New rules on capital leave hybrid bonds in limbo

Print

By Jennifer Hughes
Published: September 23 2010 20:06 | Last updated: September 23 2010 20:06

HSBC sold $750m in hybrids, with provisos

When the Basel committee laid out its new bank capital rules last week there were varied reactions, but one common to all parties was relief – that at least investors, bankers and bank treasurers knew what they were to aim for.

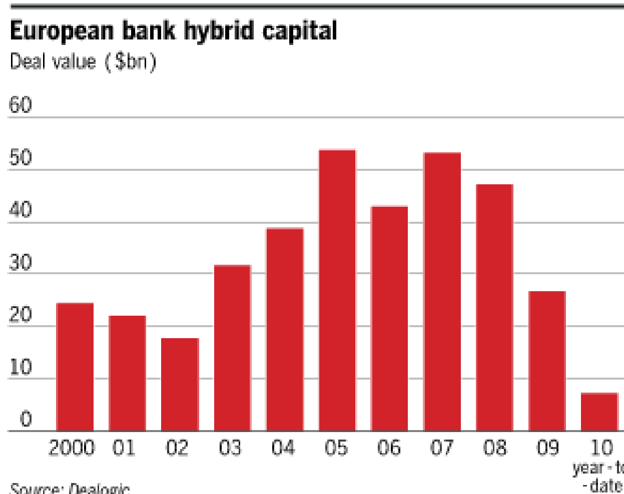
But within that, the regulators left untouched a crucial corner of the market; hybrid capital, or subordinated securities that contain features of equity and debt. As a result, the sector is stuck in an odd form of limbo.

Hybrids' equity characteristics, such as allowing banks to skip interest payments and defer redeeming the bonds, have previously meant regulators allowed them to count towards capital calculations.

Official attitudes changed during the financial crisis when most banks proved reluctant to upset powerful bondholders by exercising those equity features, meaning many banks were unable to hold on to the cash. European policymakers however forced bailed-out banks to use the equity conditions and last December, Basel announced a wider rethink of the bonds' features so that they would in future help soak up losses, as originally intended.

The market has been virtually frozen since **the December announcement**, but the lack of clarity last week was a fresh blow to those who had hoped for at least some sense of where the committee would like the market to go.

"There's definitely an issue – banks are being encouraged to redeem their existing subordinated debt but Basel hasn't yet opined on the new forms of capital it will allow," says Richard Thomson, a credit analyst at Henderson Global Investors. "The regulators need to define what the new instruments will be to enable banks to issue."



The current limbo does not necessarily leave banks short of capital-raising options. But bankers and investors say it makes it hard for executives fully to develop their plans when the shape of a sizeable chunk of the future market remains a mystery.

How much bank capital is actually affected by the uncertainty is also unclear, which only underlines the complexities that have developed in this market and which regulators would like to reduce.

The Financial Times approached a number of the top banks and data experts including ThomsonReuters and Dealogic, but none have been able to produce comprehensive numbers on the value of hybrids that have call dates over

the next two years – that give banks the choice whether to redeem the bonds or hold onto the cash.

One bank said it had calculated about €176bn ($235bn) of such securities as callable before the end of 2011 – a number that other bankers agreed could be correct. The complexities stem from the fact that many of the deals are bespoke and reflect different regulatory regimes and legal systems.

“If you’re a bank, the question is what can I do right now and the answer is we don’t fully know,” says Gerald Podobnik, co-head of capital solutions for Europe at Deutsche Bank. “We have some of the principles, but without the whole picture – and without then knowing how national regulators will look at this in detail – it’s somewhat unclear.”

Mr Podobnik says that knowing what Basel wanted would be only the first step. Any rules will have to be adopted nationally, where local legal frameworks will mean small, but important differences between countries.

Bank reaction has been mixed. In the past week **Investec**, the South African bank, dropped plans for an exchange of some of its existing hybrid bonds because it is not sure what it could swap them for.

Santander has also decided not to redeem some Abbey National hybrids at the end of this month. It did not explicitly link this to the uncertainty but other banks this year have already cited the lack of clarity over what they could issue to replace bonds due to be redeemed.

Elsewhere, **HSBC** sold $750m in hybrids with a clause that allows it to buy back the bonds if they don’t match new regulations, while **Nordea** sold €750m of similarly structured bonds with no such proviso.

Copyright The Financial Times Limited 2011. Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

"FT" and "Financial Times" are trademarks of the Financial Times. Privacy policy | Terms
© Copyright The Financial Times Ltd 2011.