

# Santander's Coco Extension Episode

Subordinated Debt Market  
Focus

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## QUICK THOUGHTS ON SANTANDER'S COCO BOND EXTENSION EPISODE

The **Banco Santander** 1.5 Bn€ 6.5% perpetual Additional Tier 1 Bond (a.k.a Coco 2019 bond) was due to be called or extend on March 19<sup>th</sup>, 2019.

Credit markets were scrutinizing this call deadline as it was the **first of the new generation Coco bonds to be at a high risk of being extended**.

Although the extension risk of the bond was already largely priced in, Banco Santander sent an ambiguous message to the market a few days ago by issuing a new (very) expensive USD Coco bond in the market.

Consequently, the market participants' expectations completely turned to finally believe that Santander would use the proceeds of the new bond in order to call the March 2019 Coco bond.

Therefore, this bond's prices recovered back from 95% to close to Par.

- A week later, Santander decided to extend that bond rather than call it, putting the entire asset class into jeopardy

### Price evolution of the Santander's AT1 Bond



Source: Ostrum AM, Bloomberg. Data from 17/08/2018 to 15/02/2019. The figures given refer to previous years. Past performance is a not a reliable indicator of future performance. The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change without prior notice. There can be no assurance that developments will transpire as may be forecasted in this material.



## Consequences? Little impact on Santander AT1 curve but no read across for the rest of the Coco's market

Apart from a small drawdown on the extended bond and on other Santander Cocos, the **Coco market has been strong and resilient** with almost no price reaction.

**Santander's dodgy behavior had no effect on AT1 primary markets:** the Svenska Handelsbanken Coco issued just after the Santander's announcement priced 50 cents below Initial Price Talk and opened above par the next day.

## Lessons and takeaways: Healthy signs for this young market

- Extension risk is understood by the investor community
- Call decisions shall be assessed on a specific basis (issuer by issuer, security by security)
- **Most important, we believe there is a value in extension:**
  - ✓ This **risk can be converted into an opportunity** to the extent one is able to correctly price it
  - ✓ In time of stress, markets tend to move from pricing bonds at call date to perpetuity even though bonds should only extend by a couple of months or years later (and be called then)

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## OSTRUM AM'S OUTLOOK ON THE ASSET CLASS

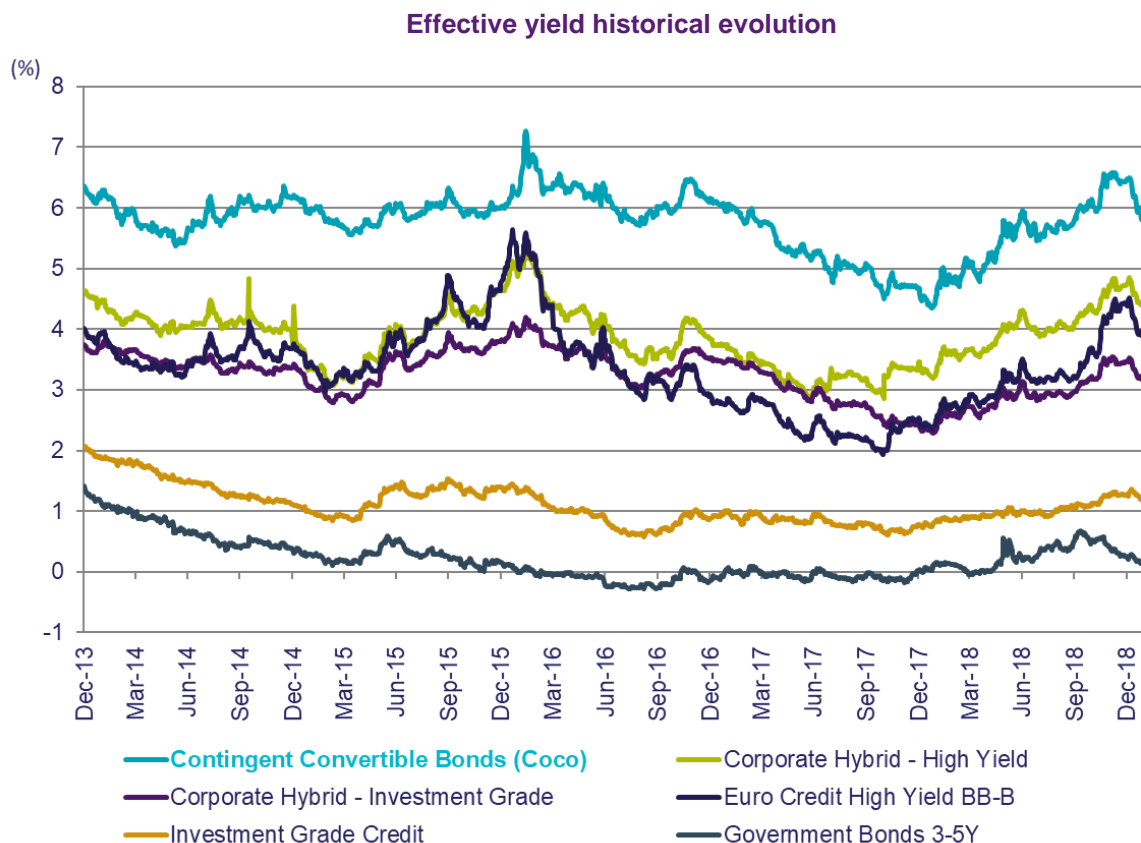
Subordinated Debt remains, in our view, very promising for 2019 with a yield between 4 and 5%, among the highest in the fixed income space.

- The asset class could increase the absolute expected return of an allocation portfolio by investing in subordinated financial debt (banks and insurance companies) and corporate bonds.
- Historically, subordinated debt\* has performed better than equities with a lower volatility. In 2018, subordinated debt\* suffered due to its high beta nature, but still less than the Eurostoxx 50 (-5.9% vs -11.3% in total return).

*\* Bloomberg Barclays Global Contingent Capital TR index Hedged EUR*

Source: Ostrum AM. **Main risks: Capital loss**, Credit, Unrated and below investment grade securities, Debt securities, Counterparty. The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change without prior notice. There can be no assurance that developments will transpire as may be forecasted in this material.

The asset class still offers yield in the fixed income space:



Source: Ostrum AM, Bloomberg, BOA Merrill. Data as of February 15<sup>th</sup>, 2019. The figures given refer to previous years. Past performance is not a reliable indicator of future performance. \*Source : Bloomberg. Indices: Bofa Coco index / Bofa Hybrid High Yield index / Bofa Hybrid Investment Grade index / Bofa Euro government index / Bofa Euro Corporate index / Bofa Euro High Yield index. The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change without prior notice. There can be no assurance that developments will transpire as may be forecasted in this material.

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