

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 the Combined 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.

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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 (<i>Barclays Plc</i>)	
BBVA SA	A	Stable	BB+	
BNP Paribas SA	A+	Stable	BBB	
Credit Agricole Group	A	Positive	BB+ (<i>CASA</i>)	
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+ (<i>Lloyds Banking Group Plc</i>)	
Nordea Bank AB	A+	Stable	BBB-	
Societe Generale SA	A	Stable	BBB-	
Swedbank AB	A-	Stable	BB	

Source: Scope Ratings

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