New Issue Forecast

Subordinated Insurance Bond Supply in 2024

Subdued supply to support secondary market

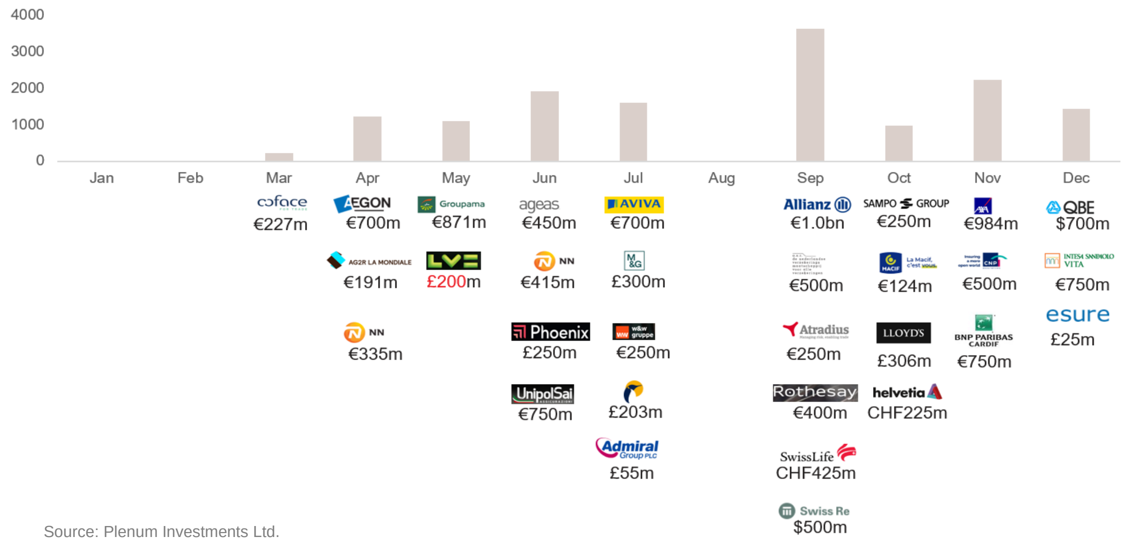
- Total subordinated insurance bond supply likely to decrease slightly
- Subdued Subordinated Insurance Bond Supply continues to strengthen investment case
- Green bonds remain a niche within the niche
- Restricted Tier 1 issuance likely to increase

December is always the season for supply forecasts and this year it is a bit of a differentiated estimate. We expect in our base case new institutional subordinated bond issues of European Insurers in 2024 to be at EUR15.7bn which is below the level of 2023. In 2023, total supply amounted to EUR17.9bn down from EUR19.9bn in 2022 across all currencies. This base case is the midpoint of our forecasted range of EUR13.3-18.0bn of which we expect EUR4.2-5.0bn to be restricted T1 (rT1) paper and EUR1.7-2.7bn in a green bond format.

For 2024, we estimate remaining refinancing needs of EUR11.5bn after some maturities and call dates were already refinanced in 2023. In addition, some insurers will refinance maturities and call dates in H125 already in 2024. This could add up to EUR7.5bn of supply in 2024. Our forecast implies that all traded institutional bonds will be called at the first call dates in line with industry practice. The number looks a bit low and counterintuitive considering that most bonds in the sector have a first call date after 10 years and the spike in new issuance in 2014. But we note that a number of bonds have been (partially) tendered in the last 10 years or have later call dates leading to more supply in 2025.

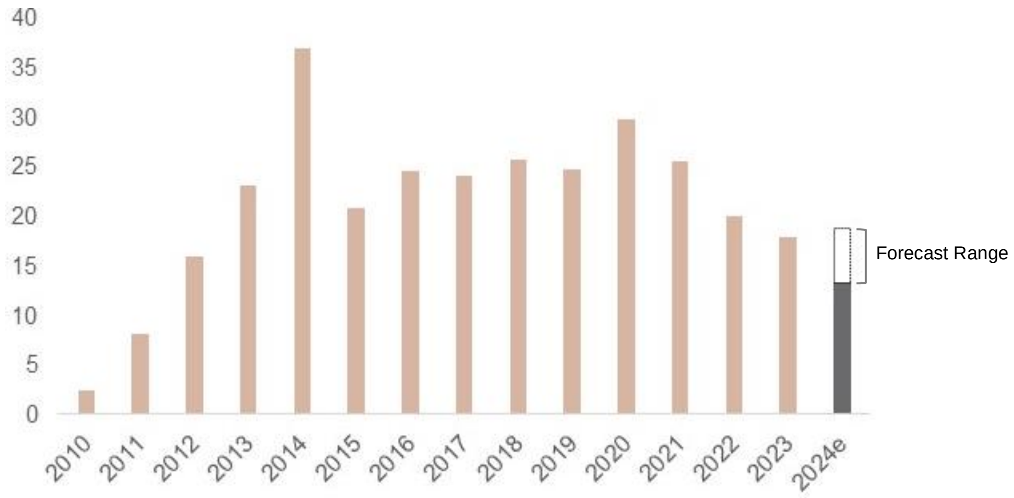
The slightly subdued level of supply should continue to support the secondary market in 2024 and the bullish outlook for this segment which remains a unique opportunity for investors.

Upcoming call dates and maturities in 2024 (EURm)



Source: Plenum Investments Ltd.

New Issues – Subordinated Insurance Bonds (EURbn)

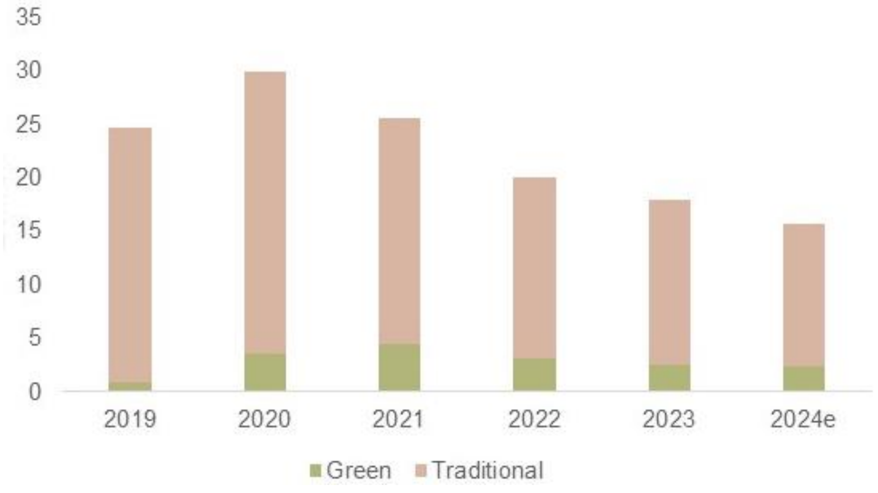


Source: Plenum Investments Ltd.

The generally strong capitalisation of the sector and excess capital of the major players should limit the appetite to fund organic growth and bolt-on M&A through additional leverage. Still we include another 15% in our estimated range of supply for potential funding for organic growth, major M&A and potential bond tenders.

In 2023, 14% of all sub insurance bonds were issued in a green bond format compared to 15% in 2022. We do not see any short-term catalyst to trigger a higher share of green bonds. Even though green bonds trade tighter than traditional paper, reporting requirements for issuers are extensive and a reason to prefer the latter. Hence, a 15% share of green bond issues, i.e. EUR2.3bn, sounds reasonable in our view.

New Issues – Green vs Traditional (EURbn)



Source: Plenum Investments Ltd.

The elephant in the room is, however, the volume of restricted Tier 1 (rT1) paper to be issued in 2024. RT1 supply collapsed after reaching its peak of EUR6.4bn in 2020 to a mere EUR0.6bn in 2023, i.e. almost all issuers in the need of rT1 capital appear to have come to the market by now. However, in 2024 and 2025 we will see a number of call dates of grandfathered T1 bonds. These were issued in 2014 and until January 2015 which was the cut-off date for grandfathering into the new Solvency II regime. The grandfathering period will end on 31 December 2025 after which the grandfathered bonds will no longer be eligible as Solvency II capital. We consider this an additional incentive to follow the industry practice and call these bonds at their first call dates in 2024-26. But not all of these grandfathered rT1 bonds will be refinanced by new Solvency II-compliant rT1 bonds. As some issuers have so far not shown any intention to issue rT1 bonds we estimate that at least EUR1.5bn of the grandfathered T1 bonds with call dates in 2024 and H125 will be replaced with T2 bonds.

In January 2025, the first benchmark sized Solvency II-compliant rT1 bond, i.e. the PHNXLN 5.625% perp-25, will have its first call date. Unlike T2 paper where non-economic calls are market practice, the lack of benchmark sized precedents means that no such market practice exists for new rT1 paper, yet. We expect that this bond is a non-economic call but we caution that the business model of its issuer Phoenix Group benefits from non-economic calls and so a call of the bond does not necessarily establish a market practice.

New Issues – RT1 versus other (EURbn)

Source: Plenum Investments Ltd.

The lower supply of sub insurance paper of EUR15.7bn from EUR17.9bn in 2023 supports our continuing positive market outlook following the rally in November and December 2023. The increasing share of rT1 relative to total new issues shows that we can expect ongoing high returns with very attractive risk premia in 2024.

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