SAVINGS

Investors rediscovering subordinated bonds All thanks to zero interest rates

Those issued by banks are the most in demand Company bonds on the other hand have lower yields

The average paid return is 1.18%, but for those who like to take risks, it can reach more than 4%

SANDRA RICCIO

There is renewed interest in subordinated bonds, i.e. those instruments of debt that provide a higher yield against a higher degree of risk than traditional bonds. Indeed these instruments involve a lower level of seniority in the event of a refund as a result of the issuer's default. This is precisely what happened in the cases of Banca Etruria, the Venetian banks and Banca Marche. Those who had a portfolio of subordinated equity were left without any compensation.

Zero interest rates have brought this type of financial instrument to the forefront. In the last few months, banking institutions and large companies have resumed issuing subordinated bonds on the market. They are becoming increasingly popular with investors thanks to generous returns which, in the case of those issued by banks, can in this phase yield even as much as 5% upon maturity. «This is an effect of the great, negative interest rate “epidemic” - said Francesco Castelli, Head of Fixed Income at Banor Capital. -. And it is not only the Eurozone to bear the brunt, where official interest rates are at the level of -0.5%, but also countries like Japan, Switzerland, Sweden and Denmark». It is estimated that the global value of negative interest rate bonds is more than 15,000 billion (euros). And now the phenomenon is not only associated with government bonds but also corporate bonds. This leads investors to accept higher risks. It is the (only) way to achieve a higher return.

«For the portion of a portfolio reserved for bonds, opportunities are concentrated around the most volatile segments of the world of credit - explained Francesco Castelli -. We believe that subordinated bank bonds are a good compromise between risk and yield. On average they provide a higher return than an industrial corporate security with the same rating level».

Looking at the data, the average yield of «Lower Tier 2» subordinated securities (calculated on the basis of main sector indices) today is 1.18%. Traditional Corporate securities in this phase pay half as much. For those who are more willing to take risks, it is possible to opt for the lower category of so-called «CoCos» (Contingent Convertible Bonds - bonds which can be converted into equity) that offer average returns above 4%. «We believe that the risk extra-premium offered by subordinated securities is an opportunity - Francesco Castelli affirmed -. The innate fear of banking bonds is a remnant of the 2009 crisis. Albeit, however, a crisis that the banking system has to a great extent overcome. Suffice it to say that on average the banks today have exactly twice the amount of capital they had before the great crisis».

A reminder worth mentioning is that, by their very nature, these securities have particularly detailed issuing prospectuses and in the event of difficulties they expose the investor to very substantial losses. «There are also advantages for issuers and banks that can guarantee strong capitalisation at a low cost - stated Marco Gozzani, debt bond consultant for SüdTirol Bank -. The risk for investors however is comparable with the risk of buying shares». —