those that are total loss-absorbing capacity-eligible or from holding-company borrowers.

Apoorva Tandon, head of Asia syndicate at TD Securities in Singapore, tells *KangaNews* the volume bump available to banks in Australian dollars provides something of a virtuous circle. It means a broader spectrum of investors in Asia can participate, including new and some returning investors from the region.

Major-bank supply is not expected meaningfully to return in 2020 (see p38), which could pave the way for further spread tightening. UBS Australia priced Australian dollar deals in May and July. Its May deal was a 2.5-year floating-rate note (FRN) deal that priced at 107 basis points over three-month bank bills.

Its July three- and five-year transaction printed at 67 and 87 basis points over swap benchmarks.

Will Gillespie, director, frequent issuer coverage and syndicate, Asia at NAB in Hong Kong, says if this rally is sustained it may end up with all-in levels that are no longer attractive to investors in the region. So far, though, he adds, demand remains robust.

The lack of bank supply is not just an Australian dollar phenomenon, though. Globally, banks are taking advantage of government support and thus have less need for senior funding. Tandon says this affects the Australian dollar market in two ways.

First, Australian dollars is primarily a senior bank market so there is less aggregate supply available. Second, the global supply void is resulting in the same tightening pressure in major markets that has been seen in Australian dollar credit – and typically to a greater extent. This could produce a disincentive to issuers as significant as the impact declining outright yield has on investors.



"The proportion of Australian dollars held in Asia continues to increase so natural demand for the currency is still there. Investment in the Australian dollar market will be determined by investor comfort on the economy, rates, liquidity and currency. At the moment these are proving resilient."

DANIEL LEONG MIZUHO SECURITIES

“The secondary market in Australia has been performing well. But if it does not perform in synch with the US dollar market it will be very difficult to attract supply from global banks,” Tandon explains.

He adds, though, that there is strong demand from Asia for Australian dollar FI product, particularly in private-placement format for long-dated, higher-yielding capital deals. This creates a good opportunity for issuers to extend curves and access capital funding at a competitive price.

Asian demand has been sufficiently strong to spur NAB’s treasury into executing three long-dated, tier-two Australian dollar deals from its GMTN programme in early August. *KangaNews* understands these to be the only deals executed by an Australian major bank between February and August, except for NAB’s domestic wholesale AT1 print in July.

DEVELOPED POSITION

Along with the yield and credit quality of the Australian dollar market, some further factors have emerged from COVID-19 relief measures that are likely to enhance Asian demand.

According to Gallimore, the Asian investor base appears to have overcome what has been a consistent roadblock in recent years – Australia’s absence from the J.P. Morgan Asia Credit Index Core. He says most credit flows in the region are passive so being off index has been an impediment.

Familiarity may have changed the story. Gallimore explains: “Over time, investors have come to understand the Australian credit landscape. They know the ports, airports, toll roads and utilities sectors after many years of engagement and are therefore happy to invest in these names through the cycle.”

The Australian dollar market is also potentially a beneficiary of the country’s ability to withstand the economic downturn precipitated by COVID-19. By early August, the spread of the virus in Australia remained relatively contained albeit with concern around an outbreak and second lockdown in Victoria. Crucially, the ability of the government to provide ongoing support stands Australia apart from many of the Asian region’s emerging markets.

Tandon says the consensus view is that Australia is well placed for economic recovery from the COVID-19 crisis and that this safe-haven status, along with the RBA’s accommodative policy, is likely to enhance the existing factors that have been drivers of natural demand for Australian dollars in the region.

OFFSHORE OPTIONS

For many investors in Asia, liquidity and currency mean the preference is still to access Australian-origin credit in regional or global markets. While the record volume on offer in the Australian domestic market may slow this impetus, its ongoing yield and liquidity considerations are drawing investors in different directions. It stacks up favourably for yield-driven buyers, while investors with a liquidity axe are still more likely to be enticed by the US dollar and euro options.

In this case, Australian dollar yield may not be sufficiently higher than other markets to offset its lower level of supply and liquidity, Lau says. “We do not see Australian dollar yields getting back to where they were a few years ago any time soon, so our investment preference is likely to remain away from the currency.”

Gallimore says investors that have been familiar with the Australian dollar market for a while, such as those in Japan and Korea, are more likely to be comfortable investing as long as the basis swap is favourable. Newer investors are more likely to be focused on liquidity and therefore drawn to US dollars.

At the beginning of the COVID-19 crisis, while the Australian dollar credit market was still closed, a steady flow of Australian corporates accessed the euro and, less frequently, the US dollar markets. In the past, Asian investors have often been large buyers of Australian corporates’ US dollar deals in particular – as well as those of the big-four banks.

However, the recovery of the Australian dollar corporate market has meant less impetus for corporate borrowers to go offshore, as larger-than-average volume was possible at home for much of Q2 and beyond. Meanwhile, the major banks have been absent from global markets for the same reason they have not been issuing at home.

Australian corporate borrowers have sporadically issued in US dollar Reg S format since 2017, and Greene says there are opportunities for issuers to access large pockets of demand. However, a lack of secondary-market turnover appears to be a stumbling block.

“Triple-B corporate issuers’ bonds have not been actively traded in the secondary market so they have remained relatively wide since the crisis. But these prices are not indicative of where a deal would be likely to price in the current environment. New primary deal flow post the initial COVID-19 market disruption has priced inside secondary levels and we continue to see investors considering a wider set of sectors when determining fair value,” Greene comments. •

“Over time investors have come to understand the Australian credit landscape. They know the ports, airports, toll roads and utilities sectors after many years of engagement and are therefore happy to invest in these names through the cycle.”

OWEN GALLIMORE ANZ



KangaNews DCM Summit RBA webinar

KangaNews hosted an exclusive briefing with the **Reserve Bank of Australia** (RBA) as part of the **KangaNews Debt Capital Markets Summit 2020** online agenda. The reserve bank updated on the market-intervention measures it has rolled out since the start of the COVID-19 crisis while market participants discussed the RBA's involvement from a range of perspectives.

BY LAURENCE DAVISON AND CHRIS RICH

Christopher Kent, assistant governor, financial markets at the RBA in Sydney, addressed more than 300 market participants on the central bank's operations in response to COVID-19, in a webinar that took place on 27 July.

Key themes in the webinar include yield-curve targeting and the shape of the sovereign-sector bond market, the term funding facility (TFF) and bank funding in general, and measures that could be enacted in future including the potential for a negative cash rate in Australia.

Kent and the panel of market participants agreed that the RBA's decision to pursue yield curve control – a commitment to purchase Australian Commonwealth government bonds (ACGBs) at the three-year mark to ensure yields stay around 25 basis points – has achieved the intended stabilisation of the sovereign and semi-government market.

Kent said the RBA's bond purchases "have had the desired effect" of redressing the imbalance of supply and demand in the Australian market. The volume of bonds presented for sale – and that were "priced to sell" at levels above mid-market price – in RBA auctions declined over time along with sovereign yield. The RBA had not been active as a bond buyer for some weeks by the time of the webinar.

Market stability returned despite a significant increase in sovereign and semi-government supply. Jim Malone, director, international fixed-income sales at TD Securities in Singapore, noted that close to A\$165 billion (US\$118.1 billion) of Australian government-sector supply came to market between 1 April and mid-July but yields had declined or held steady.

Demand has been robust beyond the RBA. Malone said the combination of Australia's relatively steep curve compared with other G10 countries and cheap market access via repo and FX hedges combine to mean it "is now very cheap to finance Australian fixed income".

The steepness of the Australian curve is also a topic of interest. When the RBA introduced its bond-buying programme, some commentators expressed surprise at the sole focus on the three-year point. The absence of longer-dated central-bank activity has

reshaped the curve, and some panellists at the DCM Summit webinar suggested the RBA could have done more.

"The RBA has argued for and pursued yield-curve control. But the objective of QE is not to buy as few bonds as possible. It is to get the economy growing and to provide more stimulus," argued David Plank, head of Australian economics at ANZ in Sydney.

The RBA has consistently stated its decision to target the three-year part of the curve because this maturity point is most relevant to local bank funding and borrowing in the real economy. Westpac Banking Corporation's Sydney-based chief economist, Bill Evans, agreed that the RBA's view on economic relevance is true but also identified another area he believes to be a focus for the reserve bank.

"It is interesting that the RBA is putting the currency front and centre in the policy of targeting the three-year rate," Evans said – adding that the reserve bank "can't seem to get the currency monkey off its back".

Meanwhile, panellists largely anticipated the RBA would return to bond buying. Robert Thompson, vice president and macro rates strategist at RBC Capital Markets in Sydney, said it is inevitable that the market would test how far the RBA is willing to let yields drift. "The market is going to want to see the RBA step in at some level. The RBA said this is about market functioning and conditions, but this is not black and white enough for the bond market."

This took barely a week to come to pass. On 4 August, as part of its monetary policy statement, the RBA announced it would re-enter secondary markets for the first time in nearly three months. While acknowledging government bond markets are functioning normally alongside a significant increase in issuance, the elevated level of three-year ACGB yield in the preceding weeks compelled it to intervene.

BANK FUNDING

Kent also discussed the RBA's provision of liquidity to the banking sector via the TFF. The facility had an initial allowance of A\$90 billion, subsequently increased to

around A\$150 billion with additional allowances granted to banks that increase their lending to business since the facility began in April.

By the time of the webinar, TFF take-up remained far short of the total available. Kent noted that the drawdown was around A\$26 billion, or 17 per cent of the total on offer. There are a number of reasons for this limited use of the facility, he added.

One is that many banks have accessed even cheaper funding from other sources in recent months, albeit at shorter tenors than three years. In particular, they have been able to issue bank bills at rates below 25 basis points. Similarly, deposits have ballooned and an increasing share of these funds has been paying rates of less than 25 basis points.

The RBA and panellists all believe, however, that the banks will ramp up their take-up of the TFF as the deadline of 30 September for the initial allowance approaches. Kent revealed the RBA is basing its expectation on direct liaison with the banks themselves.

“At that time, it will make sense for banks to compare the certain 25 basis point cost of the TFF with the uncertain cost of other sources of funding over the next three years, including bonds that would mature over that period,” he said.

DAVID PLANK ANZ

“The RBA has argued for and pursued yield-curve control. But the objective of QE is not to buy as few bonds as possible. It is to get the economy growing and to provide more stimulus.”



CHRISTOPHER KENT RESERVE BANK OF AUSTRALIA

“Our sense is negative rates would not be helpful in the current circumstances, and it is also not clear how helpful they have been elsewhere. For instance, central banks that have pursued negative interest rates have not gone further into negative rate territory.”



Kate Pairman, director, capital markets at National Australia Bank in Sydney, had the same view. She said: “The TFF has replaced term debt maturities over the past few months and this will continue to be the case as we approach its deadline. We also expect banks will use the TFF to replace some of the short-term liquidity they are carrying with a consequent run-down in outstanding volume of NCDs, repo and term deposits.”

As deposit inflows have not subsided, it makes sense for the banks to wait as long as possible to draw TFF funds to extend the facility’s horizon. Pairman also pointed out a lot of flexibility is built into the TFF because banks can repay its funds at will.

One of the key aspects of the TFF and other funding dynamics on the Australian dollar credit market has been the absence of primary senior-unsecured supply from the major banks (see p38). With major-bank issuance typically resetting price levels after market dislocation, the first effect of the absence was to remove price benchmarks.

As the months have gone by, though, this vacuum has created the opportunity for offshore financial institutions (FIs) to execute Australian dollar deals at globally competitive price levels. The success of these deals can be attributed partly to the abundance of liquidity needing to find a home, Malone said.

KATE PAIRMAN NATIONAL AUSTRALIA BANK

“The TFF has replaced term debt maturities over the past few months. We also expect banks will use the TFF to replace some of the short-term liquidity they are carrying with a consequent run-down in outstanding volume of NCDs, repo and term deposits.”



JIM MALONE TD SECURITIES

“There are longer-duration buyers in Asia that tend to preference offshore names in Australian dollars to a greater extent than domestic investors. Big volume at longer tenors lends itself to more of these transactions getting done.”



BILL EVANS WESTPAC BANKING CORPORATION

"When we had the commodity-price boom following the financial crisis, the view was that it would become inflationary. What happened was the mining companies accumulated profits but they didn't recycle them through the economy in a way that boosted demand and inflation. The same thing is going to happen again."



ROBERT THOMPSON RBC CAPITAL MARKETS

"The market is going to want to see the RBA step in at some level. The RBA said this is about market functioning and conditions, but this is not black and white enough for the bond market."

The volume of such transactions has grown to an unprecedented level. Credit Suisse Sydney Branch's A\$1.75 billion deal on 19 May was the largest from an offshore FI in the domestic market for nearly a decade. It was surpassed in short order by Sumitomo Mitsui Banking Corporation Sydney Branch's record A\$2.4 billion print in early June (see p10) and then by UBS Australia Branch's A\$2.75 billion deal on 23 July.

Further supply from offshore FIs will depend on cross-currency basis swaps and banks' levels in core currency markets, Pairman said. But she expects there will be more issuance and for it to be well supported by investors given the liquidity backdrop. Large volume on offer could make the Australian dollar option more relevant to large global bank funders on an ongoing basis.

Malone added: "There are longer-duration buyers in Asia that tend to preference offshore names in Australian dollars to a greater extent than domestic investors. Big volume at longer tenors lends itself to more of these transactions getting done."

FUTURE MEASURES

Another focus of the webinar was the future path of RBA intervention and the possibility of negative interest rates in Australia. The RBA has repeatedly stated its view that

negative rates do more harm than good, and Kent did so again in answer to audience questions.

"Our sense is negative rates would not be helpful in the current circumstances, and it is also not clear how helpful they have been elsewhere," Kent said. "For instance, central banks that have pursued negative interest rates have not gone further into negative rate territory."

The RBA clearly views going negative as more than just another cut. Kent said negative rates impinge on banks' profitability and their willingness to lend, whereas merely low rates are not a constraint on capacity or desire to borrow. He also emphasised that the issue the RBA is confronting is on the demand side and that, in this context, negative rates "would not be helpful for macroeconomic conditions".

For panellists, the issue is that the RBA's hand could be forced even in the face of its own lack of enthusiasm for going negative. Thompson said: "If the whole world went negative the RBA would have to follow. It could be dragged kicking and screaming down that path."

In the absence of a worldwide take-up of negative rates, Plank suggested the real question is what other measures the RBA will consider. "If the economy continues to be substandard and the RBA extends its forecasts out another year with inflation well below target and unemployment well above where it wants to be, I think it is unlikely it will be content to do nothing."

Kent reminded the audience that further measures would not be without cost – but he was clear that it is impossible to rule them out. "We would have to think very carefully about the circumstances we would be in, for each and every one of them. It is broadly true under the current circumstances we face that further measures are not under consideration, but this could change if things get worse."

The second lockdown in Melbourne could be the type of development that would force the RBA's hand. At the same time, market participants are clearly still paying very close attention to the planned withdrawal of some government support measures and how the economy copes.

"The big question for me is how the economy responds to the slowdown in provision of liquidity," Evans revealed. Westpac estimates direct stimulus from the federal government and the drawdown on superannuation contributed about A\$65 billion to the economy in the June quarter with a further A\$95 billion to come in the September quarter. Based on information about the extension of JobKeeper and JobSeeker, and all the remaining support measures, Evans estimated this will fall to A\$15 billion in the final quarter.

The RBA may have to take its next steps in an economy where the expected growth and inflation drivers are weaker than it anticipates. Evans added: "When we had the commodity-price boom following the financial crisis, the view was that it would become inflationary. What happened was the mining companies accumulated profits but didn't recycle them through the economy in a way that boosted demand and inflation. The same thing is going to happen again." •

No turning back

COVID-19 has dominated global market bandwidth in 2020, to the extent that many regulatory initiatives and other market-development projects have been put on pause. This cannot be said for the process of adapting to the demise of interbank offer rates (IBORs), for which the hard deadline of 31 December 2021 continues to loom.

BY LAURENCE DAVISON

In 2019, international market participants were discussing IBOR transition as perhaps the biggest challenge facing them since the financial crisis. Global regulators had decided IBORs were no longer fit for purpose in the wake of various rate-setting scandals and on the back of withered volume in short-term interbank markets.

LIBOR and its equivalent base rates are critical market infrastructure, forming the pricing foundations of trillions of dollars of contracts from banks' wholesale debt to retail home loans. Most IBORs will be gone at the start of 2022, and the market likely needed all that time to develop and implement replacement base rates for new contracts and legacy instruments.

Australia's position has always been slightly different. Its local IBOR – the bank-bill swap rate (BBSW) – is, unusually, still generally based on robust trading volume in the underlying interbank market. It should continue, with regulatory blessing, even after the global demise of IBORs at the end of 2021.

Even so, the global change is relevant in Australia. Market participants with cross-currency exposures – especially those issuing offshore – will be directly affected by the transition.

Domestically, there will inevitably be more scrutiny of the robustness of BBSW in future. The Reserve Bank of Australia has already repeatedly cautioned market participants to re-examine their use of one-month BBSW, which has notably less trading volume to support it than the more commonly used three-month rate. Issuers and investors are also expected to engage with the use of fallback rates in new contracts, to ensure the legacy issue is minimised should BBSW become unavailable in future.

COVID-19 has posed massive challenges to market participants' preparation for the demise of IBORs. Their attention has, understandably, been focused on the near-term impact of the pandemic. The means by which the industry would normally

workshop its response to a seismic shift of this nature have also been disrupted.

To take just one example, the International Swaps and Derivatives Association (ISDA) – perhaps the central global forum for transition discussion – cancelled its 2020 AGM, which had been scheduled to take place in Madrid in May.

Again, the situation in Australia is somewhat different – but arguably even more pernicious. While international markets are facing a hard deadline, by being one step removed it has been easier to put the issue of IBOR transition aside in Australia. The absence of the local major banks from wholesale funding has also had a big impact on the issue's visibility.

By the end of 2019, all the big four banks had tested the waters for sterling-denominated issuance linked to the UK's risk-free rate (RFR), the sterling overnight index average (SONIA). Commonwealth Bank of Australia (CommBank), meanwhile, became the first Australian credit issuer to print a new deal referencing the Australian overnight index average (AONIA) instead of BBSW when it priced the A\$1.5 billion (US\$1.1 billion) Medallion Trust Series 2019-1 residential mortgage-backed securities (RNBS) transaction in November last year.

The only Australian issuer to price AONIA-linked deals in 2020 is South Australian Government Financing Authority. CommBank says it would likely have brought a second RMBS with AONIA as a base rate had its wholesale funding need not evaporated at the start of the COVID-19 crisis (see p62).

BEHIND THE SCENES

IBOR transition has been the subject of fewer headlines this year. But it has certainly not dropped off the global radar.

In fact, international market users say engagement with the issue should be – and in many quarters is – ramping up.

“Not surprisingly, there were some immediate questions about how [the pandemic] would affect preparations and whether the transition work would continue at the necessary pace. Fortunately, that work has not come to a standstill.”

SCOTT O'MALIA INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION

“While we know that LIBOR will continue to be published until the end of 2021, this does not mean the need to act is still more than a year away. Nor has the need to act on LIBOR transition been pushed back by the impact of COVID-19. In fact, the 4-6 months ahead of us now is arguably the most critical period.”

EDWIN SCHOOLING LATTER FINANCIAL CONDUCT AUTHORITY

ISDA held a webinar on 16 July to update members and others on the path forward for IBOR transition. The clear message from the association and key market participants is that planning has continued even as other challenges have come to the fore. In effect, a challenge that clearly would have been the number-one focal point of the year had to stay on the agenda even as COVID-19 hit.

Scott O’Malia, ISDA’s London-based chief executive, said there was “strong recognition” among attendees at ISDA events in London and New York just ahead of COVID-19 lockdowns that 2020 “would be a pivotal year for benchmark reform and an acceptance that industry efforts would need to accelerate”.

Nothing significant has changed. O’Malia added: “Not surprisingly, there were some immediate questions about how [the pandemic] would affect preparations and whether the transition work would continue at the necessary pace. Fortunately, that work has not come to a standstill.”

All the indications are that crunch time is approaching, pandemic or no pandemic. Edwin Schooling Latter, London-based director, markets and wholesale policy at the UK’s Financial Conduct Authority (FCA), commented on the ISDA webinar: “While we know that LIBOR will continue to be published until the end of 2021, this does not mean the need to act is still more than a year away. Nor has the need to act on LIBOR transition been pushed back by the impact of COVID-19. In fact, the 4-6 months ahead of us now is arguably the most critical period in the transition away from LIBOR. Now is the time to act.”

A lot of work has been taking place in the background, that could primarily be characterised as laying the foundations for market users to build the necessary new infrastructure.

For instance, arguing that “taking our foot off the gas is no longer an option”, O’Malia pointed to ISDA’s preparation of the essential tools firms need to make a smooth and successful IBOR transition. In particular, this means finalising a documentation

protocol for transitioning IBOR-based contracts to RFR basis. The association also expects imminently to publish final guidance on fallback benchmarks for derivatives linked to key IBORs.

In the UK, the sterling risk-free rate working group has progressed with plans to tackle so-called “tough legacy” exposures, while the FCA announced in June that it expects new powers to be legislated under which it can force a change to LIBOR methodology to allow a synthetic rate to continue to be published, in certain circumstances, for tough legacy contracts.

The US alternative reference-rate committee (ARRC) has published best practices for IBOR transition, laying out detailed timelines and interim milestones for derivatives and cash markets. It also recommended conventions for cross-currency basis swaps in January and has continued work on cash-product fallback rates. The New York Federal Reserve began publishing daily component averages for the secured overnight funding rate (SOFR) in March.

“This has been a very busy year for the ARRC, despite COVID-19,” said Subadra Rajappa, New York-based ARRC member and managing director and head of US rates strategy at Societe Generale.

NUTS AND BOLTS

The outline of fallback benchmarks is now established in most jurisdictions. For instance, the UK’s approach is to use a combination of the relevant overnight RFR, compounded in arrears, and a fixed spread to reflect the premium associated with unsecured lending at term.

“These two elements have been chosen carefully and, in my view, wisely,” Schooling Latter said. “The overnight risk-free rate represents the most reliable benchmark interest rate available, derived from markets that have remained active and reliable throughout recent periods of stress.”

The ARRC, among others, is still exploring the potential offered by a forward-looking calculation of SOFR. This could

“It’s clear there hasn’t been enough takeup of SOFR, but nonetheless there will be plenty of liquidity when we get to the key point. A 10-year derivative includes eight-and-a-half years of SOFR – whether you like it or not.”

TOM WIPF MORGAN STANLEY

solve a number of operational issues by removing the problem of payment uncertainty and basis risk that comes into play when things like bond coupons can only be calculated in retrospect. The fundamental problem is that forward-looking rates need real underlying traded volume to be robust and reliable – the lack of which is the reason for IBORs' demise in the first place.

The message now is that the time has come for the wide swathe of market participants to start acting on the guidance being provided by global regulators and bodies like ISDA and the ARRC. For instance, despite the host of background work done to establish and define RFRs and their deployment, Rajappa argued that the ARRC's most important publication in 2020 was the best-practices document, which outlines the steps market participants should take to transition to new benchmarks by the end of 2021.

For this reason, she added, there is not a lot pencilled in to ARRC's own deliverables calendar for 2021. By contrast, its best-practice timeline is very busy, which she said demonstrates that banks and other market participants will be immersed in working towards compliance with best practices.

Jack Hattern, ISDA board member and managing director, global fixed income at BlackRock in New York, added: "We have talked about education throughout the process, but education at this point is not just about general awareness of what is happening. It is about understanding all the details. This is the time to 'sweat the details': to understand what is happening through your portfolio at security level and the holistic impact of the transition."

For the buy and sell side alike, Hattern explained, a great deal of internal preparedness is required – for instance upgrading systems and analytics. A lot of progress has been made but Hattern echoed the view that now is no time for complacency.

"We tend to talk about our own individual firms' internal preparedness," he claimed. "But we also need to ensure the entire market ecosystem comes along with us. Participants need a general awareness of what is going on but also to be in synch with efforts from ISDA and the like with respect to standardisation."

MARKET LIQUIDITY

There are some signs in market activity that the message is starting to sink in. But the confronting reality is that most traded volume globally continues to use IBOR reference rates. US Depository Trust and Clearing Corporation data reveal that notional value of SOFR swaps in the first half of

2020 was four-and-a-half times greater than the same period in 2019. US LIBOR-linked swap volume fell by 6.1 per cent.

O'Malia said: "We are clearly heading in the right direction. But when I tell you US\$63 trillion of US dollar LIBOR was traded in the first half of 2020, versus US\$490 billion in SOFR, you can see there is still work to be done."

Hattern added: "To be trading SOFR, we all want deep and liquid markets. A lot of work has been done and a lot of progress has been made, but there are a lot of things we need to keep building on and work to be done – and all the while the clock keeps ticking."

The impetus has never been greater, and the IBOR deadline is not the only reason. The turbulent market conditions sparked by the onset of the COVID-19 crisis demonstrated to at least some market users that RFRs now provide a more reliable basis for pricing. According to Rajappa, US front-end spreads were extraordinarily volatile around March this year. While SOFR saw a mini-spike at the time, and it experienced another one in November last year, clearly the biggest spike was in LIBOR.

"A lot of liquidity has been pumped into the market since November to the extent that SOFR has actually been trading below the interest rate on excess reserves," Rajappa revealed.

To some extent, it was inevitable that the migration of volume and liquidity to new contract benchmarks would be relatively slow. Agha Mizra, managing director and global head of interest-rate products at CME Group in Chicago, commented: "We all wish for very deep and consistent liquidity such as we have in Fed funds and Eurodollar futures. This is completely understandable. But these products are decades old. SOFR, even as just an interest-rate index, is only two years old. We are very pleased with the infrastructure backing SOFR futures and they have debuted as one of CME's most successful new products."

Tom Wipf is an ISDA board member, chair of the ARRC and Morgan Stanley's New York-based vice chairman, institutional securities. He described himself in the webinar as "naturally optimistic", including on benchmark transition, and said he is confident in growth of trading volume in contracts using RFR benchmarks from the start. "If you are trading something with maturity beyond 2021, to some degree you are already trading SOFR – particularly when it's something with fallback protocol in place," Wipf continued. "It's clear there hasn't been enough take-up of SOFR, but nonetheless there will be plenty of liquidity when we get to the key point. A 10-year derivative includes eight-and-a-half years of SOFR – whether you like it or not." •

"Education at this point is not just about general awareness of what is happening. It is about understanding all the details. This is the time to 'sweat the details': to understand what is happening through your portfolio at security level and the holistic impact of the transition."

JACK HATTERN BLACKROCK

NEXT STEPS FOR NEW REFERENCE-RATE ADOPTION

While Australia is not facing the same compulsion as other global markets to drop its credit reference rate – in this case the bank-bill swap rate (BBSW) – there is still growing reason for market participants to understand, and start using, alternative reference rates (ARRs). **Commonwealth Bank of Australia** (CBA) took a leadership position in 2019 by pricing a securitisation deal linked to Australian overnight index average (AONIA). The bank convened a roundtable with *KangaNews* to discuss the next phase of evolution.

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STATE OF PLAY

Davison What is the Reserve Bank of Australia (RBA)'s current guidance to market participants on benchmark reform?

■ **BRISCHETTO** In Australia, we are in a very different position regarding benchmark reform from jurisdictions using LIBOR. The BBSW benchmark remains robust after a lot of work to strengthen the methodology underlining it.

We are pursuing a multiple-rate approach, which means we are not advocating for wholesale transition to referencing risk-free rates (RFRs) as other jurisdictions are doing. What we are asking is for businesses to think about which reference rate makes sense for their products.

In some cases this will continue to be BBSW although, as we have mentioned previously, users of one-month BBSW should be preparing to use alternative benchmarks given the lack of liquidity in that market. In other situations, too, referencing AONIA will make more sense.

It is also worth remembering that the rest of the world transitioning to using RFRs may have an important influence on the benchmarks used here. It is important that we see progress on the use of RFRs in the Australian market.

LIBOR transition is a very different matter. It is expected to cease after the end of 2021 so continued reliance on it in contracts is just not an option. We have seen progress on LIBOR transition in Australia but it is clear continued focus and effort is required if institutions are going to be in the position they need to be by the end of 2021.

If institutions have not transitioned to ARR by the end of 2021, and put robust fallback language in legacy contracts, they will face significant risks individually and will also put the wider financial industry at risk of disruption. This remains a key focus for us.

Davison What has the RBA seen in the cash market following the support measures it introduced at the start of the COVID-19 crisis, including observations on AONIA's robustness as a benchmark through this period?

■ **BRISCHETTO** Conditions in the cash market have changed considerably due to the policy package implemented by the RBA in March. There has been a large increase in exchange-settlement (ES) balances that financial institutions hold with

the reserve bank. This increased liquidity is an intended result of the policy measures.

Increased volume of ES balances reduces banks' need to borrow from each other. This means transaction volume in the cash market has declined and the cash rate has fallen below 25 basis points.

This is different from what we have seen in the past. But it was expected and is consistent with the experience in other economies where there have been large increases in balances at the central bank. This very low level of the cash rate is also consistent with the aim of ensuring funding costs in the Australian economy remain very low.

There have been a number of days in recent months on which there has been insufficient volume to calculate the cash rate based on market transactions. The RBA has instead used expert judgement to determine the cash rate, as set out in its fallback procedures.

Users of AONIA will of course want to know the fallbacks are robust, and they can be assured that they are. On most occasions when we relied on fallbacks, the cash rate was recorded as the last published rate based on sufficient transaction volumes.

There was just one day when we published another rate, which was judged better to reflect market conditions. On this occasion, we took into account information about the rates on trades that occurred over a number of preceding days – even though the volume on any one of those days was not sufficient to publish a reliable measure based on market transactions.

We have been seeing transactions in the cash market each day, they are just not always above the A\$500 million (US\$357.9 million) threshold required to provide a reliable transaction-based measure of the cash rate. The fallback measures allow us to continue publishing a reliable cash rate even in the absence of market transactions.

In this case, the cash rate could be determined to be the last published cash rate based on sufficient transaction volume, the new cash-rate target if one is announced by the RBA board, or potentially another rate related to unsecured overnight funds for cash-market participants chosen by the RBA in its expert judgement and based on market conditions.

These procedures ensure the cash rate continues to reflect the interest rate relevant to overnight unsecured funds. Robust fallbacks are built into the cash-rate procedures themselves, so participants can be assured of its reliability as a benchmark.

"Users of AONIA will of course want to know the fallbacks are robust, and they can be assured that they are. On most occasions when we relied on fallbacks, the cash rate was recorded as the last published rate based on sufficient transaction volumes."

ANDREA BRISCHETTO RESERVE BANK OF AUSTRALIA



REPO REQUIREMENTS

In late 2019, the Reserve Bank of Australia (RBA) announced that securities without acceptable reference-rate fallback language would in future no longer qualify for repo. Progress towards this point is still being made.

DAVISON What should market users expect from the RBA consultation with industry about the timing and nature of repo-eligibility changes relating to incorporation of fallback benchmarks in floating-rate notes (FRNs) referencing bank-bill swap rate (BBSW)?

■ **BRISCHETTO** We have previously announced that once the ISDA [International Swaps and Derivatives Association] benchmark fallback provisions are published – which is expected to be very soon – new FRNs referencing BBSW must include the ISDA fallback language in order to be repo eligible. All users of BBSW are expected to adopt fallback provisions where possible.

The RBA is considering how to implement this change, including finalising the scope and timing for compliance with the new repo-eligibility rules. This involves weighing up the costs and benefits involved.

To be clear, we are waiting for the ISDA fallbacks to be published and nothing is

happening ahead of this. We appreciate it will not be straightforward to apply these fallbacks to different non-derivative contracts.

BBSW does not have the same imminent end date as LIBOR so we are also not talking about the same risks. It remains the case, though, that while BBSW is robust now things could change in the future. Fallbacks are critical to this contingency. If there is one thing the LIBOR experience tells us it is that nothing can be guaranteed forever.

To help us determine what makes sense for implementing BBSW fallbacks in the repo-eligibility context we will be conducting industry consultation in the next couple of months. This will be informal, through conversations with market participants, and will be coordinated through AFMA [the Australian Financial Markets Association] and the ASF [Australian Securitisation Forum].

The sorts of questions we will look at include how long

it would reasonably take to incorporate fallback language into new securities and how long it will take to be in a position to support this operationally.

Another question is how this will align, or compete, with institutions being ready for the demise of LIBOR at the end of 2021. We do not want to compromise this work but, at the same time, if there are synergies we should take advantage of them.

We also want to understand any constraints or hurdles institutions may face in incorporating the ISDA fallbacks in new securities and whether there are sector-specific challenges we should be aware of.

Other jurisdictions have taken the ISDA fallback provisions for derivative contracts and applied the concepts outside the boundaries of the derivatives sector – one example is the ARRC [alternative reference rate committee] in the US, which has set out language for securitisation and FRN issuance in the cash market.

However, we understand it will not always be simple. We want to understand the challenges and be aware of them when we set requirements. We are conscious that there are additional challenges to incorporating the fallbacks in existing securities and we want to make sure we understand these, too, when weighing up the costs and benefits.

DAVISON What is the timeline for the process and what does the RBA expect to produce at the end of it?

■ **BRISCHETTO** We need to be flexible in the post-COVID-19 world and it depends on the timing of the publication of the ISDA fallback supplement and protocol. This is expected soon so we hope to be able to complete the consultation process over the remainder of 2020.

If this is the case, by the end of this year or early next we will announce the new repo-eligibility requirements and when they will take effect. These will be rules to follow if issuers want their securities to be eligible for use as collateral in the reserve bank's market operations.

There may be distinctions between existing and new securities. We will weigh the costs and benefits sensibly and take a reasonable approach.

Davison What reflections do market participants have on the robustness of AONIA compared with BBSW through these last few months?

■ **KENNEDY** It is worth noting that there are differences between the credit benchmark and the RBA published rate. One of our biggest concerns in relation to the credit benchmark was that the fallbacks did not necessarily align with delivering what we thought was sustainable, robust and definable under the IOSCO [International Organization of Securities Commissions] principles.

What we are seeing now with the RBA cash rate is that it is a victim of its own successes from the deployment of unconventional monetary policy. While it is obvious that the fallbacks in place are very strong, there is still a small amount of

concern around investors' and issuers' trust in its sustainability as a benchmark if it is going for days at a time without sufficient transaction volume.

This is something we will not know until we test the water. However, SAFA [South Australian Government Financing Authority], as an issuer and investor in this landscape, has confidence the fallbacks that exist in the structure are robust according to the IOSCO principles, and can be used and relied upon for continued issuance in whichever format borrowers choose and for investors across the spectrum.

Everything that happens in markets has consequences and we are seeing some of these play out. We remain an observer but we are a strong supporter of the AONIA benchmark, because of the diversification and the risk-mitigation tool it provides and the robustness of the fallback arrangements in place.



Could retailers anticipate demand?

By connecting our customer spending data with publicly available Google Trends data, our Institutional Business is helping you see the household spending intentions of tomorrow.

🔍 NEW PERSPECTIVES



"Ultimately, we were aware that we would be the first to issue RMBS linked to AONIA and there was a reasonable chance we would also be the second. Our intention would have been to bring another AONIA-linked Medallion transaction in this financial year."

FERGUS BLACKSTOCK COMMONWEALTH BANK OF AUSTRALIA

■ **BROWN** There is a strange situation at present in that cash markets are relatively illiquid and there are very few cash-market transactions. There has also been a significant fall in transactions of bank bills that underlie BBSW calculations.

We are in a situation of flux where it is not entirely clear how the cash market will operate in three months, six months or two years. There is not immediate risk of a negative rate in Australia but New Zealand is making clear moves in that direction and it is a possibility in the US. The RBA might get to a negative rate if the rest of the world does, and if it happens in Australia there will need to be another rebalancing of how the cash system works.

None of the cash benchmarks are covering themselves in glory at the moment because the cash market is in such flux. It would be difficult to say that any particular approach is better than another because it is hard to say what the structure of the system will be, even in the near term.

■ **MIALL** BBSW has traded well inside the cash-rate target as a function of increased ES balances and the fact that the banks are very well funded. This is an interesting dynamic. From an investor perspective, it makes us look at alternatives – not necessarily for benchmarks but for yield – and to consider where our allocations are.

Hendry Could Treasury notes be a potential adjunct to a benchmark, given there is going to be a plethora of T-note issuance?

■ **MIALL** It's possible. But T-note outstandings are still a relatively small component of the total market for short-dated paper – volume on issue needs to increase meaningfully to support a viable risk-free benchmark. We are certainly headed in that direction, though, so it could have greater merit at some point in the future.

Investors already have other alternative benchmarks to BBSW. As an example, we recently implemented a segregated mandate with a floating-rate benchmark that has moved away from referencing the bank-bill index. It uses the RBA cash-rate total-return index as its floating-rate benchmark.

ISSUANCE LEADERSHIP

Davison Commonwealth Bank of Australia took a big step issuing a residential mortgage-backed securities (RMBS) transaction from its

Medallion programme linked to AONIA at the end of 2019. Why did the bank decide to lead in the securitisation space and what are the prospects for further issuance?

■ **BLACKSTOCK** We noted repeated signals coming from the RBA on its concern around liquidity of one-month BBSW and therefore its validity as an appropriate benchmark. When [RBA assistant governor] Christopher Kent spoke about issuers being prepared to use alternative benchmarks in the securitisation market in particular, we believed we had a leadership role to play as the largest issuer of RMBS and the largest mortgage provider in Australia.

Separately, we were conscious that we were responding primarily to an RBA direction. We noted that SAFA had done some work engaging with investors, though, and thanks to Andrew Kennedy for his strong leadership position.

Ultimately, we were aware that we would be the first to issue RMBS linked to AONIA and there was a reasonable chance we would also be the second. Our intention would have been to bring another AONIA-linked Medallion transaction in this financial year. However, given the context and the extra liquidity we now have through additional deposits and the RBA's term funding facility, we are less likely to be a securitisation issuer in the near term.

Davison What has SAFA's rationale been for issuance linked to AONIA and is it any surprise that others have not followed?

■ **KENNEDY** The main reason SAFA considered issuing with a non-credit benchmark was appropriateness. We are a government business and by issuing against a credit benchmark we are embedding credit risk in our portfolios – and those of investors, when they should just be taking a view on SAFA credit rather than second-derivative credit.

It was also about appropriate risk management for SAFA. The entities we lend to are government clients with their own specific financing requirements. By issuing off a credit benchmark and lending off a non-credit benchmark we are essentially creating balance-sheet risk.

We modified our internal practice in 2015 so state-government clients that borrow in floating-rate format do so based off the RBA cash rate rather than a credit benchmark. We had been doing internal work on this for a long time before we began issuing linked to AONIA.



"BBSW has traded well inside the cash rate target as a function of increased exchange settlement balances and the fact that the banks are very well funded. This is an interesting dynamic. From an investor perspective, it makes us look at alternatives – not necessarily for benchmarks but for yield."

PHIL MIALL QIC



It is about appropriate risk management as well as being able to issue against a one-month benchmark that we thought met the IOSCO principles. Aligning with this is an important risk-management tool for SAFA.

The way we have articulated this to investors is that we want them to understand this is a useful tool for SAFA but also for investors, especially if they view it as a short-term investment product. Taking daily cash risk on a one-year product significantly reduces their portfolio risk.

The ARR and RFR story has developed over a period of time and there is now acceptance about having a suite of products from which to choose. There is confidence now that the hurdles are not insurmountable to being able to transact and manage risk in any particular product. This was a significant stepping stone for a lot of investors to be able to participate.

Work is required in order to undertake a transaction linked to AONIA, which possibly explains why other issuers have not yet come to the table. It requires having a different mindset from risk management and the confidence to sell this externally.

■ **MARSDEN** We would like to follow the path SAFA and CBA have taken in issuing AONIA-linked transactions. But, before we do, there are two main challenges for us to consider. First is having comfort with the implied spread for credit and duration in the pricing of an RMBS, and second is the preparedness of investors, trustees and custodians to buy and hold an AONIA-linked transaction.

We have been doing work in the background but first need fully to understand the pricing implications of an AONIA-linked liability, given we have a lot of internal asset-pricing models calibrated to assume margins from BBSW to the cash rate. This is not insurmountable, and market preparedness for a new type of issuance is probably our biggest challenge.

Davison How prominent are the challenges for investors in participating in an AONIA-linked transaction?

■ **MIALL** Operationally, we can invest in AONIA-linked securities and in fact we did invest in SAFA's most recent deal. Our risk system accommodates AONIA.

There are other considerations, though. QIC is very focused on LIBOR transition and we've looked at and continue to monitor the fallback rates of LIBOR-referenced securities for our global credit portfolios. We're also doing this in the

securitisation market in Australia as we want to understand the fallbacks for one-month BBSW in existing RMBS deals.

There is quite an array of these, and we think the securitisation market needs some further evolution to have robust fallbacks – though I note that fallback language in some recent deals has been more robust, in our view.

Liquidity is always a consideration for the bonds we buy. We can invest in AONIA-linked securitisation, though, if it is at the right level. The AONIA-BBSW basis is negligible at the moment but we may require some compensation for liquidity while the AONIA market builds out.

Davison How closely do these comments reflect the position of participants across the market, and how close are other issuers to coming to market with AONIA-linked deals?

■ **MINEEFF** There are valid concerns and queries. In the work we undertook for the AONIA-linked Medallion deal there was a particular workstream around investor readiness. This included operational processes, systems, booking, and engaging with service providers such as trustees and custodians.

We found some positives in this process. The first is that work undertaken in offshore markets allowed a degree of replication in the Australian market for some global platforms. The AONIA calculation we used replicated the cash leg under OIS [overnight index swap], for instance, which allowed a lot of systems and booking processes to use it.

There are still challenges, but we found that working through these was the best form of engagement. We worked through investors' requirements to understand where they were capturing their data and what systems they were using. This allowed us to dig into the details as we went through the project.

It was a long process and the work SAFA had undertaken certainly helped with our engagement. In RMBS, though, it is a different level of complexity for reporting and other information provided. This was something we had been working towards for a while with the CBA funding team. By the time we got to launching the transaction, we were at the point where the information provided for the AONIA deal replicated information provided for a BBSW deal.

The events of 2020 have probably delayed some other issuers coming to the market with AONIA-linked deals. There is a natural order of potential AONIA issuers in the Australian

TRANSACTION PATHWAY PART ONE: **ASX**

Commonwealth Bank of Australia (CBA) invited three service providers that assisted its Australian overnight index average (AONIA)-linked securitisation's path to market to share their perspective on the process. Helen Lofthouse, general manager, derivatives and OTC markets at Australian Securities Exchange (ASX), gives the benchmark provider's view.

DAVISON What was ASX's engagement with the CBA Medallion securitisation transaction?

■ **LOFTHOUSE** ASX worked closely with CBA in the lead up to the Medallion transaction, focusing on providing the bank's investors with an independent, transparent reference rate.

For investors, holding bonds with an AONIA-based reference rate is new and many require an independent, observable source of pricing. We worked with CBA to ensure that the new ASX-realised AONIA reference rate delivers what its customers need, including ease of access via Bloomberg and Refinitiv pages. CBA suggested to its investors that they use ASX-realised AONIA as an independent pricing source.

ASX Benchmarks was the first licenced benchmark administrator in Australia and is administrator for the bank-bill swap rate (BBSW). ASX is supportive of a multi-rate environment in Australia and has explored the market's requirements for reference rates.

One of the rates we heard a clear need for was a transparent, independently calculated, compounded

AONIA rate. For example, a compounded AONIA rate will be used as a component for benchmark fallbacks, as well as being very relevant for some bond issuance.

Interestingly, although the AONIA rate is published daily by the RBA [Reserve Bank of Australia], there was not yet a standard, observable rate calculated across defined periods for compound AONIA. This standard rate was a key development the market needed – hence the work we have done on ASX-realised AONIA.

DAVISON Is the methodology for calculating AONIA now finalised?

■ **LOFTHOUSE** The methodology we use to calculate ASX-realised AONIA is in line with the ISDA [International Swaps and Derivatives Association] definition for benchmark fallbacks, and the compound period is determined using straight-date logic. However, some issuers may prefer to use a look-back period in the calculation and there are still various views in the market about the preferred length of any look-back period.

We will continue to work with market participants with the aim of agreeing

and publishing one or more variants, as needed. Though the calculations are the same most of the time, slight differences in the rate can arise occasionally because of differences in business days in the look-back period.

DAVISON Is a forward-looking rate achievable?

■ **LOFTHOUSE** The RBA and ASIC [Australian Securities and Exchange Commission] have been clear in their guidance that the market needs to act now on moving to new rates to replace LIBOR. Global regulators' view is that market users should transition to risk-free rates now, and that holding out for a possible forward-looking rate in the future is not the right course of action.

In Australia, the picture is somewhat different because BBSW is now a transaction-based methodology that is fully compliant with the IOSCO [International Organization of Securities Commission] principles for financial benchmarks. So benchmark users already have more flexibility to choose a rate that is appropriate for their purpose.

A different forward-looking rate is challenging, mainly because the transactional data for such a rate tends to be intermittent.

But this could change in the future.

DAVISON What engagement have you had with investors after CBA's trade?

■ **LOFTHOUSE** We have received a lot of interest in ASX-realised AONIA, from both investors and issuers. Many of the investors holding AONIA-based bonds now subscribe to the rate so they have an independently calculated reference rate, generated by a licensed benchmark administrator.

When SAFA [South Australian Government Financing Authority] was originally on the road talking about its AONIA-based deal, there was a level of uncertainty from investors around the practicalities of using the rate. Banks already calculate compounded AONIA internally, but investors generally do not – and this made it more complex for them to invest in AONIA-based bonds based on a rate they had to rely on the issuer to calculate. For some investors, this limitation means they can't invest in the product.

This is why publishing ASX-realised AONIA brings a degree of transparency and standardisation that enables issuance and allows investors to use risk-free reference rates.

market. Semi-governments are first then major banks, which we have seen, and then it is probably nonmajor banks followed by nonbanks. The lack of funding need from some of these issuers this year is one reason for there being no further AONIA-linked issuers.

Also, as Phil Miall says, basis spread has contracted significantly. Borrowers were looking at a relatively wide cash-bills spread and the fact that it is now relatively flat has perhaps driven inactivity. The logic for why AONIA works as a benchmark for securitisation issuers holds, though, so I think

it is a matter of continuing the development and engagement work regardless of the market backdrop.

GLOBAL DEVELOPMENTS

Davison There have been a lot of developments in Europe and elsewhere with the impending end of LIBOR as the primary a motivating force. What is the update on progress in offshore markets?



■ **CALDER** I think the US is now as in line with its progress towards ARR adoption as the UK. Since the first SONIA [sterling overnight index average] bond from EIB [European Investment Bank] in mid-2018, to the end of Q2 2020 there had been £88 billion (US\$114.9 billion) of issuance in 181 SONIA-linked transactions. This includes £21 billion in 56 transactions in the first half of 2020. This now is established as the only way borrowers are issuing sterling floating-rate bonds.

It is worth mentioning that very early in the COVID-19 crisis the BoE [Bank of England] and the RFR working groups came together and said there would not be any delay in transition due to the pandemic and that no-one should expect there to be an extension of LIBOR past 2021.

This has been backed up in the approach to legacy assets. These are often LIBOR-based contracts that, for instance in securitisation, are not easily transferable to a new rate. The FCA [UK Financial Conduct Authority] has been given extended powers, relatively in line with the ARRC [alternative reference rate committee] legislative proposal, which effectively means solutions can be enforced upon transactions that for whatever reason are difficult to move to a new rate.

Elsewhere, we have seen 500 SOFR [US secured overnight funding rate] transactions, with US\$800 billion of issuance, which means this is a robust market. A lot of this issuance is coming from federal institutions.

This has not quite been the case in Europe, where the approach has been somewhat different. They are focused on replacing EONIA [euro overnight index average] with ESTR [euro short-term rate] and implementing fallbacks to ESTR for Euribor, rather than replacing it. As a result there have only been six ESTR-based transactions – two of these by EIB and one by KfW Bankengruppe.

The difference in momentum is quite striking. However, one thing that comes across very clearly is that there has not been any let-up in the impetus toward standardisation over the past six months.

The BoE has started to publish a SONIA compounded index on a daily basis. This follows on from March, when the Federal Reserve Bank of New York began doing the same with SOFR. It is much easier for bond documentation to reference this official index and calculate the compounded look-back.

Davison Have there been any deviations in transition progress?

■ **CALDER** There is a wrinkle in that both the BoE and ARRC have moved toward a shift calculation rather than lag. The lag was effectively overnight SONIA compounded in arrears with a five-day lag, whereas the shift methodology calculates interest according to the number and weighting of business days in the observation period. This gives a slightly truer rate than if it included holidays and weekends.

This is fairly recent. The way it has been approached is that existing issuers using the lag can continue to issue lag-based transactions. But in all likelihood issuance will itself shift over time as the official rate is being calculated using the shift methodology.

The slight hiccup is that the major banking-systems providers have not quite got around to updating the module for calculation yet, although this is imminent and does not necessarily present an insurmountable difficulty.

We are also seeing standardisation in fallbacks. There are two issues here: credit-spread adjustment between LIBOR and the RFR, and the actual underlying successor rate.

One helpful thing is there seems to be a widespread market move behind the ISDA [International Swaps and Derivatives Association] approach to spread adjustment. This means the five-year median difference between LIBOR and the RFR is used. This effectively provides a channelling effect as we move closer to cessation with a standardised add-on over the RFR.

This has been met with widespread approval. The one difference, I would say, is that the UK bond market wants to go to compounded overnight SONIA as the successor rate but there are still calls, in the US through ARRC and in the UK loan market, to move toward a term rate. This seems a more likely proposition in the US where a robust futures market already exists. We have not seen this in the UK.

If there is an overall wrap, it is that despite the hiatus in development of a lot of areas in the last six months, this is one issue where the message from regulators is that things are continuing and there is no reason not to have cessation of LIBOR at the end of 2021. Everyone needs to be moving toward widespread adoption.

Kennedy With the BoE now publishing an index for SONIA, has investor awareness and understanding of the process improved?

■ **CALDER** The BoE only started publishing this at the beginning of August so there has not been a lot of issuance from it.

"In the last fortnight we have been engaging with our US dollar investors and there has been a noticeable change in mandate migration away from US dollar LIBOR. This is particularly noticeable in 144A accounts and the state-based retirement and pension funds."

ANDREW MARSDEN RESIMAC





"Despite the hiatus in development of a lot of areas in the last six months, this is one issue where the message from regulators is that things are continuing and there is no reason not to have cessation of LIBOR at the end of 2021. Everyone needs to be moving towards widespread adoption."

NEIL CALDER EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

In many ways, though, I see it more as a facilitation and clarification rather than an impetus for more transactions. It has become clear that the environment in the UK would not be favourable now to anyone attempting to issue in public markets based on anything other than SONIA.

We are now in the phase of fine-tuning. There has been SONIA-linked issuance since 2018. It has been widely adopted, and users have updated their systems and are clear on the spread adjustment between LIBOR and the RFR. This is often the discussion in pricing when there is a new transaction, as well as whether it is based off one-month or three-month because the bases are different.

There is wide familiarity with the mechanics in the market. These latest iterations of fine-tuning the fallbacks and the methodologies are therefore recognition of an established market and participants realising what could be done better.

LOCAL EVOLUTION

■ **BROWN** One of the biggest challenges in the Australian market at present is that a lot of users are trying to design a perfect benchmark. We need to consider what the entire financial ecosystem will look like once there is a new benchmark embedded in it.

If a term reference rate is more beneficial for some users and an overnight compounding rate more beneficial for others, what is really needed is an OIS swap – because it allows both to operate together.

In Australia, where a lot of compounding cash transactions have been written in such a way that they mimic the OIS formulation, there is no reason why issuers cannot print in one format and have a swap with a bank to provide the hedging they need rather than everything having to come from the benchmark itself.

This would be the benchmark operating together with the rest of the financial system to provide what users need. I appreciate that in some ways this is a leap of faith. Clients would have to ask their banks to help and there would be small differences in methodologies. But it is not insurmountable.

The problems seem small enough that when there is a financial incentive to solve them – as there will be if there is a widespread movement to a new benchmark – it should be possible to create a financial-markets ecosystem that works better than a benchmark would work on its own.

At CBA research, we are confident we can get to a new benchmark that does not embed credit risk into transactions where it does not need to be there. There are good reasons to strip these credit risks out of benchmarks, but it is a complicated process to get there.

We hope market users are looking at what the new benchmark ecosystem could become rather than trying to pick holes in any particular benchmark.

Davison How has the AONIA-linked market evolved over the course of SAFA's transactions? Are investors becoming more receptive despite the volatility in markets this year?

■ **KENNEDY** A good way to reflect on this is through the last transaction we did, where we decided to go out on the curve to provide some term funding in FRN [floating-rate note] format using AONIA. We went from a monthly to a quarterly coupon, and out to three years on the curve. The change in appetite and engagement from the investor base was overwhelming and we ended printing volume in excess of our target.

Dialogue has increased substantially. One of the unintended consequences of lockdown is that we can have a lot more one-on-one conversations, rather than scheduling appointments to see people. This has given us a better sense of what



"One of the unintended consequences of lockdown is that we can have a lot more one-on-one conversations, rather than scheduling appointments to see people. This has given us a better sense of what some investors' touch points are and what brings them to a transaction."

ANDREW KENNEDY SOUTH AUSTRALIAN GOVERNMENT FINANCING AUTHORITY



TRANSACTION PATHWAY PART TWO: **PERPETUAL**

Hagbarth Strom, senior transaction manager at Perpetual Corporate Trust in Sydney, discusses the trustee's role in supporting a transaction linked to a new reference rate and market development in general.

DAVISON What was Perpetual's engagement with Commonwealth Bank of Australia (CBA)'s alternative reference-rate transaction?

■ **STROM** We were involved quite early on. We had a couple of meetings with CBA treasury on the process side at our end, for instance what the transaction looks like within Austraclear and with custodians. We did some brainstorming around the process flow and how a rate might be sourced.

The CBA team went away and carried on with the work at its end. At Perpetual, led by our operations people, we had conversations with Austraclear and custodians, and conducted a deep dive into our systems to see if any issues might arise because everything is usually based around one-month bank-bill swap rate (BBSW).

DAVISON What were the main considerations?

■ **STROM** We did testing to ensure nothing would go wrong. On one-month BBSW, we take a feed from Bloomberg and combine this with directions from trust managers to make payments. Our system then double checks the output.

Moving to AONIA [Australian overnight index average] basis is predominantly a timing concern. A backward-looking benchmark has constraints on time. Operationally, we had to make a few minor amendments to our systems. But it is not that different from applying a traditional rate on first payment of a trust, where we manually impute it. The system was analogous to that.

Mainly, the consideration was how the information from us feeds through to Austraclear, and thus to

investors and to custodians. We also discussed offshore investors, specifically where they are getting feeds from.

DAVISON Did anything unexpected emerge during the process?

■ **STROM** Early on, we were in discussion with CBA to act as a calculation agent, so we developed our own AONIA calculation model. The Australian Securities Exchange (ASX) announced it was going to publish the rate while we were discussing this with CBA. This was a lot easier than any of us doing it independently, so it was a positive surprise.

Getting our heads around the timing was also important: when the rate needed to be ready, how long our systems needed to talk to Austraclear and so forth. All of this was different from a forward-looking rate like BBSW, where you have plenty of time.

At the end of the day, the trust-manager calculation in the CBA deal is the one that stands. This of course refers to ASX's AONIA rate but it is an interesting question that I think will flesh itself out more if we see further deals with an AONIA rate.

If there are questions around calculation discrepancies, it will be interesting to see which rate they land on – the ASX rate or the issuer rate.

DAVISON Are there any as-yet-unfinalised issues that could create challenges in the market moving forward?

■ **STROM** The ASX published rate is, I think, going to be universally accepted – as it is with BBSW. It will be interesting to see whether other issuers come to the market with AONIA-based deals. I suspect it will take a little while for other issuers to catch up.

some investors' touch points are and what brings them to a transaction.

The investor base has changed from what we initially thought we would see in these transactions. It has certainly broadened. We have been surprised that the number of offshore investors has grown in each transaction, well past the couple of accounts we first targeted.

We have now raised more than A\$2.6 billion in this format and have had around 80 unique investors, of which a pleasing component has been offshore. Investors' risk appetite keeps changing and appetite for diversification keeps growing.

Developments in offshore markets have been helpful in driving these changing attitudes, as has the messaging of the reserve bank to reinforce the concept of AONIA as a sustainable benchmark. We plan to continue issuing FRN funding in AONIA format.

■ **CALDER** I certainly understand the motivations of the offshore investors that have participated in SAFA transactions. It comes with the mindset that this is the way the world is moving in developed markets.

I would counter this, though, with the relative lack of compulsion we have seen in the Australian market and the fear that there will end up being a bifurcated market with a knock-on effect on liquidity. Perhaps it is early days, but I have one AONIA deal in the portfolio and many more BBSW deals – some of which were issued after the AONIA transaction.

With the swathe of secondary-market liquidity that came into the market in late March and April, it was noteworthy that we saw plenty of high-quality issuance but not much AONIA-linked issuance.

An element that has driven the market forward offshore has been not so much the carrot but the stick. I see a danger of a halfway-house approach that creates an illiquid and bifurcated market.

Davison Would a bit more "stick" get other issuers moving towards AONIA?

■ **MARSDEN** I think the market transition will be led by the buy side, whether it is by stick or by carrot. In the last fortnight we have been engaging with our US dollar investors and there



"The events of 2020 have probably delayed some other issuers coming to the market with AONIA-linked deals. There is a natural order of potential AONIA issuers in the Australian market. Semi-governments are first, then major banks, which we have seen, and then it is probably nonmajor banks followed by nonbanks."

JUSTIN MINEEFF COMMONWEALTH BANK OF AUSTRALIA

has been a noticeable mandate migration away from US dollar LIBOR. This is particularly noticeable in 144A accounts and the state-based retirement and pension funds.

We are now looking at two sets of investors. But this bifurcation is not necessarily a bad thing. Some accounts can still buy LIBOR FRNs and others are looking for SOFR-linked issuance. If we can take anything from the UK and the US, I think this is how our market should look to transition. But I think this needs to be led by the buy side.

■ **MIALL** The buy side needs to make sure it has the operational and systems capability to buy RFRs. This is certainly the buy side's role to play – but I am not sure it should necessarily lead the transition.

It needs to be a market solution and it is about timeframes. As we stand now there is no compulsion. There is a directive that the market needs to find an alternative to one-month BBSW, but there is no drop-dead date as there is with LIBOR.

The market will probably move to a solution, but in the absence of a cessation date for one-month BBSW it will likely

be over a longer timeframe and it falls on the buy side, the sell side and issuers to work on this.

The RBA's work around fallback language for BBSW improves the fallbacks for RMBS, so this may be a solution that actually prolongs the use of that reference rate. If there needs to be a quicker transition, compulsion may be required.

■ **BLACKSTOCK** I take the point raised about liquidity. Ideally, we would have some company as an issuer of AONIA. But the reality is that others need to make their own decisions, so we have made a change in our syndicate structure to try to foster secondary-market liquidity.

■ **FREILIKH** For the Medallion deal issued last year, in addition to CBA – which was arranger and sole lead manager for the deal – we appointed three co-managers to support secondary-market trading and provide bond revaluation services for investors to foster secondary activity.

We also spent considerable time with ICE Data Services to make sure it could provide secondary-market revaluation on the AONIA bonds to investors and custodians.

TRANSACTION PATHWAY PART THREE: **BLOOMBERG**

Russel Parentela, global head of cash structured products at Bloomberg in New York, explains the company's role in helping bring the Commonwealth Bank of Australia (CBA) Australian overnight index average (AONIA)-linked securitisation to market and the state of play for new benchmark adoption.

DAVISON Can you recap Bloomberg's role in CBA's AONIA-linked residential mortgage-backed securities deal?

■ **PARENTELA** Our product, data and engineering teams liaised with CBA months in advance and discussed different alternatives and how we could enable functionality to facilitate trading, quoting and scenario analysis of transactions based on AONIA

as a new risk-free rate (RFR) alternative for the Australian dollar-denominated market.

DAVISON What is the state of availability of information and system functionality for AONIA and how does this compare globally?

■ **PARENTELA** Bloomberg can support accrued interest calculation, cash-flow projections, security valuation and scenario analysis based

on both benchmarks. This information also flows through our risk and enterprise solutions so it can be fed into our customers' proprietary or third-party systems.

The situation is fairly similar for SONIA [sterling overnight index average]-linked securities in the sterling market. In the US dollar denominated market, a few slightly different conventions seem to be gaining hold in agency-backed securitised

markets, while there are still ongoing discussions around the private-label market. To date, Bloomberg supports all conventions that have been adopted.

DAVISON Is anything still to be resolved in Australia when it comes to maintaining and publishing a commonly accepted RFR?

■ **PARENTELA** From a technical point of view, Bloomberg is ready for AONIA. Whether it will be adopted as a new standard depends more on other dynamics from market participants and local regulators. We've had many questions about the methodology for rate fixing and forward-rate projections. Based on their feedback, users are generally fairly comfortable with this change.



"We need to consider what the entire financial ecosystem will look like once there is a new benchmark embedded in it. If a term reference rate is more beneficial for some users and an overnight compounding rate more beneficial for others, what is really needed is an OIS swap."

PHILIP BROWN COMMONWEALTH BANK OF AUSTRALIA



Davison Will we get to a world where three-month BBSW is seriously examined as the reference rate for bank FRNs?

■ **BLACKSTOCK** Potentially. We are not at that stage yet, though, and three-month BBSW remains a robust benchmark. While investors are keen to buy in this format we see no reason to move away from three-month BBSW.

Davison Are borrowers waiting to be nudged into the transition to AONIA-linked issuance or are some preparing to take a lead role in the way CBA has?

■ **MINEEFF** In our role of arranging and bringing transactions to market, our advice always aims to offer issuers the best transaction to bring for broad distribution and to meet the client's objectives.

The CBA funding team had a clear objective to deliver an AONIA-linked transaction with a very clear mindset and approach. It took a lot of work to get there but much of this work is replicable for other issuers.

Some issuers, as Andrew Marsden says, are positioning according to the feedback they receive in offshore markets and others are looking at whether it would work for them to bring an AONIA-linked deal in the Australian dollar market. We need issuers, investors and other stakeholders to bring this together.

We have seen, with the Medallion transaction, that it is possible and it makes a lot of sense. The deal was a capital-relief transaction, too, so we are not just talking about triple-A investors: it is the full capital stack.

I think we may have expected there to be a natural order of issuers we would see come to market with AONIA deals, but this has been disrupted over the last few months. The logic holds, though, and it is still about bringing the right parties and stakeholders together. If an issuer wants to issue linked to AONIA it absolutely can be done – we just need to do the work to bring the transaction to market.

FORWARD-LOOKING RATES

Davison There does not seem to be much progress in forward-looking ARR. Is this still a worthwhile goal and would it solve some of the operational issues with ARR?

■ **CALDER** In the US, ARRC believes a futures-based development of a forward-looking rate is the way forward. I think there is enough volume and robustness in that market to provide some degree of confidence. It is interesting, though, that UK market participants seem happy to stick with the compounded look-back rate for SONIA.

I think it will be a case of different markets deciding what is right for them. As an investor in structured finance, it would be nice to see a forward-looking rate. But having now lived with what we have for nearly two years I look at the positives and the differences and wonder whether we are gaining much by going through the process.

We are already getting a robust rate. Given the central banks' attitude to interest-rate setting I think it may be better that we have a backward looking rate. When rates go negative there will at least be a short window where we are looking back to positive rates!

I have thought about forward-looking rates a lot and want to get excited, but I find it difficult. For corporate treasurers – who want to know how much they have going out each month in interest payments – I understand totally. But as a bond portfolio manager I am less concerned.

■ **BROWN** Australia can use an old-style market benchmark of OIS rates, but there has been pushback because rates are supposed to be risk free and based on real traded instruments rather than derivatives traded between bankers.

If you are not prepared to have this kind of forward-looking rate you are left with the need to transact public instruments against a backward-looking rate. But if you want to enter into a swap afterwards you can hedge the risk. The benchmark is not the only financial-management tool.

■ **KENNEDY** We spent a lot of time looking at all the different 'risk-free' options when considering the appropriate rate to use. The problem we had was that when we reviewed the data we could not guarantee what we would get was going to meet what we considered to be a best-practice benchmark.

We didn't consider OIS or repo to be suitable, at the time, to the composition of transactions and there was a lack of progress for determining a rate-set process or fallback arrangements.

■ **CALDER** I think there is sensitivity to potential discrepancies that can emerge in forward-looking rates provided by whomever. I wonder whether the impetus will be for reliance on officially published compounded indices for official rates. •

KANGANEWS FIXED-INCOME RESEARCH POLL 2020: A NEW TOP DOG

Though the usual suspects dominate a suite of categories in the **KangaNews Fixed-Income Research Poll 2020**, there is change at the very top with one bank now clearly the market leader. This marks a major evolution for a poll that has featured consistency as perhaps its most reliable aspect.

This is the 10th iteration of the poll, which is the only independent, specialist survey of fixed-income investors' views on research in Australia. The results are based on responses to a survey of Australian fixed-income investors conducted by KangaNews in July (see box on this page).

Over the years, the poll has developed a track record of consistent performance by research providers. Australian banks have dominated the domestic-focused categories for most of the past decade, with one in particular settling in for a long stay at the top. Commonwealth Bank of Australia (CBA) was voted the best overall provider of research for the first time in 2014 (see chart 1) and then held this position for the next five years.

National Australia Bank (NAB) has emerged as CBA's closest challenger in recent years, including being the runner-up in the best overall category in every year from 2016 to 2019. In 2020, NAB takes top spot in the coveted best overall provider category for the first time and in the process ends a run of CBA dominance that has lasted for more than half a decade.

This is not an outlier. Not only has NAB's overall ranking been close to the top for several years but the bank is also now recognised as the most improved research house in 2020 as well as moving into the top spot in several categories that have been stubbornly held by other outfits for years.

Like most of the categories in this year's poll, the best overall ranking is largely a domestic-bank affair although in this case Citi breaks up the majors to take fourth place – its first-ever placing in the top five.

This year's poll features a new category covering credit research, which now includes all credit coverage rather than just corporates. NAB takes top spot – up from second in last year's corporate category. Westpac Institutional Bank (Westpac) improves on its showing in the old corporate category, too, while Citi consolidates its third place.

In another big move, Citi loses out to NAB for best global research after a prolonged run at the top for the US bank. After finishing sixth in 2018, NAB jumped to second in 2019 before narrowly eclipsing Citi this year. CBA also climbs in the latest poll outcome for global research, placing third in 2020 having only reached sixth in the 2019 results.

NAB also retains first place in two categories: foreign exchange and macroeconomics. This is its fifth consecutive year at the top of the macroeconomics category (see chart 2). The rankings among the top five remain unchanged from 2019, though the gap between NAB and Westpac in this category narrowed in 2020.

POLL METHODOLOGY

The KangaNews Fixed-Income Research Poll provides the Australian domestic fixed-income investor community with the opportunity to acknowledge the analysts who distribute the best coverage of areas relevant to the Australian debt markets.

Voting is conducted through an online platform with only Australian-based institutional-investor votes counting towards final results.

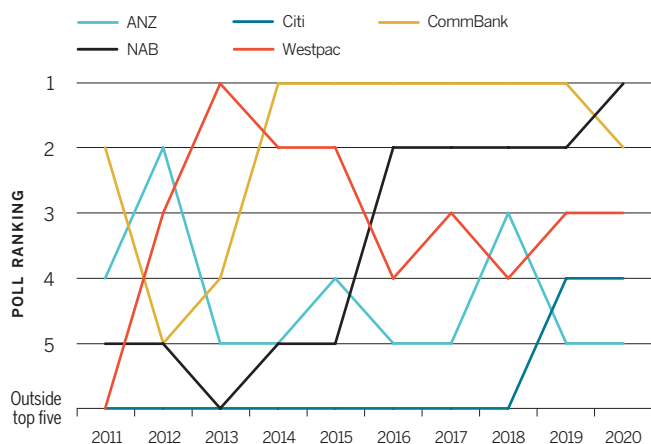
Now in its 10th year, more than a hundred qualifying votes were recorded in the 2020 iteration of the poll. The sample represents the majority of key institutional

investment funds in the Australian market across the funds-management, insurance and balance-sheet sectors.

KangaNews conducts a rigorous process of vote verification to ensure only votes from qualifying institutional fixed-income investors are included in the final count.

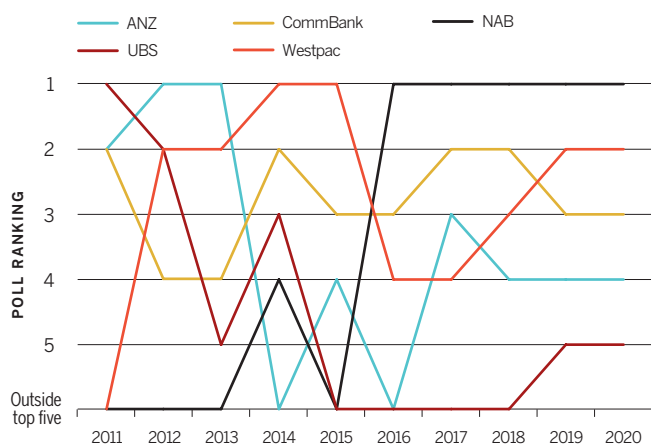
In 2020, voters were asked to nominate the top three providers of research across 10 categories: nine individual sectors and the overall best house. The best overall category is determined by a separate vote rather than as a product of the results in the other categories.

CHART 1. YEAR-ON-YEAR PERFORMANCE: BEST OVERALL



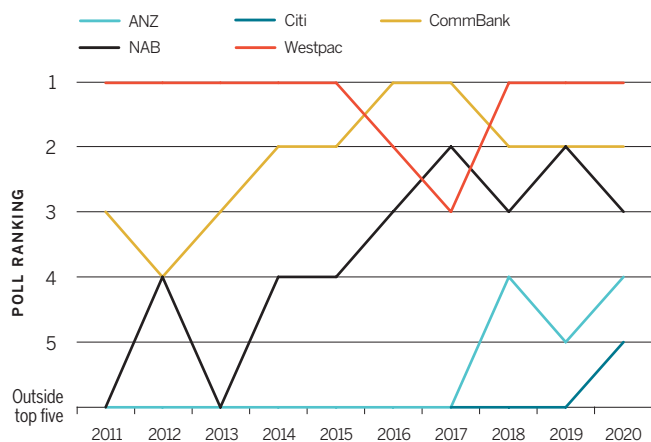
SOURCE: KANGANEWS 29 JULY 2020

CHART 2. YEAR-ON-YEAR PERFORMANCE: MACROECONOMICS



SOURCE: KANGANEWS 29 JULY 2020

CHART 3. YEAR-ON-YEAR PERFORMANCE: STRUCTURED FINANCE



SOURCE: KANGANEWS 29 JULY 2020

KANGANEWS FIXED-INCOME RESEARCH POLL 2020: FULL RESULTS

* Denotes 2019 category winner

Which team provides the best overall research on fixed income?

RANK	INSTITUTION	TEAM
1	National Australia Bank	Skye Masters, Alex Stanley, Ivan Colhoun, Alan Oster, Kieran Davies, Michael Bush, Ken Hanton, Ray Attrill
2	Commonwealth Bank of Australia*	Martin Whetton, Philip Brown, Tally Dewan, Joyce Yu, Belinda Cheung, Stephen Halmarick
3	Westpac Institutional Bank	Damien McColough, Martin Jacques, Brendon Cooper, Duncan Chellew, Leila O'Connell
4	Citi	Steven Mansell, Anthony Ip
5	ANZ	David Plank, Jack Chambers, Hayden Dimes

Which team provides the best research and analysis of Australian government, semi-government and Australian dollar SSA bonds?

RANK	INSTITUTION	TEAM
1	Commonwealth Bank of Australia**	Martin Whetton, Philip Brown, Stephen Halmarick
2	National Australia Bank **	Skye Masters, Alex Stanley
3	Westpac Institutional Bank	Damien McColough, Leila O'Connell
4	ANZ	Jack Chambers, Hayden Dimes, David Plank
5	UBS	Matt Johnston, Giulia Specchia, George Tharenou, Carlos Cacho

** In 2019, CommBank won the SSA category while NAB won the government and semi-government category.

Which team provides the best research and analysis on foreign exchange?

RANK	INSTITUTION	TEAM
1	National Australia Bank*	Ray Attrill, Rodrigo Catril
2	Westpac Institutional Bank	Robert Rennie, Sean Callow, Richard Franulovich
3	Commonwealth Bank of Australia	Joe Capurso, Elias Haddad, Carol Kong, Kim Mundy
4	ANZ	Daniel Been, John Bromhead, Rahul Khare
5	Deutsche Bank	Tim Baker

Which team provides the best research and analysis on structured finance?

RANK	INSTITUTION	TEAM
1	Westpac Institutional Bank*	Martin Jacques
2	Commonwealth Bank of Australia	Tally Dewan
3	National Australia Bank	Ken Hanton
4	ANZ	ANZ research
5	Citi	Citi

Which team provides the best research and analysis on Australian corporations and financial institutions?

RANK	INSTITUTION	TEAM
1	National Australia Bank	Michael Bush, Andrew Jones
2	Westpac Institutional Bank	Brendon Cooper, Martin Jacques, Duncan Chellev
3	Citi	Anthony Ip
4	Commonwealth Bank of Australia**	Joyce Yu, Belinda Cheung, Tally Dewan
5	ANZ	ANZ Research

** Winner of 2019 category covering corporate research.

Which team provides the best trade ideas and research on relative value?

RANK	INSTITUTION	TEAM
1	Commonwealth Bank of Australia**	Martin Whetton, Philip Brown, Tally Dewan, Joyce Yu, Belinda Cheung
2	Citi	Steven Mansell, Anthony Ip
3	National Australia Bank	Skye Masters, Alex Stanley
4	Westpac Institutional Bank	Damien McColough, Leila O'Connell, Brendon Cooper, Duncan Chellev
5	UBS	Matt Johnston, Giulia Specchia

** Winner of 2019 poll in both the trade ideas and relative value categories.

Which team provides the most valuable research on global markets to Australian fixed-income investors?

RANK	TEAM	INSTITUTION
1	National Australia Bank	David de Garis, Gavin Friend, Ray Attrill, Rodrigo Catril, Christy Tan, Tapas Strickland
2	Citi*	Catherine Mann, Matt King, Jeremy Hale, Jabaz Mathai, Steven Mansell
3	Commonwealth Bank of Australia	Joe Capurso, Kim Mundy, Martin Whetton, Philip Brown, Elias Haddad, Kevin Xie
4	ANZ	Richard Yetsenga, Tom Kenny, Brian Martin, Daniel Been
5	Westpac Institutional Bank	Richard Franulovich, Robert Rennie, Damien McColough, Elliot Clarke

Which team provides the most valuable research on Asian and other regional markets to Australian fixed-income investors?

RANK	TEAM	INSTITUTION
1=	ANZ*	Khoon Goh, Raymond Yeung, Jennifer Kusuma, Richard Yetsenga
1=	Citi	Catherine Mann, Li-Gang Liu, Johanna Chua, Kiichi Murashima, Jeremy Hale, Lu Sun, Tomohisa Fujiki, Steven Mansell
3	Commonwealth Bank of Australia	Joe Capurso, Kim Mundy, Martin Whetton, Philip Brown, Elias Haddad, Kevin Xie
4	Mizuho Securities	Mark Reade, Eric Ng
5	HSBC	Andre de Silva

NAB is also the inaugural winner of the sustainability and environmental, social and governance research category, with ANZ in second place. Citi is again the only international bank to feature in the top five.

Despite NAB's surge, CBA maintains its strong positioning in the 2020 poll. It picks up the prize in the

Which team provides the best macroeconomic research and analysis?

RANK	INSTITUTION	TEAM
1	National Australia Bank*	Ivan Colhoun, Alan Oster, Kieran Davies, Kaixin Owyong, Tapas Strickland, Gareth Spence, David de Garis
2	Westpac Institutional Bank	Bill Evans, Westpac Economics
3	Commonwealth Bank of Australia	Stephen Halmarick, Gareth Aird, Belinda Allen, Kristina Clifton, Nic Guesnon
4	ANZ	David Plank, Felicity Emmett, Cherelle Murphy, Catherine Birch, Adelaide Timbrell, Hayden Dimes, Richard Yetsenga
5	UBS	Arend Kapteyn, George Tharenou, Carlos Cacho, Seth Carpenter, Tao Wang

Which team provides the best research on sustainability and ESG in Australian fixed income?

RANK	INSTITUTION	TEAM
1	National Australia Bank	Michael Bush, David Jenkins
2	ANZ	Richard Yetsenga, Cherelle Murphy, Catherine Birch
3	Commonwealth Bank of Australia	Martin Whetton, Philip Brown, Stephen Halmarick, Joe Capurso
4	Westpac Institutional Bank	Michael Chen
5	Citi	Zoe Whitton, Edward McKinnon

Which research provider has published the most useful research related to the COVID-19 crisis?

RANK	INSTITUTION
1	Commonwealth Bank of Australia
2	National Australia Bank
3	ANZ

Which is the most improved provider of research in the last 12 months?

National Australia Bank

high-grade category, which now combines research in the Australian dollar government, semi-government, and sovereign, supranational and agency sectors. CBA also retains its pole position in trade ideas and relative value, with those categories also combined this year. It also takes out the special category of most useful research covering the COVID-19 crisis.

Meanwhile, Westpac maintains its dominance in structured finance, winning the category for a third straight year (see chart 3). Structured finance has become a narrow field in the Australian research space, with three houses sharing the top three spots for five straight years and no obvious sign of a challenge to the oligopoly.

Citi retains its place for best research in Asian and other regional markets category in 2020 but only in a tie with ANZ, which returns to the top after a dip last year. CBA shoots up to third in this category after a long spell outside the top five while Mizuho Securities – a first-time competitor in the survey – places fourth. •

KangaNews

KangaNews yearbooks – the essential guide to key issuer and market sectors

KangaNews yearbooks are **indispensable reference guides** to the most important issuer and product sectors in the Australasian debt markets. Distributed to all KangaNews subscribers and additional global investors, and available online, KangaNews yearbooks contain profiles of each sector's main players and editorial coverage of the most topical issues.

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November 2020

Nonbank Yearbook

December 2020

Investing with Impact Yearbook

February 2021

Australasian High-Grade Issuers Yearbook



If you would like to discuss commercial opportunities to be involved in KangaNews yearbooks or to discuss an idea for a new sector yearbook, please contact **Jeremy Masters** via jmasters@kanganews.com.



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Thank you

to our 14 dealer panel banks for their support
and commitment in the 2020 financial year

We are proud of the outcomes achieved in partnership
with our panel given the challenges presented to the state
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3. Citigroup Global Markets Australia Pty Ltd
4. Commonwealth Bank of Australia
5. Westpac Banking Corporation

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