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Piraeus Bank is expected this week to have to convert its state-held contingent convertible bonds (CoCos) into equity, which will put the firm under Greek government ownership. The move comes after the Single Supervisory Mechanism refused the issuer's request to settle its bond coupons in cash.

Piraeus had intended to honour the 8% annual coupon on its €2.04bn of government CoCos, which would have cost it about €165m, or 40bp in capital terms.

But the bank said on Monday that the SSM had declined its request to be able make the payment, due on December 2.

The governing council of the European Central Bank is expected to confirm the SSM's decision in the next few days.

Piraeus has already missed a cash payment on its CoCos once, in 2018. A failure to pay the coupon for a second time will lead to the conversion of the debt into ordinary shares, in line with the terms and conditions of the bonds.

This will increase the Greek government's shareholding in Piraeus from 25.4% to 61.3% — a massive dilution of its private owners.

The CoCo conversion will be the first major supervisory capital action for a European bank since the start of the coronavirus pandemic.

Piraeus has been keen to stress that it complies with all of its minimum capital targets. It has reported a total capital ratio of 16.1% of risk-weighted assets, versus a requirement of 11.25% for 2020.

The bank said the SSM had instead taken its decision on the CoCos with reference to its “recommendation towards all European banks not to distribute capital during the ongoing Covid-19 crisis”.

Banks have been asked not to pay equity dividends at all this year, though they have been permitted to pay coupons on their additional tier one (AT1) securities.

Piraeus Bank’s CoCos are structurally similar to AT1s, but they act like shares on the balance sheet, given that they count as common equity tier one (CET1) resources for capital purposes.

Looking on the bright side

The issuer has a number of privately-held tier twos outstanding in the euro market.

Its €500m 10 year non-call five tier — sold at par in February with a coupon rate of 5.5% — is now being quoted at cash prices in the 50s, to yield more than 20%.

"The tier twos are certainly trading down," said a bank capital expert. "But you couldn’t really say they are reflecting a risk of non-viability."

A conversion of debt into equity implies that a bank is in a crisis scenario.

But Piraeus highlighted in a statement on Monday that its capital position would be “materially improved” by the latest developments.

It said that it would make €495m a year in coupon savings, which could “facilitate the bank’s NPE reduction strategy in the forthcoming period”.

Piraeus is working to securitize €7bn of problem assets as part of its plan to deal with non-performing exposures (NPEs).

It believes this exercise will bring its ratio of non-performing exposures (NPEs) down from 48% of total loans to somewhere in the single digits.

Analysts at Fitch Ratings have been very concerned by the bank’s lack of provisioning for its bad loans.

They said in their latest report on Piraeus that unreserved impaired loans represented about 220% of its CET1 resources.

"Any potential capital increase that could accelerate balance-sheet clean-up, reducing current exposition to unreserved problem assets, would be positive for the credit profile of the bank in our view," Pau Labro, a director in the financial institutions team at Fitch, told GlobalCapital earlier this month.