SPECTRUM
Asset Management

Dividend Discussion – The Sequel

March 30, 2020

The European Central Bank (ECB) issued a 'recommendation' (in practical terms, issued an order) on Friday last week, 27 March, that European Union banks should "refrain from making dividend distributions and performing share buy-backs aimed at remunerating shareholders during the period of the COVID-19-related economic shock." This would last at least until the end of September 2020. No mention was made of any recommendation to halt scheduled payments on AT1 or similar securities. The stated reason behind this ECB recommendation was to preserve capital and provide resources for banks to support borrowers and the European economy. Yesterday, Rabobank, a leading Dutch bank, issued a statement that, in keeping with this ECB recommendation, it would not pay distributions on its Certificates planned for March, June and September this year. Rabobank is a mutual and, as such, has an unusual capital structure. These Certificates are, as a practical matter, common equity, though they have set payments at pre-arranged dates. **Rabobank did *NOT* say that it intends to skip payments on its AT1 securities.**

Prior to this ECB recommendation, several banks in other nations, such as Spain, Portugal and the Nordic area, have taken, or are in the process of taking, similar steps. We would expect more such dividend actions to be taken in coming days, and by non-EU zone banks in Europe as well.

What does this mean for AT1s? Spectrum does not believe that a regulatory decision to pass on AT1 payments will occur. The cash amount saved would be modest. As well, passing on AT1 payments in the absence of a clear and specific solvency challenge sends a message of weakness when strong banks are what the economy needs – and is not what AT1s were designed to do. Furthermore, a blanket failure to promptly service AT1s would increase the long-term cost of capital for banks as the market would infer a higher risk profile to AT1s. In addition, the COVID-19-induced downturn is expected to be a short, albeit sharp, event with a strong recovery, and thus more of an earnings story for banks rather than a capital one. Plus, deferred common dividends can be made up later when this crisis is over, unlike passed AT1 payments. **An AT1 payment stoppage is a highly unlikely event in the near term.**

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