FINANCE

Banking

Czech Bank's Subordinated Bond Expected To Start Trend In Region

PRAGUE—Komercni banka, the Czech Republic's largest bank, became the first bank in Central and Eastern Europe to publicly issue a subordinated bond when it launched a 10-year, $200 million issue May 7, and bankers say similar issues are on the way in other parts of the region.

"This is a new class of instrument for Central and Eastern Europe," said Komercni board member Petr Budinsky, who recently was named chairman of the Prague Stock Exchange (see report on page 364).

The bond, issued by the bank's Komercni Finance BV division, carries a coupon of 9 percent and a call option after the first five years. If that option is not exercised, the issue takes on a higher-yielding floating interest rate—5 percent above the six-month London Interbank Offered Rate (LIBOR) for U.S. dollars.

Investors who hold subordinated debt enjoy higher interest rates, but their claims are the last to be satisfied if the issuer goes bankrupt. Banks in Central Europe are starting to find subordinated debt to be an attractive instrument, and may also use the proceeds to grant U.S.-dollar loans to domestic companies at even higher rates.

Increasing Capital Base

Subordinated debt "makes a lot of sense, especially in the pre-privatization phase [of the Czech banking sector] and the Czech National Bank's steps to get banks to increase their capital base," said Petra Wendelova, vice president of the Prague branch of CS First Boston, which is lead-managing the issue along with J.P. Morgan.

Raising their so-called "Tier II" capital is crucial for many Central European banks in their quest to improve their capital adequacy ratios so they can adequately cover bad loans. The Bank for International Settlements recommends a capital adequacy ratio of 8 percent.

Although several small issues of U.S. dollar- or Deutschemark-denominated subordinated bonds have already been issued by Estonian and Slovak banks, those issues have been privately placed, Komercni officials said.

Similar Issues To Follow

Other major Czech banks, including Investicni a Postovni banka, Ceska sporitelna, and Ceskoslovenska obchodni banka, reportedly are considering subordinated debt issues, Wendelova said, and those should be of a similar structure but a smaller size. Banks in other countries of the region reportedly plan to follow suit to boost capital requirements in the run-up to European Union membership.

"Up until now, banks have not been exploring" subordinated debt, Wendelova said. But now that they are motivated to look for ways to raise capital, "they're recognizing the products demanded by international investors."

Komercni's bond was "very successful" in its recent roadshow in the United States despite the delay it suffered because of the Asian crisis, said Ellen Lederman, vice president of J.P. Morgan in Prague. The amount of the issue was increased from the original target of $150 million because of heavy investor demand.

'Comfort Letter'

A recent "comfort letter" issued by the Czech government helped assure investors of Prague's commitment to Komercni's stability and privatization, Lederman said. The letter also helped the bond receive an "excellent" credit rating, she added. Moody's Investors Service rated the bond Baa3, while Standard & Poor's rated it BB and Fitch IBCA gave it a BBB- rating.

U.S. investors—primarily emerging markets funds—bought about one-third of the issue, while another third went to European investors specializing in subordinated debt.

The issue marks Komercni's second bond issue. Its $250 million Eurobond launched in April 1996 was the first Eurobond issued by a bank in Central Europe (6 BEER 320, May 6, 1996).

Hungary

Capital-Indexed Bond Issue First Of Its Kind In Central Europe

BUDAPEST—The Hungarian government May 7 launched its first capital-indexed bond, which provides an annual interest rate 4 percent higher than the consumer price inflation rate.

The Government Debt Management Center hopes the bonds, which are the first of their kind in Central and Eastern Europe, will become a regular instrument.

The principal will be adjusted to inflation based on CPI figures published by the Central Statistical Office once a year. Consumer prices increased 16 percent in April compared with the same month of 1997.

The seven-year bonds, worth HUF 5 billion ($23.9 million), were more than two times oversubscribed, setting the average price at 100.09 percent of the nominal value.

The bonds were available to both domestic and foreign investors.

Hungary's credit rating for long-term foreign currency bonds was upgraded to Baa2 by Moody's Investors Service earlier this month (see report on page 382).