

# Understanding contingent capital securities

*Contingent capital securities, sometimes called contingent convertibles (CoCos), have evolved from niche status to become a well-developed segment of the global fixed income markets. Strong issuer credit fundamentals, meaningful income generation and an attractive risk/return profile have resulted in broad adoption of the asset class. Liquidity has increased over the years and the CoCo market has grown to near its terminal size (or maximum required capital amount for existing banks). Today, the CoCo market has about \$US 290 billion<sup>1</sup> in face value of securities outstanding, representing nearly 120 different issuers and spanning multiple currencies.<sup>2</sup> In the following pages, we provide an overview and analysis of the asset class, as well as our insights on the important role CoCos can play in fixed income portfolios.*

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## WHAT ARE CoCos?

CoCos are hybrid securities created by regulators after the 2007-08 global financial crisis (GFC) as a way to reduce the likelihood of government-orchestrated bailouts. Issued primarily by non-U.S. banks, CoCos are designed to automatically absorb losses, thereby helping the issuing bank satisfy Additional Tier 1 (AT1) and Tier 2 (T2) regulatory capital requirements (as described under “capital structure position” below).

Today, European-domiciled issuers (mostly banks but also a small number of insurance companies) make up more than 90% of the outstanding CoCo market.<sup>3</sup> Insurance companies may use these securities for capital purposes or to help manage their credit ratings.

But why are CoCos “contingent”? The contingent part of the name refers to a feature that automatically imposes a loss on the investor in the event an issuer’s capital falls below a predetermined threshold — typically 7% of its total risk-weighted assets in a “high-trigger” structure and 5.125% in a “low-trigger” structure. When this event occurs, depending on the structure of the CoCo security, there are three possible outcomes:

- The security is converted to common equity
- The investor is forced to assume a temporary writedown of the security’s value
- The investor is forced to assume a permanent writedown of the security’s value

As of June 2025, minimum regulatory capital requirements for European banks were well above the high- and low-trigger CoCo thresholds, and most banks held capital far in excess of the required minimum level.<sup>4</sup>

In the United States, banks issue preferred stock rather than CoCos to fulfill their AT1 capital requirement. The main difference between a preferred stock and an AT1 CoCo, besides the issuer's likely geography, is that only the CoCo has the contingency feature described above. In fact, because CoCos and preferred stock play nearly identical roles and rank similarly within an issuer's capital structure — i.e., lower than senior debt but higher than common equity — CoCos are commonly held in strategies that invest in preferred stocks.

## HOW DO CoCos WORK?

During the GFC, governments around the world bailed out banks at taxpayer expense and to the benefit of equity investors. CoCos, which did not exist prior to the GFC, were introduced to reduce the occurrence of such government actions in the future. They are structured to automatically absorb losses in times of crisis, with that loss absorption tied to a bank's capital level.

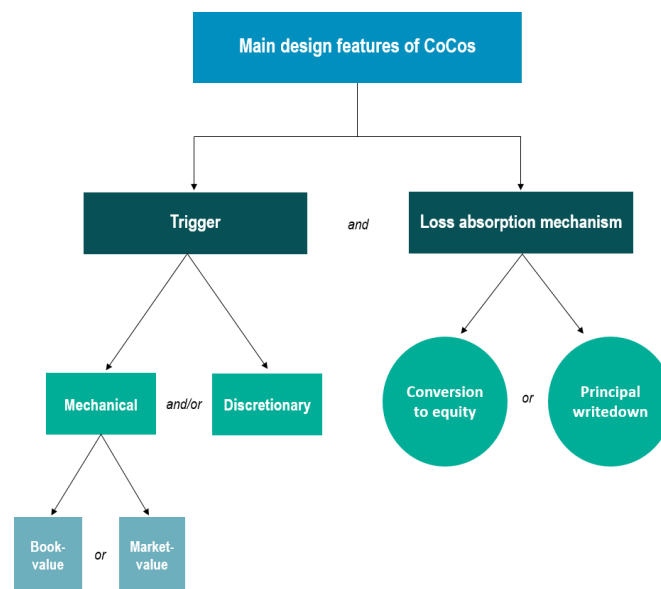
Most CoCos are defined by two elements (see **Figure 1**):

- **Trigger event.** This is the level of capital at which the loss absorption mechanism is activated. A CoCo trigger is mechanically based on the issuer's regulatory capital levels. However, regulators reserve the right to declare a "point of non-viability" (PoNV) based solely on their judgment about the issuing bank's ability to continue operating.

The concept and risk of PoNV determination is not unique to CoCo securities. U.S. regulators such as the Federal Reserve can make similar determinations about institutions under their purview. Generally, when a PoNV is declared, most investors holding securities lower in the capital stack — namely, common equity, preferred stock, CoCos or junior subordinated debt — experience a significant or full loss on their investment.

- **Loss absorption mechanism.** This may occur through (1) a conversion of the CoCo to common equity at a predefined ratio or (2) a full or partial writedown of the principal of the debt, either permanent or temporary.

**Figure 1: CoCos structure**



Source: CoCos: a primer, BIS Quarterly Review, September 2013.

While a PoNV trigger may not be an explicit part of a CoCo security's design, in reality that trigger always exists. For European banks, it is the more likely way in which a CoCo would be triggered, because regulators will declare the PoNV well before the issuer's capital level falls to an explicitly stated trigger threshold. As a result, the specific CoCo trigger is generally not expected to be activated.

That said, an actual PoNV determination would also be a rare occurrence given how well European banks are capitalized today. In fact, there has been only one officially declared PoNV event since the inception of the CoCo market.

In 2017, the European Central Bank (ECB) declared that Spain's Banco Popular had reached its PoNV. At the time, Banco Popular still had a CET1 capital level of 10%, much higher than the 5.125% trigger for its outstanding AT1 CoCos. The ECB, however, had determined that the bank was "failing or likely to fail," a supervisory classification for banks that become unable to pay their debts or other liabilities as they come due.<sup>5</sup>

Another writedown of CoCos occurred in 2023, when FINMA (the Swiss Financial Market Supervisory Authority) sought to facilitate the purchase of Credit Suisse by UBS. As a result, the Credit Suisse AT1 CoCos

were written down to zero. However, in October 2025, one of the many appeal cases pertaining to this situation received a partial decision that revoked the original writedown decree. The case is still in the legal review process.

For both preferreds and AT1 CoCos, investors bear the risk that the securities they hold could be written down to zero at the discretion of a regulator. However, the same can be said for common equity investors of those same issuers.

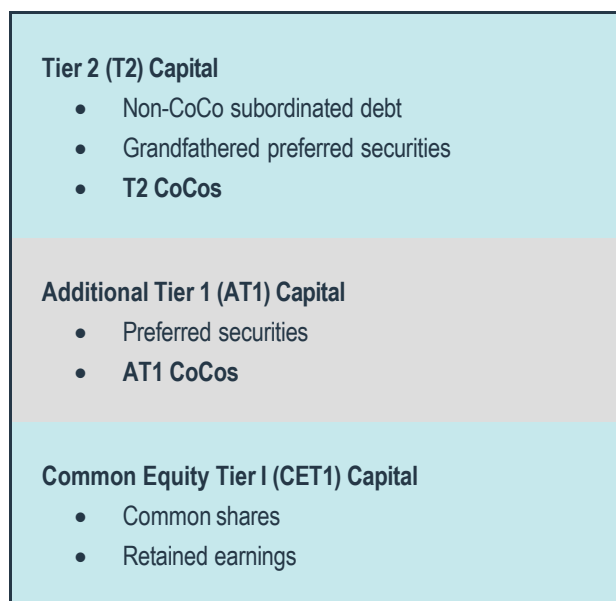
### Capital structure position

Under Basel III, the regulations that govern global banking institutions, total regulatory capital consists of:

- Common equity Tier 1 (CET1) capital
- Additional Tier 1 (AT1) capital
- Tier 2 (T2) capital

CoCos can be structured to qualify as either AT1 or T2 capital, depending on the particular security's features (see **Figure 2**). In the Basel III framework, all AT1 instruments must be perpetual, so most CoCos are issued without a stated maturity date, similar to U.S. preferred securities.

**Figure 2: Capital structure under Basel III**



Sources: Definition of Capital in Basel III, Bank for International Settlements; Nuveen.

### Differences between U.S. preferreds and CoCos

While CoCos are similar in structure to U.S. preferred securities, they have some key differences worth noting:

- **No “dividend-stopper” language.** Unlike most U.S. preferreds, AT1 CoCos (outside of Switzerland) lack dividend-stopper language, which mandates that a bond issuer will not pay a dividend if it stops coupon payments on its perpetual bonds.

While it might seem like a drawback that there's little dividend-stopper protection in the CoCo market, only three issuers have skipped an AT1 CoCo payment since the market's inception. In addition, the metrics that an AT1 CoCo issuer must meet to make AT1 CoCo payments are transparent and readily available, so investors may assess the likelihood (risk) of a skipped payment.

- **Payment deferral risk.** AT1 CoCos also have the ability to defer or eliminate interest/dividend payments if certain financial metric thresholds are breached, while U.S. preferreds are not bound to specific thresholds. This risk is also transparent, because issuers proactively publish the metrics that could potentially trigger a payment deferral, or investors can easily calculate these metrics themselves. As of June 2025, the average large bank in the western European Union (EU) held €8.6 billion in excess capital (see **Figure 4**).<sup>6</sup>

### Size of the CoCo market

The purposeful design of CoCos and the introduction of higher regulatory capital requirements have driven substantial growth in the market for these securities. Today, the combined face value of the AT1 and T2 CoCo market is near its terminal size (maximum required capital amount for existing banks) of over 300 billion (local currency).<sup>7</sup> This amount could fluctuate over time based on the size of bank balance sheets and/or changes to regulatory capital requirements.

### KEY INVESTMENT ADVANTAGES OF CoCos

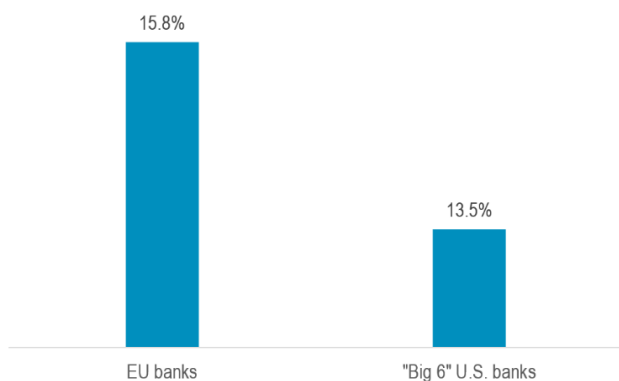
CoCos provide investors with a number of attractive features:

- **Established asset class.** Two major index providers — ICE and Bloomberg — track the CoCo market. The broad ICE BofA Contingent Capital Index includes securities issued in multiple currencies with an average market-weighted deal size of about 1 billion (local currency).<sup>8</sup>

- **Strong underlying issuer fundamentals.** Many European financial institutions that issue CoCos have stronger balance sheets than U.S. banks based on higher average CET1 levels and other measures (**Figure 3**).

**Figure 3. Stronger credit fundamentals for CoCo issuers**

*Average common equity Tier 1 (CET1) ratio*



Source: Barclays Research and company filings as of 30 Jun 2025, the most recent date for which this data is available. The "Big 6" U.S. banks consist of Bank of America, Citibank, Goldman Sachs, JPMorgan, Morgan Stanley and Wells Fargo.

Another way to evaluate the strength of CoCo-issuing European banks is to compare the size of their capital buffer relative to (a) their AT1 CoCo triggers and (b) minimum regulatory capital requirements. **Figure 4** shows that EU banks have healthy capital cushions underpinning their ability to make interest/dividend payments on outstanding CoCos.

**Figure 4. Healthy capital cushions**

Average capital buffer for EU banks	
Amount over regulatory minimum	€8.6 billion
% over regulatory minimum	4.4%

Source: Barclays Research as of 30 Jun 2025.

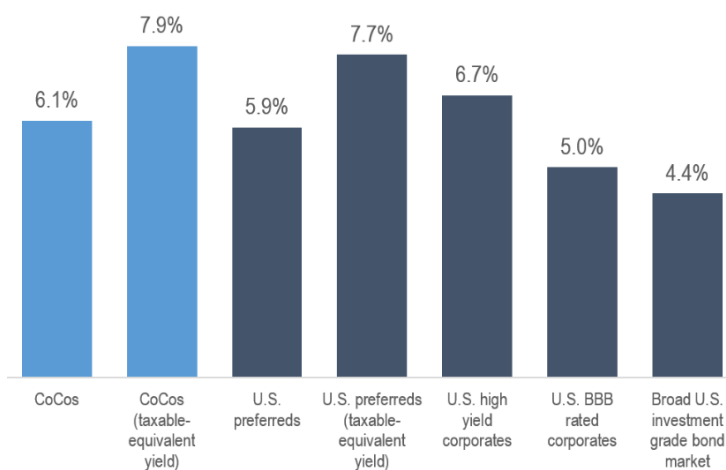
Low historical conversion and coupon deferral rates are also hallmarks of the CoCo market's financial strength. The only writedown of principal or conversion to equity in the AT1 CoCo market since the first CoCo was issued is

Banco Popular, as described on page 2. In contrast, high yield bonds and senior loans have both posted average default rates of 3.1% historically.<sup>9</sup>

- **Meaningful income from a mid-quality instrument.** CoCos are lower in the capital structure than traditional debt instruments, such as investment grade corporate bonds, and therefore may carry more risk. Investors in CoCos are compensated for this risk with a yield that is nearly as high as that of high yield bonds but well above those available in the broad investment grade bond market and on corporate debt rated BBB (see **Figure 5** below).
- **Qualified dividend income (QDI) eligible distributions.** In the United States, AT1 CoCo distributions are generally eligible for QDI treatment and eligible to be taxed at the lower capital gains rates. This makes their taxable-equivalent yield even more compelling.

**Figure 5. CoCos provide investors with attractive income**

*Yield to worst*



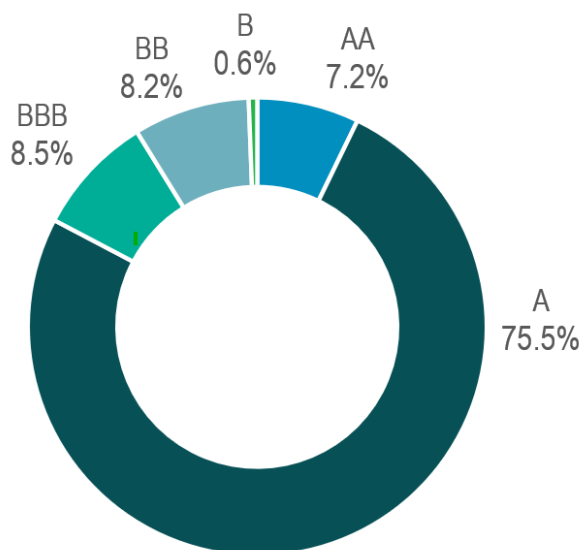
Sources: ICE BofA, Bloomberg LLC as of 30 Sep 2025.

Representative indexes: CoCos: ICE USD Contingent Capital Index; U.S. preferreds: ICE BofA U.S. All Capital Securities Index; U.S. high yield corporates: Bloomberg U.S. High Yield 2% Issuer Capped Index; U.S. BBB rated corporates: Bloomberg Investment Grade Corporate BBB Rated Index; Broad U.S. investment grade bond market: Bloomberg U.S. Aggregate Bond Index. For CoCos and U.S. preferreds, taxable-equivalent yield calculations assume all income is QDI-eligible and is taxed at the 20% QDI rate plus 3.8% Medicare surtax rate. The tax treatment of dividends is subject to change based on changes in tax rules and regulations.

- **Higher quality issuers.** While CoCos themselves are generally rated BBB (the lowest investment grade tier) to BB (the highest below investment grade tier), the issuers' senior ratings are typically four to five quality notches above that (**Figure 6**). For example, CoCos issued by global financial services firm HSBC were rated Baa3, while the company's senior unsecured debt was rated A3 as of 30 Sep 2025.

**Figure 6. Senior ratings of CoCo issuers**

Percentage of issuers rated ...

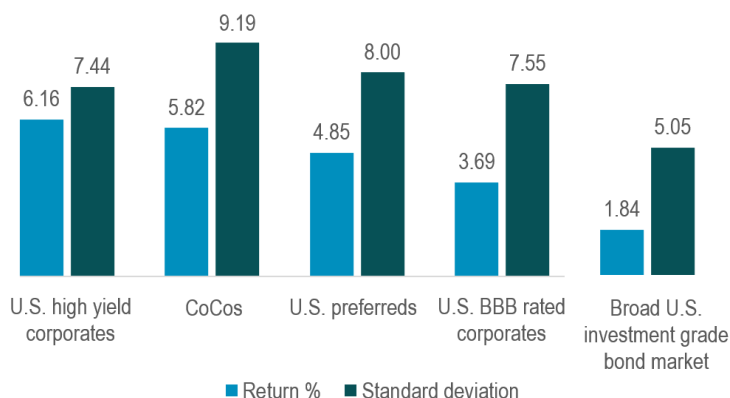


Source: ICE USD Contingent Capital Index as of 30 Sep 2025.

- **An attractive risk/return profile.** Given their income and quality profile, it is not surprising that CoCos historically have delivered better returns than preferred securities and other mid-quality asset classes, albeit with moderately higher risk as measured by standard deviation (**Figure 7**).

**Figure 7. CoCos: an attractive risk/return profile**

Returns (%) and standard deviation



Source: Morningstar Direct 10 years ending 30 Sep 2025.

Representative indexes: CoCos: ICE USD Contingent Capital Index; U.S. high yield corporates: Bloomberg U.S. High Yield 2% Issuer Capped Index; U.S. preferreds: ICE BofA U.S. All Capital Securities Index; U.S. BBB rated corporates: Bloomberg Investment Grade Corporate BBB Rated Index; Broad U.S. investment grade bond market: Bloomberg U.S. Aggregate Bond Index.

## CONCLUSION

We believe CoCos offer several investment advantages. They have developed into a large, liquid market, are supported by strong issuer credit fundamentals, provide generous income for a mid-quality investment and have an attractive risk/return profile. However, given their relatively complex structure, CoCos are best suited for actively managed strategies backed by deep research capabilities.

**For more information, please visit us at [nuveen.com](https://nuveen.com).**

#### Endnotes

- 1, 2 Source: ICE BofA Contingent Capital Index, 30 Sep 2025
- 3 Source: ICE BofA Contingent Capital Index, 30 Sep 2025
- 4 Source: Barclays Research, 30 Jun 2025
- 5 The Single Resolution Board, the European Banking Union's resolution authority, exercised its power to resolve Banco Popular in a way that facilitated its transfer to Banco Santander. Equity and subordinated bondholders were wiped out, but preferred senior debt was spared. Source: Morgan Stanley, the EU's First Resolution, June 7, 2017.
- 6 Source: Barclays Research, 30 Jun 2025
- 7 Source: ICE BofA Contingent Capital Index, 30 Sep 2025
- 8 Source: ICE BofA Contingent Capital Index, 30 Sep 2025
- 9 Source: JPMorgan as of 30 Sep 2025

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