Press Cutting

Client	Axiom Alternative Investments
Date	12 June 2017
Source	Financial Times
Page	https://www.ft.com/content/40583184-4f74-11e7-bfb8-997009366969

Subordinated debt at small Spanish banks feels the heat

Banco Popular wipeout hits Liberbank and Cajamar's bonds

Subordinated debt at small Spanish lenders such as Liberbank and Cajamar has come under pressure after similar securities were wiped out in Banco Popular's shock resolution last week.

While the collapse of Banco Popular has done little to rattle the overall market for Additional Tier 1 bonds — the riskiest type of bank debt — both the debt and equity of Liberbank have been in the crosshairs after its peer was wound down last Wednesday.

Liberbank's €300m 6.875 per cent Tier 2 bond crashed as low as 81 cents on the euro on Friday, having been trading well above par ahead of Popular's resolution.

The bonds regained some of their lost ground on Monday after Spain's stock market regulator imposed a ban on short selling in Liberbank shares but are still bid at just 91 cents.

Privately held lender Cajamar is also feeling the heat in the debt markets with its parent company's €300m 7.75 per cent Tier 2 bond trading virtually in lockstep with Liberbank. The bond was bid at around 90 cents on Monday, having been raised at par barely a fortnight ago on May 31.

Jérôme Legras, head of research at Axiom Alternative Investments, said that, because the ECB and the EU's single resolution board (SRB) used liquidity issues to justify their action on Banco Popular, bank resolutions are now less predictable.

"Even if you have a positive view on the fundamentals of banks such as Liberbank or Cajamar or others, you now have that binary risk that liquidity could dry up," he said. "And the shocking thing on Popular was that recovery rates were exactly the same on the AT1 and Tier 2 — zero."

Tier 2 bonds are higher up in the pecking order than AT1 bonds and, in contrast to their lower-ranking cousin, have a fixed maturity date and cannot skip coupon payments.

One distressed debt trader said there were concerns from some investors that the decision to totally wipe out Popular's Tier 2 bonds could have triggered a "Lehman moment" for Spain's smaller lenders.

"They've actually created a crisis of confidence here and it's evident in Liberbank and Cajamar — they've jacked the cost of subordinate debt for these guys substantially," he said, adding that he would not own the Tier 2 bonds at their current trading levels.

"The ECB has just changed the rules . . . you can get zero-ed overnight," he added.

Liberbank's large stock of non-performing loans has made it a target, particularly as Santander made a higher than expected €7.2bn of additional provisions on Banco Popular's real estate portfolio.

Mr Legras said that Liberbank differs from Banco Popular in several crucial aspects, however.

Banco Popular's focus on SME customers made it more susceptible to large deposit withdrawals, whereas Liberbank is mainly retail focused. And while Banco Popular had a liquidity coverage ratio (LCR) of 146 per cent, Liberbank's is far healthier at 332 per cent.

Liberbank also exited Spain's asset protection scheme in December, at which point it had to provide a full appraisal of its portfolio benefiting from the public guarantee — meaning there should be fewer nasty surprises lurking on its balance sheet.

"My base case is that they'll muddle through and won't need a resolution," said Mr Legras. "But, clearly, the market is going to be very nervous for at least a few weeks and there will be a lot of volatility — and big swings in bond prices — for quite some time."