



LET'S TALK ABOUT...

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CoCo Bonds

Despite its pretty exotic echo, the term is simply the acronym of Contingent Convertible Bonds, that is bonds (debt instruments) which change into shares (equity) at certain conditions and when certain events take place. In most cases the condition is that the issuer needs liquidity. Thus they are being issued – and will likely be widely issued in the future – by banks, under the new rules on their capitalization levels, particularly the Tier1 Capital ratios. Were such required ratios to become inadequate, CoCo Bonds would be automatically switched into equity. CoCo Bonds can then be viewed as hybrid financial products, with undefined features in terms of redemption, expiration and return, due to their uncertain nature, more governed by the issuer than the holder/investor himself.

They are very different from ordinary convertible bonds: convertibles can actually be changed into equity, but at the investor's choice and according to her/his market evaluations, and not automatically and somehow forcedly as in the case of CoCos.

Of course the issuer has to make them attractive through high yielding coupons which may compensate the risk premium they involve. At the moment of conversion the issuing bank will likely be in a difficult position, with a high liquidity risk. Its ordinary bonds would then be given away hugely, maybe in a sort of panic selling which could make its position even worse. According to the banking sector regulators, automatic conversions are aimed at avoiding such market troubles.

Although CoCo Bonds issued by banks according to the new Tier 1 Capital criteria are currently the most diffused, other types of them with different features exist. For example CoCos may change into equity when a certain predefined price level (striking price) is reached, so incorporating a sort of option right. - *GLT*

The views expressed are not necessarily those of the Swiss Association of Asset Managers