# AT1 risk repricing in Europe: Driven by perception of higher coupon risk

**Since the beginning of 2016, the prices of European banks' Additional Tier 1 (AT1) securities have fallen significantly. The Markit iBoxx EUR Coco AT1 Index declined 15%, partly mirroring market aversion to risky assets, but in Scope's view also reflecting heightened concerns over coupon risk. Some market participants have stated that their concerns partially stem from comments by EU regulators related to Pillar 2 requirements.**

As going-concern capital, AT1s can help banks absorb losses at times of stress through conversion to equity or writedown (temporary or permanent). The fully discretionary nature of coupon payments also provide banks with financial flexibility. Moreover, in certain circumstances, coupon distributions are subject to mandatory restrictions.

Due to these equity-like characteristics, AT1s are also referred to as contingent capital securities, and it is logical that their price performance be more volatile than for more senior liabilities. The recent sell-off in AT1s should hence be read in the context of the wider risk-off attitude in markets, which has seen European bank shares decline by c. 25% year-to-date. In fact, looking at individual names, there is a certain degree of correlation between the performance of shares and AT1 securities of the different banks.

However, we note that recent AT1 performance also reflects, in part, factors which are more specifically related to individual securities. While principal loss remains a very remote scenario for all the rated AT1 instruments, the recent disclosures of the ECB's SREP capital requirements, added to the EBA's indication that Pillar 2 requirements stack below the Combined Buffer Requirement (CBR), have reduced the buffer to the Maximum Distributable Amount (MDA) threshold for many banks in the Eurozone.

On our calculations, euro area (EA) banks display buffer-to-CBR levels ranging from around 1%-3%. Generally we find that the higher the level, the better the AT1s have held up in the market in recent weeks.

Outside of the EA, the interaction between Pillar 2 requirements and the MDA is less clearly defined. Interestingly, among the best performing AT1s in 2016 are the ones issued by Swedish banks. The Swedish supervisor Finansinspektionen recently reiterated that "the capital requirement under Pillar 2 does not affect the level at which the automatic restrictions on distributions linked to theCombined Buffer Requirement come into effect". Similarly, the Norwegian FSA.has stated that "failure to achieve the expected capitalisation as expressed in the SREP will not automatically entail restrictions".

The other factor potentially leading to mandatory coupon restriction for AT1 securities is lack of Available Distributable Items (ADI). Few banks have indicated these amounts for 2015 (annual reports are yet unpublished) but based on 2014 accounts we believe that in the case of AT1 securities rated by Scope the banks have sufficient ADI to pay the coupons.

Table 1 overleaf summarises the main quantifiable coupon risk factors for the European banks with AT1 securities rated by Scope.


## Analysts

**Marco Troiano, CFA (Author)**
m.troiano@scoperatings.com

**Pauline Lambert**
p.lambert@scoperatings.com

**Chiara Romano**
c.romano@scoperatings.com

**Sam Theodore (Team Leader)**
s.theodore@scoperatings.com


## Related Research

**EBA Opinion 24/2015: Clarity added to the MDA debate** – January 2016

**Bank Capital Instruments Methodology** – July 2015


## Scope Ratings AG

Suite 407
2 Angel Square
London EC1V 1NY, UK

Phone +44 20 3457 0452

### Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100
Service +49 30 27891 300

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

**Table 1: Estimated distance-to-CBR and ADI, selected European banks (amounts in EUR unless indicated otherwise)**

| Issuer | 2016 CET1 requirement including CBR | Latest CRD IV CET1 Ratio | Distance-to-CBR (%) | Distance-to-CBR (m) | ADI (2014, bn) |
|---|---|---|---|---|---|
| Credit Agricole SA | 9.5% | 10.4% [1] | 0.9% | 2,742 | 14.7 |
| Credit Agricole Group | 9.75% | 13.3% [1] | 3.6% | 17,999 | |
| BNP Paribas | 10.0% | 11.0% | 1.0% | 6,300 | 20.6 |
| Societe' Generale | 9.75% | 11.4% | 1.7% | 5,886 | 12.0 |
| KBC | 10.3% | 13.7% [2] | 3.4% | 2,917 | 4.3 |
| Deutsche Bank | 10.75% | 12.9% [5] | 2.2% | 8,544 | 2.9 [5] |
| Santander | 9.75% | 12.6% | 2.8% | 16,397 | 3.0 |
| BBVA | 9.75% | 12.1% | 2.4% | 9,432 | 7.9 |
| Nordea | 16% [3] | 16.5% | 0.5% | 716 | 16.6 |
| Swedbank (SEK) | 19.9% [4] | 24.1% | 4.2% | 16,976 | 45.1 |
| Barclays (GBP) | 7.2% [6] | 11.1% | 3.9% | 14,892 | 7.4 |
| Lloyds (GBP) | 7.2% [6] | 13.7% | 6.5% | 14,594 | 7.8 |
| HSBC (USD) | 6.85% [6] | 11.8% | 5.0% | 56,602 | 48.9 |
| DNB (NOK) | 15% [7] | 14.4% | -0.6% | -6,099 | n.d. |
| Danske Bank (DKK) | 6.6% [8] | 15% [9] | 8.4% | 70,022 | n.d. |

Source: Scope Ratings

1 As of Q3 2015

2 Pro-forma repayment of state aid

3 Requirement for 2016 estimated by Nordea

4 Requirement for Q4 2015

5 Pro-forma Hua Xia Bank sale. ADI for 2015 were EUR1bn

6 Based on 2015 Pillar 2A requirement

7 Based on 2015 Pillar 2 requirement. Requirement to be met by year-end

8 Does not include Pillar 2 requirement as it can be met with AT1 securities

9 Pro-forma share buyback announced for 2016

| Bank | Senior Unsecured debt ratings | Outlook | AT1 Ratings | |
|---|---|---|---|---|
| Banco Santander SA | A+ | Stable | BBB- | |
| Barclays Bank PLC | A | Stable | BB *(Barclays Plc)* | |
| BBVA SA | A | Stable | BB+ | |
| BNP Paribas SA | A+ | Stable | BBB | |
| Credit Agricole Group | A | Positive | BB+ *(CASA)* | |
| Danske Bank A/S | A- | Positive | BB | |
| Deutsche Bank AG | A- | Stable | BB | |
| DNB Bank ASA | A+ | Stable | BBB- | |
| HSBC Holdings PLC | AA- | Stable | BBB | |
| KBC Group NV | A | Stable | BBB- | |
| Lloyds Bank PLC | A | Stable | BB+ *(Lloyds Banking Group Plc)* | |
| Nordea Bank AB | A+ | Stable | BBB- | |
| Societe Generale SA | A | Stable | BBB- | |
| Swedbank AB | A- | Stable | BB | |

Source: Scope Ratings

## Disclaimer

## Scope Ratings AG

### Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

### Frankfurt am Main
Rüsterstraße 1
D-60325 Frankfurt

Phone +49 69 97944 754

### Paris
21, Boulevard Haussmann
F-75009 Paris

Phone +33 1 53 43 29 89

### London
Suite 407
2 Angel Square
London EC1V 1NY, UK

Phone +44 20 3457 0452

### Madrid
Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

info@scoperatings.com
**www.scoperatings.com**