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## Positive for AT1 instruments, including new ANZ NZ OTC; Neutral for T2 instruments over the medium to long term.

By Matthew Macreadie

APRA's [announcement](#) today outlined changes to the capital structure for banks which would see Additional Tier 1 (AT1) capital instruments phased out. The date for expected implementation is 1 January 2027, with all current AT1 on issue expected to be replaced by 2032. APRA is not proposing changes to AT1 settings for insurers. Essentially, AT1 capital instruments are being replaced with Tier 2 (T2) and common equity Tier 1 (CET1) capital. Large, international banks would replace the 1.5% AT1 with 1.25% of T2 and 0.25% of CET1 capital. Smaller banks would replace all AT1 with T2, with a reduction in Tier 1 (T1) requirements.

Basically, this would see AT1 end as a market once existing instruments are called. This should be positive for the capital prices (i.e. tighter credit spreads) on AT1 instruments, e.g. the new ANZ NZ OTC perpetual subordinated (indicative pricing is 3mBBSW+[320-330]bps) currently in the market. Although this instrument is not AT1, the proceeds are being used to purchase an ANZ NZ Bank perpetual preference share which is AT1 and so it is essentially quasi-AT1.

In our view, Tier 2 (T2) credit spreads should (all-else-equal) widen on the back of the higher supply on issue. However, there is strong investor demand in this space which will be an offsetting factor and will likely see credit spreads remain resilient (or neutral). Furthermore, there is still a question mark over whether T2 products will remain an over the counter (OTC) instrument (unlisted) or be eventually ASX-listed (facilitating retail demand) creating significant demand for the T2 product. Nonetheless, even if credit spreads were to widen, this would be an opportunistic time for new investors to get into the T2 market for a high-quality asset class which is likely to outperform over the medium to long-run.

Based on current AT1 capital levels of the major banks, we estimate this equates to around AUD23bln of T2 (1.25% of T2) and AUD5bln of CET1 (0.25% of CET1 capital) issuance, respectively. Note this is based on the current risk-weighted asset (RWA) profile of a major bank, whereby a major bank has an average 2% of their RWA in AT1 and doesn't account for growth in the asset book. Furthermore, there is an estimated AUD2bln shortfall of T2 across the major banks based on current Total Loss Absorbing Capital (TLAC) requirements which will need to be met.

# THOUGHT PIECE

AUDmIn	AT1 – current (~2% of RWA)	T2 (1.25% of RWA)	CET1 (0.25% of RWA)
CBA	9,272		
NAB	8,590		
ANZ	8,297		
WBC	10,930		
Total	37,089	23,181	4,636

Summarising, this equates to around potential additional net supply of AUD25bln or 20% of T2 outstanding.

T2 = AUD23bln

T2 TLAC Shortfall = AUD2bln

Total = AUD25bln (or 20% of T2 outstanding)

Note, APRA has indicated a 5-year transition period from 1 January 2027 and so this will mean a gradual transition which will help neutralise the impact on T2 credit spreads. Nonetheless, the additional net supply will represent an additional call on current T2 investors, who will replace AT1 investors. Retail investors hold around 50% of AT1. Thus, the demand for T2 will be met by institutional and retail investors at around AUD12.5bln over 5 years or AUD2-3bln pa.

*In our view, AUD2-3bln pa can be managed appropriately to ensure there is not a wide dislocation in credit spreads in the T2 market.*

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