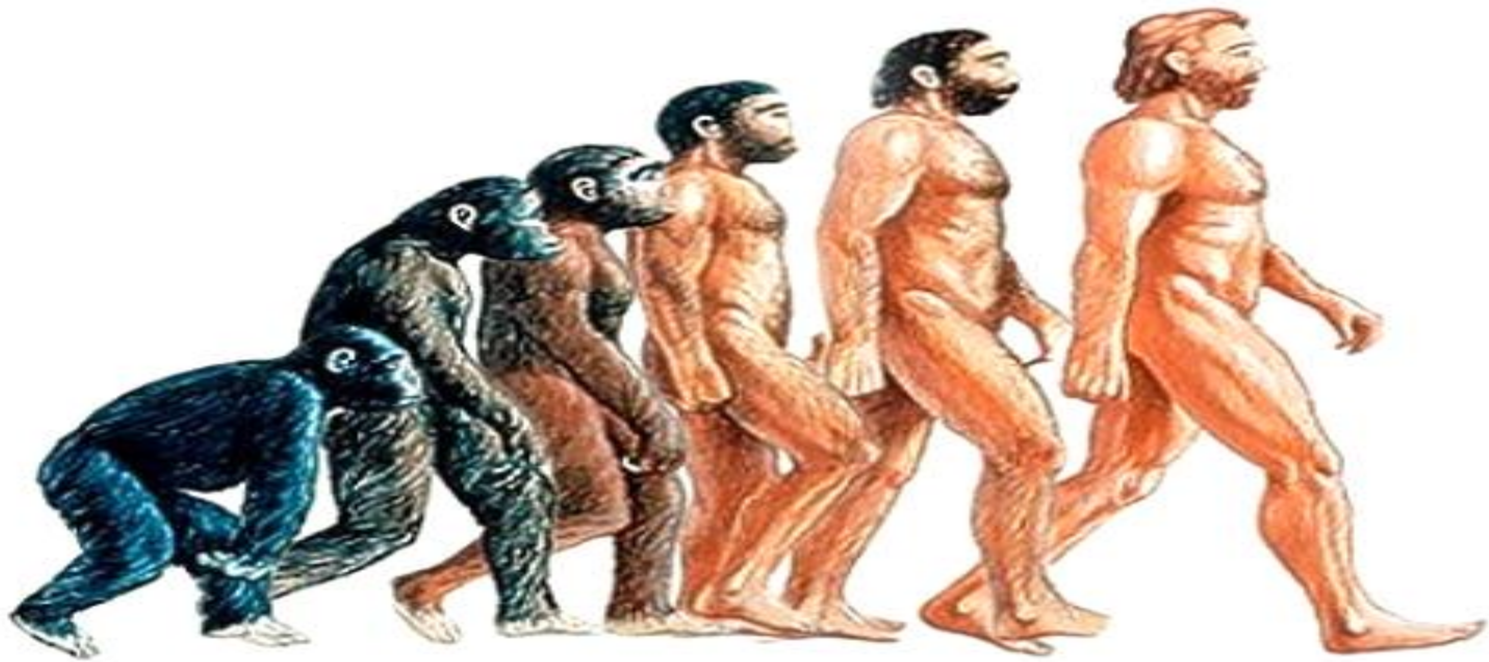
Hybrid Tier Is Evolution: From CRD I to CRD IV / CRR

Federico Ravera – Head of Strategic Portfolio, Group Finance

Milan, ottobre 15, 2013

Hybrid Tier 1s evolution: from CRDI to Basel III / CRDIV



Tier Is CRD I	Tier Is CRD II	Tier Is CRDIV / Basel III
Issued mid 90's - 2009	Issued from 2010	Issued from 2013
Low ability to Absorb losses	Intermediate ability to Absorb losses	High ability to Absorb losses

Hybrid Tier 1s evolution: From CRDI to Basel III / CRDIV

- There are two ways of absorbing losses:
  - I. **Coupon payment cancellation** and/or
  - II. **Principal value reduction**, to be achieved via:
  - (a) temporary write-down; (b) permanent write-off; (c) conversion into shares

- Tier 1s instruments may be divided into 3 categories, based on their loss absorbency capacity:

➢ **Tier 1s CRD I** compliant:
- High Incentives to redeem: Call Option & Step up
- **Mandatory Coupons:** unless net loss or no share-dividends
- Dividend pushers / Stoppers (with extensive look back period)
- **Loss Absorption: Temporary write-down**

→ Low ability to Absorb losses

➢ **Tier 1s CRD II** compliant: UGCM 9.375
- Low Incentives to redeem: limited / no Step up
- **Discretionary Coupons**: Bank / Regulator may cancel payment
- Dividend pushers / Stoppers: more limited and shorter look back period
- **Loss Absorption**: **Temporary write-down**

→ Intermediate ability to Absorb losses

➢ **Tier 1s Basel III / CRDIV**: SOCGEN 8.125
- No incentives to redeem
- **Fully Discretionary Coupons**
- No dividend pusher / stopper
- **Loss Absorption: Temporary write down (with stringent write up)**

→ High ability to Absorb losses

Hybrid Tier 1s Main Features: How they evolved

Main Features	CRD I	CRD II	CRD IV / CRR
Maturity	Dated with minimum 30 years / Perpetual	Perpetual	Perpetual
Call Options	10 years	Min 5 years	Min 5 years
Coupon Payment	Mandatory unless very specific situation (net losses, TCR < min, etc)	Discretional, but mandatory payment in certain cases	- Fully discretional & non-cumulative . - Limited by the Maximum Distributable Amount
Step Up	Permitted	Permitted, up to 100bps	Not Permitted
Dividend Pusher	Full Dividend Pusher: <u>12-month look back period</u>	Limited Dividend Pusher: <u>3-month look back period</u>	Not Permitted
Dividend Stopper	Permitted	Permitted (best effort basis)	Not Permitted
Principal Write down	Temporary: When the TCR falls below the minimum requirements or the Regulator requires to do so	Temporary: *Pari passu and pro rata with the* Bank's share capital when Tier 1 < 6% or the Regulator requires to do so	Temporary / Permanent or conversion into shares: when CET1 < 5.125% or in case of non-viability.
Write up	Even if the write down is just temporary, write up mechanism is not clear ….	*Pari passu and pro rata with the* Bank's share capital; and within the limits of the available distributable profits	- Discretional - Slow -Limited by Maximum Distributable Amount

New Style Tier 1s: Conversion, Permanent or Temp write-down

Selected Tier 1 Instruments	BBVA	BARCLAYS	SOCIETE GENERALE	CRÉDIT AGRICOLE
Issue Date	Apr-13	Apr-13	Apr-13	Sep-13
Amount	USD 1.5bn	USD 1bn	USD 1.25bn	USD 1bn
Coupon	9%	7.75%	8.250%	8.125%
Structure	Perpetual Convertible Tier 1	Contingent Capital Notes	Perpetual Tier 1	Contingent Capital Notes
Host Instrument	Tier 1 (Perp NC5)	Tier 2(10NC5)	Tier 1 (Perp NC5)	Tier 2(20NC5)
Trigger	CET1 < 5.125%, Capital Principal & EBA CT1 < 7%,Tier 1 ratio < 6%	CET1 or CT1 < 7%	CET1 or EBA CT1< 5.125%	CET1 or CT1 < 7%
Loss Absorption	Conversion	Permanent write down	Temporary write down	Permanent write down
Features	Conversion of principal into a variable number of shares	Upon breach of trigger, a permanent principal write down	Upon breach of trigger, a permanent principal write down and then discretionary write up	Upon breach of trigger, a permanent principal write down
PONV Approach	Contractual PONV	Risk factor	Risk factor	Risk factor

- **Conversion into shares** preferred **vs Permanent write-off**
  1. Preferred options for investors => It gives a potential upside
  2. Less attractive for issuers => it is a potentially dilutive instrument
  3. It creates a mixed debt/equity instrument which could attract demand from equity and credit investors

- **Temporary Write Down / Write Up**
  1. Write down when CET1 < 5.125% => going concern or gone concern trigger?
  2. Point of Non-Viability may be triggered earlier
  3. Write up is discretionary, proportional and limited by the distributable profits

Conversion into share is preferred over Permanent write-off
Temporary write down provides a (limited) upside to investors

New Style Tier 1s in Italy: Open Issues

- In order to be able to issue either a convertible or a write-down new style AT1 within the Italian framework, there are still a number of obstables that need to be overcome
- Accounting treatment
  - is it equity or debt accounted?
- Tax treatment
  - Are interest payment tax deductible?
  - What could it happen in case of write down?
- What are the legal constraints in case of a convertible instrument?
- What are the funding needs of Italian Banks?
- What is the market capacity?