AT1 CoCos: a review of 2025 and what lies ahead

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Key Takeaways

- AT1s matured in 2025 with strong demand, smooth absorption of record supply and resilient performance in volatility.
- With tight spreads, the value now lies in high yield and income as we transition back into a lower rate regime.
- AT1s continue to offer attractive yields and income while providing exposure to a well-capitalised and stable European banking sector.

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2025 was a good year for AT1s (Additional Tier-1), and an important one given the macroeconomic noise. The clearest highlight was the sheer depth of demand for new issues. Order books frequently ran to ten times deal size, and the market absorbed elevated supply without strain. Outstanding AT1 volumes pushed to record highs, and the more impressive part was that demand didn't break under that growth, it broadened. When the market digests record supply cleanly, it's not just a technical signal; it tells you the investor base is becoming more stable and institutional.

The second highlight was the performance of bonds traditionally associated with extension risk, notably structures with thin economics beyond the first call date, what many investors shorthand as a 'low back end.' In 2025, these bonds significantly outperformed as concerns around extension risk faded. A notable example came in the spring, when Deutsche Bank opted not to call one of its USD AT1 bonds while calling another. In the past, a decision like this could have sparked broader market disruption, yet it passed without meaningful contagion. This marked an important sign of market maturity, with investors increasingly distinguishing between issuer-specific considerations and genuine systemic stress.

During the Liberation Day sell-off, spreads widened, but the move was far less disorderly than prior historical turbulence. Crucially, the market displayed a visible buy-the-dip reflex that didn't exist in the earlier years of the asset class. Underneath all of this, fundamentals stayed strong. Banks have been operating with very high capital buffers and low non-performing loans, leaving them better positioned than in prior cycles. In a tariff-heavy environment specifically, banks tend to feel the effects indirectly and later in the cycle through clients and credit conditions, rather than immediately like traded goods sectors.

Looking ahead at 2026

Looking ahead to 2026, if we start from today's relatively low spread levels, further broad-based tightening is likely limited. This means returns may skew more toward relative value within the capital stack. Furthermore, if fundamentals remain solid, there's room for AT1 to tighten versus equivalently rated non-financial high yield, even if the whole credit market is already tight.

The key caveat is if 2026 brings a renewed bout of market turbulence, extension risk will get revisited. When volatility rises, the market tends to reprice instruments where outcomes depend on issuer discretion or supervisory discretion around coupon and capital mechanics. In that environment, some of the 2025 winners, especially the low back-end cohort that benefited most from the disappearing extension premium could underperform again as the premium returns.

In December 2025, the European Central Bank (ECB) published recommendations from its High-Level Task Force on simplification. Within that package, the ECB explicitly raised the question of whether AT1 and Tier 2 always behave like true going-concern capital in fast-moving stress, and it presented two broad directions: enhance AT1 features to better ensure loss absorption in going concern while remaining Basel compliant, or remove non-CET1 instruments from the going-concern capital stack entirely, a much more radical path with significant capital neutrality and Basel questions.

Yes, AT1 is being questioned. But it's being questioned in a way that reads less like a threat and more like a roadmap. Our interpretation is that the ECB saying they're not fully comfortable that AT1 always absorbs pain early enough and predictably enough, and that if we're going to keep calling this going-concern capital, the mechanics need to be more credible in stress.

A realistic path forward could be medium-term redesign around coupons, calls, and loss absorption mechanics, call it AT1 2.0. If the redesign is meaningful, you almost automatically end up with grandfathering, which implies two parallel markets: a legacy AT1 cohort and a new-generation cohort, each with its own pricing and liquidity dynamics.

In summary, the ECB's signal looks to us like an upgrade path to keep the asset class but refine how it behaves in stress, with any meaningful redesign likely phased in over years via grandfathering, not delivered as a sudden shock.

Conclusion

WisdomTree provides a comprehensive solution to accessing the European AT1 markets in the form of the WisdomTree AT1 CoCo Bond UCITS ETF. The exchange-traded fund (ETF) aims to provide a broad exposure to the liquid AT1 market within Europe. A key consideration is the inclusion of bonds denominated in any of the three currencies (USD, EUR or GBP) which in turn leads to a wider selection of countries and more diversified portfolio.

AT1s have been on a one way path since the collapse of Credit Suisse AT1s. We have seen continuous tightening of spreads and price appreciation leading to the current tight spreads. The value proposition now is less about spread tightening and more about high yields and income as the market transitions back into a lower rate environment. At 20 January 2026, the Index (iBoxx Contingent Convertible Liquid Developed Europe AT1 Index) tracked by the WisdomTree AT1 CoCo Bond UCITS ETF has a weighted average coupon of 6.59% with yield-to-worst of 5.9%. This positions AT1s as an attractive way to access higher yields while gaining exposure to a resilient segment of the European banking sector, even amid ongoing geopolitical uncertainty.

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