



# Pricing and Structuring Data-points on New Generation Capital Instruments

Prepared by: HSBC

Date: October 2013



# New World Order

## Assessing Risk of New Generation Capital Instruments

### Basel I / II

*Capital instruments expected to have limited recovery in liquidation*

*Credit Analysis focussed on Default Probability*

*Same for Tier 1 & Tier 2*

*What is my Loss Given Default ?*

*Same with Tier 1 & Tier 2 + Clear Credit Hierarchy*

### Basel III

*Capital instrument claims may no longer exist in their original form in liquidation due to NVLA provisions*

*New Probabilities: Ratio Breach, Point of Non-Viability, etc*

*Gone Concern  
Tier 2*

*Going Concern  
Tier 1 OR Tier 2*

*What is the format of loss absorption ?*

*Conversion  
(T1 / T2)*

*Write down +  
Write up (T1 / T2)*

*Write off  
(T1 / T2)*

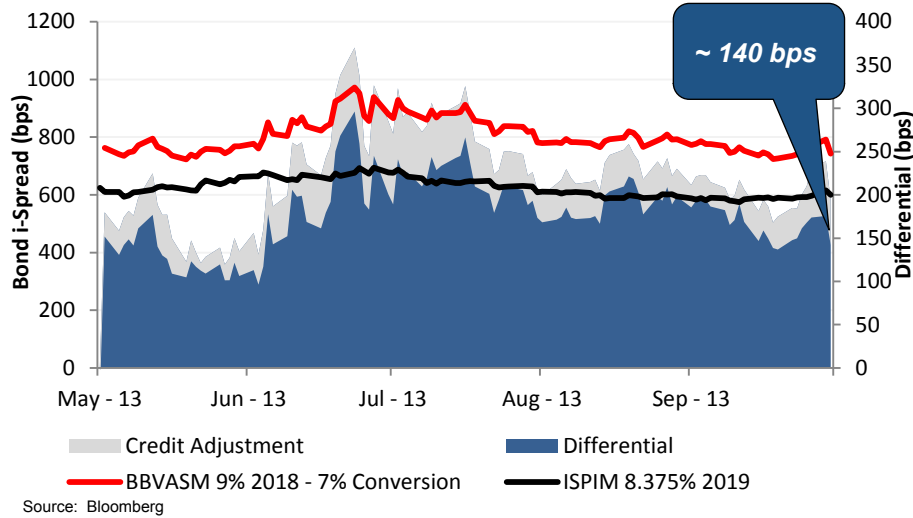
**New frameworks and instrument structures involve a re-assessment of risk**

**Lack of contractual protections may force an 'equity-like' view to be taken on management intent**

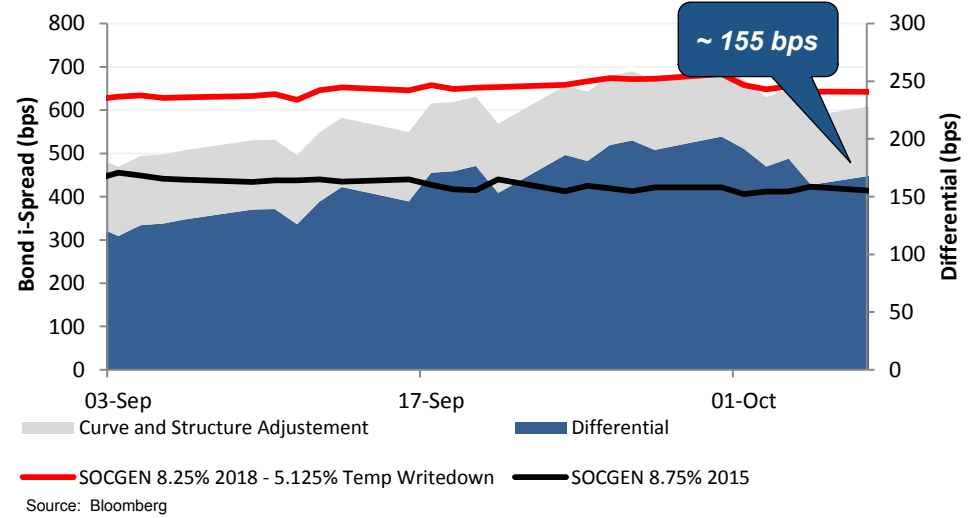
# Cost of New Style Additional Tier 1 Features

## A Look at AT1 Data-Points

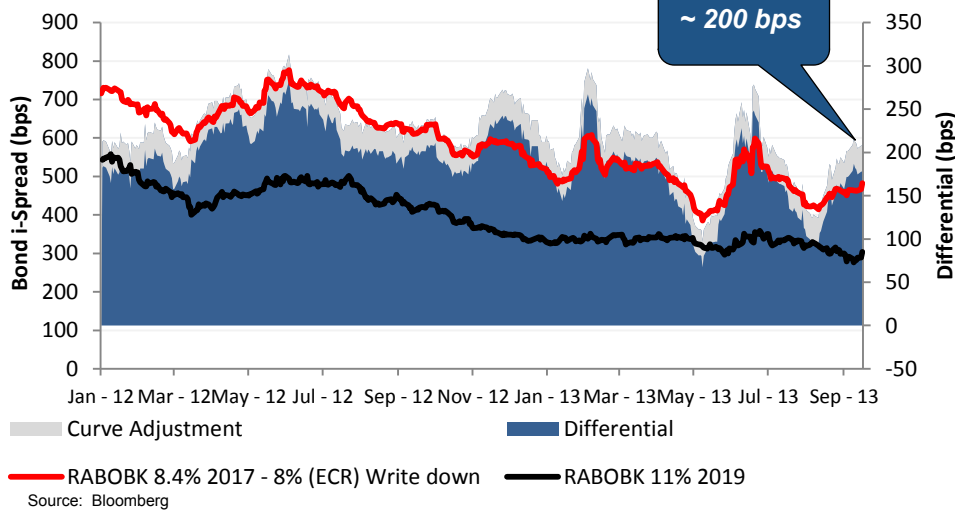
**Basel III AT1 Vs “Old Style” (Conversion Structure)**



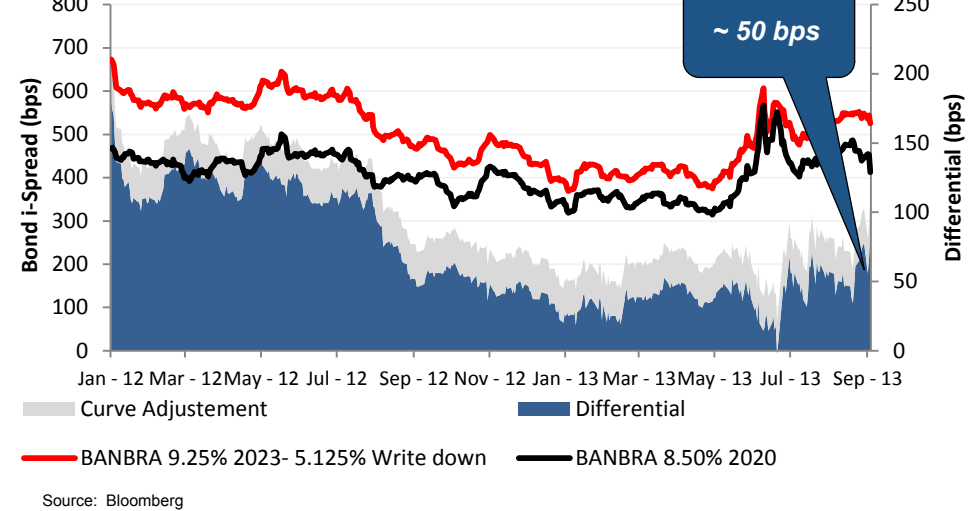
**Basel III AT1 vs “Old Style” (Temporary Write-Down)**



**Basel III AT1 Vs “Old Style” (Permanent Write Down) - Europe**



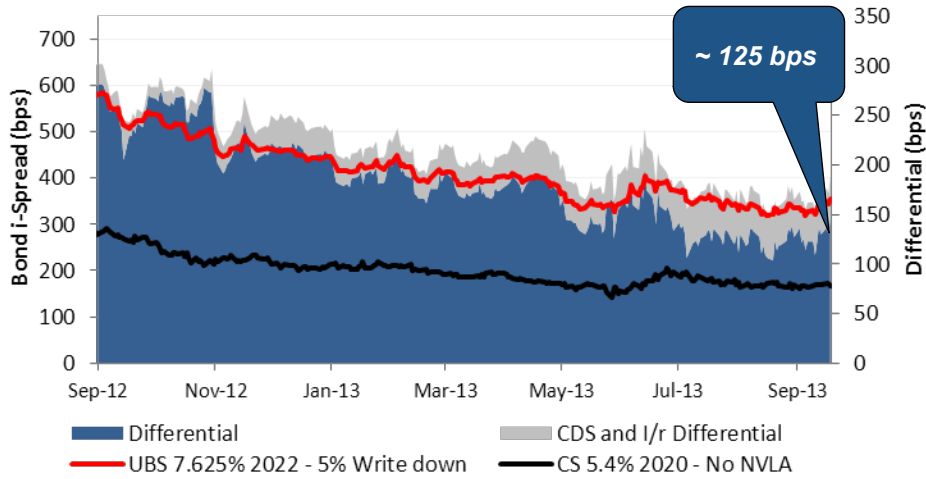
**Basel III AT1 Vs “Old Style” (Permanent Write Down) - Brazil**



# Cost of Basel III Features

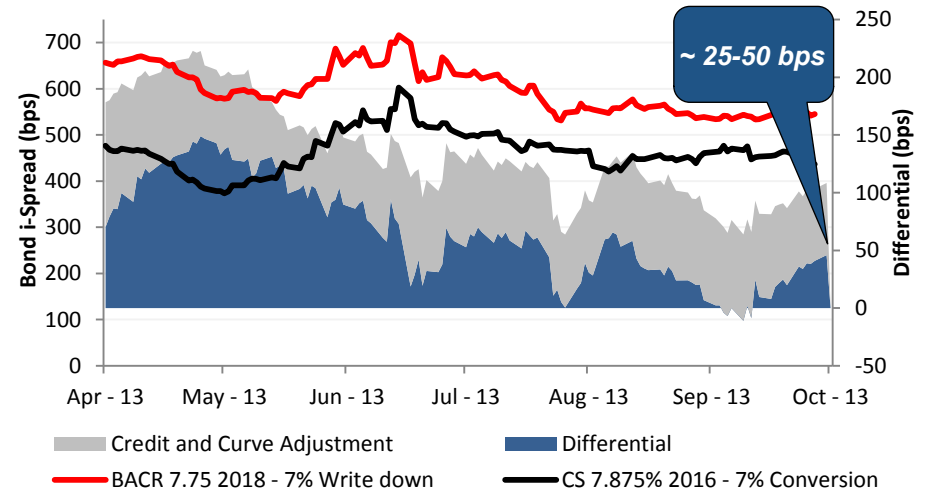
## What Can we Learn from the CoCo Market ?

### Cost of a "Low Trigger" (5% CET1) + NVLA in Tier 2



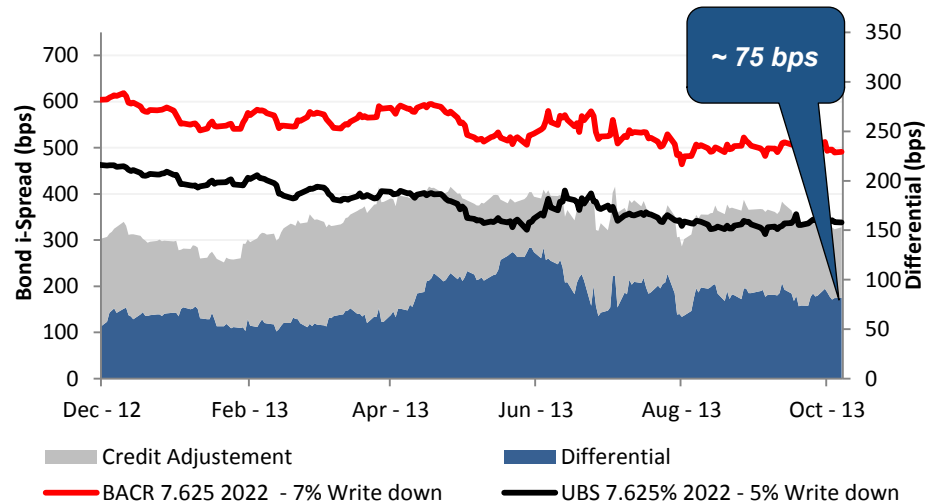
Source: Bloomberg

### Conversion vs. Permanent Write Down in Tier 2



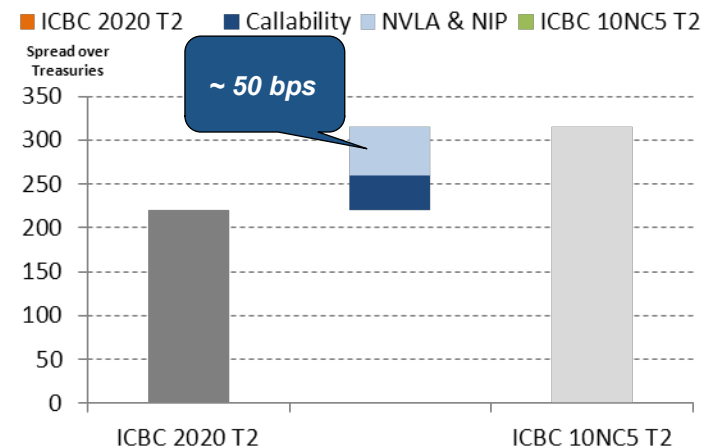
Source: Bloomberg

### "High" (7.0% CET1) vs. "Low" (5.0% CET1) Trigger in Tier 2



Source: Bloomberg

### Non-CET1 Based Non-Viability Trigger in Tier 2



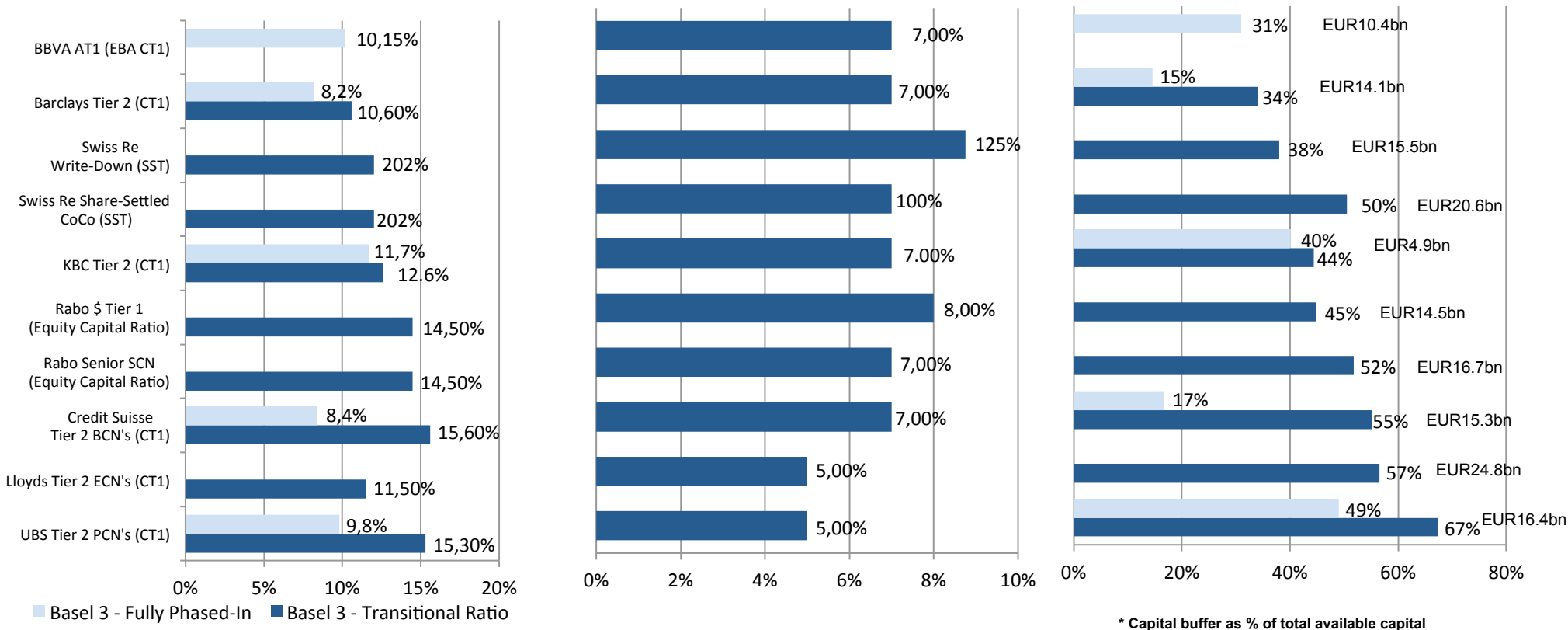
# “Capital Buffer” above Trigger for CoCo Precedents

Current instruments have between 31% and 67% “Capital Buffer”, will instruments below or above this range also price efficiently ?

Actual ratio of issuer

Trigger ratio

Actual vs trigger ratio: Capital Buffer\*



- Issuers are comfortably in excess of the respective capital ratio trigger ratios
- However, Resolutions/bail-ins may be initiated prior to any breach of capital ratio triggers

Capital Headroom of Sample  
(% of CT1 capitalisation)

Average

47%

# European AT1 Structures

## Emerging Homogeneity in Structures or Bespoke Structures for Each Issuer ?

Coupon and call structures relatively homogeneous thanks to the new European regulations permitting limited choice (no step-ups permitted and 5 year minimum non-call period).

Principal loss absorbency mechanisms and triggers are less homogeneous given the higher degree of choice.

Issuer call rights are broadly similar but vary somewhat from transaction to transaction.

	Banco Popular	Société Générale	BBVA
ISSUE DATE	Oct-13	Aug-13	May-13
SIZE / COUPON	EUR 500m / 11.50%	USD 1.25bn / 8.25%	USD 1.5bn / 9%
FORMAT / STATUS	Tier 1 / Deeply Subordinated Notes	Tier 1 / Deeply Subordinated Notes	Tier 1 / Deeply Subordinated Notes
MATURITY	Perpetual	Perpetual	Perpetual
COUPON RESET	2018 and every 5 years	2018 and every 5 years	2018 and every 5 years
STEP-UP	None	None	None
OPTIONAL DEFERRAL	Non-cumulative at the Issuer's full discretion (no pushers, no stoppers)	Non-cumulative at the Issuer's full discretion (no pushers, no stoppers)	Non-cumulative at the Issuer's full discretion (no pushers, no stoppers)
ISSUER CALL	At year 5 and then at any time thereafter	2018 and every reset date there after (5 years)	2018 and any time thereafter
PRINCIPAL LOSS ABSORPTION MECHANISM	Conversion	Temporary Write down	Conversion
PRINCIPAL LOSS ABSORPTION TRIGGER	<ol style="list-style-type: none"> <li>CET1 Capital ratio of the Bank falling below 5.125% or;</li> <li>Tier 1 &lt;6.0% &amp; decreased by one third reduction in reserves over 4 quarters due to losses</li> </ol>	<ol style="list-style-type: none"> <li>Prior to CRDIV implementation EBA CT1 ratio, &lt; 5.125%;</li> <li>After CRDIV implementation CET1 ratio &lt; 5.125%</li> </ol>	<ol style="list-style-type: none"> <li>CET1 &lt; 5.125%;</li> <li>EBA CT1 ratio, &lt; 7.000%;</li> <li>Capital Principal ratio, &lt; 7.0%</li> <li>Tier 1 &lt;6.0% &amp; decreased by one third reduction in reserves over 4 quarters</li> </ol>
NON-VIABILITY LOSS ABSORPTION MECHANISM	Write off or Conversion via statutory regime (Risk factors)	Write off or Conversion via statutory regime (Risk factors)	Conversion via terms and conditions
REGULATORY CALL	Yes, at Par (full disqualification from capital)	Yes, at Par (full or partial disqualification from capital)	Yes, at Par (full or partial disqualification from capital)
TAX EVENT CALL	Yes, at Par	Yes, at Par	Yes, at Par

Sources: Offering Circulars

# European Tier 2 Structures – Relative Homogeneity thanks to Loss Absorbency Achieved through future EU Bail-In Legislation

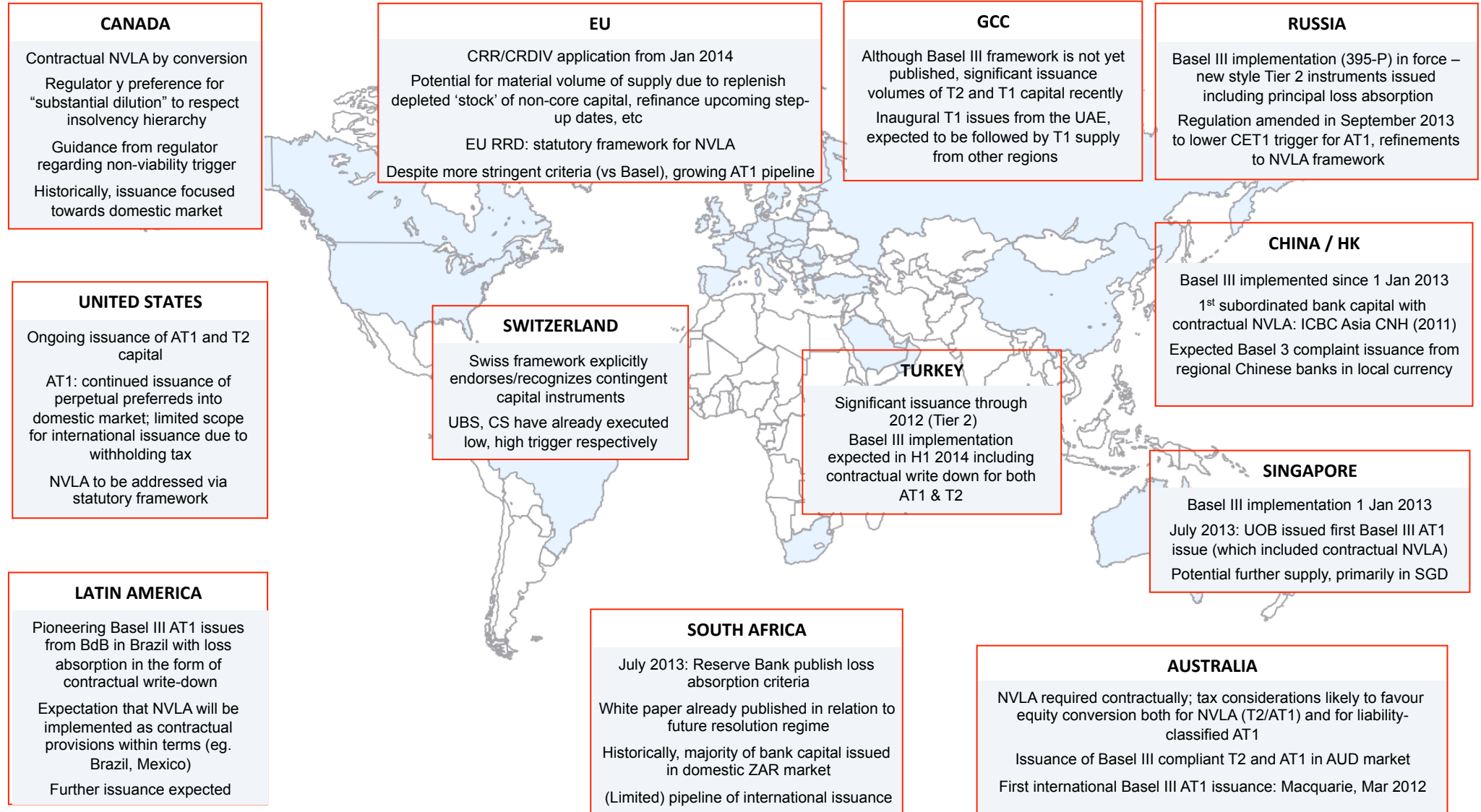
BUT: Triggers May Still Be Activated by National Regulators

	Danske Bank	DNB	HSBC	Rabobank	BPCE	Societe Generale	Nationwide
<b>ISSUE DATE</b>	Sep-13	Sep-13	Sep-13	Jul-13	Jul-13	May-13	Mar-13
<b>SIZE / COUPON</b>	EUR 1bn / 3.875 %	EUR 750m / 3.000%	EUR 1.5bn / 3.375%	EUR 1bn/ 3.875%	EUR 1bn/ 4.625%	EUR 1bn/ 4.000%	EUR 1.25bn / 4.125%
<b>MATURITY</b>	10 years	10 years	10.25 years	10 years	10 years	10 years	10 years
<b>ISSUER CALL</b>	2018 (one time)	2018 (one time)	2019 (one time)	None	None	None	2018 (one time)
<b>COUPON RESET</b>	2018	2018	2019	None	None	None	2018
<b>STATUS</b>	Subordinated	Subordinated	Subordinated	Subordinated	Subordinated	Subordinated	Subordinated
<b>NON-VIABILITY LOSS ABSORPTION MECHANISM</b>	Could be subject to write-off or share conversion under future EU regulation*  Documented in risk factors	Could be subject to write-off or share conversion under future EU regulation  Documented in risk factors	Could be subject to write-off or share conversion under future EU regulation  Documented in risk factors	Could be subject to write-off or share conversion under future EU regulation  Documented in risk factors	Could be subject to write-off or share conversion under future EU regulation  Documented in risk factors	Could be subject to write-off or share conversion under future EU regulation  Documented in risk factors	Could be subject to write-off or share conversion under future EU regulation  Documented in risk factors
<b>SUBSTITUTION AND VARIATION</b>	None	None	None	None	None	Yes	None
<b>REGULATORY CALL</b>	Par, partial disqualification	Par, full disqualification	Par, full disqualification	Par, full disqualification	Par, full disqualification	Par, full disqualification	Par, full disqualification
<b>TAX EVENT CALL</b>	Par	Par	None	Par	Par	Par	Par

\* Also contains contractual gone concern loss absorption in the form of write down after Equity and Tier 1 are written down – in line with current Danish Tier 2 criteria  
Sources: Bloomberg, offering documentation

# Bank Capital Development

## Taking a Look at the Global Picture

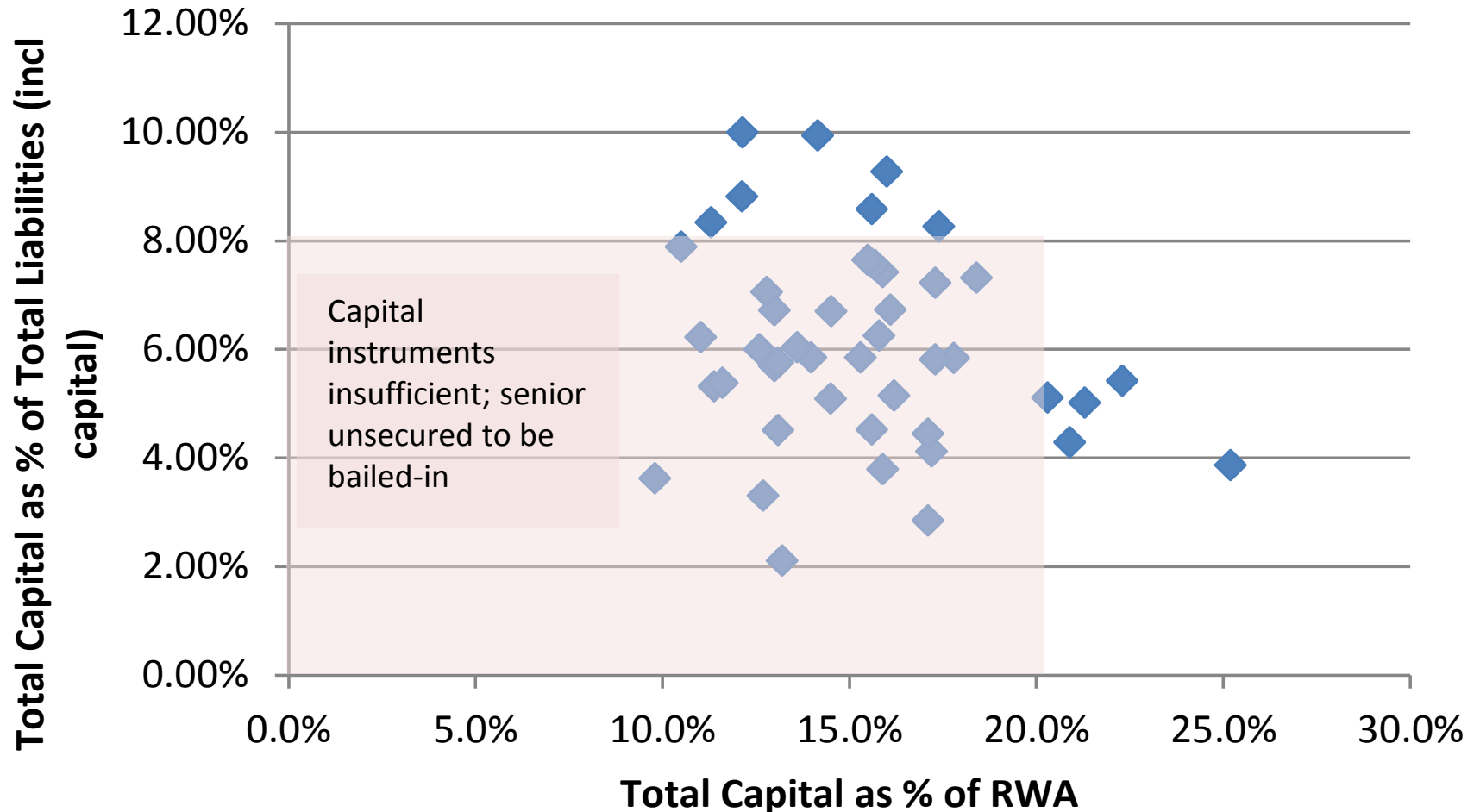




# 8% of Total Liabilities / 20% of Risk Weighted Assets Minimum Bail-In

Analysis of Impact of Draft EU Bail-In Directive on a EU Bank Sample

## Minimum Bail-in Requirements



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