

Additional Tier 1 CoCo Bonds – A Fast-Developing Asset Class

Issuance by Allied Irish Banks of EUR500m of Additional Tier 1 Securities was a notable development for this type of capital security in the European market.

2015 has been the second busiest ever for this market (after a record year in 2014). Additional Tier 1 securities can count as regulatory equity capital and hence permit banks to meet capital targets.

Whereas the general trend has been for more AT1 instruments to achieve higher ratings in the investment grade category, the AIB bond was notable for its 4x over-subscription despite a B- rating.

The regulatory framework is becoming clearer at the national level in most jurisdictions as well as at EU level. Banks capacity and willingness to issue AT1 securities seems clear – so further heavy issuance can be expected over the next few years.

Banks in the UK, Switzerland, Spain, Italy, France, the Nordics and most recently the Netherlands have all issued significant levels of AT1 securities. Two law firms, Linklaters and Allen & Overy have dominated this market, with approximately 50% of all instructions during 2014 and 2015.

Additional Tier 1 CoCo Bonds – Systemically Important for European Banks

Following the financial crisis, regulators sought to create capital buffers for any future crisis with a view to limiting the potential for any state or EU institutional support.

Higher capital requirements implied significant capital raising, asset sales and/or de-risking by banks. One of the solutions has been the development of Additional Tier 1 securities, sometimes referred to as “coco” bonds.

Since Lloyds Bank exchange offer in 2009, almost every European banking institution has raised capital via AT1 instruments.

As the market develops, greater investor acceptance and understanding of the risks has gone alongside regulatory clarification.

As higher rated institutions have issued CoCo bonds, the “average” rating for the bonds has also increased, with 50% of bonds now investment grade, according to Fitch Ratings.

Additional Tier 1 CoCo Bonds – Defining Triggers and Loss Absorption Features

