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How have CoCo bonds changed over the years after the financial crisis?

BACHELOR'S THESIS

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ABSTRACT

Convertible contingent (CoCo) bonds were first introduced in 2009, as a response to the challenges posed by the financial crisis, from which the economy had not yet fully recovered. The goal of this new type of bond was to strengthen the equity base of financial institutions in order to prevent the occurrence of another financial crisis in the future. Even though CoCo bonds are a relatively new class of bonds, they have been the subject of numerous research papers. Some papers concentrate on the effects, models, and types of CoCo bonds, but the majority of them deal with the pricing of these bonds. Since there are multiple factors that make the pricing of such bonds challenging, one finds various different approaches to pricing. Notwithstanding the above, no papers have been written on the changes that have taken place in relation to CoCo bonds or with their development. This thesis tries to fill this gap by answering the following question: *How have CoCo bonds changed over the years after the financial crisis?* In order to answer this question, it was decided to analyze the different characteristics of CoCo bonds, including the trigger, trigger level, loss absorption mechanism, coupon type, coupon frequency, Basel III classification, and maturity type. The approach was to analyze these characteristics over time and to detect any changes in them. The necessary data were obtained from Bloomberg Terminal and evaluated with Excel. Data show that issue patterns and the characteristics of CoCo bonds were influenced primarily by the application of Basel III and by the investors to whom these bonds cater. There has been no change in the type of the trigger (mechanical or discretionary); there has always been a clear trend towards mechanical triggers. Before the introduction of Basel III, equity conversion was common. With the application of Basel III, issued CoCo bonds were increasingly of the write-down kind. This trend also applies to latest issue of CoCo bonds. In the case of the coupon type there was also a change of prevalence: Before the implementation of Basel III, there were more CoCo bonds with fixed coupons. Subsequently, the proportion of variable coupons increased over time. Moreover, after the introduction of Basel III the proportion of CoCo bonds classified as AT1 capital increased over the years. CoCo bonds have been used primarily to meet AT1 capital requirements, which has remained the case up to today. The changes in the maturity of the CoCo bonds reflect the classification into AT1 and T2 under Basel III. This means that there has been and still is a trend towards perpetual CoCo bonds. The analysis of the coupon frequency (annual, semi-annually etc.) indicates that in the past there was no clear tendency towards a certain coupon frequency. However, in the past two years the majority of issued CoCo bonds have paid out coupons on a quarterly basis.