AT1 CoCos: boring, at last

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Key Takeaways

- AT1 Cocos are becoming a mature asset class. The absence of market drama despite geopolitical tensions, steady bank fundamentals and orderly trading suggests AT1s have moved beyond their reputation as a volatile niche market.
- Higher yields are being driven by interest rates, not weaker credit. Credit spreads remain close to record lows, while higher government bond yields have lifted all-in yields, improving income opportunities without a deterioration in bank credit quality.
- Carry is likely to drive returns from here. With spreads already near historic tights, further spread compression appears limited. Strong technicals, low net supply and healthy bank balance sheets remain supportive, but future returns are likely to come primarily from coupon income rather than capital gains.

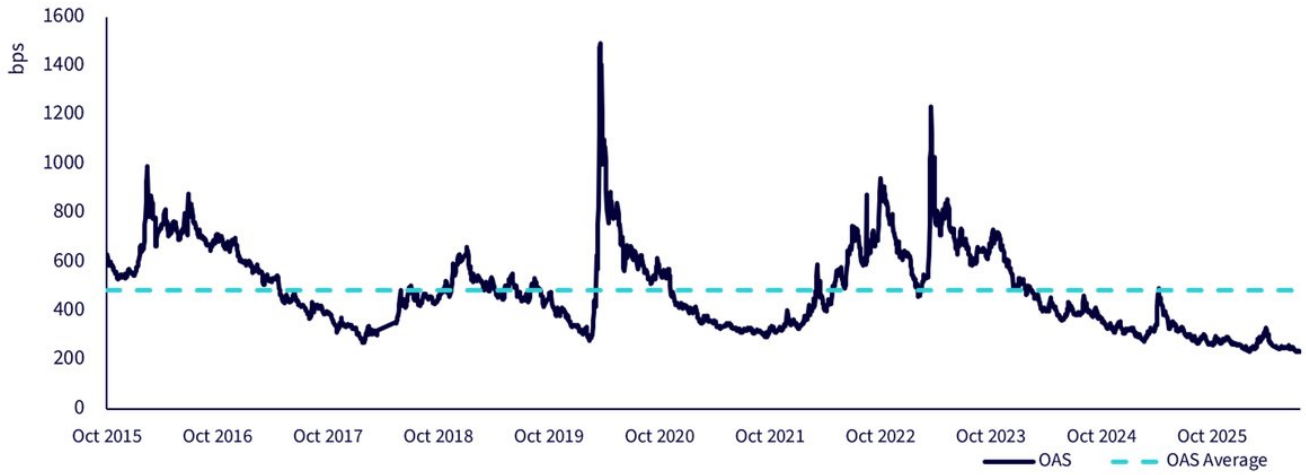
Additional Tier 1's (AT1s) have finally become boring, and that may be the most important development in the asset class. Spreads sit around their all-time lows. Yields have risen, but for reasons that have nothing to do with credit. Bank results so far are unremarkable. Issuance has gone quiet for the summer. Restricted Tier 1's (RT1s) are tracking AT1s. That is the quarter.

For most asset classes this would not be worth a paragraph, let alone a blog. For AT1s it is worth both, because for most of this market's existence, 'nothing happened' was not a sentence anyone could write. The most interesting thing about AT1s in Q2 is how uninteresting they have become. This looks less like a lull and appears increasingly consistent with a more mature asset class.

Spreads have tightened to an all-time low

The Option Adjusted Spread (OAS) spent the quarter grinding back toward the record low in February. Recall the shape of last quarter: the outbreak of the Iran conflict pushed the index out briefly above 300 bps in March. The round trip back took a matter of weeks. The market absorbed a live geopolitical shock and returned near the lows within a quarter, with no lasting damage to the primary market and no forced sellers of note.

Figure 1: Historical AT1 OAS



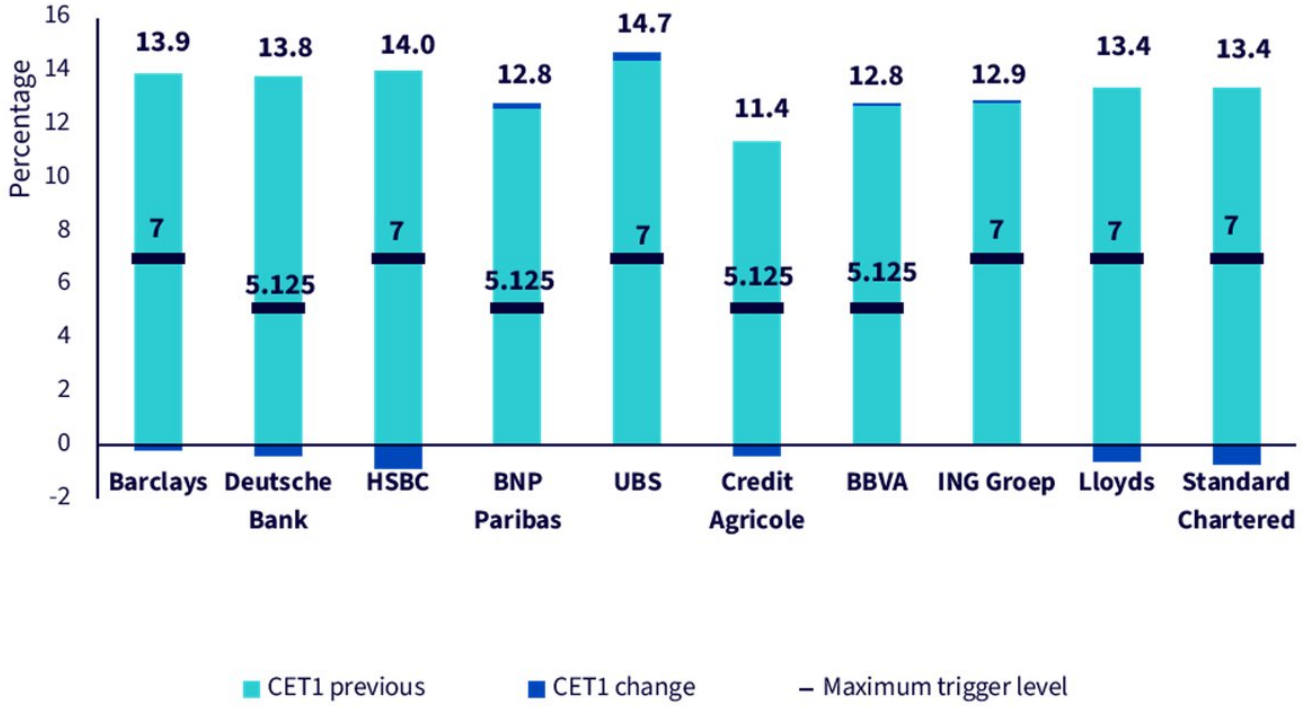
Source: WisdomTree, Markit. Period from 01 October 2015 to 20 Jul 2026. Calculations include backtested data. OAS is the option-adjusted spread reported by Markit and is based on the effective duration-adjusted market value weighting. Workout dates used in the OAS calculation of individual bonds are reset at the end of the month in case the bonds are not called. This calculation approach impacts the OAS figures for the index intramonth until the workout dates are reset. The strategy is represented by the iBoxx Contingent Convertible Liquid Developed Europe AT1 Index. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

By any historical yardstick, current levels are expensive, but the market does not appear to mind, and this quarter gave it no reason to. All-in yields on the asset class are higher than they were three months ago. It would be easy to read this as risk being repriced. It is not. The spread component has been flat near the lows all quarter; the move has come entirely from base rates, with government bond curves drifting higher. Mark-to-market performance this quarter was a duration story, not a credit story. Current spreads suggest the market is not demanding materially greater compensation for holding junior bank risk. For income buyers, the arithmetic has quietly improved: headline entry yields are better than they were in the spring, for reasons that have nothing to do with the banks themselves.

Banking sector remains healthy

Meanwhile, the 2026 first half reporting season is underway. With most banks having published their results, and the honest summary is that there is nothing to report. Capital ratios remain comfortably above requirements. Asset quality is stable. Profitability continues to be supported by the rate environment, for reasons discussed last quarter: banks earn the gap between what they charge on assets and what they pay on deposits, and higher-for-longer keeps that gap healthy. The absence of outliers is itself the observation. Coupon capacity is ample, distance to triggers is wide. Stronger bank balance sheets have contributed to more stable trading conditions for AT1 securities.

Figure 2: Capital buffers of the top 10 AT1 CoCo issuers



Source: WisdomTree, Markit, Bloomberg Finance L.P, respective issuers' financial results. Data as of 30 Jun 2026. CET1 change represents the value change in CET1 ratios from data available as of 30 Jun 2026 (generally Q1 2026 available reporting) compared to the latest data available as of 31 Mar 2026 (generally Q4 2025 available reporting). No change may indicate the reporting cycle has not ended. CET1 ratio is the Common Equity Tier 1 Capital ratio reported on a fully loaded basis available on Bloomberg Finance L.P and from the issuer's latest financial results, if not reflected on Bloomberg Finance L.P. Maximum trigger level is represented by the maximum trigger observed across all CoCo issues of a given issuer. The strategy is represented by the iBoxx Contingent Convertible Liquid Developed Europe AT1 Index. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

New issuance slowed sharply into the summer, as it usually does. But the seasonal effect is only half the story. Most issuers dealt with their 2026 call schedule earlier in the year, at levels they were happy with, and are in no hurry to return. Nobody is being forced to print.

Conclusion: carry could drive future returns

It is worth stepping back and asking why the quarter was this quiet, because the answer is not luck. This market has spent a decade being educated in public. The Deutsche Bank coupon scare of 2016 taught it about distributable items. March 2020 taught it about liquidity. The Credit Suisse write-down of March 2023 was the most significant stress event in the asset class's history: roughly $17bn of instruments zeroed, an existential question asked of the whole asset class, and a forceful answer from EU and UK authorities on where AT1s sit in the creditor hierarchy. Each episode resulted in greater market understanding of how the asset class functions. The years since have been an exercise in normalisation. Issuers have called bonds on schedule, and the market has learned to price extension risk rather than panic about it. UBS itself

returned to AT1 issuance within months of absorbing Credit Suisse. The investor base has institutionalised and broadened. New issues are routine exercises rather than events.

That is the context in which Q2 should be read. An asset class that once repriced on a single headline absorbed the outbreak of a war, widened 80 bps, and went back to the lows. Then it spent three months doing nothing. This is what becoming an established asset class looks like: predictable calls, predictable coupons, understood regulatory treatment, and volatility migrating elsewhere.

But boring at the lows is an asymmetric proposition. With spreads near record tights, there is far more room to widen than to tighten. The capital gains phase of this cycle looks largely spent. From here, carry is likely to be the primary driver of returns if spreads remain close to current levels.

The bottom line is that spreads are low, yields are up on rates, fundamentals are steady and supply is quiet. There were no major disruptions within the AT1 market over the quarter, and that stability is itself noteworthy. AT1s have spent years earning the right to be dull, and this quarter they exercised it.

AT1 CoCo bonds are subordinated instruments and involve additional risks compared with conventional corporate bonds, including the potential for coupon cancellation, conversion into equity or principal write-down under certain circumstances. Their value may fall as well as rise and investors may lose part or all of their investment.

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