

Bank+Insurance HybridCapital

Jul-Aug 2014

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CORPORATE & INVESTMENT BANK



Team UK

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regulatory headwinds

CASA
AT1 commitment

UniCredit
Quality over quantity

Coming of age
Corporate special with Bayer & EDF



We offer you our world of solutions ✓

SEPTEMBER 2014


CRÉDIT AGRICOLE S.A.
CRÉDIT AGRICOLE S.A.
USD 1,250,000,000
6.625% Additional Tier One
PerpNC5
Global Coordinator and
Sole Bookrunner

SEPTEMBER 2014


HSBC
HSBC HOLDINGS PLC
USD 1,500,000,000
5.625% Additional Tier One
PerpNC5
Joint Lead Manager

SEPTEMBER 2014


hannover re
HANNOVER RÜCK SE
EUR 500,000,000
3.375% / 3mE+325bp
Subordinated Notes
PERP NC 2025
Joint Bookrunner

SEPTEMBER 2014


UniCredit
UNICREDIT S.P.A.
EUR 1,000,000,000
6.75% AT1
PerpNC7
Joint Bookrunner


MAY 2014


CNP ASSURANCES
EUR 500,000,000
4.25% 31NC11
Subordinated Notes
Due 2045
Joint Bookrunner

MAY 2014


**LANDESBANK
BADEN-WÜRTTEMBERG**
EUR 500,000,000
2.875% 12NC7 Tier 2
Subordinated Notes
Due 2026
Joint Bookrunner


MAY 2014


Bankia
BANKIA
EUR 1,000,000,000
4.00% 10NC5 Tier 2
Subordinated Notes
Due 2024
Joint Bookrunner


MAY 2014


BANCO SANTANDER S.A.
USD 1,500,000,000
6.375% AT1
Perp NC5
Joint Bookrunner

APRIL 2014


WOORI BANK
WOORI BANK
USD 1,000,000,000
4.75% Tier 2
Subordinated Notes
Due 2024
Joint Bookrunner


APRIL 2014


CRÉDIT AGRICOLE S.A.
CREDIT AGRICOLE S.A.
GBP 500,000,000
7.5% AT1Perp NC12
Joint Bookrunner
Global Coordinator and
Structuring Advisor

FEBRUARY 2014


UBS
UBS AG
EUR 2,000,000,000
4.75% 12NC7 Contingent
Capital Subordinated Notes
Joint Bookrunner

JANUARY 2014


AXA S.A.
AXA S.A.
GBP 750,000,000
5.625% 40NC20
Subordinated Notes
Joint Bookrunner

Choose a bank which engages its expertise in hybrid capital for
the sole benefit of serving its clients.



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Crédit Agricole took its total AT1 issuance to some Eu3.8bn with a \$1.25bn deal on 11 September. Olivier Bélorgey, head of the financial management department, Crédit Agricole, and Bernard du Boislouveau, head of FI DCM France, Crédit Agricole CIB, discuss how Crédit Agricole is building its franchise in the hybrid market.



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The UK has led the way in new-style bank capital instruments and sterling issuance has found its way into investors' portfolios, but the pace of regulatory change has brought with it uncertainty. A difficult summer has meanwhile thrown up many questions about the asset class. Leading players gathered in London on 2 September to discuss the latest developments.

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Italy's UniCredit launched its second AT1 transaction, a €1bn issue, into a hesitant post-summer market. Waleed El Amir, head of strategic funding and portfolio at UniCredit, gives his take on the changing dynamics of the market.

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Issue and be damned



Publish and be damned. Quite. With comic timing, our last issue of *Bank+Insurance Hybrid Capital* went to press with an iteration of an oft-used post-crisis rhetorical question: “Correction? What correction?”

That Banco Espírito Santo would collapse as the ink was drying on that publication was, of course, unpredictable. But perhaps the serious correction that followed over the summer was not.

The Portuguese bank’s woes may have been “idiosyncratic” (or simply idiotic) but it did not take a genius to see that the inflation of AT1 order books and prices was setting the market up for a fall. That duly arrived when BES combined with other factors to undermine the market’s props. Rising geopolitical tensions in Ukraine and the Middle East and the ejection of AT1s from key Bank of America Merrill Lynch indices made matters worse, and price falls and volatility were further exacerbated by forced sellers in a thin summer market.

But wait — didn’t Nordea just price an AT1 with the lowest coupon ever?

It is true that the Swedish bank’s 5.5% set a new coupon low only days after HSBC reminded us of the glory days of AT1 with a multi-billion book.

However, these investment grade gems may prove the exception rather than the rule in a market that has sobered up. Witness the difficulty faced by Santander in reopening the market, as shown by its disappointing aftermarket performance. That and other deals suggest that investors have learned that AT1 is no one way bet.

So while debutant, rare or highest quality issuers may still be able to reel in investors and yields, second tier and repeat issuers are going to have to tread a lot more carefully. Banks may well have to choose between price or size, and not be so greedy that they help themselves to both. If they do, the secondary market is likely to hold up their avarice for all to see.

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Market news

AT1 restart tough, but HSBC revives sentiment

The AT1 market reopened only hesitantly after a difficult summer when the first new issue from the asset class, a Eu1.5bn deal from Santander, generated lukewarm demand and traded down in the aftermarket, although debut deals from HSBC and Nordea soon helped get the sector back on track.

Heading into the quiet summer period, the market had to contend with the fallout from the collapse of Banco Espírito Santo (BES).

The most immediate impact of the Portuguese bank's woes came on 10 July when Banco Popular Español (BPE) had to pull an AT1 issue it was in the midst of launching.

The Lower Tier 2 market then bore the brunt of the fallout from BES when junior bondholders were bailed in as part of a rescue plan, being left with the rump bad bank, while senior creditors were transferred to a new entity, Novo Banco.

Persistent flare-ups in the Ukraine crisis, the ejection of AT1 from Bank of America Merrill Lynch indices, and concerns expressed by UK authorities about the sale of the instruments to certain investor classes all added to a difficult summer, with market participants saying that thin trading exacerbated volatility.

Santander was the then the first issuer to take the plunge into a post-summer AT1 market that was expected to be potentially less receptive to the instrument than the successes of the start of the year.

Those fears were more than realised when Santander's perpetual non-call seven issue attracted Eu3bn of demand and, after pricing a Eu1.5bn issue, the deal performed disappointingly in the aftermarket.

"It's fairly priced, but there's no real premium," said an investor, "and given that it is the first deal after the summer lull, I think every investor wanted a little



bit of love to help bring some confidence back into the market."

The order book compared with more than Eu15bn of demand for an inaugural AT1 in March — although that deal also hit the market at a difficult time and other investors noted that Santander was a tricky name.

UniCredit launched a Eu1bn perp non-call seven AT1 the following day, adopting a more pragmatic approach,

Every investor wanted a little bit of love to help bring some confidence back

being careful about pricing and sizing a modest transaction, and was rewarded with a better performance in spite of garnering a smaller order book than its Spanish peer.

"Investors at the moment do not like large deals because it just means that there are potentially more loose bonds, and it doesn't take a lot of sellers to really move a price very much in a thin market," said Waleed El Amir, head of strategic funding and portfolio at UniCredit. (See Q&A for full coverage).

Investment grade fervour
Echoes of the glory days of the mar-

ket at the start of the year were ultimately provided by an inaugural and investment grade \$5.6bn equivalent (Eu4.36bn, £3.43bn) AT1 for HSBC on 10 September.

Rated Baa3/BBB, the deal amassed more than \$30bn of demand, some three-quarters of that for two US dollar tranches, and the balance for a Eu1.5bn euro piece. The larger, US dollar portion was split into \$1.5bn of 5.625% perpetual non-call fives and \$2.25bn of 6.325% perpetual non-call 10s, while the euro was a 5.25% perpetual non-call eight.

"HSBC was a sizeable landmark trade, one of the few AT1 transaction performing in the secondary market," said Vincent Hoarau, head of FIG syndicate at Crédit Agricole CIB. "The euro and two US dollar tranches are trading above par in secondary since the break. The long-dated US dollar tranche is performing better in the secondary market due to the higher coupon, as investors search yield.

"The participation of Asian private banks has been extremely high given the footprint of the issuer in the region," he added.

A \$1.5bn dual tranche debut for Nordea the following week, on 16 September, underlined the greater appetite that inaugural issuers could uncover and tighter pricing they could achieve, with

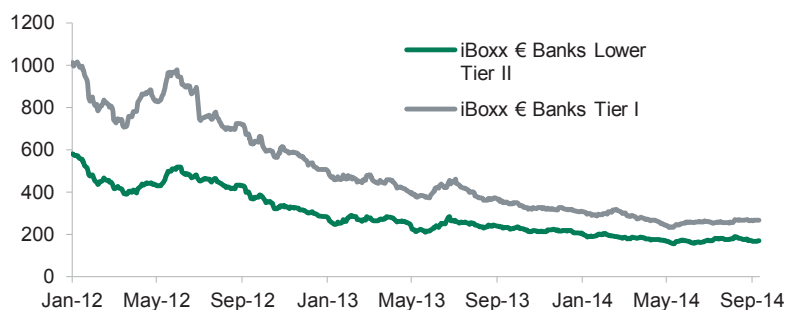
a \$1bn perp non-call five tranche hitting a record coupon low of 5.5% (*see separate article for full coverage*).

In the meantime Crédit Agricole had the day after HSBC's issue returned for \$1.25bn with a 6.625% perp non-call five that attracted some \$5bn of demand, taking the French bank's AT1 issuance to some Eu3.8bn (*see case study for full coverage*).

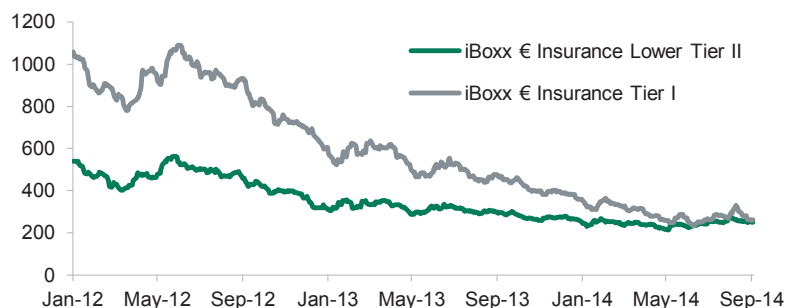
In light of the mixed results of the post-summer supply and the impact of BES and BPE's pre-summer reversal on potential second tier issuance, the outlook for the AT1 market was left more subdued than in the first half of the year, according to market participants, with the European Central Bank's Asset Quality Review also to come.

However, the asset class's underlying drivers remain in place and ultimate pipeline big, so further supply is awaited. Aareal Bank, for example, has already mandated banks for investor meetings ahead of a euro-denominated AT1 debut. The deal, with a 7% transitional CET1 trigger, is expected to be rated B+ by Fitch. ●

Secondary bank subordinated indices



Secondary insurance subordinated indices



Source: Markit, Crédit Agricole CIB

ASIA-PACIFIC

ICBC leads Chinese Tier 2s, CommBank PERLS hit A\$2.6bn

ICBC first as Chinese banks sell CNY Tier 2s: Industrial & Commercial Bank of China (ICBC) priced a Tier 2 bond on 5 August, making ICBC the first of the large five state-owned banks to embark on such an issuance. ICBC set price guidance on its 10NC5 Basel-III compliant Tier 2 offering at a yield of 5.5%-6.0%, with the deal finally being priced at a coupon of 5.8%.

Later that week, Bank of China raised CNY3bn of Tier 2 capital in an onshore 10 year issue, also for a yield of 5.8%. Agricultural Bank of China (ABC) was the next in the series, pricing a CNY30bn 10NC5 note also at 5.8%, while Bank of Communications raised CNY28bn in Tier 2 capital at the same level, as did China Construction Bank Asia (CCB Asia), for CNY20bn.

The deals marked the successful sale of new-style bank capital from China's big five commercial banks in the onshore market. The loss-absorbing notes will be written off if the China Banking Regulatory Commission deems a bank to

be non-viable or if the regulator determines that the lender needs government support to survive.

CBA closes books on A\$2.6bn Tier 1 offering: Commonwealth Bank of Australia (CBA) in the last week of August completed the bookbuilding process for its CommBank PERLS VII Additional Tier 1 hybrid securities. Strong demand for the Basel III-compliant notes allowed CBA to achieve a record breaking \$2.6bn of the notes, a size significantly higher than the deal's indicative \$2bn issue size. Initial guidance for the deal was set at the low end of three month BBSW plus 280bp-300bp. The offering comes in the form of perpetual subordinated unsecured notes, featuring a CET1 trigger, where the notes will convert into ordinary shares if the bank's solvency ratio falls below 5.125%. The notes are callable in December 2022 and will be mandatorily converted into CBA ordinary shares in December 2024. The offer closed on 19 September, with the issue date for the notes set for October 1. ●

Nordea sets AT1 tight with Swedish first

Nordea achieved the lowest coupon on an AT1 with the first such issue from Sweden on 16 September, a \$1.5bn (Eu1.16bn, Skr10.7bn) transaction split into two tranches that included a \$1bn perpetual non-call five tranche paying 5.5%.

The other tranche was a \$500m perpetual non-call 10 issue carrying a coupon of 6.125%.

"We are very happy with the coupon, which was the lowest ever," said Rodney Alfvén, head of investor relations at Nordea. "Also the spreads were very attractive. So we are satisfied with the transaction."

"It was a very extensive exercise," he added. "We spent three days on the road, met a huge amount of investors, and then the order book filled up nicely. I think it was a well run transaction."

The deal attracted some more than \$10bn of demand, according to a syndicate official at one of leads Bank or America Merrill Lynch, Citi, Goldman Sachs and UBS. Nordea's transaction is rated BBB/BBB+ and, coming after the success of an inaugural HSBC AT1 the previous week, the syndicate official added that investment grade AT1s are "flavour of the month".

The leads were able to tighten the coupons by 0.25% and 0.375%, respectively, on the back of the strong demand, to end up at a level inside where HSBC had printed. Meanwhile, the transaction helped strengthen the AT1 market, which had suffered a weak post-summer reopening at the beginning of the month, said the syndicate official, with bids returning to the asset class after Nordea's deal and bonds trading up 0.25% to 1%.

Vincent Hoarau, head of FIG syndicate at Crédit Agricole CIB, said that the issuer had adopted a sensible approach when giving guidance to investors and limiting the combined size to \$1.5bn.

"Size matters in today's market and investors really appreciated any scarcity element," he said. "In the secondary market, the smaller (and longer) tranche is outperforming."



Rodney Alfvén, Nordea

Only one previous AT1 had been issued out of the Nordics — by Danske Bank in March — and Swedish banks had been awaiting regulatory clarity, but were known to be looking to access the market. Nordea did so after announcing its deal last week and holding a roadshow.

"We thought the timing was good and it fitted our long term capital plan-

ning — we have two bonds that are callable early next year, subject to FSA approval," said Alfvén.

"We have a trigger of 8% to the group and then we have a solo trigger of 5.125% to the parent company," he added, "and that was settled after having a discussion with the FSA."

He said that the choice of maturities and currency reflected investor demand as well as fitting Nordea's needs.

"We had the deal roadshow last week and we listened to what investors preferred," said Alfvén. "We found good interest in a US dollar transaction with non-call five and non-call 10 tenors."

"A US dollar transaction was chosen as it suits our balance sheet structure and we assessed it as cost efficient."

Nordea's future AT1 needs are now expected to be "limited", the issuer has said.

"We will have 1.5%-2% of our risk exposure amount in AT1, which corresponds to some Eu2.5bn-Eu3bn all in all, so it's a very small amount," said Alfvén. ●

RUSSIA

Promsvyazbank exchange, VTB Swissie

Promsvyazbank completes exchange after Tier 2 issue: Russian lender Promsvyazbank completed an any-and-all, sub-for-sub exchange offer on 28 July, following the sale of a \$300m seven year Tier 2 (Subordinated Loan Participation Notes) on 15 July at a yield of 10.5%. As customary for Basel III-compliant instruments under Russian regulations, the notes contain a contractual write-down clause triggered by a capital ratio breach (2% CET1) or regulatory intervention.

The existing notes in the exchange were \$200m 12.75% 2015s and \$200m 11.25% 2016s. The aggregate principal of the notes tendered and accepted for exchange was \$19.51m and \$10.95m for the 2015 and 2016 notes, respectively.

According to the issuer, the purpose of the offers was to improve the composition of the issuer's regulatory capital and to lengthen its debt redemption profile.

VTB Bank sells Sfr350m Tier 2: On 3 July, Russian lender VTB Bank sold a 10NC5 Tier 2 note with a coupon of 5%, in line with guidance of the 5% area. VTB is the second Russian issuer to have sold a Swiss franc-denominated Tier 2 in 2014, after a 10 year Tier 2 from Gazprombank in January. Despite the recent macro-economic turmoil, VTB met with strong demand from retail accounts, along with participation from institutional investors. ●

Hannover Re T2 shows issuers' market for insurers

Hannover Re issued a Eu500m perpetual non-call 10.75 Tier 2 issue on 8 September that highlighted the strong market conditions for insurance companies bringing hybrid bonds.

Leads Barclays, Citi, Commerzbank and Crédit Agricole CIB went out with initial price thoughts of the 240bp over mid-swaps area for a no-grow Eu500m deal. With orders approaching Eu2bn, guidance of the 230bp over mid-swaps area (plus or minus 5bp) was set, and then the level fixed at 225bp over with a final order book of Eu2.2bn comprising 212 accounts.

According to Robert Chambers, FIG syndicate manager, at Crédit Agricole CIB, this put the pricing some 10bp through where the leads had seen fair value.

"Pricing power in the insurance sector is very much in the hands of the issuer, as opposed to the recent AT1 deals where investors have had the upper hand and are able to sit trades out," he said.

"As well as the issuer-specific scarcity, this is partly due to the recent lack of supply in the sector and also anticipation that the pipeline is not as large as in AT1. That provides for a positive backdrop for insurance names."

Chambers added that the deal traded



Photo: Hannover Re

up on the break as real money accounts looked to add to their allocations.

Germany and Austria took 36%, Switzerland 15%, the UK 12%, Italy 11%, France 10%, Benelux 8%, Iberia 2%, Nordics 3%, and others 3%. Asset managers were allocated 70%, insurance companies and pension funds 16%, banks 7%, and others 7%.

"The new bond enables Hannover Re to take advantage of the low level of interest rates and to optimise the maturity profile of the outstanding hybrid capital," said Hannover Re chief executive officer Ulrich Wallin.

The transaction was priced with a coupon

of 3.375% to the first call, after which it pays three month Euribor plus 325bp.

The insurance company noted that it traditionally uses hybrid bonds to optimise its cost of capital, with Hannover Re now having four hybrids outstanding in the capital markets.

Hannover Re's last issue was a 30 year non-call 10 structure in November 2012. According to Chambers, that was structured in anticipation of future Solvency II Tier 2 rules and the new instrument is very similar, with identical S&P treatment, except for the perpetual maturity and its ranking in liquidation (subordinated to senior and dated subordinated debt). ●

INSURANCE

Swiss Re dollar Solutions, Admiral sterling, NN follow-up

Swiss Re in US dollar Tier 2 debut: Swiss Re successfully sold a \$500m 30NC10 Tier 2 note on 4 September. IPTs for the notes were set at the 4.625% area and were revised to 4.5%-4.625% on the back of an order book of nearly \$1.9bn. The notes were finally priced at a yield of 4.5%. The Swiss Re group has accessed the subordinated market several times, but this was the first deal from the Corporate Solutions subsidiary.

Admiral Group issues £200m Solvency II-compliant Tier 2: UK insurer Admiral Group in mid-July issued a £200m 10 year Solvency II-compliant Tier 2 transaction,

rated BBB- by Fitch. The final yield on the bond was set at 5.5%, down from IPTs of the 5.625% area.

NN Group sells Eu1bn PerpNC11.5 Tier 2: On 8 July, NN Group, the insurance arm of ING, launched a PerpNC11.5 subordinated deal, which followed a \$2.1bn IPO. The Eu1bn deal, which is expected to benefit from Tier 1 grandfathering treatment, was priced at 300bp over mid-swaps, the tight end of IPTs of 300bp-310bp, and had an order book of around Eu2bn. The transaction marked NN Group's second subordinated issue this year, after it sold a Eu1bn 30NC10 bond at 295bp over mid-swaps in April. ●

NEWS IN BRIEF

Euro Tier 2 flurry, Indian, Canadian and Brazilian firsts

Intesa Sanpaolo, BPCE and Man Group sell Tier 2 notes: On 8 September, Intesa Sanpaolo priced a €1bn Tier 2 deal at mid-swaps plus 260bp. Later in the session, BPCE came to market with a 10.5 year Reg S/144A US dollar Tier 2. The bank was able to complete a \$1.25bn deal at mid-swaps plus 220bp, from IPTs of plus 230bp.

Finally, Man Group went for a relatively small \$150m 10NC5 note. IPTs were the low 6% area, before pricing of 5.875%.

Virgin Money sells GBP160m PerpNC5 AT1: Virgin Money, the UK-based banking arm of Virgin Group, on 25 July raised £160m of Additional Tier 1 securities to finance a UK government loan it took to acquire Northern Rock. The notes replace £150m of Tier 1 capital held by the Treasury that the lender bought back for £154.5m and marks Virgin Money's inaugural access to the unsecured debt capital markets. The notes include a 7% CET1 trigger with an equity conversion mechanism. The transaction drew a three times oversubscribed order book, allowing the issuer to price it at mid-swaps plus 579bp, for a 7.875% coupon.

India

Bank of India doubles Basel III-compliant AT1 first: State-owned Bank of India, rated Baa3/BBB-, in early August completed a sale of a INR25bn Basel III-compliant AT1 note, with a coupon of 11% for the PerpNC10 issue. The deal was initially planned at a size of INR12.5bn with a greenshoe option of INR12.5bn, but, on the back of a strong order book of INR29.36bn, the issuer opted to double the size of the deal. The transaction was the first Indian AT1 issue.



RBC, Toronto

Africa

Ecobank Nigeria sells \$250m 7NC5 Tier 2: Ecobank Nigeria sold a \$250m 7NC5 Tier 2 note on 7 August, rated B- by S&P. IPTs for the deal started at the high 9%, before final guidance was tightened to 9%.

North America

Citigroup, Northern Trust Corp bring US dollar subs: On 29 July, Citigroup placed \$750m of 10 year bullet subordinated notes at T+157bp, down from IPTs of the mid to high 160s, for a coupon of 4%. On the same day, Northern Trust Corporation issued \$400m of PerpNC5 non-cumulative preferred securities, rated Baa2 and BBB by Moody's and Fitch, for a coupon of 5.85%.

RBC sells first NVCC Tier 2: Royal Bank of Canada (RBC) sold C\$1bn of 10NC5 non-viability contingent capital (NVCC) notes on 11 July, the first issue of this kind from a Canadian financial institution. The notes include contractual Point of Non Viability language whereby they will convert into equity upon regulatory intervention or the acceptance of capital injection, or equivalent support, from a government entity or agency. The NVCC requirements are imposed

by the Office of the Superintendent of Financial Institutions (OSFI) to ensure that investors in non-common regulatory capital instruments bear losses before taxpayers where the government determines it is in the public interest to rescue a non-viable bank. The notes are rated Baa1 and A- by Moody's and S&P, two notches below the adjusted BCA and SACP, respectively.

Latin America

Caixa Econômica Federal issues \$500m 10NC5 Tier 2: On 16 July, Brazilian lender Caixa Econômica Federal issued a 144A/Reg S \$500m 10NC5 Tier 2 at 555bp over Treasuries, for a coupon of 7.25%. The transaction, which followed a roadshow in the US, Europe and Asia, attracted approximately \$2bn of orders. The notes — which include contractual Point of Non-Viability language under Brazilian regulation with a trigger set at 4.5% CET1 or a regulatory decision to make a public sector capital injection — are the first Basel III-compliant Tier 2 (Nivel 2) offering from a Brazilian bank, and they will contribute 0.25 percentage points to Caixa's Total Capital Ratio. The notes were rated Ba3 by Moody's, one notch below the adjusted BCA of the issuer, and BB+ by Fitch, two notches below the issuer's long term IDR. ●

Regulatory updates

BANKING

Comprehensive Assessment moves ahead

ECB publishes “join-up” manual: The European Central Bank (ECB) on 8 August published a manual detailing how it will incorporate findings from its AQR (Asset Quality Review) into stress test projections, the so-called “join-up” or Phase 3 of the Comprehensive Assessment process. The ECB will compare findings for individual banks with those of their peers and will apply its own top-down stress test model. Banks may be required to provide further evidence as part of a “comply or explain” approach, in addition to providing further analysis and, if necessary, resubmitting their stress test projections. Findings from the portfolios examined in the AQR will be used to determine the starting point of the stress test and, for the purpose of the exercise, may lead to an adjustment to the year-end 2013 balance sheet. Where evidence from the AQR points to a bank having insufficient provisions, this will be reflected in adjustments to the bank’s simulated projected losses in 2014, 2015 and 2016 for both the baseline and adverse scenarios. In addition, it will have an impact on the simulated profits and losses under stress test scenarios. Between September and October, the national authorities and the ECB will finalise the results, associated disclosure templates and capital requirements (Phase 4), and share partial, preliminary information on specific components of the Comprehensive Assessment with banks, to enable them to mount a challenge on items of concern. Final results will be communicated to the banks very shortly before publication (second half of October).

EBA publishes final templates for the 2014 stress test: The European Banking Authority (EBA) on 20 August published the final templates that will have to be used for the publication of data for the stress test. The templates are common for all EU banks and illustrate the type

and format of data that will be disclosed to the EBA. Acting as the coordinator of the stress test, the EBA will be publishing up to 12,000 data points per bank across the whole of the EU, acting as the central hub for all information related to stress test outcomes of EU banks. The data will cover banks’ composition of capital, risk weighted assets, profit and loss, exposures to sovereigns, credit risk and securitisation. In addition, for the first time, the EBA will disclose a fully-loaded CRR/CRD4 Common Equity Tier 1 (CET1) capital ratio for each bank. By disclosing data in a consistent and comparable user-friendly format across the Single Market, the EBA aims to bring greater transparency to the EU banks, contributing to stronger market discipline of the EU banking sector.

ECB

ECB publishes final list of significant credit institutions: The European Central Bank on 4 September published the final list of the 120 significant credit institutions whose direct supervision it will assume on 4 November. The ECB will directly supervise credit institutions, financial holding companies or mixed financial holding companies that are deemed significant at the highest level of consolidation within participating Member States. The significant credit institutions account for almost 85% of total banking assets in the euro area. The significance assessment has been based on banks’ year-end 2013 figures, the total value of their assets, the importance for the economy of the country in which they are located or the EU as a whole, the

scale of their cross-border activities and whether they have requested or received public financial assistance from the ESM (European Stability Mechanism) or the EFSF (European Financial Stability Facility). The ECB has also published a list of less significant institutions. These banks will continue to be supervised by national competent authorities. However, the ECB can decide at any time to exercise direct supervision in order to ensure consistent application of high supervisory standards.

EBA

EBA publishes new XBRL taxonomy for remittance of supervisory reporting: The EBA on 18 August published a new XBRL taxonomy to be used by competent authorities for remittance of data under the EBA Implementing Technical Standards (ITS) on supervisory reporting. The new taxonomy will apply from 31 December onwards and will be used for the first reports on asset encumbrance and funding plans.

EBA publishes final RTS on the treatment of equity exposures under IRB approach: The EBA on 5 August published its final draft Regulatory Technical Standards (RTS) specifying the treatment of equity exposures under the internal ratings-based (IRB) approach. These RTS establish that competent authorities are allowed to grant institutions a temporary exemption from the IRB treatment for certain equity exposures provided such exemption was being applied on the last day of application of CRD I (31 December 2007). This exemption will end on 31 December 2017.

EBA consults on criteria to assess O-SIIs: EBA on 18 July launched a consultation on draft Guidelines setting forth criteria to identify the so-called Other Systemically Important Institutions (O-

These updates are split into bank and insurance, and after the initial updates listed according to the relevant body, with the most recent first.

SIIs). Relevant authorities may require each O-SII to maintain an additional capital buffer of up to 2%, consisting of CET1. The consultation runs until 18 October. The Guidelines aim at achieving an appropriate degree of convergence in the identification process, and envisage a two-step process for the identification of O-SIIs:

- In the first step, on the basis of mandatory quantitative indicators (related to size, interconnectedness, relevance for the economy, complexity), competent authorities will obtain scores indicating the systemic importance of each bank. Banks scoring above a certain threshold (upper threshold) will have to be identified as O-SIIs, those scoring below a certain threshold (lower threshold) can never be identified as O-SIIs;
- In the second step of the process, competent authorities can still qualify banks scoring between the lower and upper thresholds as O-SIIs, by using their supervisory judgment, but only on the basis of a closed list of optional indicators set forth in the Guidelines.

EBA publishes final draft RTS and Guidelines on recovery plans: The EBA on 18 July published two final draft RTS specifying (i) the information to be included in a recovery plan, and (ii) the criteria that competent authorities should apply when assessing the recovery plan of an institution or a group. The final draft RTS are complemented by Guidelines providing the range of scenarios to be used when testing recovery plans. In more detail:

- The first set of RTS specifies the information institutions should include in their recovery plans, which is broken down into different sections: (i) the summary of the recovery plan; (ii) informa-



ESMA, Paris

tion on governance; (iii) a strategic analysis; (iv) a communication plan; and (v) a description of preparatory measures;

- The second set of RTS identifies the principles and criteria that supervisory authorities shall follow when assessing (i) the completeness, (ii) the quality and (iii) the credibility of recovery plans;

- The RTS are complemented by a set of Guidelines specifying the range of scenarios that institutions should consider to test the effectiveness and adequacy of the recovery options and indicators. Scenarios of macroeconomic and financial distress need to be designed taking into account the specific characteristics of the bank involved, including its size and interconnectedness. These scenarios should include situations where the bank would be at risk of failing if recovery measures were not implemented in a timely manner.

EBA issues Opinion on macroprudential tools laid down in the CRR/CRD: EBA on 8 July issued an opinion addressed to the European Commission on the macroprudential tools laid down in the CRR/CRD IV. Under Article 513 of the CRR, the Commission is required to review whether the macroprudential

rules contained in the CRR and CRD IV are effective, proficient and transparent with regard to mitigating systemic risks. Alongside this, the opinion sets out a number of policy recommendations for the Commission to consider in its review of the macroprudential toolkit. The document included the following main points:

- The cap on the O-SII buffer is considered too low and should be raised;
- Mandatory coordination process between competent authority or the designated authority to be put in place;
- Pillar 2 is primarily to be viewed as a microprudential tool. Furthermore, the hierarchy between the tools should be adjusted by placing the Systemic Risk Buffer (SRB) before Pillar 2 and moving Article 458 CRR (also named flexibility package) so that it is in line with Pillar 2;
- With respect to the SRB buffer it is suggested that: (i) the process be clarified in particular with respect to Article 133(11) to (15), and (ii) guidelines be written to clarify its activation, exploring possible quantitative indicators, and the risks covered. The max-rule (SRB vs. G/O-SII buffer) should be maintained;

- The ability to review risk weights or LGD (loss given default) floors in real estate should be made more consistent. Article 164 CRR should be further aligned with Article 124;
- Further work should be done to evaluate the need and the exact nature of tools addressing exposure based risks.

EBA publishes consultation on a framework for common supervisory procedures and methodologies: On 7 July, EBA launched a consultation on its draft framework for common procedures and methodologies for the Supervisory Review & Evaluation Process (SREP). This framework will be applied in the supervision of all institutions across the EU and will help form a consistent supervisory culture across the single market. The consultation runs until 7 October.

EBA clarifies grandfathering, Danish Compromise in new Q&As: EBA added three new relevant answers to the Single Rulebook Q&A on 4 July:

- [2013_544] The question relates to the need of a contractual reference to Art. 77 of CRR (conditions for reducing own funds) in order for legacy non-step Tier 1 bonds to qualify as fully eligible Tier 2. According to the EBA, any call options, redemptions or repurchase transactions related to Tier 2 instruments must meet the requirements of Article 63 of CRR. More specifically, Article 63(j), in conjunction with Article 77 of the CRR, stipulates that the institution must not effect the call, redemption, repayment or repurchase prior to the date of an instrument's contractual maturity without the prior permission of the competent authority. Legacy Tier 1 instruments should therefore contain an explicit reference to these regulatory conditions in their terms in

order to be reclassified as fully eligible Tier 2. The answer takes a conservative stance, as the adherence to Art. 63(j) could theoretically be handled on a statutory basis, and adds a further filter on top of the recent confirmation on the treatment of step-ups on sequent calls;

- [2013_543] EBA confirmed that an arrangement, contractual or otherwise, whereby an issuer or related entity guarantees to pay a compensation to shareholders even in loss years, enhances the seniority of those shareholders and therefore is non-compliant with Article 28(1)(l) of the CRR. The original question asked whether a contractual obligation of the majority shareholder of a credit institution to pay a compensation to the minority shareholders even in loss years, due to a pre-existing profit and loss transfer agreement, would be permissible under CRR. Article 28(1)(l) of the CRR states that CET1 instruments should not be not secured, or subject to a guarantee that enhances the seniority of the claim by the parent undertaking of the institution;

- [2013_502] The question relates to the application of the quantitative thresholds pursuant to Article 471(1)(d) of CRR (exemption from deduction of equity holdings of insurance subsidiaries from CET1), namely, (1) equity holdings of the institution in the insurance company not in excess of 15% of the CET1 instruments issued by that insurance company as at 31 December 2012, and (2) the amount of the equity holdings not in excess of the amount held in CET1 instruments in the insurance company as at 31 December 2012. According to EBA, the two conditions apply together and shall both be met in order for equity holdings not to be

deducted. However, failing one of the two does not compromise the entire treatment. If only one of the condition is met, only the amount that is above one of the two caps have to be deducted from own funds.

EBA publishes new set of final draft RTS: On 4 July, EBA published new sets of final draft RTS, including (1) RTS on the conditions for assessing the materiality of extensions and changes of the Internal Models Approach (IMA) for market risk, and (2) RTS on minimum margin periods of risk that institutions acting as clearing members may use for the calculation of their capital requirements for exposures to clients.

BASEL COMMITTEE

GFMA & IIF write supplementary letter to Basel Committee: The Global Financial Markets Association (GFMA) and the Institute of International Finance (IIF) on 29 August published a follow-up letter to their comment letter of 11 April to the Basel Committee on Banking Supervision (BCBS). The initial letter was on the Committee's consultation paper on the revised net stable funding ratio (NSFR). The follow-up letter expresses the GFMA's and IIF's serious concerns and expresses the view that the treatment of equities under the revised NSFR will increase transaction costs across equity markets significantly.

Basel Committee releases Technical Paper on counterparty credit risk exposures: On 28 Aug, the Basel Committee published a working paper to explain the different modelling assumptions that were used in developing the standardised approach for measuring counterparty credit risk exposures (SA-CCR). The paper also clarifies certain aspects of the SA-CCR calibration that are not discussed in the final standard that was published in March.

BCBS consults on review of the Pillar 3 disclosure requirements: On 24 June, the Basel Committee published for consultation a review of the Pillar 3 disclosure requirements. The proposals promote greater consistency for risk disclosure by banks and aim to assist market participants in assessing a bank's overall capital adequacy more effectively. The proposal does not include disclosures on capital requirements and capital buffers, which are governed by a previous Basel Committee publication (*Composition of capital disclosure requirements*, June 2012). These disclosure requirements will be considered in the second phase of the review. On 27 August, the Committee announced that the consultation period on the proposed revisions had been extended from 26 September to 10 October.

EUROPEAN COMMISSION

European Commission adopts geographical exposure RTS: The European Commission on 29 August adopted the Delegated Regulation containing RTS on the identification of the geographical location of the relevant credit exposures for calculating institution-specific countercyclical capital buffer rates. The institution-specific countercyclical capital buffer rate shall consist of the weighted average of the countercyclical capital buffer rates that apply in the jurisdictions where the relevant credit exposures of the institution are located or applied (Article 140(1) of the Directive). The delegated act specifies the method for the identification of the geographical location of the relevant credit exposures. It has submitted the text to the European Parliament and Council for scrutiny before its final publication.

SRM published in the official EU Journal: On July 30, the regulation establishing a Single Resolution Mechanism (SRM) was published in the Official Journal of the EU, one year after the European Commission presented its proposal. The regulation entered into force on 19 Au-



gust. The provisions relating to the co-operation between the Single Resolution Board and the national resolution authorities for the preparation of the banks' resolution plans will apply from 1 January 2015 and the SRM should be fully operational from 1 January 2016.

The EU Council had on 14 July adopted the regulation establishing the SRM. Its adoption follows the agreement reached with the European Parliament at first reading in early April, along with the Bank Recovery & Resolution Directive (BRRD) adopted in May. The inter-governmental agreement will enter into force once ratified by member states participating in the SSM/SRM that represent 90% of the aggregate of the weighted votes of all participating member states.

LCR to be potentially postponed to October 2015: According to media reports based on leaked documents, the European Commission is considering a postponement of the application of the Liquidity Coverage Ratio (LCR) to October 2015, with a proposal due late September.

ESAS

EBA, EIOPA and ESMA warn about self-placement of hybrid instruments: As part of their respective mandates, the

three European Supervisory Authorities (EBA, EIOPA and ESMA) published a joint paper on the placement of financial instruments with depositors, retail investors and policy-holders. The authorities expressed their concerns over the practices used by some financial institutions to comply with enhanced prudential requirements (CRR/CRD IV, pending BRRD, and Solvency II, as well as the ongoing EBA stress test and the ECB's Comprehensive Assessment) by selling to their own client-base financial instruments that they themselves have issued, regardless of the fact that the loss bearing features of many of these products expose consumers to significant risks that do not exist for other financial instruments. The document reports that ESMA has been asked to provide technical advice to the European Commission for the adoption of Commission delegated acts under MiFID II in a number of areas, including conflicts of interest with regard to underwriting and placing. Similarly, on the back of the mandate following an amendment of the IMD (Insurance Mediation Directive) by MiFID (Markets in Financial Instruments Directive), EIOPA has published a Discussion Paper on conflicts of interest in sales of insurance-based investment products, which focuses on the conflicts of interest that could harm consumers.

EBA, EIOPA and ESMA release Joint Consultation Paper on risk concentration: See *insurance updates* for details.

NATIONAL MEASURES

ESRB publishes commentary on macro-prudential measures: The European Systemic Risk Board (ESRB) on 22 July published an official commentary on national macroprudential measures. The document considers the measures that have been notified and subsequently published on the ESRB's website in the period from January to June 2014, with notifications from Belgium, Croatia, Denmark, Estonia, Latvia, the Netherlands, Slovenia and the

UK. In most of the reported cases, the SRB (Systemic Risk Buffer) is used as a substitute for the O-SII buffer, which is subject to more stringent requirements in terms of level (cap of 2%) and availability (only from 2016 onwards). According to the ESRB, this is not ideal as the O-SII buffer is the dedicated instrument to address systemic risks resulting from O-SIIs. The level chosen for the SRB in the reported cases resulted in a simple notification procedure without the need for a formal opinion or approval, which begs the question as to the role of procedural considerations in the selection of the given measure and its level.

PRA consults on implementing the BRRD: The UK Prudential Regulation Authority (PRA) on 24 July launched an official consultation (CP13/14) on the UK implementation of the BRRD. The initiative follows similar actions by other European regulators (including Sweden and Germany) as local authorities will have to transpose the directive into national law.

Norwegian FSA will not allow CoCos in Pillar 2: According to Bloomberg, Norwegian FSA deputy director general Emil Steffensen confirmed that the required trigger level on contingent capital instruments will be decided later this year as part of the adoption of the draft regulation. However, Pillar 2 requirements will have to be met by CET1 capital only, as opposed to a combination of equity and hybrid instruments. The decision goes against the approach taken by UK and Danish counterparts.

EBA issues opinion on a structural measure notified by France: EBA on 17 July published its Opinion on a draft structural measure of banking separation impacting the limits to intra-group large exposures that France intends to implement at national level. The EBA Opinion assessed the structural measure of banking separation aimed at reducing group risk profiles, which would be

introduced through an order in application of French national law 2013-672 (loi 2013-672 du 26 Juillet 2013 de separation et regulation des activités bancaires). In its opinion on the matter, EBA said that the measure did not aim at ring-fencing institutions alongside their national borders, but rather at restricting proprietary trading activities, regardless of their geographical location. On the basis of the information received, the EBA concluded that no evidence was found suggesting that this measure would be inconsistent with the general principles governing the EU internal market.

FPC launches consultation on the review of the leverage ratio: The Financial Policy Committee (FPC) on 11 July launched a consultation on the design of a leverage ratio framework for the UK. It forms part of the FPC's review of the role of the leverage ratio within the capital framework for banks, as requested by the Chancellor of the Exchequer in November 2013. The consultation paper sets out the FPC's analysis of the policy choices that would determine the role of the leverage ratio within this framework. The responses to the paper will inform the final review, intended to be published in November.

German cabinet approves national BRRD transposition: German Chancellor Angela Merkel's cabinet on 9 July approved four bills that will transpose the BRRD into German law. According to press reports, the country will accelerate the activation of the bail-in tool to 2015, one year before the date prescribed under the European rules. Moreover, the bank restructuring power of the SoFFin, Germany's financial markets stabilisation fund, will come under the Federal Agency for Financial Market Stabilisation (FMSA), which will be subject to BaFin's supervision.

Swedish Financial Crisis Committee presents BRRD application proposal: The Swedish Financial Crisis Committee

(Finanskriskommittén) on 3 July published a draft proposal to the Ministry of Finance on the implementation of the BRRD. The document, which recommends the debt office be the country's resolution authority, includes the possibility for precautionary measures ahead of actual resolution. The government will take over distressed banks if any bankruptcy would threaten financial stability, and then sell all or parts of the bank or restructure it.

RATING AGENCIES

Moody's publishes its methodology for Rating Bank Contingent Capital Securities: Moody's on 16 July released its updated guidelines for rating junior bank obligations. A request for comment was originally published on 1 May. The revised criteria incorporates the following changes:

- High trigger contingent capital securities will now be rated by Moody's using a model-based approach. The model incorporates the agency's view of the issuing bank's current financial strength as expressed through its BCA, its current capital level (possibly adjusted for a forward view of capital), the capital level associated with the point of non-viability, and the capital level associated with the trigger in the security being rated which determines the distance to trigger breach. It will be available upon request;
- The proposed Ba1 rating cap in the request for comment will not apply to high trigger contingent capital securities;
- The notching (from the BCA) applied to non-viability securities has been revised. Moody's has notably removed the additional notch applied to AT1. As a consequence, the agency upgraded the ratings of several AT1 issues. ■

INSURANCE

ESAs Joint Committee, G-SIIs, PRA news

EIOPA publishes update on Guidelines and Submission of Information to NCAs: On 18 August, the European Insurance & Occupational Pensions Authority (EIOPA) published updated information concerning the guidelines on submission of information to the National Competent Authorities (NCAs) to support the implementation by insurance and reinsurance undertakings of the Solvency II Directive.

EBA, ESMA and EIOPA release joint consultation paper on risk concentration: The Joint Committee of the three European Supervisory Authorities (ESAs) launched a consultation on 24 July on draft RTS (Regulatory Technical Standards) on risk concentration and intra-group transactions within financial conglomerates. The technical standards are aimed at enhancing supervisory consistency in the application of the Financial Conglomerates Directive (FICOD). The objective of the draft RTS is to clarify which risk concentrations and intra-group transactions within a financial conglomerate should be considered as significant. In addition, the RTS provide some supervisory measures for coordinators and other relevant competent authorities when identifying types of significant risk concentration and intra-group transactions, their associated thresholds and reports.

Basic Capital Requirements for G-SIIs: On 9 July, the International Association of Insurance Supervisors (IAIS) issued the second public consultation document regarding the development of global Basic Capital Requirements (BCR) for Global Systemically Important Insurers (G-SIIs). The first consultation looked for feedback on design possibilities for the development of the BCR, while the second will allow the IAIS to gain input on a specific proposal



EIOPA chairman Gabriel Bernardino

to facilitate the final design and calibration of the BCR. The requirements are expected to apply from 2015. The latest consultation ended on 8 August. The BCR proposal, which is expected to be delivered to the G20 summit in November, includes the following definition of BCR ratio:

- Qualifying capital resources: classified as either core or additional capital. The IAIS is still considering whether one or both categories will be assessed as far as compliance with the BCR is concerned. In the meantime, the BCR relies on the proposed Com-Frame definition for core (equity and perpetual non-cumulative instruments) and additional (min. five year subordinated instruments with maturity lock-in or 20% p.a. amortisation in the final five years) capital resources.
- Required capital: calculated on a consolidated group-wide basis and determined using a factor-based approach (15 factors applying to defined segments).
- The development of the BCR is

part of the IAIS's project to develop group-wide global capital standards. It will be followed by the development of Higher Loss Absorbency requirements (HLA, which will expand on the BCR) to apply to G-SIIs, due to be completed by the end of 2015. The final step will be the development of a risk-based group-wide global Insurance Capital Standard (ICS) to be applied to Internationally Active Insurance Groups (IAIGs) from 2019.

UNITED KINGDOM

PRA publishes update on Solvency II implementation: On 29 August, the UK Prudential Regulation Authority (PRA) published an update on implementation of the Solvency II Directive. The update provides information on the relationship between the risk margin and the calibration of non-hedgeable risks, and provides clarity on assessing credit risk for matching adjustment portfolios.

PRA publishes supervisory statement on valuation risks for insurers: On 22 August, the PRA published a supervisory statement setting out its expectations of insurance firms in relation to rules already in place on the valuation of financial assets. The statement applies to all PRA-authorised insurers and may also be relevant to insurance holding companies and other entities in the same group. The statement is equally relevant to life and general insurers, whether they are mutuals or proprietary companies. The statement intends to reduce the risk to the PRA's objectives caused by intended or unintended misstatement of values and hence misstatement of capital resources, by clarifying the PRA's existing expectations. The statement aims to clarify the PRA's expectations and does not represent any form of policy change. Further clarification

tions or expectations on the topic may be added to the statement in future.

PRA release final supervisory statement on the use of subordinated guarantees:

the same day, the PRA released the final supervisory statement on the use of subordinated guarantees and the quality of capital for insurers following the consultation paper released on 30 May (*see previous issue*). The statement has been subject to a public consultation, which closed on 11 July, and reflects feedback received by the PRA. Some feedback suggested alternative wording to make the statement clearer and these suggestions were accepted where clarity would be improved. There is no change in policy intent following the consultation.

PRA publishes directors' update: On 19 August, the PRA published an update letter to all Solvency II-affected life and general insurers. The update attaches a timetable of activity for the period August to December 2014 and includes more information on when the PRA will be communicating with firms. The update letter reminds firms that the PRA has issued its third consultation paper on Solvency II (CP16/14) (*see below for more*) and that the closing date for responses is 7 November. The letter also announces the PRA's intention to conduct a pre-application process for the matching adjustment approval process in Q1 2015. Further information on this process, including timings and participation details, will follow in Q4.

PRA consults on the transposition of Solvency II: On 11 August, the PRA published a consultation paper that sets out proposed changes to the PRA's rules to implement the Solvency II Directive as amended by the Omnibus II Directive (OMD II). It also contains draft supervisory statements that set out the PRA's expectations of firms and what firms may expect of the PRA. CP16/14 is the



third consultation on the transposition of Solvency II and consults on rules to transpose the amendments introduced by OMD II and on the implementation of areas deferred from the previous two CPs issued by the Financial Services Authority. The PRA is required to transpose the Solvency II Directive by 31 March 2015, while the Solvency II regime will apply to all affected firms from 1 January 2016. This consultation closes on 7 November.

- The document sets out how regulatory capital items that could be used to meet capital requirements before 1 January 2016, but that do not meet the criteria for available basic own funds, will be treated under the Solvency II transitional measures for own funds, for up to 10 years from 1 January 2016. Upper Tier 2 GENPRU instruments will be grandfathered as restricted Tier 1.
- In relation to paid-in ordinary share capital, matters such as the absence of mandatory fixed charges or encumbrances will be a characteristic until such time as a dividend is declared but the shares would cease to meet this criterion unless there is the ability to cancel a dividend after this point but prior to payment.

HM Treasury launches short consultation on Solvency II implementation:

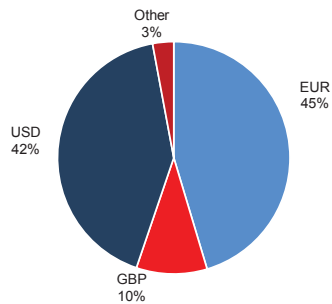
In addition to the PRA initiative, the HM Treasury released on 6 August a short consultation (*Solvency II: resolving the remaining policy issues for UK transposition*) intended to complete the consultative process on the UK transposition of Solvency II, which began in 2011. It seeks views on two policy issues. Firstly, on the use by undertakings of the volatility adjustment and whether it should be subject to prior approval by the PRA. Secondly, on the approach to be adopted in removing business permissions where an undertaking fails to meet the Minimum Capital Requirement. This consultation will run until 19 September. A further publication will take place later this year to include feedback on this consultation, an updated impact assessment and a final statutory instrument to be submitted for Parliamentary approval.

PRA publishes update on implementation of Solvency II:

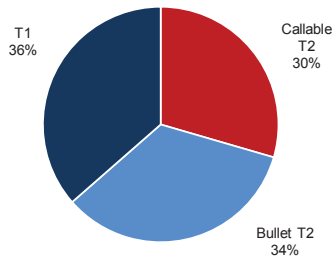
On 25 July, the PRA published an update to provide further clarity on progress towards the implementation of Solvency II. In the document, the regulator stated that it expects the Solvency II Delegated Acts and Implementing Technical Standards to include an availability assessment that requires the PRA to consider two types of restrictions: (1) the fungibility of the own fund items of related undertakings (i.e. whether they are dedicated to absorb only certain losses); and (2) the transferability of the own fund items of related undertakings. According to the PRA, some groups appear to have only considered the legal restrictions when providing information to the PRA on the availability of own funds at the group level. However, the PRA expects groups to consider both legal and regulatory restrictions when considering any limitations on availability. The authority expects this to be in line with the requirements to be set out in the Delegated Acts. ■

Currencies, structures and distribution

Bank hybrid issuance by currency (2013-2014 ytd)

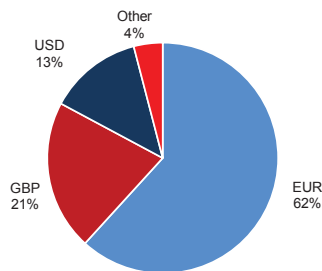


Bank issuance by instrument/structure (2013-2014 ytd)

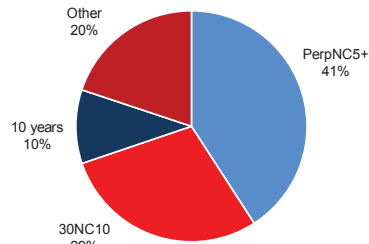


Source: Crédit Agricole CIB

Insurance hybrid issuance by currency (2013-2014 ytd)

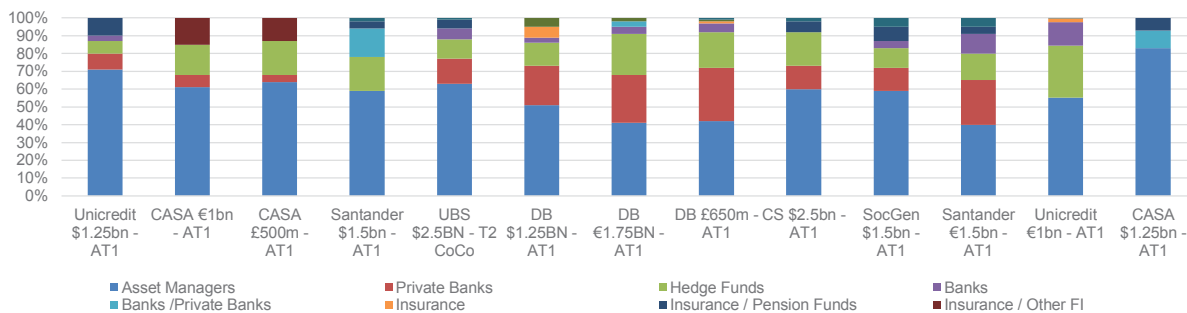


Insurance issuance by instrument/structure (2013-2014 ytd)

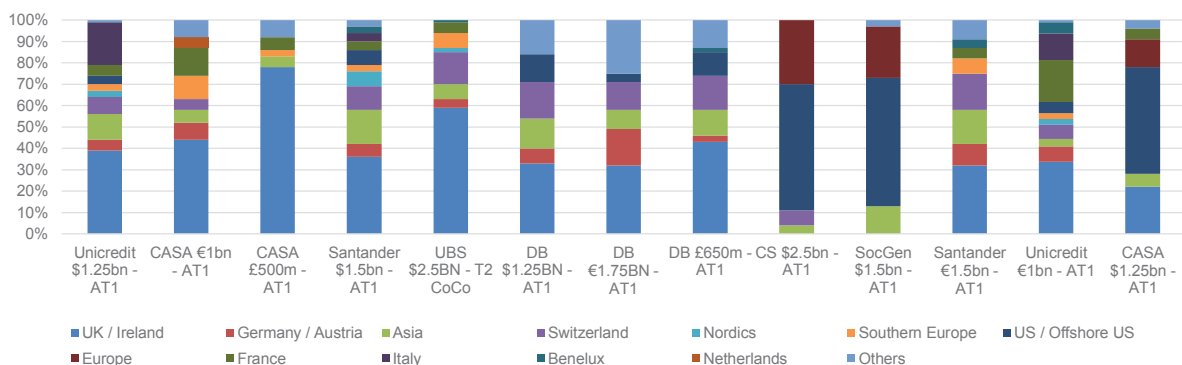


Source: Crédit Agricole CIB

Distribution by investor type



Distribution by geography



Source: Crédit Agricole CIB

AT1, Tier 2 CoCos

AT1 performance monitoring (as at 16/9/14)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	Principal loss absorption	Trigger	Price	I-Spread	Yield to call
10-Sep-14	HSBC	Baa3e/-/BBBe	EUR	1,500	5.250%	Perpetual	16/09/2022	CE	7.000%	100.50	429	5.17
03-Sep-14	UCGIM	-/-/BB-	EUR	1,000	6.750%	Perpetual	10/09/2021	TWD	5.125%	99.88	609	6.77
02-Sep-14	SANTAN	Ba1e/-/-	EUR	1,500	6.250%	Perpetual	11/09/2021	CE	5.125%	97.25	612	6.75
13-Jun-14	BACR	-/B+/BB+	EUR	1,077	6.500%	Perpetual	15/09/2019	CE	7.000%	99.25	635	6.68
20-May-14	DB	Ba3/BB/BB+	EUR	1,750	6.000%	Perpetual	30/04/2022	TWD	5.125%	97.75	548	6.38
01-Apr-14	ACAFP	-/BB+/BB+	EUR	1,000	6.500%	Perpetual	23/06/2021	TWD	7%/5.125%	104.50	505	5.69
28-Mar-14	SOCGEN	-/-/BB	EUR	1,000	6.750%	Perpetual	07/04/2021	TWD	5.125%	102.00	574	6.37
20-Mar-14	LLOYDS	-/BB-/BB	EUR	750	6.375%	Perpetual	27/06/2020	CE	7.000%	103.00	527	5.76
12-Mar-14	KBCBB	-/BB/BB	EUR	1,400	5.625%	Perpetual	19/03/2019	TWD	5.125%	98.50	571	6.01
05-Mar-14	SANTAN	Ba1/-/-	EUR	1,500	6.250%	Perpetual	12/03/2019	CE	5.125%	99.00	624	6.51
05-Mar-14	DANBNK	-/BBB-/BB+	EUR	750	5.750%	Perpetual	06/04/2020	TWD	7.000%	102.50	471	5.22
11-Feb-14	BBVASM	-/-/BB	EUR	1,500	7.000%	Perpetual	19/02/2019	CE	5.125%	102.50	607	6.35
03-Dec-13	BACR	-/B+/BB+	EUR	1,000	8.000%	Perpetual	15/12/2020	CE	7.000%	106.50	620	6.72
01-Oct-13	POPSM	-/-/-	EUR	500	11.500%	Perpetual	10/10/2018	CE	5.125%	114.00	730	7.47
19-Jun-14	VIRGMN	-/-/-	GBP	160	7.875%	Perpetual	31/07/2019	CE (*)	7.000%	103.21	516	7.09
19-Jun-14	COVBS	-/-/BB+	GBP	400	6.375%	Perpetual	01/11/2019	CE (*)	7.000%	98.00	481	6.84
13-Jun-14	BACR	-/B+/BB+	GBP	698	7.000%	Perpetual	15/09/2019	CE	7.000%	96.38	595	7.89
20-May-14	DB	Ba3/BB/BB+	GBP	650	7.125%	Perpetual	30/04/2026	TWD	5.125%	97.88	459	7.40
01-Apr-14	ACAFP	-/-/BB+	GBP	500	7.500%	Perpetual	23/06/2026	TWD	7%/5.125%	100.50	481	7.44
20-Mar-14	LLOYDS	-/BB-/BB	GBP	1,481	7.000%	Perpetual	27/06/2019	CE	7.000%	100.00	509	7.00
20-Mar-14	LLOYDS	-/BB-/BB	GBP	1,494	7.625%	Perpetual	27/06/2023	CE	7.000%	101.50	498	7.39
20-Mar-14	LLOYDS	-/BB-/BB	GBP	750	7.875%	Perpetual	27/06/2029	CE	7.000%	103.38	474	7.50
04-Mar-14	NWIDE	-/BB+/BB+	GBP	1,000	6.875%	Perpetual	20/06/2019	CE (*)	7.000%	98.25	535	7.31
16-Sep-14	NDASS	-/-/BBB	USD	500	6.125%	Perpetual	23/09/2024	TWD	5.125%	101.00	326	5.99
16-Sep-14	NDASS	-/-/BBB	USD	1000	5.500%	Perpetual	23/09/2019	TWD	8.000%	99.875	354	5.53
11-Sep-14	ACAFP	-/-/BB+e	USD	1,250	6.625%	Perpetual	23/09/2019	TWD	7%/5.125%	99.75	477	6.73
10-Sep-14	HSBC	Baa3e/-/BBBe	USD	2,250	6.375%	Perpetual	17/09/2024	CE	7.000%	101.25	348	6.21
10-Sep-14	HSBC	Baa3e/-/BBBe	USD	1,500	5.625%	Perpetual	17/01/2020	CE	7.000%	100.00	360	5.63
19-Jun-14	SOCGEN	Ba2/-/BB	USD	1,500	6.000%	Perpetual	27/01/2020	TWD	5.125%	94.50	522	7.25
13-Jun-14	BACR	-/B+/BB+	USD	1,211	6.625%	Perpetual	15/09/2019	CE	7.000%	97.50	534	7.23
10-Jun-14	CS	-/BB/BB+	USD	2,500	6.250%	Perpetual	18/12/2024	PWD	5.125%	98.50	370	6.45
20-May-14	DB	Ba3/BB/BB+	USD	1,250	6.250%	Perpetual	30/04/2020	TWD	5.125%	97.88	451	6.71
08-May-14	SANTAN	Ba1/-/-	USD	1,500	6.375%	Perpetual	19/05/2019	CE	5.125%	98.25	502	6.81
07-Apr-14	LLOYDS	-/BB-/BB	USD	1,675	7.500%	Perpetual	27/06/2024	CE	7.000%	103.50	436	7.00
27-Mar-14	UCGIM	-/-/BB-	USD	1,250	8.000%	Perpetual	03/06/2024	TWD	5.125%	102.50	493	7.63
15-Jan-14	ACAFP	-/BB+/BB+	USD	1,750	7.875%	Perpetual	23/01/2024	TWD	7%/5.125%	104.38	463	7.23

Principal loss absorption: CE = conversion into equity; TWD = temporary write-down; PWD = permanent write-down; *Converts into Core Capital Deferred Shares (CCDS)

T2 CoCo performance monitoring (as at 16/9/14)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	Principal loss absorption	Trigger	Price	I-Spread	Yield to call
08-Mar-12	CS	-/-/BBB-	CHF	750	7.125%	22/03/2022	22/03/2017	CE	7.000%	107.23	397	4.02
23-May-14	NYKRE	-/BBB-/BBB	EUR	600	4.000%	03/06/2036	03/06/2021	PWD	7.000%	101.27	303	3.78
06-Feb-14	UBS	-/BBB/BBB+	EUR	2,000	4.750%	12/02/2026	12/02/2021	PWD	5.000%	106.50	288	3.59
11-Sep-13	CS	-/BBB/BBB+	EUR	1,250	5.750%	18/09/2025	18/09/2020	PWD	5.000%	111.50	294	3.59
29-Jul-11	BKIR	-/-/-	EUR	1,000	10.000%	30/07/2016	-	CE	8.250%	108.88	468	-
08-May-14	UBS	-/BBB/BBB+	USD	2,500	5.125%	15/05/2024	-	PWD	5.000%	99.25	247	N/A
12-Sep-13	ACAFP	-/BBB-/BBB-	USD	1,000	8.125%	19/09/2033	19/09/2018	PWD	7.000%	113.25	282	4.47
01-Aug-13	CS	-/BBB/BBB+	USD	2,500	6.500%	08/08/2023	-	PWD	5.000%	110.00	248	-
15-May-13	UBS	-/BBB/BBB+	USD	1,500	4.750%	22/05/2023	22/05/2018	PWD	5.000%	101.75	265	4.22
03-Apr-13	BACR	-/BB+/BBB-	USD	1,000	7.750%	10/04/2023	10/04/2018	PWD	7.000%	110.50	304	4.52
17-Jan-13	KBC	-/BBB-/	USD	1,000	8.000%	25/01/2023	25/01/2018	PWD	7.000%	112.50	257	3.98
14-Nov-12	BACR	-/BB+/BBB-	USD	3,000	7.625%	21/11/2022	-	PWD	7.000%	110.50	346	-
10-Aug-12	UBS	-/BBB/BBB+	USD	2,000	7.625%	17/08/2022	-	PWD	5.000%	117.75	240	-
15-Feb-12	UBS	-/BBB/BBB+	USD	2,000	7.250%	22/02/2022	22/02/2017	PWD	5.000%	108.50	249	3.52
15-Feb-12	CS	-/-/BBB-	USD	2,000	7.875%	24/02/2041	24/08/2016	CE	7.000%	106.25	370	4.46

Principal loss absorption: CE = conversion into equity; TWD = temporary write-down; PWD = permanent write-down

Source: Crédit Agricole CIB

Latest bank Tier 2, insurance hybrids

Latest Tier 2 performance monitoring (as at 15/9/14)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	I-Spread	Yield to call
09/09/2014	SOCGEN	Baa3/-/BBB+	EUR	1,000	2.500%	16/09/2026	16/09/2021	187	2.66
08/09/2014	BPCEGP	Baa3/-/A-	USD	1,250	4.500%	15/03/2025	-	201	-
08/09/2014	ISPIIM	Ba1/BBB-/BBB	EUR	1,000	3.928%	15/09/2026	-	235	-
05/09/2014	BACR	Ba1/BBB-/A-	USD	1,250	4.375%	11/09/2024	-	195	-
26/06/2014	BPCEGP	Baa3/-/A-	EUR	1,000	2.750%	08/07/2026	08/07/2021	188	2.89
19/06/2014	ISPIIM	Ba1/BBB-/BBB	USD	2,000	5.017%	26/06/2024	-	221	-
04/06/2014	BKIR	-/B/-	EUR	750	4.250%	11/06/2024	11/06/2019	368	4.33
03/06/2014	BPCEGP	Baa3/BBB+/A-	USD	800	4.625%	11/07/2024	23/09/2024	197	-
03/06/2014	STANLN	A3/A-/A+	GBP	900	5.125%	06/06/2034	-	208	-
22/05/2014	SEB	Baa2/BBB+/A	EUR	1,000	2.500%	28/05/2026	28/05/2021	147	2.45
21/05/2014	RBS	Ba3/BB+/BBB-	USD	2,250	5.125%	28/05/2024	-	229	-
20/05/2014	LBBW	Baa2/-/-	EUR	500	2.875%	27/05/2026	27/05/2021	184	2.82
14/05/2014	BFCM	Baa1/BBB+/A	EUR	1,000	3.000%	21/05/2024	-	143	-
14/05/2014	RABOBK	A2/A-/A+	EUR	2,000	2.500%	26/05/2026	26/05/2021	163	2.61
14/05/2014	RABOBK	A2/A-/A+	GBP	1,000	4.625%	23/05/2029	-	164	-
13/05/2014	BKIASM	-/B-/B+	EUR	1,000	4.000%	22/05/2024	22/05/2019	344	4.08
12/05/2014	DANBNK	-/BBB/A-	EUR	500	2.750%	19/05/2026	19/05/2021	167	2.65
02/04/2014	FRLBP	-/BBB/-	EUR	750	2.750%	23/04/2026	23/04/2021	164	2.60
08/04/2014	BPCEGP	Baa3/BBB+/A-	GBP	750	5.250%	16/04/2029	-	208	-
26/03/2014	NDB	Ba1/-/-	USD	500	6.250%	10/04/2024	-	369	-
02/04/2014	BBVASM	Baa3/BBB-/BBB+	EUR	1,500	3.500%	11/04/2024	11/04/2019	211	2.74
21/03/2014	STANLN	A3/A-/A+	USD	2,000	5.700%	26/03/2044	-	204	-
20/03/2014	RBS	Ba3/BB+/BBB-	EUR	1,000	3.625%	25/03/2024	25/03/2019	247	3.09
13/03/2014	BNP	Baa2/A-/A+	EUR	1,500	2.875%	20/03/2026	20/03/2021	164	2.59
11/03/2014	AARB	-/-/BBB-	EUR	300	4.250%	18/03/2026	18/03/2021	237	3.32
05/03/2014	HSBC	A3/A-/A+	USD	2,000	4.250%	14/03/2024	-	129	-
05/03/2014	HSBC	A3/A-/A+	USD	1,500	5.250%	14/03/2044	-	144	-
18/02/2014	INTNED	Baa2/BBB+/A-	EUR	1,500	3.625%	25/02/2026	25/02/2021	208	3.02
17/02/2014	SWEDA	Baa2/A-/A	EUR	750	2.375%	26/02/2024	26/02/2019	143	2.04
12/02/2014	RBIIV	Baa3/BBB/*-/A-	EUR	500	4.500%	21/02/2025	21/02/2020	329	4.06
14/01/2014	SOCGEN	Baa3/BBB+/BBB+	USD	1,000	5.000%	17/01/2024	-	185	-
13/01/2014	BPCEGP	Baa3/BBB+/A-	USD	1,500	5.150%	21/07/2024	-	176	-
07/01/2014	SHBASS	Baa1/A-/A+	EUR	1,500	2.656%	15/01/2024	15/01/2019	137	1.96
05/03/2014	HSBC	A3/A-/A+	USD	2,000	4.250%	14/03/2024	-	129	-
05/03/2014	HSBC	A3/A-/A+	USD	1,500	5.250%	14/03/2044	-	144	-
18/02/2014	INTNED	Baa2/BBB+/A-	EUR	1,500	3.625%	25/02/2026	25/02/2021	208	3.02

Insurance performance monitoring (as at 15/9/14)

T1/T2	Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity Date	First Call Date	New issue spread (over mid-swaps)	I-spread
T2	11-Sep-14	ALVGR	A2e/-/-	EUR	1,500	3.375%	Perpetual	18/09/2024	220	225
T2	08-Sep-14	HANRUE	-/A/-	EUR	500	3.375%	Perpetual	26/06/2025	225	213
T2	18-Jul-14	ADMLN	-/-/BBB-	GBP	200	5.500%	25/07/2024	-	-	265
T2	08-Jul-14	NNGRNV	Baa3/BBB/-/-	EUR	1,000	4.500%	Perpetual	15/01/2026	300	324
T2	26-Jun-14	PICORP	-/-/-	GBP	300	6.500%	03/07/2024	-	-	354
T2	25-Jun-14	AVLN	Baa1/BBB/-	EUR	700	3.875%	03/07/2044	03/07/2024	248	240
T2	19-Jun-14	LGEN	Baa1/BBB+/BBB	GBP	600	5.500%	27/06/2064	27/06/2044	-	229
T2	06-Jun-14	USIMIT	Ba2/BB+/A-	EUR	750	5.750%	Perpetual	18/06/2024	418	461
T2	06-Jun-14	DLNA	-/BBB/-	EUR	750	4.375%	Perpetual	13/06/2024	290	335
T2	02-Jun-14	ZURNVX	A3/A/-	CHF	200	2.750%	Perpetual	30/09/2021	208	171
T2	27-May-14	CNPFP	-/BBB+/A-	EUR	500	4.250%	05/06/2045	05/06/2025	260	238
T1	22-May-14	CCAMA	-/-/BBB	EUR	1,100	6.375%	Perpetual	28/05/2024	477	471
T2	21-May-14	POSIM	-/-/BBB	EUR	750	2.875%	30/05/2019	-	-	172
T2	14-May-14	AXASA	A3/BBB/BBB	EUR	1,000	3.875%	Perpetual	08/10/2025	225	246
T2	07-May-14	WUWGR	-/BBB/-	EUR	250	5.250%	15/07/2044	15/07/2024	350	337
T2	23-Apr-14	ASSGEN	Baa3/BBB+/BBB	EUR	1,000	4.125%	04/05/2026	-	225	201
T2	17-Apr-14	AEGON	Baa1/BBB/BBB	EUR	700	4.000%	25/04/2044	25/04/2024	235	226
T2	01-Apr-14	NNGRNV	Baa3/BBB-/BBB-	EUR	1,000	4.625%	08/04/2044	08/04/2024	295	279
T2	19-Mar-14	COFCHD	Baa1/-/A-	EUR	380	4.125%	27/03/2024	-	235	193
T2	22-Jan-14	ALVGR	-/A+/A	CHF	500	3.250%	Perpetual	04/07/2019	257	197
T2	08-Jan-14	AXASA	A3/BBB/BBB	GBP	750	5.625%	16/01/2054	16/01/2034	227	214

Source: Crédit Agricole CIB

League tables

Bookrunners all European FI hybrids (all currencies)
01/01/2014 to 15/09/2014

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	HSBC	21	10,505	12.6
2	Deutsche Bank	22	7,236	8.7
3	UBS	19	5,710	6.9
4	BAML	20	5,173	6.2
5	Société Générale	16	4,821	5.8
6	BNP Paribas	15	4,037	4.9
7	Credit Suisse	11	4,035	4.9
8	Barclays	16	3,824	4.6
9	Crédit Agricole CIB	12	3,639	4.4
10	Citi	14	3,567	4.3
11	Morgan Stanley	16	3,422	4.1
12	Goldman Sachs	15	3,062	3.7
13	JP Morgan	14	2,839	3.4
14	RBS	14	2,743	3.3
15	Natixis	8	2,141	2.6
Total		105	83,199	

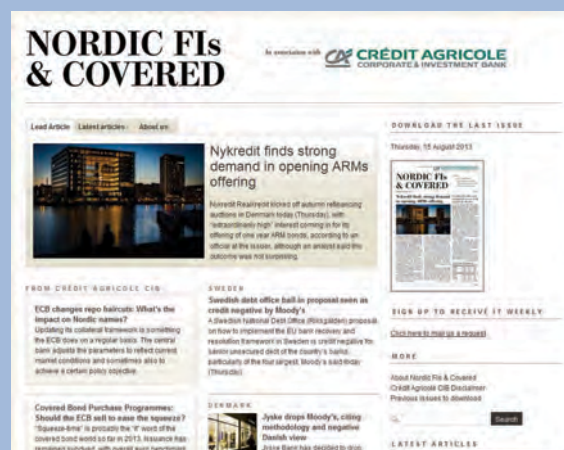
Source: Dealogic, Thomson Reuters, Crédit Agricole CIB

Bookrunners all financials (euros)
01/01/2014 to 15/09/2014

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	Deutsche Bank	57	14,586	8.2
2	BNP Paribas	66	14,034	7.8
3	Société Générale	45	11,027	6.2
4	Barclays	55	10,807	6.0
5	Morgan Stanley	42	10,391	5.8
6	Natixis	29	9,843	5.5
7	Crédit Agricole CIB	28	9,044	5.1
8	Goldman Sachs	38	8,950	5.0
9	HSBC	41	8,690	4.9
10	Citi	35	7,788	4.4
11	JP Morgan	42	7,473	4.2
12	UBS	24	6,360	3.6
13	BAML	26	5,065	2.8
14	Credit Suisse	22	4,394	2.5
15	UniCredit	24	3,575	2.0
Total		350	178,858	

Includes banks, insurance companies and finance companies.
Excludes equity-related, covered bonds, publicly owned institutions.

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CASA

AT1 commitment

Crédit Agricole took its total AT1 issuance to some €3.8bn with a \$1.25bn deal on 11 September, making it one of the most active banks in Basel III-compliant capital instruments. Here, Olivier Bêlorgey, head of the financial management department, Crédit Agricole, and Bernard du Boislouveau, head of FI DCM France, Crédit Agricole CIB, discuss how Crédit Agricole is building its franchise in the hybrid market.

Neil Day, Bank+Insurance Hybrid Capital: This was your fifth contingent capital trade since you launched your inaugural Tier 2 hosted CoCo in September 2013. What is the rationale behind this latest AT1 transaction?

Olivier Bêlorgey, Crédit Agricole: The rationale is totally in line with our previous issues. That is: firstly, we want to strengthen the capital structure of the group in order to protect our rating and to comply with the expectations of the market concerning our capital structure. We have therefore reused exactly the same structure that we conceived in January and already reused in April, which is a dual trigger instrument with one trigger, the low trigger, at Crédit Agricole SA (CASA) level — which is the issuing entity of this instrument, and hence the trigger is a regulatory one — and we have added a high trigger, at group level — which is our own decision, because when we explain the strength and the capital structure of Crédit Agricole, we always refer to the

group, so we also wanted this instrument to be linked to the group level.

Plus, more specifically for this issuance: it is part of the capital roadmap we disclosed to the market in our medium term plan, but we perhaps issued a little more quickly than we anticipated because of a methodological change by Standard & Poor's regarding their evaluation of a hybrid instrument issued by our insurance company subsidiary. Since May these instruments are now, in the RAC calculation, deducted from our core equity Tier 1, whereas they were previously deducted from Tier 1 or Tier 2. This methodological change had an impact of 40bp on our RAC ratio, and even if we remain above the 7% threshold — which is very important for S&P in terms of RAC ratio — we had less room for manoeuvre, and we wanted to restore this room. That's why we issued a little more quickly than the market, perhaps, and we, anyhow, anticipated in April.

Bernard du Boislouveau, Crédit Agricole CIB: We can also say, Olivier,

that the timing of the issue was linked with the fact that the market is in a quite good shape, no?

Bêlorgey, Crédit Agricole: Yes. Finally, even if the market is clearly heavier than during the first half of the year, it remains good — especially for issuers that have a good track record in this type of instrument, or issuers with highly appreciated names in the market. HSBC, for instance, who came the day before us, and ourselves — these two issues were, I think, well received by the market with large order books.

So, the market is of course heavier than in the first half, but in a sense it's a market more balanced between issuer and investors — and anyway we didn't expect this euphoria of the first half to last forever.

Day, BIHC: Every time you've done an AT1 transaction, you've done a roadshow. Why do you place so much importance on this?

Bêlorgey, Crédit Agricole: These are

high yield instruments, and even if it's the fourth or fifth time we are issuing, and even if some issuers have used this instrument many times now, it remains rather a new instrument, with a level of risk that is clearly not at all the risk of senior unsecured issuance. We therefore think that it remains important for us to go and see the investors to re-explain all the features.

And, to be honest, each time we have done so we have seen the market evolving and investors focusing on more and more detailed and specific elements of the structure and regulations. As evidence of that, I would say that in January the market was very focused on the write-down mechanisms and all the buffers before write-down – and that's practically all that was focused on. After that, in April, the market was focused on the mandatory distribution restriction – and this was natural, as it is a very pertinent issue. So the market has understood, OK, I have big buffers before write-down, but will I receive my coupon? Because in the regulations there are some elements that are tricky to understand in relation to cancelling the coupons. So the market was focused on what these elements are, what kind of buffer there is before that eventuality. And right now, in September, the market was even more precise: on top of these buffers in relation to coupon cancellation, they also focused on what we



Olivier Bélorgey, Crédit Agricole

call distributable items that you have in order to pay the coupon.

So we think that the market is not yet mature, and that it was worth doing another roadshow. And I think also it's a sign of respect towards investors to come and see them face to face, one on one, when you sell this kind of high yield instrument.

Day, BIHC: Were there any structural changes for this new issue?

Bélorgey, Crédit Agricole: There were only two very small amendments to the structure, both dictated by regulatory developments. One concerns the contractual acknowledgement of the EU

authorities in terms of bail-in as this new paper is issued under New York law, and the other element concerns the cap on the maximum write-down amount. I won't enter into the details here, because it is very technical, but clearly these were only very minor adjustments that were necessary given in light of clarity on the regulations.

Du Boislouveau, Crédit Agricole CIB: And we can say that during the roadshow – whether in London, New York or Boston – this structure was very well understood, and we had no specific questions on the already well-benchmarked dual trigger structure, to be frank.

Bélorgey, Crédit Agricole: Yes, and I think that the investors responded very well to the fact that we took the time to explain these little differences, which were very technical.

Du Boislouveau, Crédit Agricole CIB: One thing that is very interesting that we heard – not during this roadshow but the previous one – is that some of these investors want to be treated similarly to equity investors. That's the reason why they want to be as close as possible to issuers, and that's also probably the main reason why CASA is spending so much time on the road, explaining its funding strategy and es-

CASA USD RESETTABLE CALLABLE NOTE PERPNC5

Rating: BB+ (Fitch)

Amount: \$1.25bn of Additional Tier 1 capital. Principal writes down (but can be written back up)

Maturity: perpetual

Call option: 23 September 2019

Capital Ratio Event: "Capital Ratio Event" will be deemed to have occurred if (i) Crédit Agricole SA's CET1 Capital Ratio falls or remains below 5.125%, or (ii) the Crédit Agricole Group's CET1 Capital Ratio falls or remains below 7%

Fixed/re-offer price: 100.00%

Coupon: 6.625% p.a. until call date; thereafter reset

every five years at the prevailing five year USD mid-market swap rate plus initial spread (469.7bp)

Yield at re-offer: 6.625%

Launched: Tuesday 11 September

Payment date: 18 September 2014

Sole bookrunner: Crédit Agricole CIB

Distribution:

Geography

North America 50%, Asia 6%, Europe 44%

Type

Asset managers 83%, bank and private banks 10%, insurance companies and pension funds 7%

pecially what it intends to do with this type of instrument.

Day, BIHC: Did the aftermath of BES present any challenges?

Bélorgey, Crédit Agricole: Our CFO did a wonderful job in this respect when explaining the first half results, and to be honest only perhaps one-third of the investors asked us about BES, and it was more or less to have confirmation of what our CFO explained in August. So it was not a problem.

Day, BIHC: Why was a PerpNC5 structure chosen? Did you consider a long five year non-call period like Société Générale or HSBC?

Bélorgey, Crédit Agricole: We told investors that we were very flexible on the date of the first call, either non-call five or non-call 10, and we just gathered up investors' requirements and chose the maturity that fitted the majority of them. And after that we chose to be very simple.

Day, BIHC: How much have you raised in AT1 format so far and what are your plans by 2016? Will we see CASA back in the capital space soon?

Bélorgey, Crédit Agricole: We have already raised Eu2.9bn plus this one, which was just over Eu0.9bn, so we have already raised a little more than Eu3.8bn. Our target for the medium term plan for the period 2014-2016 was Eu4bn plus. Due to the methodological change of S&P, during the roadshow I indicated to the investors that our revised target will probably ultimately be more around Eu6bn than Eu4bn.

We will be a little opportunistic and it will depend on the appetite of the market and so on and so forth, but we don't need to return to market very quickly in the coming months. That leaves around Eu2bn for the next two years.

In our medium term plan we disclosed a capital plan whereby we do not issue any Tier 2, but I clearly indicated



Bernard du Boislouveau, CACIB

to investors that this medium term plan was built without taking into account all the discussions concerning MREL and GLAC or now TLAC. Obviously these discussions will now steer us to issue some Tier 2 one day. I don't know exactly the quantum, but the next move will also be in the direction of Tier 2. Right now it's really too early to give the market precise indications.

Another thing I mentioned to the investors is that due to the methodological change made by S&P on the hybrid instrument issued by our insurance company, it gives us some more economic incentive to issue hybrid instruments through our insurance company directly into the market, rather than the current situation, where all its issuance was subscribed by Crédit Agricole SA and the banking side. Due to the evolution from Solvency I towards Solvency II, it would have been efficient to issue directly from our insurance company into the market from 2016, but this S&P methodological change makes it relevant right now. So I also indicated that we had different instruments available to partially compensate for S&P's change, either issuing a little more at bank level and also issuing potentially — it's not a commitment — partly through our insurance company.

Day, BIHC: This was the first time that you have appointed a sole bookrunner for a deeply subordi-

nated US dollar transaction. Were you satisfied with the structure of the syndicate, the pricing parameters and quality of the order book?

Bélorgey, Crédit Agricole: Absolutely. Our CIB has made a lot of progress, and a lot of investment to be in that position and to be credible in that role. In fact it's also part of our medium term plan objective for our CIB. The market was a little surprised by our ambitions in terms of the CIB business. We explained that we deleveraged a lot during the crisis, perhaps more than some competitors, and that right now, in a client-driven environment and business, we wanted to invest more in what we call our CIB debt house. We therefore invested in this fixed income platform, and to be honest the results have reached our targets. On this transaction the syndicate was successful, while the sales team did a wonderful job. We had more than 400 clients — that's clearly a great result.

Du Boislouveau, Crédit Agricole CIB: The main thing I would take away from this transaction is the focus the issuer placed on trying to be as consensual as possible and acting in the way investors expect when bringing a transaction to the market. The issuer is clearly showing that it invests time in a dialogue with its core investor base for these high beta transactions, as demonstrated by the success of this deal. Despite the fact that a couple of recent transactions were put in the market in a much more awkward manner, Crédit Agricole managed to garner a book of \$7.5bn with a good spread performance after the break, and it is still the case today. This proved that the way CASA is executing its global funding strategy and tactics for its funding is spot-on.

Day, BIHC: What do you expect from the forthcoming AQR?

Bélorgey, Crédit Agricole: I cannot disclose anything. What I should indicate to the investors is that we don't expect any material impact from the AQR. ●

Crédit Agricole

Navigating different markets

Much has changed since Crédit Agricole SA first accessed the US dollar Additional Tier 1 market in January, meaning a flexible approach was adopted for its latest AT1. Here, Vincent Hoarau, managing director, head of FIG syndicate at Crédit Agricole CIB, discusses how CASA's track record supported execution and how CACIB is developing its hybrid franchise.

What factors influenced the approach to pricing?

Vincent Hoarau, Crédit Agricole CIB:

The pricing rationale looked straightforward at first sight. CASA's 7% 01/29/49 was bid at 105.75%, or 7.10% in yield-to-call and an I-spread of 450bp before the initial price thoughts were announced.

Based on pricing levels for HSBC's US dollar PerpNC5 and PerpNC10 the previous day, the curve was flat between five and 10 years. With the five year US dollar swap rate at around 1.95% during the process, the area of mid-6% YTC looked like fair value.

Nevertheless, Société Générale's curve was strongly inverted, with a spread differential between its 6% 10/27/49 (NC5) and 7% 12/29/49 (NC10) of around 40bp. On this basis many investors argued for a higher coupon level. Meanwhile, some key investors saw a credit spread differential of 100bp between an investment grade HSBC AT1 and non-investment grade CASA AT1. HSBC's PerpNC5 was

priced at 5.625% the day before CASA priced. Finally, some opportunistic buyers highlighted an eye-catching 7% coupon mark as the lowest level at which they would commit in primary.

Given market circumstances and investor behaviour in previous deals, we could not afford to ignore that. We therefore tried to adopt a consensual approach, but kept in mind the range of 6.5%-6.75% as a pricing target subject to the new issue premium ultimately requested. We set IPTs at 6.75%-7% early morning, and in doing so incorporated the wide range of investor feedback. We verbally gave guidance to investors on sizing, saying that \$1.5bn was off the table, and incorporated a scarcity element in the process while ensuring a strong bookbuilding process.

When books crossed the \$5bn mark we refined guidance to 6.625% (+/- 0.125%) and waited for the New York open and further traction from US investors to fix the coupon and announce a transaction of \$1.25bn. Books closed around the \$7.5bn mark, with more than 400 investors engaged.

CASA has been very active this year in the AT1 space while the market turned less issuer-friendly. Did you feel any kind of "CASA fatigue"?

Hoarau, CACIB: Not at all. The perception of the signature has improved significantly since the darkest phase of the crisis and the sale of Emporiki. The equity story and the solid credit spread performance is a perfect illustration of the appetite for the signature. Elsewhere, outstanding CASA AT1s outperformed the rest of the market during the sharp correction move in early August. Investors like that. So the appetite for the credit is intact and real money investors continue to increase exposure. They love the retail-focused business model of the group, the level of capital generation, the group guarantee mechanism, but also the levels of distributable items.

Did you experience any resistance to pricing?

Hoarau, CACIB: Resistance to the IPT level was virtually non-existent since we

adopted a consensual attitude and listened carefully to investors. Nevertheless, there are a lot of opportunistic and fast money investors out there. Some of them dropped out when we fixed the coupon at 6.625%. The size of \$1.25bn was widely accepted.

The USD AT1 curve of your direct peer Société Générale is inverted, but CASA's PerpNC5 was priced flat to the outstanding PerpNC10 launched in January 2014 — how come?

Hoarau, CACIB: HSBC had set fresh references in the market, pricing NC5 and NC10 tranches in US dollars flat to each other in terms of spread versus swaps. So there was no point in considering Société Générale's outstanding curve. In the secondary market there are a lot of anomalies and sometimes outstanding references are bad guides.

You executed this USD RegS/144a transaction intra-day, while you adopted a longer execution timeframe for the inaugural trade. Why was that?

Hoarau, CACIB: You are right. Back in January, when we executed the inaugural US dollar AT1 trade, we opened books in Asia hours and continued bookbuilding into European and US hours. But the markets have proven to be very volatile those days — overnight risk is back — and the investor mood is also very erratic, while we did not expect much traction out of Asia. Markets and investor behaviour have changed, so we adapted the execution strategy accordingly and executed the transaction intra-day.

Regarding the profile of Asian demand, it has changed drastically since the beginning of the year. We see more institutional-style buy-side accounts and hedge funds involved. Asian private banks have almost left the market and their strong participation in the inaugural HSBC AT1 transaction was due to the investment grade profile of the trade and, more importantly, the footprint of the issuer in the region.

Were you satisfied with the book-



building process and the quality of the order book? Did you see any major change in the distribution profile?

Hoarau, CACIB: We were extremely satisfied. It was key for us to demonstrate that confidence had been restored in the AT1 segment. And \$7bn and 400 investors is a strong headline, no?

But the inaugural CASA US dollar AT1 transaction attracted \$24bn with more than 900 investors involved. How do you explain the difference?

Hoarau, CACIB: Demand out of Asia has decreased significantly, with limited support from private banks in AT1s. Lot of fast money, opportunistic buyers and low quality hedge funds across Europe also quit the segment since the sharp correction in August. In general, investors are much more selective and price sensitive, so the profile of the books and sizes change. More importantly, order inflation has disappeared in most transactions. In primary we will observe a strong differentiation going forward. Inaugural core AT1s will be synonymous with frenzy and inflation, and the others with sober investors.

How did the deal perform in the aftermarket?

Hoarau, CACIB: The bonds traded up off the break, up to 100.5% and down to 99.50% one day after pricing, before stabilising around par. As mentioned earlier, the level of inflation in this trade was very limited and the final size of the book reflected the real size of the demand. So a secondary trading level close to par implies pricing and sizing were spot on.

This was CACIB's debut as sole bookrunner for a deeply subordinated US dollar-denominated transaction. Did you experience any specific challenges and were you satisfied with the overall outcome?

Hoarau, CACIB: We were sole bookrunner for CASA's inaugural euro-denominated AT1 transaction back in the second quarter. So the sole bookrunner role for a US dollar benchmark was a natural objective for the capital markets franchise. Working alone for the mother company is a challenge per se. There is zero tolerance and you must tick all the boxes. You can't rely on a group of banks.

When we look at the pricing level, aftermarket trading as well as the quality, granularity and overall size of the order book, we are highly satisfied. Over the last two years, CACIB has invested a lot in the hybrid franchise, particularly in the distribution capacity of the US dollar platform. Now, we have a strong set up in place with Coverage, DCM, Capital Solutions, Syndicate, Trading, Sales and Research fully aligned.

How do you expect the AT1 market to evolve for the rest of the year?

Hoarau, CACIB: In Europe, I think we will face some hectic moves around the AQR announcement while the geopolitical environment will remain unstable for some time. Volatility in equities might increase again, with some spill-over effects in the AT1 space, which is highly correlated with the evolution of stock markets.

Spreads should find a floor for the rest of the year, with the 5% coupon mark as a critical resistance level and zone of profit-taking. ●



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Team UK

The UK has led the way in new-style bank capital instruments and sterling issuance has found its way into investors' portfolios, but the pace of regulatory change has brought with it uncertainty.

A difficult summer has meanwhile thrown up many questions about the asset class. Leading players gathered in London on 2 September to discuss the latest developments.

Neil Day, Bank+Insurance Hybrid Capital: How has supply from UK banks panned out versus expectations?

Pascal Decque, Crédit Agricole CIB: What we can say is that UK banks were among the first movers in the AT1 market, back in late 2013 with Barclays first issuances. Since then, including the exchanges that Lloyds and Barclays made, plus issues from Coventry and Nationwide, we can say that in the last 12 months UK supply has been around 30%-40% of the whole market. They have been first movers and big contributors to the market.

Regarding expectations, it's a trickier question, because the market did not have a very good view at the start of the year of how the market would grow. I would say that globally supply has been more or less in line with our expectations. Breaking it down on a name by name is much more difficult — although Barclays has always made clear that they want to issue at least 1.5% of risk weighted assets.

On top of that I would say that the icing on the cake was the announcement of HSBC's Additional Tier 1. Meanwhile Royal Bank of Scotland, if I'm not wrong, has made clear on their side that is not a topic for them in the short term.

Christian Scarafia, Fitch: Yes, there was strong supply in the first half of this year. We rated upwards of £10bn of UK AT1 instruments — and there was also sizeable issuance from other European countries and emerging markets. The incentive remains there for banks to fill up the 1.5 percentage point buffer, so we would expect further issuance. The other thing we saw in

the first half was certain medium-sized institutions issuing in the UK, the building societies and some smaller issuers as well.

Day, BIHC: Has the UK proven an interesting area of supply for investors?

Sebastiano Pirro, Algebris Investment Management: Yes, it has been very interesting for us. We have dedicated money that we only invest in bank capital, which we gradually shifted to Basel III-compliant securities along with the new issuance. Barclays and Lloyds were first-movers in terms of announcing deals. We expected big supply out of UK banks, and we still foresee significant issuance from UK banks in the future.

Day, BIHC: Has it been an advantage for UK banks coming first, or is it more of a challenge?

Vishal Savadia, Lloyds: If you think back to the turn of the year, a lot of work was being done by issuers with investors on AT1 instruments, and it was uncertain how the market would grow as we went into 2014. From a UK issuer standpoint, we saw a number of pieces align as we came into 2014, particularly on the regulatory side, and I think that gave issuers the confidence to then go out and access the market. It has been positive to see the depth of demand.

It's hard to say if there is a first-mover advantage or not. If you looked at the market six weeks ago you'd say that the guys who issued in the first part of the year did well. It'll be interest-



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Moderator: Neil Day,
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ing to see how the market develops and as a broader issuer base accesses the market.

From our perspective at least, we've gone out with a trade that filled our AT1 bucket. We've now got 2% of AT1 in our capital structure, which has largely taken AT1 off the table for us in the medium term, and positions us well in my mind in what I think is the next regulatory debate — developments with regards to total capital planning, bail-in and recovery and resolution.

Scott Forrest, RBS: In terms of our plans, we had AT1 issuance pencilled in not for 2014 but for 2015, so we have been comfortable with our plans and the trajectory of our capital position. Your ability to issue AT1 instruments is, to some extent, dictated by the distance to your trigger levels as well, so those two things can go hand in hand — as our CET1 position builds up then we can plan for the issuance of AT1.

The only thing that I would add in terms of early-mover perspective is, if you look at the likes of Nationwide or Coventry, they issued instruments that they thought would count in totality towards their leverage position, but given that we are now in a changing environment it is questionable whether they will get the full value for those instruments.

Richard Staff, Standard Chartered Bank (SCB): AT1 makes sense for all UK banks to issue given the regulatory incentive attached to meeting CRR minimums with the appropriate tier of capital. As an institution we had no intention of being a first-mover regarding AT1 and have continued issuing Tier 2 capital. I think the FPC leverage consultation paper released over the summer has made UK issuers take a hard look at the value of AT1 and the value of being early to the market.

Aravind Chandrasekaran, Camares: I would argue that the first-mover advantage has actually been for the investors if you look at how the earlier deals priced versus how these new deals are pricing. Even from a structural perspective, generically we tend to prefer the older generation of higher coupon higher resets. And to the extent that you see evolution in Europe towards higher triggers, you're better off holding the 5.125% triggers. So I'd say it's the exact opposite.

Matthew Williams, Carmignac: I agree that with the asset class being new and the investor base as yet undetermined, new issuers had to pay up to attract investors to these instruments. That evolution may now be behind us, but we'll see. So I think the first mover advantage was for investors to get in first, rather than for issuers to issue first.

Grégoire Pesques, Amundi: In general you have a first-mover advantage. However, for this particular asset class, when there is no identifiable bias, you can have prices that vary very significantly from what you consider fair value. So then you can have behaviour that you were not expecting even if you are well aware of all the different covenants and specificities of each particular bond. So I'm a bit more, I would say, cautious. You have



Scott Forrest, RBS: "As our CET1 position builds up then we can plan for the issuance of AT1"

the idea of your fair value, but given that it remains relatively untested as an asset class — with no natural buyers so far — maybe the buyers at the very beginning were not the same as now, and the technicals of this asset class may stay quite volatile. So I think it's true if you have a long term investment horizon, but in the short term you can have some discrepancies that you were not, I would say, expecting, just for technical reasons.

Day, BIHC: In the UK, which is one of the more mature sectors, we've seen issuers beyond the national champions come to market. Do people expect there to be more supply from and investor interest in the mid-sized names?

Amreetpal Summan, Crédit Agricole CIB: I think there won't be as much supply in mid-size UK banks. The cost of issuing an AT1 for some of these smaller banks is going to be fairly expensive given the profitability of the business — they are run with very tight margins — and most of these guys are actually pre-empting the leverage ratio, more than anything else. Everyone expected Barclays, Lloyds and so on to be issuing, but I think everyone was quite surprised when the mutuals began to issue, especially with them finding solutions with the CCDS, which has actually made it even more interesting for the investors. A lot of investors prefer the CCDS over the AT1. So yes, I agree with you, many customers I speak to would love to have these kinds of securities but opportunities will be limited. We believe the recent issuance was driven by the fear that the leverage ratio would increase from 3% to 4%. At the same time, most of these deals will be in sterling, thus limiting your investor base and given the smaller issue size they will be very well held.

Michael Benyaya, Crédit Agricole CIB: A CCDS qualifies as



Vishal Savadia, Lloyds: "We shouldn't get carried away that the market's going to stay like this forever"

CET1 and is definitely very specific to the UK market and also specific to some issuers. When the CCDS came onto the market earlier this year there was a kind of debate as to whether it was closer to equity or to fixed income instruments. But it was mainly placed towards the fixed income investors, which was, I believe, an overall positive signal for the development of capital instruments for smaller issuers.

Day, BIHC: We have seen three markets clearly open — euros and dollars as well as sterling. What are the differences? You did different currencies in your ECN exchange at Lloyds.

Savadia, Lloyds: For a business like Lloyds with a largely sterling balance sheet, issuance in sterling is preferable. That

The sterling market is and will probably remain a smaller asset class

was very much in mind as we structured the exchange. AT1 instruments have accounting complexities attached to them which make in some certain instances foreign currency issuance slightly more challenging from a balance sheet management perspective.

That said, I think it is positive to see demand across currencies, and we've launched AT1 across sterling, euros and US dollars. Going back to some of the points raised earlier, there is a finite demand for sterling AT1, and so in that respect you are going to see issuers looking outside their core currency as evaluate access to the market.

Day, BIHC: Scott, are you encouraged by how the different currency markets have evolved?

Forrest, RBS: Yes. From our perspective, from any issuer's perspective, you're looking at where the strength and depth of the market is and what's going to be cost effective for you to issue. We all have CFOs that we have got to report into, and they've all got a focus on the pennies. It'll be encouraging to see even more development in terms of the sterling market. I think it's there for longer duration capital instruments, and depending on how you want to build out your capital profile and maturity buckets, then sterling could play a role there, but it's not as strong and it's not as deep as other markets such as dollars.

Staff, SCB: The ability to issue to as diverse an investor base as possible is clearly useful. That said, the challenge of hedging this particular asset class makes it more challenging to look outside of US dollars for Standard Chartered.

Benyaya, CACIB: The accounting angle is important, because the AT1 are accounted for as equity under IFRS, so it cannot be hedged, so the choice of currency to some extent reflects the businesses of the issuer.

Pirro, Algebris: We are generally agnostic towards currencies — we can invest in all of them.

In 2014 we have been focusing more on euros, which was a less developed asset class in the AT1 space and offered compelling value opportunities, both in terms of spread and yield. Right now, we have a balanced allocation towards euros and dollars. The sterling market is and will probably remain a smaller asset class for the space.

Pesques, Amundi: At Amundi in London we are mostly managing global portfolios, which means that we like to have the choice between the different currencies. And it's all the more important for this particular asset class: you can have a yield approach or a spread approach, or at least relative value opportunities between the different tranches. So, yes, we like to have multiple currencies, but we were there for some smaller issuers who for reasons of hedging or liability management just issue in their domestic currency, whether it is sterling or for some other issuers euros.

Forrest, RBS: It's great to hear that everyone around this table buys the asset class, but there is a group there in terms of the insurers who struggle to buy AT1 instruments, just because of the impact on Solvency II. I think that if that group were able to buy the instrument, then you'd see a new class of investors come in. They may have difficulties buying it directly, but perhaps they could buy into active funds of funds.

Summan, CACIB: We have recently seen sellers of CoCos from Asian life insurers. There was recently a ruling that Tai-

wanese life insurers could not hold CoCos and following that we saw a few Chinese and regional life insurance companies sell down holdings in RAC Tier 2s and AT1s. This could become a theme across Europe as well, where insurance companies are effectively restricted from buying CoCos. As you said, under Solvency II it is very punitive to hold CoCo and equity on the books. So that's one of the big hurdles in terms of investor base.

Pesques, Amundi: There are many countries where insurance companies can't, in their own mandate or dedicated funds, invest in CoCos. For significant numbers of our mandates for insurance companies, at least in Europe, we can't invest in CoCos and according to them it is the regulator.

Day, BIHC: The UK PRA has its one year hold on selling CoCos to retail in place. Does anyone have any views on the wisdom of that, and how that might restrict demand?

Forrest, RBS: To a certain degree I find it quite curious because if you pick up an offering circular it is plastered with health warnings all the way through it to its very core. So there are restrictions for retail investors from buying those instruments, but they can go out and buy equity, which is more subordinated, more junior, without having the same warnings.

But I can see what they're getting at, namely is this an instrument that should be in retail hands, or is it something that should be in institutional hands?

Decque, CACIB: But nevertheless both the Bank of England and the FCA hit the market in the summer — although it was caught up in the BES issue, which was affecting the market at the same time. The Bank of England mentioned in its Financial Stability Report that investors potentially haven't a full understanding of all the risks of potential triggers on this type of instrument. And on top of that the FCA issued its circular — although if I'm not wrong they excluded high net worth individuals from the retail investor base. This is strange behaviour given that at the same time they are requiring that banks meet very, very high capital ratios and to meet these the banks are forced to issue this type of instrument.

Summan, CACIB: I don't think it had too much of an impact, because most UK private investors were not involved, because a lot of the banks were probably too scared to even sell it to them. Litigation risk remains high, with retail banks constantly in the spotlight following the PPI scandal, so there is a fear of further mis-selling headlines. So I think it was never really a concern.

The only real private investors were in Asia, and that was on the initial dollar deals, some of which were actually promoted as retail deals. Recent flows have shifted away from retail/private wealth investors and towards more institutional accounts. So unless this ban spreads — maybe into Asia, let's say — I don't really see too much of an impact.



Aravind Chandrasekaran, Camares: "Sometimes you wonder if they move too much, too quickly"

Most of the move in the summer was not necessarily the FCA ban but more from the changes in the Merrill Lynch index and the general market tone. Investors jumped on that bandwagon and pushed bonds lower. But in terms of effect from the UK retail ban on CoCos, it should not really have an impact.

There is still some divergence amongst national regulators

Day, BIHC: How much of an impact might the BAML index change have?

Chandrasekaran, Camares: For us, it makes little difference as we don't track a benchmark. But I don't really have a sense that many people were following it.

It wasn't the case that all AT1s were included in there, and I also think it had both dated and undated instruments together in the index. So it wasn't the cleanest index to follow to begin with. So I'm not sure it's that big of a deal, really.

Pirro, Algebris: I think it is irrelevant in the long term, but it did have some consequences in the short term. We estimated a direct impact of 1%-1.5% of the high yield mandates, which is negligible. It nevertheless did have an influence and added a catalyst to sell back in July — when a series of negative events all came together. I don't think we'll see technical pressure when this comes through in late September, but it may remove some of the hype in the primary markets that we saw in the first half of 2014.



Pirro: Yes, there is enormous value compared to high yield in most of these trades.

Pesques: This is the perfect situation for a high yield portfolio manager, when you have a restricted benchmark but you have the ability to use some CoCos to beat the benchmark, to add some beta, to add some alpha. So high yield portfolio managers are quite keen on that sort of news.

Chandrasekaran, Camares: Yes, the existing high yield investor base that can already buy CoCos is arguably incentivised for it not to be in the index.

Day, BIHC: Switching back to the UK authorities' approach to these instruments: UK issuers have been at the forefront of issuing while other countries still faced hurdles, with tax issues, for example. Have the authorities been supportive in getting the market going?

Savadia, Lloyds: To date they have been supportive. As you say, we've had regulatory clarity on structure, we've had clarity from the tax side, and that gave us the pieces of the puzzle we needed to issue.

However, there still remains ongoing regulatory discussions at the moment, for example on the leverage side which the PRA has recently been consulting on. That still needs to play out but will be an important additional consideration going forward.

To date, we have had a generally good market backdrop, we've had the investor base for this asset class grow, with a search for yield that has supported it. But we shouldn't get carried away that the market's going to stay like this forever, and I think that's one thing that the regulators do need to be mindful

of as they move ahead with further regulation that impacts the market backdrop for these instruments.

Forrest, RBS: Also we've not had a common approach in terms of CRD IV, which is driving issues of AT1. We've got the PRA's view in the UK, but the other national regulators have their own views on appropriate levels for trigger levels, etc. So there is still some divergence amongst national regulators.

Coming out with the tax position was a massive help. I imagine some of our Dutch peers are chomping at the bit to get the tax situation in the Netherlands resolved.

Staff, SCB: The early resolution of the tax treatment on AT1 in the UK was helpful, but to some extent it would have been more helpful to have a consistent view across national regulators on the structure of AT1. We have developed a market with transitional triggers versus fully-loaded triggers and low versus high trigger securities, which I think has hindered the appetite for these securities

Scarafia, Fitch: What we see when we are rating these instruments is there's still some uncertainty in terms of the final capital structure of the banks, also in the context of GLAC and MREL. This means that further adjustments of target capitalisation is likely, but we expect the regulator to give the banks time to adjust to new capital requirements and our ratings of these instruments are based on our expectation that this should be doable.

Chandrasekaran, Camares: To that point, sometimes you wonder if they move too much, too quickly. Take ECNs, for example, or Barclays Lower Tier 2 CoCos. It's hard to say whether two years from now UK AT1s will look vastly different or not, but in the last five years you have had two huge pockets of issuance that are effectively somewhat meaningless at this point.

Day, BIHC: If we can switch tack to something that has nevertheless come up a few times already: what has happened over the summer and the market reopening. Obviously things got ugly around BES. To what extent does BES and its impact have more than an immediate effect on the market?

Pesques, Amundi: BES is more a specific event. Over the summer you also had a lot of different stories, with Russia, overall weakness, and more negative macro figures. Of course it has some impact. It's very clear for me that senior remains something that is very strong until the bail-in, and we have some good years still in terms of the valuation of senior paper. The impact on Tier 2 was not a surprise. What really remains to be seen is what the impact of a coupon pass on an AT1 would be, in terms of price impact on the specific bond and the asset class as a whole. That's something that will enable us to really assess how strong this asset class is and the potential impact on a particular bond. I saw a survey recently where people were expect-

ing that any coupon pass would trigger a fall of more than 24% in the price of the particular bond. So that's something that will be a real test for the CoCo market. I would not say that I want it, but that would be a real test.

Decque, CACIB: It was specific to one name, for sure, but it was a violent reminder for the market and investors that banks are still black boxes, and you can have nasty surprises on the balance sheet or the structure. We often mention national champions compared to the others, but BES was the national champion.

Pesques, Amundi: You are right, but it's also very close to a situation more or less like Parmalat.

We have also this summer seen how the different pieces in the capital structure have changed, Lower Tier 2, equity, AT1. We had a good test.

It also gives us some clues about liquidity. At one point, when the Crossover was trading at 300, if you had a Eu50m position on an AT1 and you wanted to sell, it was not possible, or you would have a big discount.

Summan, CACIB: The key word is "confidence". The market has lost its confidence in some of the structures. Post-BES any sort of knee-jerk reaction will be very fast. BES's Tier 1 ratio was at 11.4% and then with additional provisioning they were down to 5% at 2Q14. Apply that to any mid-size bank in the UK and they would be severely impacted. People will become very wary of the sudden change in core capital and that can exacerbate moves on periphery and second tier banks. But, yes, I agree with everyone that BES is a specific story, it had a very messy structure.

At the same time, there are fund managers looking for opportunities in underperforming periphery capital.

Day, BIHC: It has been noted here that the AT1 market is off its highs whereas the corporate market is back at its highs. Is now a good time to be getting involved in the market, to be picking up stuff that other people aren't as confident in?

Chandrasekaran, Camares: On the AT1 versus corporate hybrids point, corporate hybrids have outperformed in terms of cash price, but on a spread basis they have actually underperformed. That's a function of the fact that AT1s still trade as a total return yield product and corporate hybrids trade as spread products. But coming back to your point, generically we still tend to like where some of these AT1 bonds are versus where high yield deals are pricing. Yes, it's at the tight end of the range, but on a relative value basis it can still be attractive.

Pesques, Amundi: I do not find the asset class very attractive for the moment. It is a bit expensive, particularly because, as you said, the big difference — particularly if you make a comparison with corporate hybrids — is that this asset class is trading more on a yield basis, and yields are too low. That's the reason why



Pascal Decque, CACIB: "You could say that most of the AQR has been done so it's almost a non-story now"

you can see an amazing situation where the spread curve can even be inverted. So for long term investors, at least, it doesn't make a lot of sense currently. Looking at dividend yield is also very important for assessing relative value.

Williams, Carmignac: There's a seemingly 100% certainty of calls, given the way these are being valued on a yield to call basis, and I'm not sure that in call cases you should put a 100% probability of call.

Day, BIHC: Do UK names trade at the right kind of level?

Williams, Carmignac: My big picture view is that I find the PRA one of the faster moving but also unpredictable and opaque regulators. And businesses are changing, too, with respect to various restructuring plans, etc. So my view is that they trade roughly fair. They don't stand out as outstandingly cheap on a pure relative value basis vis-à-vis the Continent.

Chandrasekaran, Camares: I think it's difficult. The UK is the only one to have the 7% fully-loaded trigger so far. You kind of need to see the Scandinavians or others come with similar structures. Their business models are also pretty different, whether it's Barclays or Lloyds, so I don't really have a strong generic UK view versus Europe.

Summan, CACIB: Following on from what Matthew was saying with regards to the PRA being a little bit unpredictable, that's affecting the market's pricing, because we don't know if they'll add on another buffer and a buffer on top of that. That's why the UK banks trade wider than some of the European banks. But at the same time, the UK regulator is effectively leading the



Sebastiano Pirro, Algebris: "The AQR and stress test will be a positive catalyst for bank credit"

way and on the back of that you could see the rest of Europe follow suit, and thus over time a convergence between the two. But given the fact, again, because they're just so unpredictable, you're kind of pricing that in, with Barclays, for example, trading wider than some of their European peers.

Decque, CACIB: I do agree that the analysis is difficult given the change in business models, in reporting, the deleveraging or refocusing, and over the short term it is quite difficult. From Q1

We've seen a fairly long derisking programme from the UK banks

through to Q3 we have a different set of reporting and numbers, and that's not very easy and I can understand that investors do not like that.

I do agree on the PRA. I don't know if they are a leader, or if they will be followed by others, or if they will remain on top of the rest, like the Swiss. Then there is the potential arrival of the Nordics with yet another standard. We are all looking for harmonisation, but we already have the low and high triggers and we will have a super-high trigger, 8%, in the Nordics. I'm not sure that will help.

Looking at UK banks going forward, I would just repeat what we see in the numbers and what the rating agencies said recently when changing the outlook. The improvement on the macro and the operating side will be offset by the lasting deep uncertainties and potential impact of litigation risk, misconduct and related costs.

Savadia, Lloyds: If we take a step back, one thing you can say about the UK — and where we are compared with some of our European counterparts — is that when it comes to legacy risk or charges, UK bank balance sheets are so much more well prepared to absorb these charges now. We've seen a fairly long derisking programme from the UK banks, strengthening their core capital base, working to a slightly higher standard than some of their European counterparts on an accelerated timeline. So I take the points around possible regulatory uncertainty, but from a UK standpoint I hope to see that we will get some benefit around derisking, around the simplification of our business models, which makes the analysis of our capital instruments slightly easier from an investor perspective. It's not just a case of looking at buffer to trigger, for example, but increasingly investors are hopefully doing a lot of work around the earnings volatility of the businesses and looking at the organic capital generation banks will look to create over the next few years and the defence that provides on coupons for those investors. Hopefully we see the positive impact of this come through further as investors review UK issuers.

Day, BIHC: What did you make of the timing of Moody's going negative on the UK banking sector outlook recently?

Savadia, Lloyds: All agencies are currently looking at the removal of sovereign support notching for banks. However, this comes back to my earlier point around the introduction of recovery and resolution regimes, and the focus on the UK regulator in that respect. As part of this you also need to consider the strengthening of capital levels at UK banks. So if any ratings change is driven by a broader market dynamic, the question is, how do you expect UK banks to fare relative to their global counterparts? I think it's difficult to pull up the UK on its own in that respect.

Scarafia, Fitch: I would agree with that. The removal of support is something that will affect most countries in Europe and the US. We have a slightly different approach in our ratings, but we changed the outlooks of most issuer ratings that are based on sovereign support in the affected countries to negative earlier this year. There will be no impact on the hybrid ratings, though, as we already do not assume support for those instruments.

We've also seen the UK regulator setting high requirements and expectations, and banks being able to meet them, by changing business models and/or by raising capital if necessary. And if you look at the targets, that the UK but also the Swiss have, and which some other countries have, they are significantly higher. It's normal to see CET1 targets well above 10%.

Forrest, RBS: Just look across to the continent, where BNP had \$9bn or \$10bn of fines. They were able to absorb that without the blink of an eye because they've got the higher capital levels.

Summan, CACIB: A lot of people thought that HSBC was not going to issue an AT1 anytime soon. Now there is chatter that

BNP and similar high quality banks will potentially issue AT1s just in case their local regulator demands higher capital buffers.

Yes, you have these kinds of shock events which they can absorb, but I would not be surprised if they will look to issue AT1s to develop a credit curve for themselves. They still have the ability to issue at a reasonable level given the strong investor appetite for the name, so I wouldn't be surprised if they come to the market.

Chandrasekaran, Camares: It'll be interesting when we see some of the upcoming deals being investment grade, and how that reprices the market. I'm not sure from a mandate perspective whether IG will really see much more demand than what we've seen so far given it's an equity-like product, and whether that has a secondary impact on where existing non-IG bonds are trading.

Summan, CACIB: When Danske Bank was upgraded and thus their AT1s became IG rated, they jumped up 1.5 points. Bonds were originally traded with non-domestic accounts and post-upgrade we saw a surge in demand from regional long term investors — pension funds, etc. This helps to stabilise and improve holdings of the paper.

Day, BIHC: How does Fitch approach the “8%” bail-in rule? Can banks achieve higher ratings to reflect strong buffers in the form of subordinated or bail-in-able debt?

Scarafia, Fitch: First of all, it's quite important to be clear that the 8% rule only applies if you want to use resolution funds. Only in that case do you have to bail-in 8% of total liabilities. What it shows is that the liability structure in general has become much more important.

Our general approach is that we assign Viability Ratings that look at the standalone strength of a bank and Support Rating Floors that look at the support that we expect a bank to receive. The Issuer Default Rating is then generally the higher of the two ratings, and senior debt is usually rated at the same level as the Issuer Default Rating. Since January, when we updated our criteria, we said there could be situations where we can rate the Issuer Default Rating above the Viability Rating if we believe that there is sufficient junior debt available that in fact protects the senior creditor. So the idea is a bank would fail and that the bail-in of the junior debt is sufficient to fix the problem such that the senior debt doesn't default. We give some indication in our criteria on what the amount would have to be, and we say that it should be sufficient to recapitalise the balance sheet to a minimum requirement, which probably in the UK would be the Pillar 1 requirements, say 8%. That's the sort of level when we would start looking at it.

So far we haven't done it, and I think one of the reasons is that we would want to see some steady state in the liability structure of the bank, and with GLAC and MREL coming in, we expect some more clarity on that after Brisbane. Once we see that, that could be the case.



Christian Scarafia, Fitch: “What is clear is that there is uncertainty on buffers and all the topics in the UK”

And I think that's the right way to do it because in a way you take away state support or implicit government support for senior creditors and you replace it with loss absorbing instruments that are there to protect senior creditors.

There have been some cases where we had the Issuer Default Rating above the Viability Rating, but those were very low rated banks when you could have visibility on how the stress scenario was really affecting the credit and its various debt levels. The Cooperative Bank was an example, where the Viability Rating went to the lowest levels but the Issuer Default Rating, when there was clarity that senior creditors would not suffer losses, was kept slightly above. And we say that if we do rate the Issuer Default Rating above the Viability Rating for reasons of large buffers of subordinated debt it will be only one or maximum two notches above, so it is still a very close link.

They were able to absorb that without the blink of an eye

Day, BIHC: Is it a challenge keeping your rating methodology up to date given the changes in regulation?

Scarafia, Fitch: We have to review them annually, in any case. Regarding hybrids, the latest review was in January, and the changes were reasonably limited — there wasn't any impact on ratings. What is clear is that there is uncertainty on buffers and all the topics in the UK. But what we've seen so far is that, particularly for highly rated institutions, there is financial flexibility to reach targets and that we expect the regulator



to give sufficient time to meet them. When you assign ratings or when we affirm them, one of the sensitivities of the ratings that we put out is sudden shifts in regulatory requirements or expectations, or in management of capital, which could lead to a change of rating. So, yes, ratings could change, for instance, if the leverage ratio requirement is moving from a backstop towards a more binding ratio with additional buffers — we would have to see how the banks respond to that, how they manage their capital stack.

In the coming years the regulator will be more demanding

But we acknowledge that there are changes and some uncertainties, but so far we see that they have been managed pretty well by the banks.

Day, BIHC: How have the issuers found their dealings with the rating agencies?

Forrest, RBS: They've got their views. We appreciate the approach when there is a consultation that comes out, that gives you the opportunity to provide an input to the process and changes. These things evolve, and the agencies were heavily criticised for being behind the curve going into the crisis, and in a similar tone to the approach the PRA has taken, they are seeking to be more at the forefront of developments. From an issuer's perspective, we welcome clarity and dialogue on GLAC, TLAC, MREL and any other abbreviation you want to throw in there. The sooner we have clarity on these things,

the sooner it enables us to plan effectively for what our capital stack is going to look like.

Savadia, Lloyds: I agree. We welcome the dialogue. We understand that there are challenges and uncertainty; however, we will continue to actively work with the agencies to understand where they are going with their assessments of balance sheets, and it's a valuable discussion to have. It is also positive that investors are doing their own independent work.

Staff, SCB: Broadly speaking, the relationship we have with all three agencies is good, but the repeated review of methodologies over the last 12-18 months has been challenging for all market participants. However I think investors have adopted a more proactive approach and rely less on ratings than previously.

Day, BIHC: Do the investors pay much attention to the rating agencies, beyond technical aspects like index eligibility, for example?

Pesques, Amundi: They are very important, if you look at what happened to the corporate hybrids after the changes in methodology. This asset class suffered a lot from this uncertainty. With AT1, you still have uncertainty about the regulatory regime and uncertainties regarding how stable the rating methodologies are. So if the regulators and issuers do want AT1 to really become an established asset class, you need all this to be clear and fixed, otherwise it could remain something really uncertain, with a lot of primary market activity for sixth months and then a rating change or a new buffer that stops that. In this asset class, the regulator is very important and the rating agencies, too, and they need to make things clear and stable so that investors can take a long term view.

Transparency is also key: buffers, distributable items are not always easily accessible.

Day, BIHC: Do you fear AQR, or will it be a non-event given the long run-up to it?

Pirro, Algebris: A few bad outcomes are expected, mainly from smaller German and Italian unlisted institutions. In general, we do not expect any surprise that might negatively affect the performance of our portfolios. There might be a couple of banks that do not pass and are forced to raise equity — ultimately this will prove to be a very positive outcome for credit holders. The AQR and stress test will be a positive catalyst for bank credit and this should bring spread tightening over time.

Williams, Carmignac: If you look at the structure of the final disclosure, it starts with the 2013 accounts, and I think moves its way through the various scenarios, and then 10 pages in you have the capital and balance sheet actions taken throughout 2014. So I agree with your sentiment. There may be a little bit more to it, where you get a surprise with a name that either fails or comes very close, but where the capital ac-



tions that they have taken throughout 2014 mean that everything's OK.

Decque, CACIB: You could say that most of the AQR has been done so it's almost a non-story now. What was important is that they have forced banks to make capital increases, a very long list, to sell some non-performing assets or non-core assets, and to increase provisions. And most of the job has been done. The result will be probably quite poor — a few banks probably won't pass — but it won't depress the market much.

Pirro, Algebris: And that is going to be positive for the asset class in general. Bank sub capital has been a great trade in the past two years, and that is likely going to continue. Especially because in the coming years the regulator will be more demanding, as we saw with the US banks, and the shift towards higher quality balance sheets and more transparency will go on.

Day, BIHC: What is the biggest risk to performance and/or supply on the horizon, if anything?

Decque, CACIB: The risk we have is that it is a young market, liquidity is scarce, the investor base is not really wide enough yet, and there is high volatility in difficult times, and any BES-like story or geopolitical stress or any unexpected surprise on the AQR would have an impact on one of the names and that could affect the whole sector. But we have seen that the regulator, banks and even investors in their search for yield have a very strong interest in seeing the market develop, and I suspect that it could recover anyway. This a market that is well set for a long time.

Day, BIHC: Aravind — you talked early on about investors having first mover advantage. How do you see the

investor base developing? And do you agree with Pascal's points?

Chandrasekaran, Camares: It's quite important for market structure that regulation not always be a moving target and that we also have fixed ratings methodologies. If the market structure gets fixed, I think you can start to see a lot more people being involved. It's still a fairly young asset class, right?

The way we tend to look at these instruments, in addition to

**This is a market
that is well set for
a long time**

relative value versus high yield, is versus equity, versus where dividend yields are trading, versus where cost of equity is, and I think you tend to get different conclusions than just looking at RV on a pure AT1 basis. Sometimes not — but sometimes you get interesting opportunities. And the fact that it's a young market also presents a lot of opportunities.

Day, BIHC: Scott, 2015 is likely to be in the calendar for you: do you see any risks to your longer term plans panning out?

Forrest, RBS: We are cognisant of the competing supply that may come into the market at this time. You know, you can't sit in my seat or in Vishal's seat without a friendly investment bank coming to bang on the doors telling you now's the time to issue AT1, but fundamentally you have to work to your own plans and find the window that works for you. ●



Duck-billed platypus: Like any hybrid animal, its appearance is perfectly explainable by its environmental constraints, but by no means simple or familiar at first glance
Photo: Beth Hoffman/Flickr

Corporate hybrids

Coming of age

The corporate hybrid market has grown up since the crisis, attracting a broader range of credits. Here, *Jonathan Blondeau*, DCM, capital structuring & liability management at *Crédit Agricole CIB*, explores its evolution. In this special feature we also take a look at the state of the market today and hear from two leading proponents of the instrument: Bayer and EDF.

In biology, “hybrid” is used to define the offspring of two animals or plants of different breeds, varieties or species, and in general, as a result of combining two things that are different by nature. For corporate hybrid bonds, it is about mixing debt with equity content by extending it, adding coupons with no obligation to pay — like deductible dividends — and making it somehow loss absorbing. Corporate hybrid bonds are issued because they offer tax, accounting and rating benefits. Finding the right balance between the different drivers and structuring features (interest rates, rating agency methodologies, accounting constraints, etc.) took some time before a stable and liquid market could emerge. This is now the case, in a reassuringly more standardised but somehow less creative way.

Born from the free union of debt and equity

Unlike banks or insurance companies, corporates are not constrained by regulations with regard to the issuance of hybrid debt. They therefore needed a solid rationale to issue what could at first be seen as expensive debt rather than cheap equity. However, the main benefits are pretty clear:

- Accounting: with a perpetual maturity, hybrid bonds can be accounted for as equity if coupons are deferrable.
- Rating: rating agencies can grant equity content to hybrid bonds and take it into consideration in the calculation of the credit metrics of the company.
- Tax: even if from an accounting and rating perspective hybrid debt is considered as equity in full or in part, coupons are generally tax-deductible.

- Hybrid bondholders have no voting rights and it is therefore a non-dilutive instrument.

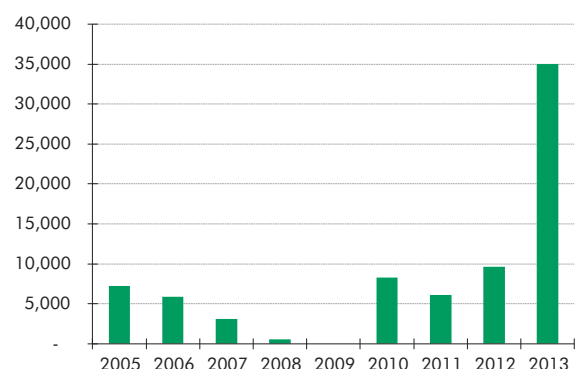
As a consequence, hybrids have been considered by corporates in many situations in order to protect ratings or senior debt covenants, to finance M&A activity or investments, or to fund pension deficits.

Rating agencies: the fairy godmothers?

The first generation of non-financial hybrids emerged in 2003. After Moody's defined its rules for hybrid equity treatment in 2005-2007, closely followed by Standard & Poor's, supply became steady (albeit much lower than current volumes).

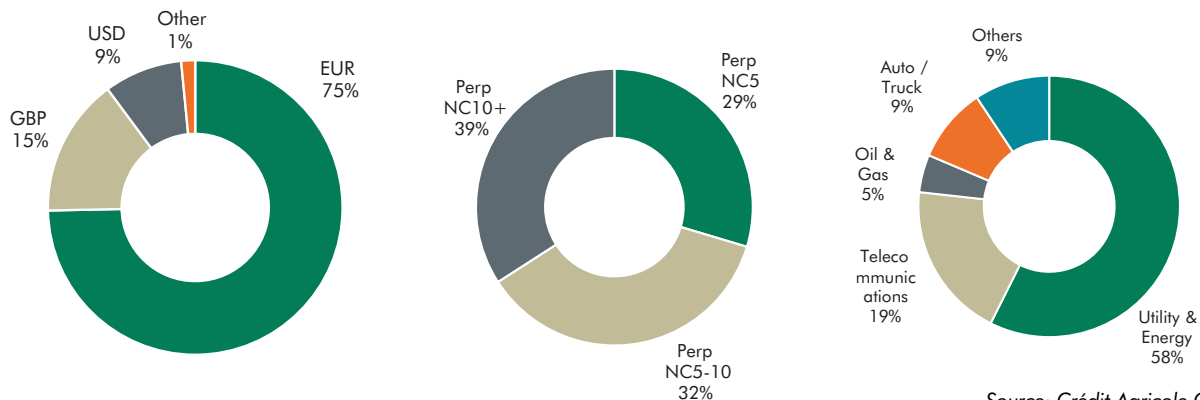
Rating agencies have always been a key driver for the hybrid market. The importance of the rating of any hybrid security is

Global corporate hybrid issuance 2015-2014 (Eu m)



Source: *Crédit Agricole CIB*

Corporate hybrid issuance by currency, structure and industry (2013-2014)



Source: Crédit Agricole CIB

twofold as it determines its “equity content” and its notching down from the issuer’s rating. Obviously the deeper the notching down, the higher the equity content, and vice versa.

The release of the Moody’s “Toolkit” in 2005 clarified how to structure hybrid securities to gain the optimal mix of equity credit from the rating agency by detailing the main features that were required:

- Permanence: very long maturity or perpetuity
- Financial flexibility: no ongoing payments, with the ability to defer or cancel coupon payments
- Subordination: loss absorption

S&P soon followed with its Hybrid Capital Handbook and Fitch with its Corporate Methodology (see *timeline*). Rating agencies thus clarified the criteria for getting equity credit for hybrids and set the basis for the unregulated corporate sector.

But potential changes to their methodologies and the related risk of loss of equity content have also been a matter of concern for rated issuers. If rating agencies have paved the way for this market, their various methodology changes may have limited its development, discouraging eligible issuers to join the market.

The mix of criteria have dictated the structures that have been issued since and which are the most common today. Like

any hybrid animal, its appearance is perfectly explainable by its environmental constraints, but by no means simple or familiar at first glance (see *illustrative term sheet* below).

The most recent changes have led to the end of high equity content from S&P and of any equity content granted to non-investment grade companies by Moody’s: these two changes have both limited the range of possible structures and the number of issuers who could access this market (see *box*).

Rating agencies have thus greatly helped the process of natural selection in this market, leading to an even increased standardisation, which may be detrimental to some issuers (and structurers!) but offers greater clarity to investors. This may be considered as the descent with modification from which a viable asset class can arise.

From childhood to adulthood, through bumpy teenage years

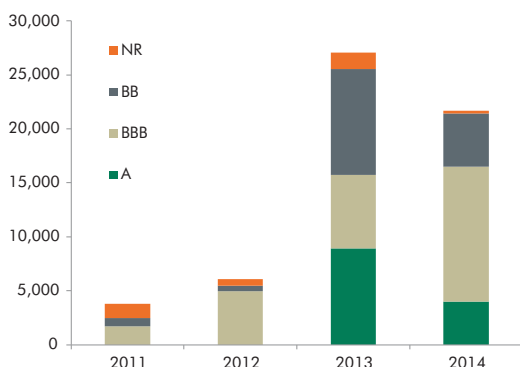
Supply of corporate hybrid bonds ceased completely with the advent of the crisis, from the end of 2007 until 2010, when the market resumed. An unprecedented period of growth for the corporate hybrid capital markets then started after Veolia Environnement, and more importantly EDF (see *Q&A*) came to the market. Issuance soared from Eu7bn in 2012 to almost Eu27bn in 2013, and has already reached Eu22bn since the beginning of the year. This boost has been mostly driven by the low interest rate development and clarifications from the rating agencies.

For European issuers, the market has been dominated by euro issuance, followed by sterling and US dollars. After 2013, the breakdown of implicit (before call first date) maturities also started to evolve and increased quite significantly compared with the previous perpetual non-call five structures.

An extended family: from core to peripheral and from utilities to more diverse issuers

After the halt in 2008-2009, supply returned in 2010 from utilities from core countries (RWE, Alliander, SSE, Suez Environnement, EnBW, Dong). Progressively, the market reopened to new countries (Austria, Italy, Spain) and more diverse sectors (telecoms, retail, automotive, hotels).

Euro issuers’ corporate hybrid issuance by rating (Eu m)



Source: Crédit Agricole CIB

RATING AGENCIES

Changes to methodologies & early redemptions

First generation hybrid structures were often less transparent, which made their early redemption harder to anticipate. Here are a few examples.

Alliander lost its equity credit due to an upgrade, because the upgrade made its replacement clause null and void, and the replacement clause was the determinant in the granting of equity credit by Standard & Poor's. As the price of the early redemption option was below market levels, Alliander decided to launch an Exchange Offer to existing holders at 102.5 instead of 101. As of today, the exchanged bond is trading around 105.

Changes to rating agencies' hybrid methodologies have been the cause of a number of early redemption calls, either at the time the methodology changed or later as a consequence of it.

Nordic utility Dong lost maximal equity content because of a change to S&P's methodology and could have called its hybrid at 101 because of a change-of-methodology



Telecom Italia: time to call?

clause, but proposed an exchange price of 104 instead of 101. Before this transaction, the bond was trading at 112, but the exchanged bond is now trading around 116 thanks to a 6.25% coupon.

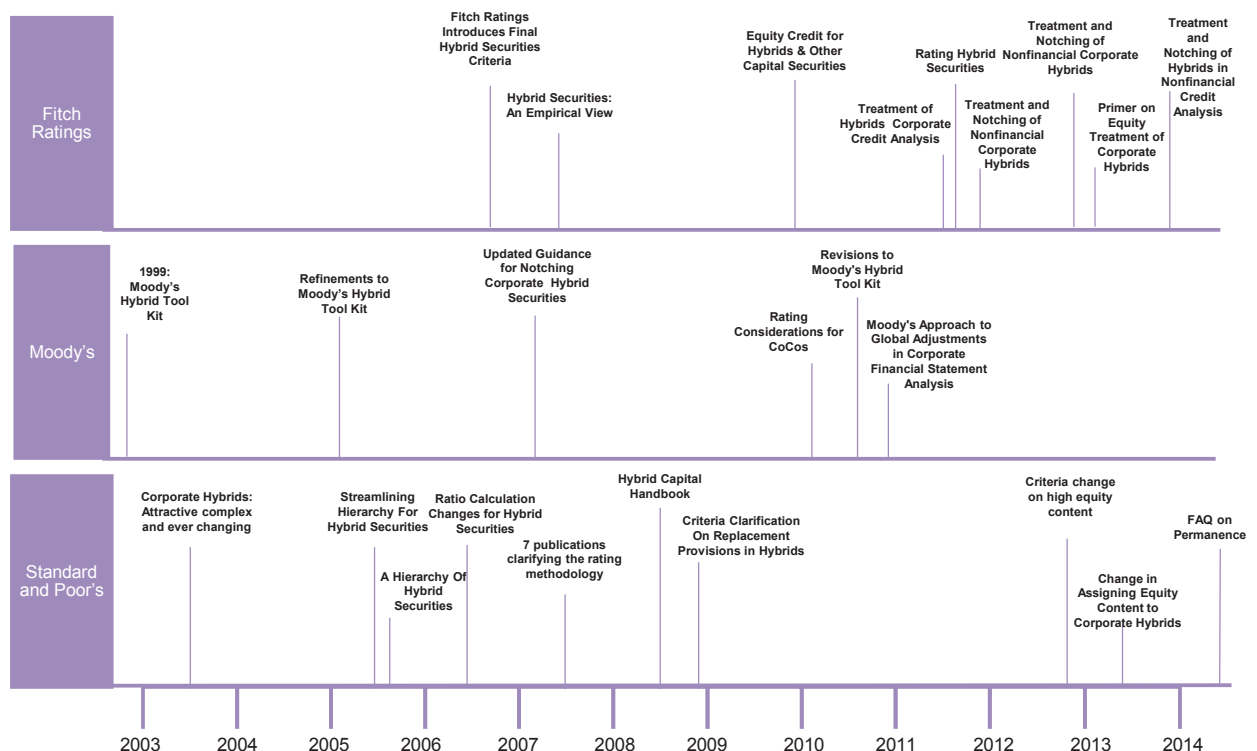
Telecom Italia and ArcelorMittal both issued hybrids before Moody's withdrew the possibility of equity credit for speculative grade issuers in July 2013. In November 2012, ArcelorMittal was downgraded by Moody's, so when the methodology

changed in July 2013 it automatically lost the equity credit at Moody's and became eligible for an early redemption option. On 21 January 2014, ArcelorMittal finally decided to call the bond at 101.

Telecom Italia's hybrid lost its equity credit when the issuer was downgraded in November 2013, and Telecom Italia decided to recall its hybrid on 29 January 2014.

Due to the complexity of the hybrid structures, these call had not been fully anticipated by investors. ●

Evolution of corporate hybrid rating agency methodologies



Source: Crédit Agricole CIB

Unrated issuers like Voestalpine, Eurofins or Trafigura have chosen to access the market to strengthen their balance sheets at attractive levels.

A growing number of admirers: the investor base broadens

The asset class has grown thanks to the support of traditional fixed income investors who usually buy senior but are attracted by higher yield in the hybrid sector. Most of them have started to consider it as a suitable investment, particularly if the hybrid is issued by a well-established issuer whose credit story is better known and understood by this kind of investors than a high yield name. Nowadays, the spread to senior ranges from 150bp for a single-A category name to up to 250bp for a low triple-B. Corporate hybrids' performance can of course prove more volatile, but in a low interest rate world their yield remains very attractive.

An increasing share of hybrids has been incorporated into bond indices, increasing their acceptance and visibility.

The next generation?

The corporate hybrid market has strengthened and will probably in the future be more resilient than it has proved in the past.

We expect refinancing of some of the first generation of hybrids to fuel the market over the next two years, as some of these bonds were issued with intend-based replacement lan-



Jonathan Blondeau, CACIB

guage. These old structures may be worth replacing by cheaper and more efficient new structures.

M&A may also be a strong driver. As experienced by Bayer (see Q&A) or Telefónica, the issuance of hybrids helps mitigate the negative impact of an acquisition on credit metrics.

Last, but not least, we now expect the market to open more broadly to smaller issuers, rated or not, with very specific needs, and perhaps more tailor-made structures. ●

New-style corporate hybrid illustrative term sheet

Perp NC5 Hybrid Bond

Notching		2/2/2	Notching
			Rating agencies are notching down corporate hybrids from the rating of the issuer because of the subordination and the coupon deferability. For new style structures, it is usually 2 notches minimum down from the stand alone credit rating.
Moody's Equity Credit	Basket C		Equity Content
S&P Equity Credit	Intermediate (50%) until First Call Date		
Fitch Equity Credit	50%		
			50% for all 3 agencies
Maturity	Perpetual		Permanence/Effective Maturity
First/Subsequent Call Dates	5y+ and every subsequent interest payment thereafter		
Step-up	25bp (in Year 10) / 75bp (Year 25)		
Coupon Structure	Yrs 1–5 : Fixed		S&P: Equity treatment disappears 20 year before the Effective Maturity, so until the first call date in 2020 and 2025.
	Yrs 5–10 : Fixed Reset		
	Yrs 10-25 : Fixed Reset + 25bps Step-Up		
Early Redemption Provisions	Yr 25 : Fixed Reset + 75bps Step-Up		Moody's keep the Equity treatment all life long is the first step up is after year 10.
	Tax/Accounting/Rating/Minimal amount outstanding/ Gross Up		
Optional Interest Deferral	Optional		Financial Flexibility
Mandatory Deferral	None		
Dividend Pusher/Stopper	Pusher: Deferred interest repayable following certain distribution and other payments on equity or parity securities		
Deferred Payments	Stopper: applicable in some jurisdictions		Deferrable and cumulative coupons with a dividend pusher.
	Cumulative		

Source: Crédit Agricole CIB

New-style corporate hybrid issues											
Issuer	Issue Date	Current Moody's Rating	Current S&P Rating	Current Fitch Rating	Amount	Coupon (pre-call)	First Call	Maturity	I-Spread Mid	YTC Mid	Price Mid
EUROS											
Veolia	9-Jan-13	Baa3	BB+	BB+	1,000	4.450%	16-Apr-18	Perp	289	3.32	103.79
EDF	22-Jan-13	A3	BBB+	A-	1,250	4.250%	29-Jan-20	Perp	211	2.69	107.71
EDF	22-Jan-13	A3	BBB+	A-	1,250	5.375%	29-Jan-25	Perp	254	3.70	114.27
Telekom Austria	24-Jan-13	Ba1	BB+	-	600	5.625%	1-Feb-18	Perp	277	3.19	107.74
Iberdrola	21-Feb-13	Baa3	BB+	BBB-	525	5.750%	27-Feb-18	Perp	233	2.76	109.79
KPN	5-Mar-13	Ba2	BB	BB	1,100	6.125%	14-Sep-18	Perp	354	4.01	107.71
National Grid	11-Mar-13	Baa3	BBB	BBB-	1,250	4.250%	18-Jun-20	18-Jun-76	210	2.73	108.05
Hutchinson Whampoa	7-May-13	Baa2	-	BBB	1,750	3.750%	10-May-18	Perp	242	2.86	103.04
DONG Energy	19-Jun-13	Baa3	BB+	BBB-	700	6.250%	23-Jun-18	Perp	297	3.96	116.76
DONG Energy	2-Jul-13	Baa3	BB+	BBB-	500	4.875%	8-Jul-18	Perp	238	2.83	107.34
GDF Suez	3-Jul-13	A3	BBB+	-	600	3.875%	10-Jul-18	Perp	217	2.37	105.47
GDF Suez	3-Jul-13	A3	BBB+	-	750	4.750%	10-Jul-21	Perp	220	2.95	111.00
Volkswagen	29-Aug-13	Baa2	BBB	-	1,250	3.875%	4-Sep-18	Perp	167	2.12	106.68
Volkswagen	29-Aug-13	Baa2	BBB	-	750	5.125%	4-Sep-23	Perp	236	3.37	113.43
America Movil	2-Sep-13	(P)Baa1	BBB	BBB+	900	5.125%	6-Sep-18	6-Sep-73	206	2.53	109.75
America Movil	2-Sep-13	(P)Baa1	BBB	BBB+	550	6.375%	6-Sep-23	6-Sep-73	307	4.08	116.98
Enel	3-Sep-13	Ba1	BB+	BBB-	1,250	6.500%	19-Jan-19	10-Jan-74	324	3.74	110.88
Telefonica	11-Sep-13	Ba1	BB+	BBB-	1,125	6.500%	18-Sep-18	Perp	308	3.54	110.94
Telefonica	11-Sep-13	Ba1	BB+	BBB-	625	7.625%	18-Sep-21	Perp	384	4.62	117.72
Casino	17-Oct-13	-	BB	BB	750	4.870%	31-Jan-19	Perp	311	3.61	105.03
Solvay	4-Nov-13	Ba1	BBB-	-	700	4.199%	12-May-19	Perp	265	3.18	104.36
Solvay	4-Nov-13	Ba1	BBB-	-	500	5.425%	12-Nov-23	Perp	316	4.18	109.30
Alliander	20-Nov-13	(P)A3	A	-	500	3.250%	27-Nov-18	Perp	147	1.95	105.22
Enel	8-Jan-14	Ba1	BB+	BBB-	1,000	5.000%	15-Jan-20	15-Jan-75	310	3.69	106.25
EDF	15-Jan-14	A3	BBB+	A-	1,000	4.125%	22-Jan-22	Perp	228	3.09	106.74
EDF	15-Jan-14	A3	BBB+	A-	1,000	5.000%	22-Jan-26	Perp	254	3.78	111.08
Orange	29-Jan-14	Baa3	BBB-	-	1,000	4.250%	7-Feb-20	Perp	276	3.35	104.36
Orange	29-Jan-14	Baa3	BBB-	-	1,000	5.250%	7-Feb-24	Perp	316	4.21	107.92
EnBW	11-Mar-14	Baa2	BBB-	BBB	1,000	3.625%	2-Apr-21	2-Apr-76	283	3.54	100.50
Volkswagen	17-Mar-14	Baa2	BBB	-	1,250	3.750%	24-Mar-21	Perp	212	2.83	105.44
Volkswagen	17-Mar-14	Baa2	BBB	-	1,750	4.625%	24-Mar-26	Perp	246	3.71	108.47
Telefonica	24-Mar-14	Ba1	BB+	BBB-	750	5.000%	31-Mar-20	Perp	342	4.02	104.78
Telefonica	24-Mar-14	Ba1	BB+	BBB-	1,000	5.875%	31-Mar-24	Perp	384	4.92	107.13
Deutsche Annington	1-Apr-14	-	BB+	-	700	4.625%	8-Apr-19	8-Apr-74	340	3.91	102.95
GDF Suez	22-May-14	A3	BBB+	-	1,000	3.000%	2-Jun-19	Perp	201	2.53	102.06
GDF Suez	22-May-14	A3	BBB+	-	1,000	3.875%	2-Jun-24	Perp	235	3.44	103.54
Suez Environnement	16-Jun-14	Baa2	-	-	500	3.000%	23-Jun-20	Perp	211	2.75	101.34
Accor SA	23-Jun-14	BB	BB	BB	900	4.125%	30-Jun-20	Perp	347	4.10	100.13
Bayer AG	25-Jun-14	-	BBB	BBB	1,500	3.750%	1-Jul-24	1-Jul-74	213	3.23	104.35
Bayer AG	25-Jun-14	Baa2	BBB	BBB	1,750	3.000%	1-Jul-20	1-Jul-75	197	2.60	102.13
STERLING											
Veolia	9-Jan-13	Baa3	BB+	BB+	400	4.850%	16-Apr-18	Perp	294	4.75	100.29
EDF	22-Jan-13	A3	BBB+	A-	1,250	6.000%	29-Jan-26	Perp	261	5.15	107.27
KPN	5-Mar-13	Ba2	BB	BB	400	6.875%	14-Mar-20	14-Mar-73	373	5.89	104.48
National Grid	11-Mar-13	Baa3	BBB	BBB-	1,000	5.625%	18-Jun-25	18-Jun-73	238	4.95	105.49
GDF Suez	3-Jul-13	A3	BBB+	-	300	4.625%	10-Jul-19	Perp	166	3.59	104.07
America Movil	2-Sep-13	Baa1	BBB	BBB-	550	6.375%	6-Sep-20	6-Sep-73	271	4.90	107.49
Enel	3-Sep-13	Ba1	BB+	BBB-	400	7.750%	10-Sep-20	10-Sep-75	340	5.61	110.68
EDF	15-Jan-14	A3	BBB+	A-	750	5.875%	22-Jan-29	Perp	268	5.34	105.28

Source: Crédit Agricole CIB

EDF

Hybrid landmarks

EDF has launched some of the largest hybrid transactions in the market. Here, Carine de Boissezon, senior vice president, investors and markets at EDF, discusses what makes the hybrid instrument attractive to the company, how it approaches new issuance, and what it expects from the market going forward.

Bank+Insurance Hybrid Capital: EDF's hybrid transactions in 2013 and 2014 have established themselves as the reference for other European names, with the 2013 transaction being the largest multi-tranche corporate hybrid ever: what was the rationale for EDF to issue this kind of instrument?

Carine de Boissezon, EDF: EDF is investing in its future growth and is one of the few companies in the sector which has such an important development capex. Given the long term construction span of most of its industrial projects, the Group today has around Eu11bn of capital employed not contributing to its EBITDA. The rationale for issuing an instrument such as a hybrid was to strengthen our balance sheet through the investment cycle. With around Eu10.1bn of hybrids done through our transactions in 2013 and 2014, we have almost aligned our hybrid funding with our capital needs for future growth.

BIHC: To what extent do you think

hybrids have changed the perception of your name to investors (credit and equity)? In your view, what have been the most important benefits?

De Boissezon, EDF: We have given the same message to both categories of investors, and this was about the alignment of our financing structure with our industrial strategy. When we first issued in January 2013, we managed to raise Eu6bn because investors understood that this was not a one-off to avoid a rating downgrade. For both categories of investors, it became clear that EDF had done the most drastic work in the utility sector in terms of balance sheet restructuring over the last four years: by selling non-core assets, increasing the maturity of our debt while reducing our average coupon, etc...

BIHC: What were the main structuring challenges that you had to face before issuing?

De Boissezon, EDF: Given that in both 2013 and 2014 we were issuing multiple

tranches in multiple currencies, the main challenge has been one of organisation and time to market, as it took several days between the launch and closing of the operations, and we were in different time zones. We wanted to be first movers, as well, in order to achieve the right level of interest. What makes it a success is that we could offer investors what they really care for in terms of products and maturities thanks to regular interactions that we conduct with them through the year. Contrary to most of our peers, we clearly spent more time meeting debt investors than equity investors in 2013 and 2014.

BIHC: How important was the equity accounting for you and the impact on your financial structure/credit metrics?

De Boissezon, EDF: It is one of the critical elements in connection with the cost. Given the significant decrease in the subordination premium, it became a very attractive instrument for us back in 2013. Another of the important aspects was the



Tour EDF, La Défense
Photo: Pierre-Louis Ferrer/Flickr

investor diversification it brought us. As a regular issuer, we also need to ensure we are tapping new pockets of funds.

BIHC: EDF has also been innovative in its mix and extension of maturities: how did you determine your best choice of maturities?

De Boissezon, EDF: One of the most important objectives of the management when it joined about five years ago was to adapt the financing structure to the industrial strategy, and one of the first actions was to extend the maturity of our gross debt, which stands now at 13.2 years versus 8.6 in 2010, while our average coupon is now 3.46% versus 4.4% over the same period. This move was strongly helped by the 100 year bonds we issued back in January 2014 in both sterling and US dollars.

BIHC: What determined the currency mix between euros, US dollars and sterling? Was it about liquidity purposes or to create a natural hedge for your operations?

De Boissezon, EDF: We consider both the liquidity and the rationale with our operations. In that respect, the sterling market stands out. It is our second domestic market in terms of operations as we are the biggest generator in the UK and we are strongly investing for the future with our new nuclear projects. But it is also a market where you can raise very long dated bonds, as was demonstrated with our 100 year bond issue, which had never been done before, not even by the Bank of England! As far as US dollars is concerned, we issued a very



Carine de Boissezon, EDF

large amount in January 2014 while our operations there are more limited, but it was, firstly, linked to the strong demand we had identified from US investors for good European corporate credits, and secondly, given the attractive rates, we swapped most of it back in euros.

BIHC: What is your view on current market conditions and on the potential evolution of this asset class?

De Boissezon, EDF: Monetary policies have clearly distorted what people view as “normal market conditions”. The recent move from the ECB is another step in this direction. The current market is therefore an issuer’s market, and sovereign and corporate issuers can benefit from exceptional financing conditions. The quest for yield from investors has led to two different trends: more risks; and longer maturities.

On the other hand, the hybrid asset class is here to stay because it does address a real need on the liability side of the balance sheet. The surge in this as-

set class in the corporate sector follows a well-established trend in the FIG sector.

BIHC: Do you have further plans or any strategic intention to issue given the attractive conditions?

De Boissezon, EDF: EDF monitors the market on a regular basis and has an opportunistic view to seizing the right windows.

BIHC: Do you plan to continue your diversification by currency and the build-up of your (hybrid) curve?

De Boissezon, EDF: Given our focus on extending our debt maturity and investor diversification, we will indeed be looking at all opportunities that fit this strategy. But it is clear that euros and sterling will remain our core currencies.

BIHC: EDF also issued what was at the time the largest ever century bond: what were the merits of this relative to hybrids? Did you enlarge your investor base with new accounts? Did you consider alternatives?

De Boissezon, EDF: Compared to the hybrid issuance and looking at a 15 year horizon, the coupon for the century is not that different, but the liquidity in sterling was striking and this was the reason we decided to go ahead. Demand from private wealth management was quite important, too. And, as mentioned before, our primary objective is to extend the maturity of our debt and clearly the century bonds have played a big part in reaching that goal. ●

Pricing Date	Issue Ratings	Currency	Amount (m)	Coupon	Maturity Date	First Call Date	New Issue Spread (over mid-swaps)
15-Jan-14	A3/BBB+/A-	EUR	1,000	4.125%	Perpetual	22-Jan-22	244
15-Jan-14	A3/BBB+/A-	EUR	1,000	5.000%	Perpetual	22-Jan-26	279
15-Jan-14	A3/BBB+/A-	GBP	750	5.875%	Perpetual	22-Jan-29	280
14-Jan-14	A3/BBB+/A-	USD	1,500	5.625%	Perpetual	22-Jan-24	279

Source: Crédit Agricole CIB

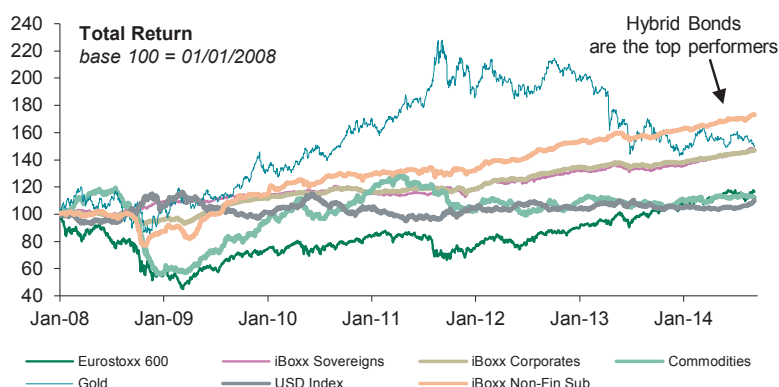
Corporate hybrids

Relative value

The non-financial hybrid market enjoyed something of a renaissance in 2013, with conditions proving just right for issuers and investors alike. The technicals of the instrument have been the main concern for investors in the past; however, valuation has become more and more important. *Elisa Belgacem*, quantitative strategist at Crédit Agricole CIB, presents here elements of relative valuation within the euro hybrid universe.

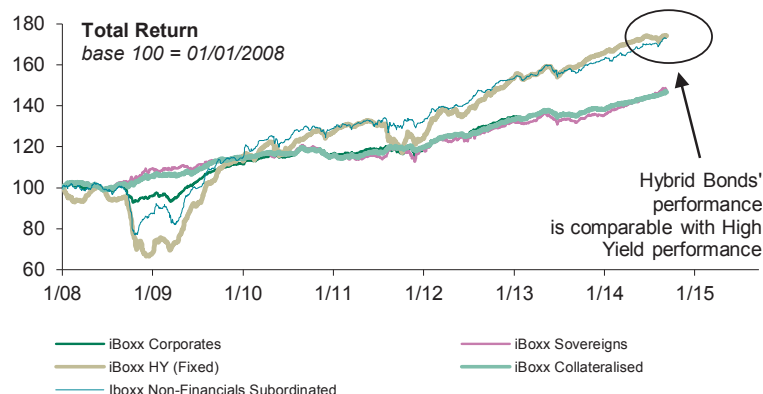
Hybrids vs other asset classes since 2008

The environment for investing in hybrids has been favourable since 2009, and this is reflected in hybrid total returns versus other asset classes over the same period (please note we have included only investment grade sectors in the fixed income space).



Hybrids vs other credit classes since 2008

Within the credit market, and since 2008, the performance of hybrid bonds has been comparable to the high yield market. This year, the performance of high yield is lagging slightly, due to the large number of new issues to be absorbed and two cases of early redemption — ArcelorMittal in US dollars and Telecom Italia in euros.



Source: Crédit Agricole CIB

Hybrids are not as volatile as high yield

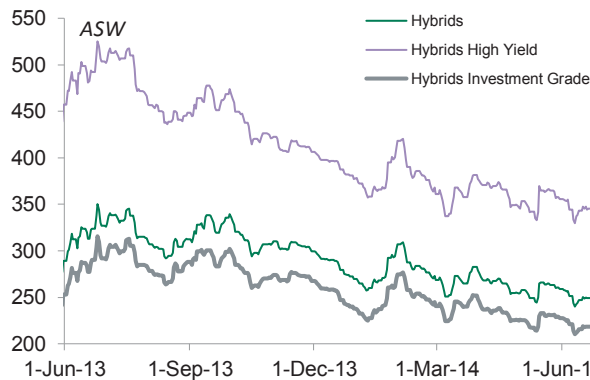
Even if the hybrids of today greatly differ from those issued before the crisis, the hybrid asset class in general appears to have been less volatile than high yield since 2008.

This lower volatility reflects the lower probability of default of the hybrids compared with high yield. The probability of default of a hybrid bond is linked to its issuer, which is rated two notches higher than the hybrid issue.



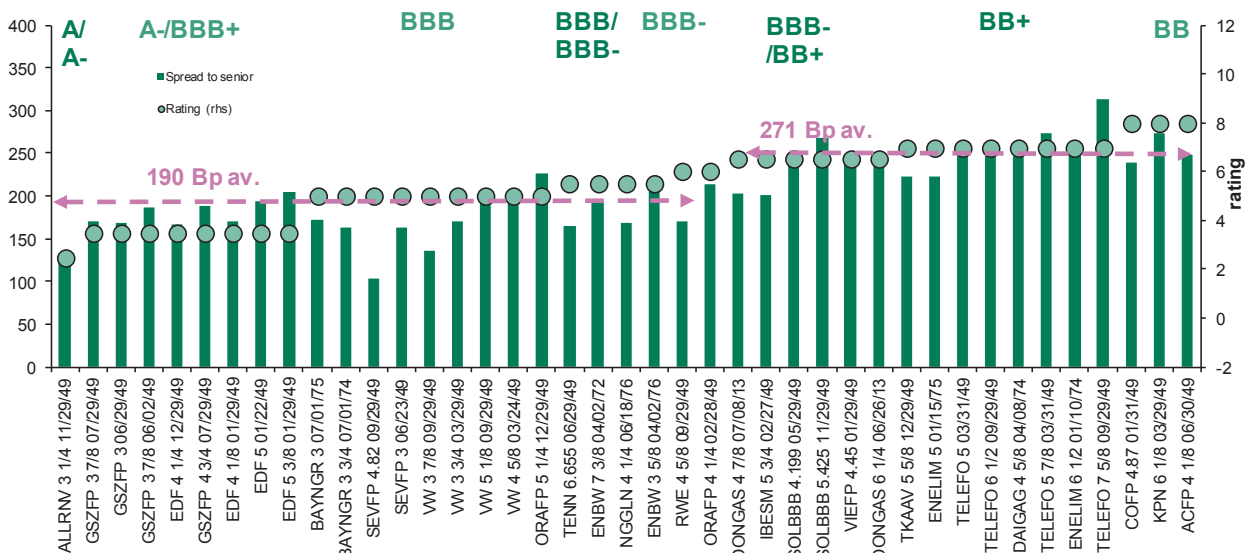
Evolution of hybrid spreads: investment grade vs speculative grade

Overall we have seen investment grade hybrids slightly outperforming in 2014 as their market value weighted average spread tightened by circa 5% while speculative grade hybrids tighten by 3%.



Hybrid premium over senior curve by rating

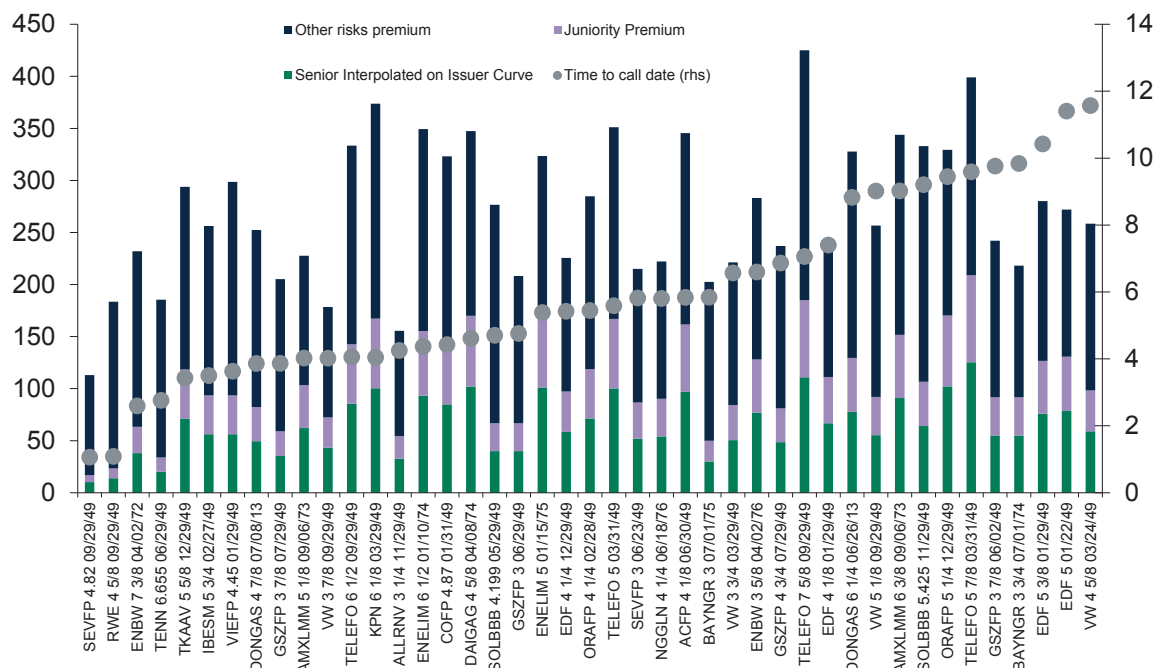
The spread over senior is the most common valuation measure used by the market. It has the advantage of being correlated to the credit quality of the issuer, in contrast to the senior or CDS multiple, which tends to be higher for the highest rated names as senior levels as well as CDS are currently very low.



Source: Crédit Agricole CIB

Premium Breakdown - Hybrid spreads, breakdown by risk type (asw bp lhs, years to call rhs)

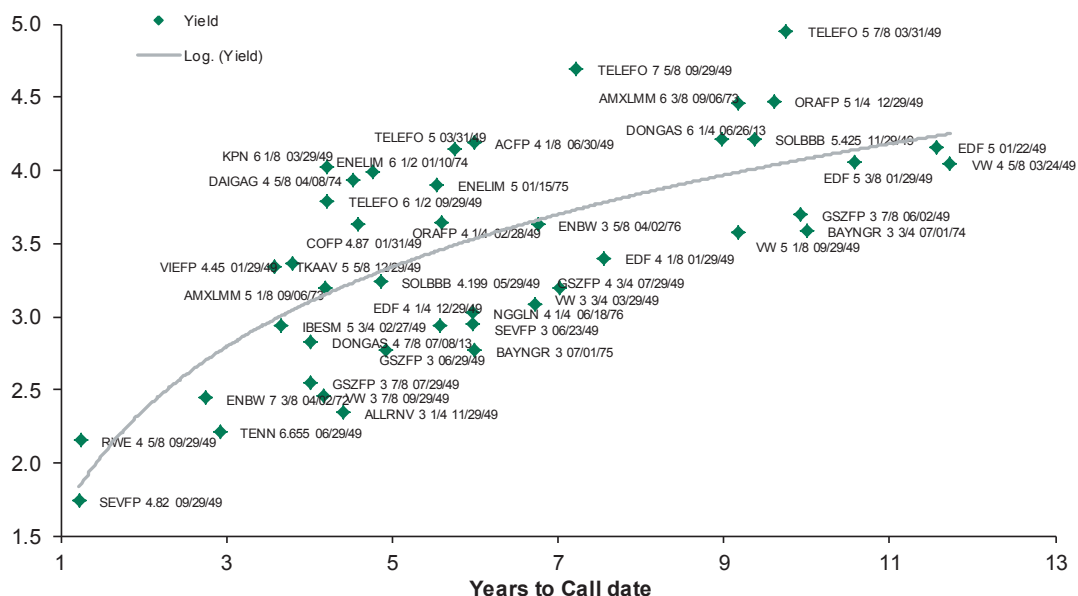
A more sophisticated way of finding value within hybrid bonds is to isolate the part of the hybrid spread that compensates for hybrid-specific risks, i.e. coupon deferral risk, extension risk and early redemption risk. We deconstruct the hybrid spread into three components: the senior component, the juniority premium and the residual (blue bar on the chart) compensation for hybrid specific risks.



Source: Crédit Agricole CIB

Hybrid euro universe yield vs years to call date

Spreads are well correlated with ratings, while yields are well correlated with time to maturity. "Spread or yield?" remains the question in this market. We tend to think that the investment grade part of the curve responds to spread logic while the speculative grade hybrid universe would rather be driven by the yield.



Source: Crédit Agricole CIB

Bayer

Lighting up the market

Germany's Bayer on 25 June launched the largest euro hybrid bond transaction, a Eu3.25bn dual tranche deal, as part of a major acquisition financing. In doing so, it returned to an instrument it previously issued in 2005. Dr Sven Vorstius, head of capital markets at Bayer AG, explains how hybrids fit into the corporate's strategy.

Bank+Insurance Hybrid Capital: What were the rationale and the most important drivers for Bayer issuing a hybrid bond at the time of the acquisition?

Dr Sven Vorstius, Bayer AG: Hybrid capital has been used in Bayer's funding mix since 2005. Having at that time been a very special instrument and a means of supporting our rating, hybrid capital has since developed into a more standardised instrument with a broad investor base. This makes it today a product that is relatively easy to handle, on the one hand, and a fair to favourably priced instrument from the cost of capital perspective. In this context, it was the product of choice to support our funding activities in the recent acquisition of Merck's Consumer Care Business, which created a total funding need of \$14.2bn.

BIHC: All the hybrid instruments issued by Bayer have been dated: what is the rationale for that? How important was the equity accounting for you?

Vorstius, Bayer: There are still various ways to design some of the details of the hybrid bond structure in one or another way. We had no need to book the hybrid bond as equity accounting-wise, e.g. to achieve certain ratios. We rather prefer to have an IFRS treatment as debt because this allows us to trade interest rate derivatives and apply hedge accounting as we actively manage our interest rate exposure over time.

BIHC: Did you consider other alternative products? What were the main considerations to go for the one or the other?

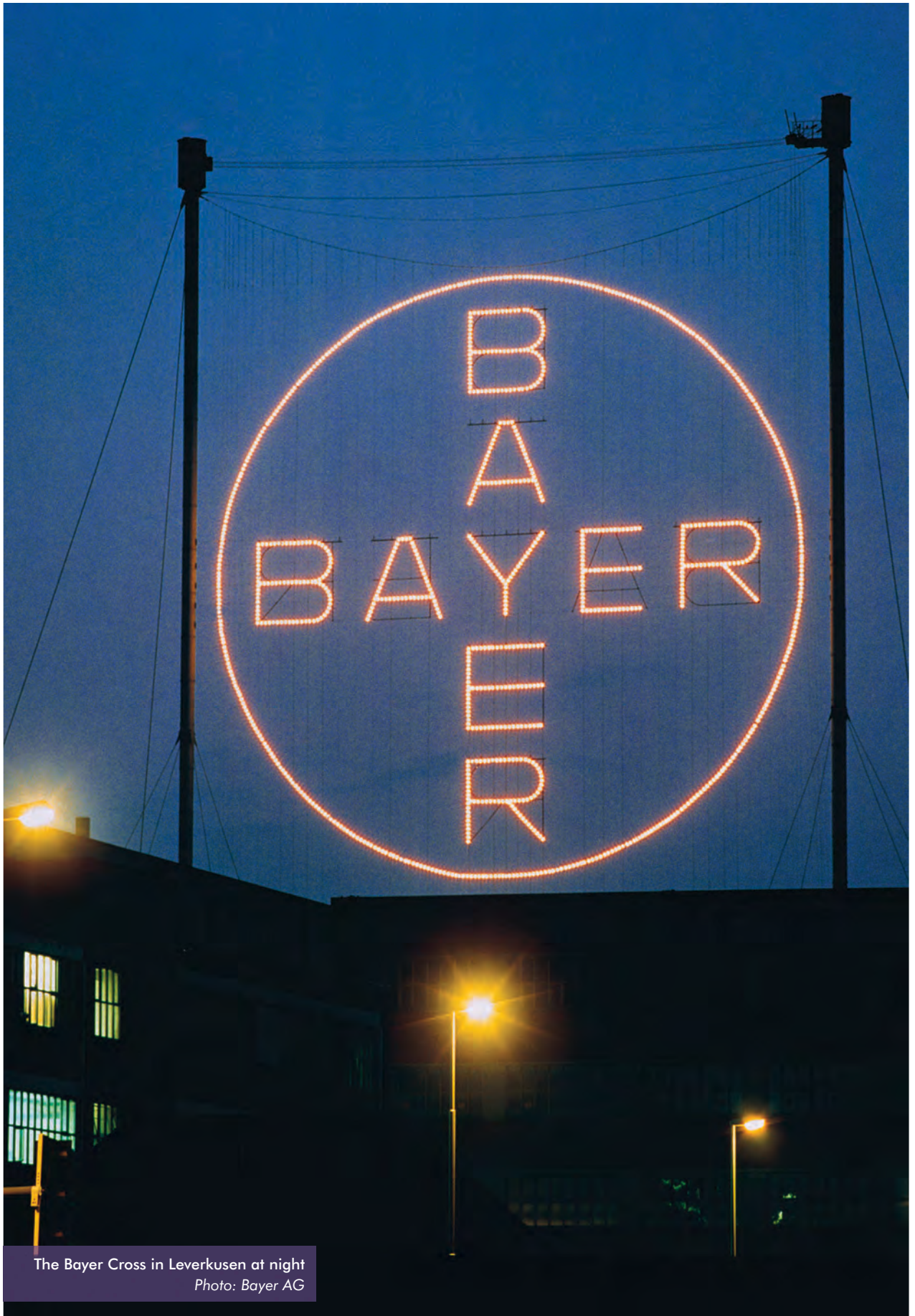
Vorstius, Bayer: Obviously the alternative to a hybrid bond is equity. Besides the theoretical economic cost benefit of the

hybrid compared with equity, you have no dilution and in our case the possibility of tax deductibility of the interest expense. Of course, you pay something for the equity-like features, even with an all-time low subordination spread, making the hybrid still more expensive than straight debt. We have had experience of hybrids through Bayer's first hybrid bond, from 2005, and our capital structure allowed for substantially more funding of that kind. The experiences we had in this context with the rating agencies were sound and reliable. This was also proven in the context of the current transaction.

The aforementioned cost aspects as well as the complexity of the hybrid transaction compared to equity clearly favoured more hybrid capital. We were able to accomplish the full process from kick-off to market launch of the hybrid within four weeks. The market environment also supported such a transaction at this point in time, making the decision even more straightforward.

BIHC: Would you have considered financing your acquisition with hybrids also at a higher level (i.e. cost) or was it just an opportunistic financing? What is your view on current market levels and on the potential evolution of the market?

Vorstius, Bayer: As an issuer we always look at the respective cost of an instrument first, but a number of further non-quantitative aspects are no less important. We strongly value a diversified investor base. In addition, our capital structure had more room for this instrument and this matched very nicely with the good demand from investors at this point in time. But we would definitely not call it an opportunistic financing from the cost side. We would have probably been prepared to do such



The Bayer Cross in Leverkusen at night
Photo: Bayer AG

a transaction even in less strong markets. In the current situation we had to pay up very little to have the benefit of investor diversification if you look at the portfolio from a debt financing perspective, which was very welcome.

BIHC: How do you determine the mix of currencies and markets that you tap? How did you decide the best choice of maturities?

Vorstius, Bayer: The tenors of the issuance are driven by the permanence characteristics of the instrument, firstly, and then in addition by some technical requirements. In the context of the current financing activities, we would also have had need for US dollars. But the higher documentation requirements and the currently higher interest cost favoured the euro market.

BIHC: What were the main challenges you faced before issuing?

Vorstius, Bayer: We continuously have detailed exchanges with the rating agencies. This, plus the trustful relationship we have with both agencies, did help make for a very smooth process during this transaction. The market regards the structure we used as a now common and reliable documentation framework. Investors' appetite and liquidity for our paper is strong in basically all markets and surely helped make this transaction very efficient. The challenge, we felt, was rather to get to market quickly after the acquisition was signed and to manage all internal and external transaction processes accordingly.

BIHC: Bayer issued its first hybrid back in 2005. The structuring requirements of rating agencies have evolved significantly in the meantime. Was the equity content on the old instrument maintained by the rating agencies?

Vorstius, Bayer: Yes. The outstanding hybrid did not play a role in this year's transaction.

BIHC: In case of non-call, what would be the treatment? In case of call, what kind of structure and maturity would you consider?

Vorstius, Bayer: We understand that investors have clear expectations when hybrids reach the first call date. We nevertheless cannot pre-empt any decision that we will only take at the



Dr Sven Vorstius, Bayer AG

time when such an event is due to occur and we do not want to speculate here.

BIHC: Do you expect any further evolution in rating agency methodologies?

Vorstius, Bayer: We consider the treatment of hybrid bonds by the rating agencies to be broadly stable for the foreseeable future. We understand that besides a number of pre-defined criteria the rating agencies apply in any case a company-specific assessment in their overall rating evaluation. This will become even more meaningful if more first call dates of various hybrid bonds in the market approach and companies cope with that situation differently.

BIHC: Do you have further plans or any strategic intention to diversify in currencies or to build-up your (hybrid) curve going forward?

Vorstius, Bayer: In general, we see benefits if diversification into other currencies becomes available, but for us this is not a priority.

We do not look at having multiple hybrid bonds outstanding from an interest rate curve perspective. As the total hybrid volume outstanding in our portfolio increased substantially with this year's transaction it is more important for us to analyse and structure potential losses of equity credit over time. ●

Pricing Date	Issue Ratings	Currency	Amount (m)	Coupon	Maturity Date	First Call Date	New Issue Spread (over mid-swaps)
25-Jun-14	Baa2/BBB (M/S&P)	EUR	1,750	3.00%	01-Jul-75	01-Jul-20	217.6
25-Jun-14	Baa2/BBB (M/S&P)	EUR	1,500	3.75%	01-Jul-74	01-Jul-24	230

Source: Crédit Agricole CIB



building success together ✓

JUNE 2014



BAYER AG

EUR 1,500,000,000

3.75% Subordinated Notes
2074 NC 2024

EUR 1,750,000,000

3.0% Subordinated Notes
2075 NC 2020

Joint Lead Manager

MAY 2014

GDF SUEZ

GDF SUEZ S.A.

EUR 1,000,000,000

3% Subordinated Notes
PerpNC5

EUR 1,000,000,000

3.875% Subordinated Notes
PerpNC10

Joint Bookrunner

JANUARY 2014



ORANGE

EUR 1,000,000,000

4.25% PerpNC2020
Subordinated Notes

EUR 1,000,000,000

5.25% PerpNC2024
Subordinated Notes

Joint Bookrunner

JANUARY 2014



EDF

EUR 1,000,000,000

4.125% PerpNC2022
Subordinated Notes

EUR 1,000,000,000

5.0% PerpNC2026
Subordinated Notes

Joint Bookrunner

JANUARY 2014



ENEL S.P.A.

EUR 1,000,000,000

5% Subordinated Notes
2075 NC 2020

Joint Bookrunner

GBP 500,000,000

6.625% Subordinated Notes
2076 NC 2021

Co-Manager

SEPTEMBER 2013



ENEL S.P.A.

EUR 1,250,000,000

6.5% Subordinated Notes
2074 NC 2019

Joint Bookrunner

GBP 400,000,000

7.75% Subordinated Notes
2075 NC 2020

Co-Manager

JULY 2013

GDF SUEZ

GDF SUEZ S.A.

EUR 600,000,000

3.875% Subordinated Notes
NC 2018

EUR 750,000,000

4.75% Subordinated Notes
NC 2021

Global Coordinator &
Joint Bookrunner

MARCH 2013

TELECOM ITALIA

TELECOM ITALIA S.P.A.

EUR 750,000,000

7.75% Hybrid Notes
2073 NC 2018

Joint Bookrunner

JANUARY 2013



EDF

EUR 1,250,000,000

4.250% Subordinated Notes
NC 2020

EUR 1,250,000,000

5.375% Subordinated Notes
NC 2025

Joint Bookrunner

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UniCredit, Milan
Photo: UniCredit

UniCredit

Quality over quantity

Italy's UniCredit launched its second AT1 transaction, a Eu1bn issue, into a hesitant post-summer market at the beginning of September. Here, Waleed El Amir, head of strategic funding and portfolio at UniCredit, gives his take on the changing dynamics of the market, how order books are evolving, and what this means for execution strategy.

What was behind the timing of your Eu1bn AT1?

Waleed El Amir, UniCredit: There were effectively two windows where we felt you could bring an AT1 transaction: in September, or you would have to wait until after the AQR results. Even after the AQR results come out you'd probably have to wait a couple of weeks further as the market digests them. Meanwhile, we thought there would potentially be less supply in September than in November because a lot of people would have had to work through the August period because it takes a long time to get the documentation up and running. Hence we thought September was a better window to issue.

The last thing that happened before the summer was BES and one of the Spanish banks had to reverse its plans to issue at that time. Were you concerned that there would be any lasting impact?

El Amir, UniCredit: BES was a less relevant event. It was very idiosyncratic rather than systemic. Before any state aid can come in, all the capital has to be effectively written off and that capital includes Lower Tier 2. So I think BES was irrelevant.

I think the Spanish transaction you are alluding to had different issues. It was

a smaller bank that was trying to do an AT1 deal with a 7% trigger, which was always going to be much more difficult because people were beginning to second guess whether you are trying to front-run the stress tests or not. What didn't help that issuer was that it had done its first deal with a 5.125% trigger and then increased it to 7%. So there were different dynamics at play here.

So I don't think either of those issues really impacted our deal.

Overall, did you feel that the market was in good shape?

El Amir, UniCredit: To say it was in "good shape" would be overdoing it. It was in OK shape. The thing that really spooked the market was the fact that the asset class, at least in terms of cash price and spread, was very volatile. In August you basically saw securities go from a cash price of 110 to 101 on very thin trading volumes. And a lot of accounts that had quite large positions in the product, when they tried to sell they realised that it wasn't so easy to get out of those positions. And the fact that the asset class was so volatile and people were having to mark to market their positions, and that there was not liquidity in the market, was one of the main driving factors why books were lower than they had been historically.

That was quite a change, to see the market reopen with books of that magnitude, even if nobody expected the massive books we saw at the start of the year.

El Amir, UniCredit: Clearly there's a very different dynamic in terms of the books. If you look at our own deals, the first deal had a book of 8bn, the second had a book of 2bn. What was happening in the earlier deals is that there was a lot of order inflation — and the size of book doesn't tell you how a deal's going to trade in the secondary market. We have seen a lot of deals have huge order books but trade poorly in secondary because they had a lot of fast money that got allocated. The key is actually to have good buy and hold investors buying your paper so you don't have a lot of loose bonds. So we have seen quite a different dynamic between where our deal had traded versus other transactions, resulting in us outperforming other comparables in the secondary market.

Are you happy with how the deal went?

El Amir, UniCredit: I'm very happy, although competitors didn't make our lives easy at all.

Were there any particular structuring considerations on this AT1?



Waleed El Amir, UniCredit:
"Investors at the moment do not like large deals"

El Amir, UniCredit: No. I think we wanted to give investors the most investor-friendly instrument that we could, and that's with a 5.125% trigger — lower than the 7% — and a write-up/write-down structure, which is in my view the best structure we could basically offer to the market.

There was an expectation that the pipeline was building and investors sometimes talk about that as a factor in their considerations. Was that a factor in the execution of your deal?

El Amir, UniCredit: Certainly, I think that's right, that there is quite a lot of supply coming from the banks, and the week after that we did see HSBC and CASA in the market. But I think it ultimately returns to the question of whether people like the credit or not, and if they want to get exposure to it. The really big factors were the volatility in the asset class, the

lack of liquidity in the market, and the fact that we priced the day after Santander when effectively a deal had traded pretty poorly in the secondary market, which makes life pretty difficult. Supply was a factor, but a lesser factor than the other three.

Your last issue was in dollars — why did you choose euros this time?

El Amir, UniCredit: I think it's less about currency and more about what the market is doing. In a bull market people will buy whatever currency. Most of the large investors that are buying AT1 product are currency-agnostic, so they'll happily buy euros and they'll happily buy dollars. It is more about market timing, right?

The way some transactions have been sized is another element. We did Eu1bn versus Santander doing Eu1.5bn. Barclays has done deals as large as Eu3bn. Investors at the moment do not like large deals because it just means that there are potentially more loose bonds, and it doesn't take a lot of sellers to really move a price very much in a thin market. So all those things are much more important than the currency chosen.

We decided to do euros because we had done dollars previously and it was just a way for us to diversify the investor base, for example we had much larger French participation in the euro deal versus the US dollar deal. We are likely to pursue a diversification process as we continue to fill up our AT1 basket, is-

suing a combination of dollar and euro transactions.

What can you tell us about any targets you have in terms of AT1 and what we might see from UniCredit going forward?

El Amir, UniCredit: We have told the market that we would like to do more. Some banks have significantly accelerated their plans. CASA has done four trades so far in the space of 12 months, Santander has done three. What we said to the market is that we would like to be a little bit more controlled in terms of the pace, so one to two deals a year is what we are planning to do right now.

Any final takeaways?

El Amir, UniCredit: We were happy with the deal in the end, because I think the most important thing was the secondary performance. It was not an easy market, but we are very happy with the performance. Post-deal I spoke to the top five investors — some of whom also invested in the previous trade — and they were very happy with the way that it was handled and how it has traded in secondary. That for us is always the key factor at the end of the day because people look at all kinds of statistics, but secondary trading performance is where investors ultimately make the decision to come back and invest in with you or not. That is the litmus test for us. ●

UniCredit SpA

Rating: BB- (Fitch)

Amount: Eu1bn of Additional Tier 1 capital. Principal writes down (but can be written back up)

Maturity: perpetual

Call option: 10 September 2021

Capital Ratio Event: 5.125% CET1 trigger: if the Group or Issuer CET1 falls below the trigger level, the instrument will be temporarily written down by the amount required to cure the breach, taking into consideration other instruments with similar write down triggers

Fixed/re-offer price: 100.00%

Coupon: 6.75% p.a. until call date; thereafter reset over the prevailing five year mid-market swap rate plus 610bp

Yield at re-offer: 6.75%

Launched: Wednesday 3 September

Payment date: 10 September 2014

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building SUCCESS together ✓

SEPTEMBER 2014



HYPO NOE GRUPPE BANK AG

EUR 500,000,000

0.750%
Hypothekenpfandbrief
Due 2021

Joint Bookrunner

SEPTEMBER 2014



CAISSE FRANÇAISE DE FINANCEMENT
LOCAL

EUR 1,250,000,000

0.375% Obligations
Foncières Due 2019

Joint Bookrunner

SEPTEMBER 2014



ZURICH INSURANCE COMPANY LTD VIA
CLOVERIE PLC

EUR 500,000,000

1.75% Senior Unsecured
Notes 2024

Joint Bookrunner

JULY 2014



DG HYP

EUR 500,000,000

0.875%
Hypothekenpfandbrief
Due 2021

Joint Bookrunner

JUNE 2014

Berlin Hyp

BERLIN HYP AG

EUR 750,000,000

0.625%
Hypothekenpfandbrief
Due 2019

Joint Bookrunner

JUNE 2014



OP MORTGAGE BANK

EUR 1,000,000,000

0.750% Covered Bond
Due 2019

Joint Bookrunner

JUNE 2014

Danske Bank

DANSKE BANK A/S

EUR 1,000,000,000

1.250% Covered Bond
Due 2021

Joint Bookrunner

JUNE 2014

BBVA

BANCO BILBAO VIZCAYA ARGENTARIA SA

EUR 1,000,000,000

2.25% Cédulas Hipotecarias
Due 2024

Joint Bookrunner

MAY 2014



KUTXABANK S.A.

EUR 1,000,000,000

1.75% Cédulas Hipotecarias
Due 2021

Joint Bookrunner

MARCH 2014



BANCO SANTADER TOTTA

EUR 1,000,000,000

1.5% Obrigações
Hipotecárias Due 2017

Joint Bookrunner

MARCH 2014



DEXIA CRÉDIT LOCAL

EUR 1,750,000,000

1.375% Senior Unsecured
Guaranteed Notes
Due 2019

Joint Bookrunner

MARCH 2014



CAISSE CENTRALE DESJARDINS

EUR 1,000,000,000

1.125% Covered Bond
Due 2019

Joint Bookrunner

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