

Bank+Insurance HybridCapital

Mar-Apr 2015

With  **CRÉDIT AGRICOLE**
CORPORATE & INVESTMENT BANK

Nordic season!



Scandi competitors touch down with
AT1 debuts in quick succession

CASA
Tier 2 record-breaker

Solvency II
Tier 1 take-off eyed

TLAC/MREL
Coupon cancellation risk



We offer you our world of solutions ✓

MARCH 2015

CRÉDIT AGRICOLE S.A.
CREDIT AGRICOLE S.A.
EUR 2,000,000,000
2.625% Tier 2 Subordinated
Notes Due 2027
USD 1,500,000,000
4.375% Tier 2 Subordinated
Notes Due 2025
Sole Bookrunner

JANUARY 2015

CRÉDIT AGRICOLE ASSURANCES
CRÉDIT AGRICOLE ASSURANCES
EUR 1,000,000,000
4.25% Subordinated Notes
PNC 10
Global Coordinator,
Sole Structuring Advisor and
Sole Bookrunner

NOVEMBER 2014

AXA S.A.
AXA S.A.
**Exchange Offer for
2 EUR and 2 GBP Undated
Deeply Subordinated Notes**
Exchanged into EUR Undated
Deeply Subordinated Resettable
Notes and GBP Undated Deeply
Subordinated Resettable Notes
Joint Dealer Manager

NOVEMBER 2014

CNP ASSURANCES
CNP ASSURANCES
EUR 500,000,000
4.000% Subordinated
Notes PerpNC10
Joint Bookrunner

SEPTEMBER 2014

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

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

MAY 2014

LB BW
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

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



4

INTRODUCTION

3 A rising tide

MARKET NEWS

4 HSBC caps Q1 as ECB QE reboots AT1

Greenshoe promises greater AT1 stability •

Starting gun fired on TLAC Tier 2 supply •

Allianz hits post-crisis tight with Eu1.5bn Tier 2 •

CAA under the wire, Solvency II Tier 1 awaited

REGULATION

9 Potential MREL/TLAC impact

Plus: G20 Istanbul agenda and more in banking updates from Crédit Agricole CIB's DCM solutions team

DATA

18 Bank and insurance hybrids

LEAGUE TABLES

21 Bookrunners of financials



13



22

CASE STUDY

22 Crédit Agricole: Tier 2x2

Crédit Agricole on 9 March sold the largest ever Tier 2 issue, a dual-tranche transaction comprising Eu2bn and \$1.5bn pieces that attracted record demand and constituted the first dual-tranche Tier 2 benchmark.



COVER STORY

26 Nordic season!

A year ago Nordic banks had yet to issue AT1, but 12 months on virtually all the region's leading players have taken up the capital instrument — whether in euros, dollars or their local currencies. However, their ultimately limited AT1 needs have combined with high credit quality to ensure that issuance has in the main been easily absorbed.

INSURANCE

32 Solvency II Tier 1 take-off

The impact of Solvency II is expected to hit the capital markets in 2015 via the first Tier 1-style structures under the new framework. Bank+Insurance Hybrid Capital surveyed leading market participants to find out how the new asset class is likely to evolve, as well as its wider impact on insurers' funding and capital strategies.



SOLVENCY II TIER 1

42 Investor survey

Crédit Agricole CIB conducted an investor survey in January and we present the results here.

46 A tool to satisfy capital requirements

Hervé Ekué of Allen & Overy offers an overview of Tier 1 issuances under Solvency II.

49 Disclaimer

A rising tide



With the launch of full scale quantitative easing on 22 January the European Central Bank finally delivered on the promise of president Mario Draghi's July 2012 pledge to do "whatever it takes" to preserve the euro. Even if deflation is cited as the bogeyman being targeted by the central bank, the action arguably puts in place buffers to protect the Eurozone in the event of a Greek exit — referred to by an increasingly wide range of observers and nationalities by the appropriately ugly contraction, Grexit.

The addition of the big bazooka of government (and SSA) bond purchases alongside existing covered bond and ABS purchase programmes to every month inject Eu60bn of liquidity has more than ever proved the aphorism that a rising tide lifts all boats.

Small wonder that the subordinated debt markets have found the first months of the year easy-going. The fireworks of early 2014 may have been missing, but after the volatility that followed those heady days, most market participants were probably willing to sacrifice the highest highs to avoid the darker days that followed.

Investors continue to be attracted to the risk/reward profile of Tier 2, with its must-pay coupons, while the yields of the Additional Tier 1 market retain their lure. Order books have ebbed and flowed, but an increasingly stable investor base and reasonably steady flow of issuance has meant that all but the unluckiest issuers have found the market accommodating — while the most preferred names have been able to set the market alight, particularly in dollars.

How long can the good times last? After brushing off multiple risk factors in the first quarter, the market's nerves have gradually been increasing again — mainly due to the unpredictability of Greece's negotiations with its creditors.

Thanks to the ECB, the talks need no longer be seen as a Mexican stand-off. Perhaps.

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Market news

HSBC caps Q1 as ECB QE reboots AT1

HSBC provided a late highlight to first quarter Additional Tier 1 activity with a \$2.25bn transaction in late March that rounded off a constructive first quarter in which issuers across the credit spectrum were able to find takers for their capital instruments on the back of bullish credit markets.

The UK bank on 23 March sold its perpetual non-call 10 high trigger, equity conversion securities at 6.375% on the back of some \$14bn of demand, with a \$2bn AT1 debut for Standard Chartered later the same week confirming the healthy state of the market with a similarly sized book.

The transactions were an encouraging and rapid comeback from a lacklustre DNB \$750m AT1 debut the previous week that had attracted a modest \$2bn of demand, with levels off highs enjoyed by its Nordic peers earlier in the quarter.

"There are numerous risk factors to credit spreads which have largely been discounted so far this year: Russia, the Middle East, oil price volatility and Grexit," said a market participant. "However, AT1 and Tier 2 markets are susceptible to corrections."

Market participants meanwhile noted that HSBC erred on the side of caution in pricing its AT1: one said that initial price thoughts of the 6.625% area or the investment grade instrument had offered a new issue premium of more than 60bp.

"Unsurprisingly, the bonds immediately traded up a full 1.5 points off the break," he added.

Pricing levels approached a peak in mid-February when Svenska Handelsbanken was able to price a \$1.2bn perpetual non-call six AT1 debut at a record coupon low of 5.25% on the back of \$4.7bn of demand, with its Swedish peers enjoying similar levels in the first quarter. (*See Nordic feature for more.*)

Rabobank had gotten the asset class off to a solid start on 15 January with the first Dutch AT1, a Eu1.5bn 5.5% perpetual



non-call 5.5 issue launched after the tax treatment of the instruments in the Netherlands was set out late in 2014. Following IPTs of the 5.625% area, pricing was set at 5.5% on the back of a Eu4bn book.

The accommodating tone of the market was demonstrated by Banco Popular Español finally getting away a long-planned and previously-postponed AT1 transaction, albeit in a club-style deal. The Spanish bank sold its unrated Eu750m perpetual non-call five issue at a coupon of 8.25% on 4 February.

'More and more investors are looking to the asset class'

Market participants attributed the much-improved sentiment in the AT1 market to wider market considerations, notably the European Central Bank finally on 22 January confirming its plans for full-scale quantitative easing. Its Expanded Asset Purchase Programme helped lift issuance across asset classes to record levels at the same time as credit markets rallied.

"Globally speaking, I'd say that we still feel reasonably constructive on the subordinated debt markets, both for fundamentals and valuations reasons,"

said François Lavier, portfolio manager and analyst at Lazard Frères Gestion. "I'd add that thanks to the recent ECB asset purchase programme more and more investors are looking to the asset class, which is very encouraging from a technical perspective."

The environment of apparently ever lower rates has meanwhile on the supply side made all-in yields more attractive for issuers.

However, despite recovering from a mixed second half of 2014, the market remains off its highs of earlier last year, according to Vincent Hoarau, head of FIG syndicate at Crédit Agricole CIB.

"Valuations in AT1s have recovered massively since volatility decreased and the Greece situation declined in relevance in Q1," he said. "The frenzy observed during the same period of 2014 has nevertheless gone, perhaps forever – who would have thought that the long-awaited inaugural Rabobank AT1 would get 'only' Eu4bn of orders?"

"In primary, we are far from the average book sizes of 2014 as order inflation has disappeared and since many opportunistic buyers exited the asset class. That said, AT1 is being entertained by more and more dedicated players, suggesting that the asset class may have found a home." ●

Greenshoe promises greater AT1 stability

UBS used a greenshoe on an Additional Tier 1 on 13 February, including the option for the first time on such an instrument in a bid to improve the performance of AT1s by allowing lead managers to better support new issues.

After a two day European roadshow, UBS Group issued \$3.45bn of CoCos split into \$1.15bn perpetual non-call five and 10 tranches as well as a Eu1bn (\$1.15bn) of perpetual non-call seven. Its investment bank – as sole bookrunner – then increased the two dollar tranches to \$1.25bn apiece at the re-offer price through the greenshoe of up to 10%, taking the total issue size to \$3.65bn.

The greenshoe option was touted as giving the lead greater confidence and ability to short the paper and stabilise the issue, with a 5% limit on short positions under the Market Abuse Directive cited.

“Launching the transaction with the greenshoe feature helped to significantly assuage some investor concerns around short term secondary marketing performance of recent Additional Tier 1 offerings, leading to incremental demand during the ongoing bookbuild process,” said UBS.

The three AT1 tranches were priced inside initial price thoughts on the back of large order books: the \$1.15bn perpetual non-call five high trigger at 7.125% after IPTs of the 7.25% area with demand over \$4.5bn; the \$1.15bn perpetual non-call 10 low trigger at 7% after IPTs of the 7.125% area and \$5.25bn of orders; and the Eu1bn perpetual non-call seven low trigger at 5.75% after IPTs of 5.875%-6.000% and books exceeding Eu4.7bn.

On 23 March HSBC Holdings followed UBS's example on a \$2.25bn perpetual non-call 10 AT1 that was increased to \$2.45bn with the exercise of the greenshoe (*see separate article*).

Mariano Goldfischer, global head credit trading and syndicate at Crédit Agricole CIB, said that the technique can limit the performance of AT1s to the downside but also the upside.



UBS, Zurich

“In a bull market, the bond could underperform the broad market as syndicate has the free option to exercise its greenshoe rather than reach into the secondary market – potentially to the detriment of investors,” he said. “In a bear market, the bonds will outperform as there will be a good bid from syndicate due to a potential need to cover a short via a secondary market bid.

“At the end of the day, it is the job of the syndicate desk to have a good read of the market and price appropriately to make sure the bonds performs and issuers don't leave too much on the table,” he added, “and overall the greenshoe is of greatest benefit to the syndicate. But you can also argue that it is beneficial for investors to know that there will be a bid in the sec-

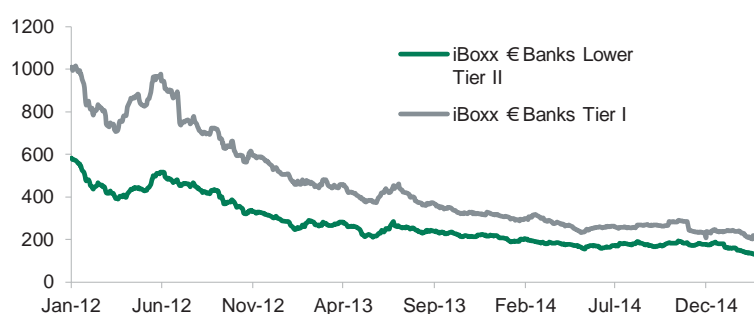
ondary market if the market deteriorates.”

Given the volatility witnessed in the asset class, AT1 investors looked on the positive side of the initiative.

“We see it as a strong signal to the AT1 market,” said Dan Karsenty, portfolio manager and vice president, Eiffel Investment Group, “helping dealers stabilise new issues and reassuring investors on price stabilisation amid contained volatility. In 2014, AT1 proved to be a very volatile asset class and the repricing, as well as the scarcity of liquidity the market experienced in H2, pushed investors to be more cautious when looking at the AT1 market.

“The asset class is still growing and the investor base is still not set, so any help in stabilising prices on new issuances is beneficial.” ●

Secondary bank subordinated indices



Source: Markit, Crédit Agricole CIB

Starting gun fired on TLAC Tier 2 supply

Banks' efforts to build up Total Loss Absorbing Capital started in earnest in February as they began an anticipated wave of Tier 2 issuance in the wake of the TLAC blueprint released by the Financial Stability Board on 10 November.

In the month from 9 February, when Deutsche Bank kicked off supply, European G-SIBs raised some Eu8.25bn of Tier 2 in euros alone, with further issuance in a variety of other currencies — Crédit Agricole notably including a dollar tranche in a record-breaking dual-tranche Tier 2 benchmark on 9 March.

A surge in Tier 2 supply early this year had been forecast after the FSB launched a consultation on its proposals in November, while in the longer term Standard & Poor's has estimated total TLAC-eligible assets needs of around Eu500bn by 2019.

"Whilst the banking sector is becoming safer from a fixed income investor's perspective," said one investor, "what we will certainly see is a pick-up in supply of the more junior instruments."

Issuers have equally been weighing the likely impact on spreads of the potential Tier 2 glut. A week before the German bank's Tier 2 opener, Deutsche Bank's head of regulatory policy, for example, wrote in a response to the FSB consultation that a maximum of Eu50bn per annum in Tier 2 can be issued in aggregate without impacting spreads, with the amount of an individual issuer being around E3bn-Eu5bn.

Deutsche set the tone for the series of Tier 2s with a Eu1.25bn 10 year bullet that attracted almost Eu4.5bn of demand, allowing pricing to be tightened from initial price thoughts of 225bp over mid-swaps to 210bp over.

"The TLAC race has started and Tier 2 appears to be the instrument of choice," said Vincent Hoarau, head of FIG syndicate at Crédit Agricole CIB in London. "It is a 'must-pay' coupon security paying investors a relatively good yield at a time



Deutsche Bank, Frankfurt

when 10 year senior in core names pays just above 1% and we are seeing negative yields paid in primary on low beta names and formats.

"Tier 2 is being seen as 'the new senior,'" he added, "and we are seeing more and more done in private placement format, too."

In the public markets Deutsche was joined in February by France's BNP Paribas and Société Générale, the former with a Eu1.5bn 10 year bullet that attracted some Eu1.5bn of orders at 170bp over and the latter some Eu3.8bn for a Eu1.25bn 10 year at 190bp over. Spain's Santander then on 4 March sold

a Eu1.5bn 10 year bullet at 190bp over mid-swaps that attracted some Eu8bn of demand.

"The longer issuers waited, the less they paid in this bullish market," noted a syndicate official.

Belgium's KBC meanwhile sold a Eu750m 12 year non-call seven issue on the same day as Santander's deal.

The culmination of the Tier 2 benchmarks was the dual-tranche Crédit Agricole transaction on 9 March, which was split into Eu2bn and \$1.5bn pieces that generated Eu10bn and \$7bn order books, respectively. The French bank's strategy was to raise its 2015 Tier 2 needs in one shot (*see case study for further details*).

Other European issuers ventured further afield to meet their Tier 2 needs, with France's BPCE following the Netherlands' Rabobank into the Samurai market. Rabobank had in December sold a ¥50.8bn 10 year bullet, the first Tier 2 Samurai from a European bank, and BPCE on 23 January raised ¥48.3bn across three tranches.

"This Basel III Tier 2 Samurai issue confirms the interest of larger spread paper for a wider investor base, that goes much beyond the usual core-investors," said a banker at one of BPCE's leads. "This market still needs to grow, but each transaction will help in that direction." ●

ASIA-PACIFIC NEWS IN BRIEF

Aussie, Japanese and Dim Sum firsts

National Australia Bank sold its first offering of Basel III-compliant Tier 2 notes in the domestic wholesale market on 20 March. The A\$1.1bn 10 year non-call five offering priced directly in line with guidance at three month BBSW plus 185bp.

BPCE sold a CNH750m 10NC5 Tier 2 note on 18 March at a yield of 5.75%, in line with initial guidance.

Mitsubishi UFJ Financial Group priced Japan's first yen-denominated AT1 note, a ¥100bn perpetual non-call five issue at a coupon of 2.7% on 17 March. The offering features a permanent write-down mechanism with a CET1 trigger at 5.125%.

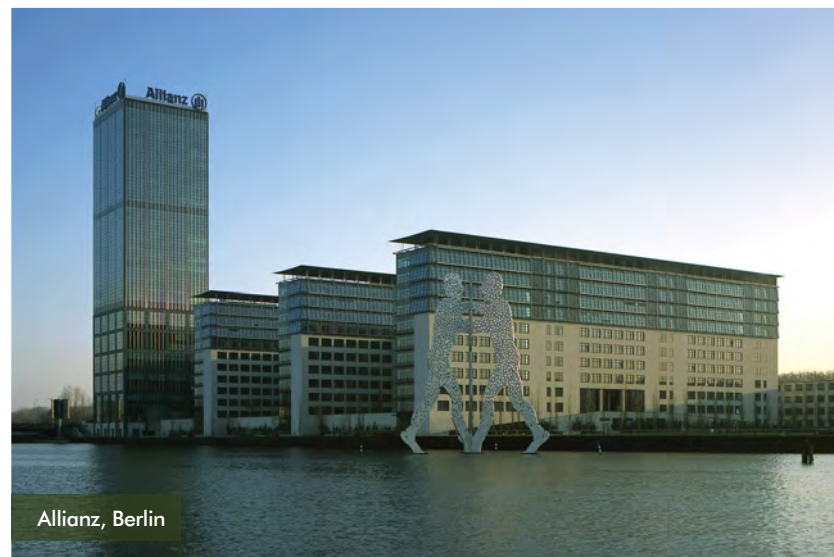
Allianz hits post-crisis tight with Eu1.5bn Tier 2

Allianz achieved the lowest coupon and tightest spread on a subordinated transaction in the insurance sector since the financial crisis with a Eu1.5bn 2.241% 30 year non-call 10 Tier 2 issue on 30 March.

The insurer hit the market just before the Easter break, at the end of a quarter when the attractive levels available had led to record-breaking issuance levels but ahead of a possible drying up of liquidity in the market resulting from the public holidays.

Leads Citi, Commerzbank, Crédit Agricole CIB, Deutsche Bank and HSBC went out with initial price thoughts of the mid-swaps plus 180bp area. Allianz 5.75% 2041NC2021s were quoted at I-spread of plus 148bp, bid, and its 5.625% 2042NC22s were at plus 150bp, implying fair value of mid-swaps plus 154bp, according to Robert Chambers, FIG syndicate at Crédit Agricole CIB, while Allianz perpetual notes bid at around 200bp suggested a similar level of the low 150s taking into account a perpetuity premium of 40bp-50bp.

Guidance was refined to 165bp-170bp after two-and-a-half hours on the back of Eu3bn of orders, and the books reached a final Eu4.25bn comprising over 300 accounts by the time they were closed soon afterwards. The re-offer was set at the tight end of guidance, at 165bp over,



Allianz, Berlin

with Chambers noting that this larger than usual move from IPTs to re-offer was possible thanks to the very granular and high quality nature of the order book. The ultimate pricing put the new issue premium at around 10bp, he added.

“When considering premiums, it is important to remember the current backdrop in which short dated senior unsecured transactions have been paying double-digit premiums and long dated corporate senior unsecured trades are paying new issue premiums of 35bp or more at the IPTs stage,” said Chambers. “As a result, the relatively minimal NIP paid by Allianz reflects their strong

credit profile and also the strength of the insurance sector among the institutional investor base.”

Having closed re-offer bid on the first day of trading, the bonds widened marginally into the Easter holidays as liquidity dried up. However, Chambers noted that as liquidity returned to the market the bonds performed well to trade comfortably inside re-offer.

The UK took 31%, Germany and Austria 20%, France 19%, Asia 9%, southern Europe 6%, the Benelux 5%, Switzerland 4%, Nordics 3%, and others 3%. Funds were allocated 76%, insurance companies and pension funds 16%, and banks 8%. ●

ASIA-PACIFIC NEWS IN BRIEF (continued)

Australia & New Zealand Banking Group Limited sold a S\$500m 12NC7 Tier 2 on 16 March, its first offering in the currency. Initial price thoughts for the offering were launched at high 3% area, with final pricing set at 3.75% following orders of over S\$700m from 47 accounts. The notes are being issued off ANZ's \$60bn euro MTN programme.

Australian financial services company **AMP Ltd** sold a A\$275m perpetual non-call five FRN AT1 offering on 13 March to wholesale investors. IPTs were set at 400bp over for a size of A\$150m, although strong demand allowed the offering to be increased. From a structural perspective, the notes include a mandatory conversion occurring in year seven

(at the 20 day volume-weighted average price*99%), subject to certain conditions being met.

Commonwealth Bank of Australia sold a Basel III-compliant Tier 2 bond in the offshore renminbi market on 4 March. The 10 year non-call five deal was priced in line with IPTs of 5.15% for a size of CNH1bn following a book of CNH1.5bn from 41 accounts. The deal was allocated to Asian funds only.

BNP Paribas made its debut in the Dim Sum market on 3 March, pricing a CNH1.5bn 10 year non-call five Tier 2 note at a coupon of 5%. Order books for the offering reached CNH2bn, with 98% of the 42 investors comprising Asian demand. ●

CAA under the wire, Solvency II Tier 1 awaited

Crédit Agricole Assurances in early January squeezed in the last grandfathered Tier 1 trade before Solvency II took full effect later in the month, with the sector now awaiting the first fully-fledged trades under the new insurance industry regulatory framework but otherwise quiet in the interim apart from limited Tier 2 supply of which Allianz provided a highlight (*see separate article*).

The publication of Solvency II Delegated Acts in the Official Journal of the EU on 18 January closed the door on such grandfathered trades from the following day. Indeed the anticipated yet uncertain end date had already almost closed down issuance.

“CAA was a highlight at the beginning of the year as nobody could believe that anyone would run the risk of tapping the primary market with the cut-off date potentially being announced during the trades execution and hence disqualifying it as Tier 1,” said a market participant.

The French insurer launched its transaction on 8 January, a Eu1bn perpetual non-call 10 issue. The structure is treated as grandfathered Tier 1 during the Solvency II transitional period and fully-eligible Tier 2 thereafter, and matched that of a Eu750m perpetual non-call 11 issued by Crédit Agricole Assurances (CAA) in October.

The new Eu1bn issue was priced at mid-swaps plus 350bp on the back of a Eu2.5bn book comprising some 200 accounts, and following IPTs of the mid-swaps plus 360bp area. The paper tightened 6bp on the day of launch.

The supply situation and wider technicals offered the insurance sector support through the opening months of the year, according to Robert Chambers, FIG syndicate manager at Crédit Agricole CIB.

“Having now passed the cut-off date for grandfathered Tier 1 transactions, such structures continue to outperform other FI paper as investor demand heavily outweighs realised/potential supply,” he said. “Whilst the global macroeco-



nomie headlines have caused volatility in most sectors, any selling pressure in insurance hybrids has been easily recycled to other asset managers in Europe.

“Tier 2 bonds are also extremely well supported due to the lack of supply so far this year.

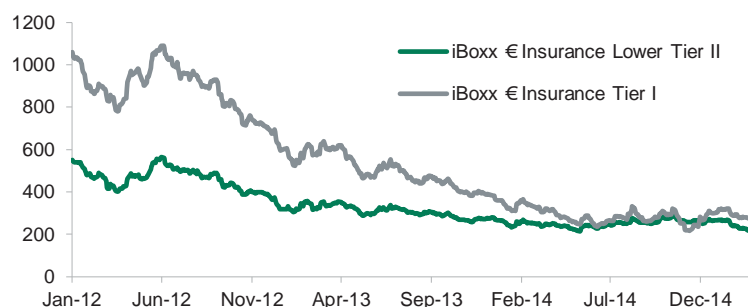
Achmea launched one of the few such transactions, a Eu750m perpetual non-call 10 Tier 2 transaction at mid-swaps plus 355bp on 28 January. On the back of a Eu3bn order book, the pricing was tightened from IPTs of 370bp to the 355bp re-offer, which was seen as offering a new issue premium of some 20bp – and the paper quickly tightened 20bp.

Vienna Insurance Group on 18 February issued Eu400m of 31 non-call 11 subordinated notes as part of a liability

management exercise in which it was repurchasing December 2022 notes and a perpetual non-call 2018 subordinated issue. The paper was priced at 3.75% following IPTs of the 4% area and guidance of the 3.875% area, with the order book having reached Eu700m.

A market participant said that the new notes priced flat to outstanding 2043 non-call 2023 paper of the issuer, noting that this was in line with recent tender and new issue processes where the issuer has opted to pay the premium on the tender leg rather than the new issue. The exercise closed on 26 February, with Eu33.363m and Eu49.983m tendered out of Eu180m of the 2022s and Eu250m (outstanding, against an original Eu500m) of the perpetual non-call 2018s. ●

Secondary insurance subordinated indices



Source: Markit, Crédit Agricole CIB

AT1 coupon cancellation risk

Consequences of MREL and TLAC breaches

Crédit Agricole CIB's capital solutions team provides here an overview of the development of the global TLAC and EU MREL measures, exploring their differences and highlighting their potential impact on the Additional Tier 1 market.

The consultation of the Financial Stability Board (FSB) on the Total Loss Absorbing Capacity (TLAC) term sheet proposal ended on 2 February. The framework, which responds to the FSB's 2010 agenda for addressing the systemic and moral hazard risks associated with the so-called "too big to fail" problem, will apply an internationally agreed loss-absorbing capacity standard to Global Systemically Important Banks (G-SIBs).

In the EU, loss absorbing capacity in resolution is regulated by the Bank Recovery & Resolution Directive (BRRD) in the form of a Minimum Requirement for Own Funds and Eligible Liabilities (MREL). The BRRD was finalised in 2014, and EU member states were expected to transpose it by 1 January 2015, with MREL to apply from 1 January 2016, unless brought forward.

While the TLAC and the MREL frameworks share common objectives, they likewise present material differences due to fundamentally inconsistent approaches and legal uncertainties. Among these, the consequence of their breach is one of the most problematic, given the potential effect on the risk of mandatory coupon cancellation for Additional Tier 1 (AT1) instruments.

The TLAC proposal

The FSB-proposed term sheet includes a minimum TLAC requirement, set within the range of 16%-20% of risk weighted assets, and at least twice the Basel III Tier 1 leverage ratio (i.e. 6% of the total exposure amount, or whatever the final requirement will eventually be).

a G-SIB may breach its buffer requirements in the same way that it may breach its buffer requirements if maturing Tier 2 instruments that count towards the Basel III total capital requirement are not replaced". According to the text, this should trigger the same automatic restrictions set out in the Basel III frame-

work "for the duration of the breach".

The term sheet appears to refer to the mandatory restriction on distributions to shareholders, employees and Additional Tier 1 coupon payments, introduced by Basel III, and transposed in the EU legislation by the Capital Requirements Directive (CRD IV) in the form of the Maximum Distributable Amount (MDA). However,

this would technically be the consequence of the indirect breach of the combined buffer requirements, rather than TLAC per se, due to the principle of no-double-counting described above.

KEY TAKEAWAYS

- TLAC and MREL share common objectives, but the approaches are materially different
- While the FSB pillar 1 TLAC proposal will sit above the Basel III capital requirements but below the capital buffers, European MREL takes both into account to compute a parallel metric
- Because of the positioning in the capital stack, a breach of TLAC requirements may lead to distribution restrictions similar to buffer breaches
- Meanwhile automatic implications of MREL breaches are not specified in the relevant rules
- Furthermore, MREL does not include an explicit disclosure framework, thus hindering the possibility for market participants to effectively monitor this risk

TLAC was developed as a Pillar 1 measure, incorporating Basel III minimum capital requirements but excluding Basel III capital buffers. As such, the minimum TLAC requirement should be met first, and only afterwards should any surplus of Common Equity Tier 1 (CET1) capital be available to meet the capital buffers.

As a consequence of the above principle, section 7 of the TLAC term sheet states that "if debt that matures or no longer qualifies as TLAC is not replaced,

The MREL framework

In the EU, the European Banking Authority (EBA) has the mandate to provide the secondary legislation that will specify the criteria to set bank-specific MREL, as prescribed by the BRRD. A public consultation on the MREL draft Regulatory

Technical Standards (RTS) was launched on 28 November 2014. The metric will be calibrated to ensure that institutions have sufficient own funds and eligible liabilities available to absorb losses and contribute to recapitalisation.

Contrary to the FSB TLAC term sheet, neither the BRRD nor the EBA draft RTS contain specific provisions covering the implications of an MREL breach. This is partially stemming from the fact that MREL is not constructed to be a Pillar 1 metric. While its computation takes into account, among other elements, the existing Basel III minimum capital requirements, it also includes any applicable capital buffers, and translates both into a total-liabilities-based metric, along with the amount required to recapitalise the resolved entity. It therefore lacks the direct relationship with the Basel III capital conservation regime.

In general, EU legislators appeared to have taken a softer approach, where the possible MREL breach would likely be dealt with by the resolution authority, which has the power to require an institution to take “other steps” to meet the metric under article 17(5) of the BRRD. However, it appears that it would not automatically trigger statutory restrictions on equity or AT1 distributions. Furthermore, contrary to TLAC, MREL does not include an explicit disclosure framework, thus hindering the possibility for market participants to effectively monitor this risk.

Implications for AT1 coupons

It is currently unclear whether the need to transpose the TLAC framework into the European legislation will force a



change in the MREL approach. The EBA expects the MREL RTS to be compatible with the proposed FSB TLAC term sheet. However, mandatory distributions restrictions following a breach of the combined buffer requirements are regulated under CRD IV. Consequently, secondary legislation, such as the EBA RTS, would not be able to absorb the related TLAC requirements.

Therefore, if the TLAC breach provision is eventually confirmed in the final term sheet, there might be two scenarios.

First, EU authorities could implement TLAC with an ad hoc legislation, which would likely have to amend certain sections of the CRR and CRD IV. This would ideally be calibrated towards G-SIBs only.

Alternatively, the TLAC breach provision could be adopted indirectly using the current EU legislative base. In this context, it might fall under article 104(i) of CRD IV, which already gives regulators the power to cancel AT1 distributions. However, this approach might not be considered fully-compliant by the FSB,

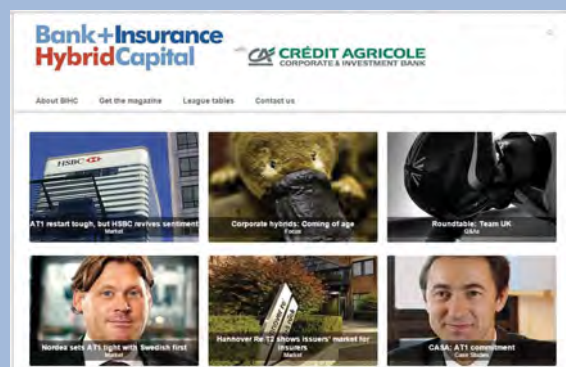
due to the lack of automaticity. Moreover, it might be imposed on institutions other than G-SIBs as well, thus going against the proportionality principle.

The issue has potentially strong implications for the AT1 market, as there is a risk that the mandatory restrictions could apply at considerably high capital levels. Moreover, it would force institutions to keep even higher levels of loss absorbing instrument to create a “management buffer” on the top of the minimum requirements.

The FSB is expected to perform a quantitative impact assessment on TLAC throughout the first half of 2015, and to present a finalised version of the term sheet in time for the next G20 meeting in November 2015.

The EBA MREL RTS consultation closed on 27 February. The EBA is further mandated by the BRRD to submit a report to the European Commission by 31 October 2016 on the technical implementation of MREL at national level, which could address the issues described above through a modification of the BRRD. ●

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BANKING

FSB sets out G20 Istanbul agenda

The Financial Stability Board (FSB) published on 11 February its Letter to G20 Finance Ministers and Central Bank Governors on Financial Reforms. The document sets out the FSB's work programme to advance these goals during the Turkish G20 Presidency in 2015, ahead of the February G20 meeting in Istanbul. Among the main points, the FSB mentioned:

Completion of the capital framework for banks:

The Basel Committee will conduct public consultations and quantitative impact assessments to enhance the Basel framework standardised approaches for calculating risk-weighted assets, to be finalised in 2016, and publish measures that address excessive variability in internal model-based approaches to Basel III. In addition, the Basel Committee will continue to work towards agreement of the appropriate standard for the leverage ratio, to be finalised by 2017 at the latest

Ending too-big-to-fail (1/2): The FSB will finalise the international standard for Total Loss-Absorbing Capacity (TLAC) of Global Systemically Important Banks (G-SIBs). The FSB members will take measures to promote industry adoption of contractual provisions recognising temporary stays on the close-out of financial contracts when a firm enters resolution.

Ending too-big-to-fail (2/2): At the same time, progress must be made towards addressing the too-big-to-fail problem in financial institutions other than banks, including insurers, finance companies, market intermediaries, investment funds and critical market infrastructure. Work on methodologies to identify non-bank, non-insurer global systemically important institutions is progressing and, by the Antalya Summit in November, the International Association of Insurance Supervisors (IAIS) will finalise higher loss absorbency requirements for Global Systemically Important Insurers (G-SIIs).



FSB publishes public responses to TLAC consultation: The Financial Stability Board published on 6 February the public responses to the November consultation on the TLAC for G-SIBs. The recurring themes include:

RWA requirement: As expected, participating institutions are generally advocating 16% of Risk Weighted Assets (RWA) as a common Pillar 1 Minimum TLAC requirement;

Leverage ratio: First, responses generally highlighted that the transposition of the leverage ratio from Basel III to the TLAC framework should not be anchored to a “double-of” moving target. Second, respondents are concerned that the leverage ratio as a basis for TLAC calculation could have a disproportionate effect on those banks that have portfolios with low RWA density. In addition, the final TLAC standard should make clear that, as under Basel III, CET1 held toward buffers counts toward the leverage ratio for TLAC purposes;

Gold-plating and Pillar 2 requirements: Respondents underlined that most of the issues that might be considered to justify Pillar 2 TLAC additions are already covered by other regulatory requirements and, especially, the recovery and resolution planning process and resolv-

ability assessments, and G-SIB surcharges. Furthermore, “gold-plating” by national authorities should not be incentivised.

Subordination: The responses highlight the particular difficulties faced by banks that would be subject to both TLAC and the EU Bank Recovery & Resolution Directive (BRRD). More specifically: (1) structural subordination is not available to banks that are structured under an operating parent company; (2) contractual subordination is made difficult by the current wording of the BRRD, which requires a change in the insolvency status; and (3) statutory subordination as a potential way forward may be considered in some jurisdictions, but would require substantial analysis and time for implementation. For European banks, this would require a legal mechanism either at the EU level, via an amendment to the BRRD, or through national legislation, the feasibility of which is not fully established at this juncture.

33% debt requirement: According to the majority of the responses, the expectation that 33% of the requirement should be met with debt may become restrictive if outstanding senior debt cannot be used to fulfil it. Moreover, it was duly noted (e.g. by the Financial Markets Law Com-

mittee) that it is not clear whether equity-accounted Additional Tier 1 capital, which is legally a debt, would be permitted to count towards the long term debt requirement if it satisfied all other TLAC eligibility criteria.

Structured notes: The majority of respondents argued that structured notes should not be arbitrarily excluded from TLAC, as long as they satisfy the key requirements of the final TLAC term sheet. Structured note obligations do not differ conceptually from vanilla instruments that are hedged, and are equally capable of being written down or converted as a vanilla note. Some suggested that they should be permitted to count towards the requirement if the bank can demonstrate that the notes can absorb losses without giving rise to valuation or legal uncertainty, which is closer to the EBA stance and could be a compromise solution;

Internal TLAC: First, many participants concluded that 65%-75% would be a better range within which to fix a requirement for internal TLAC, with a presumption toward 65%. A higher requirement could create a situation where the sum of internal TLAC requirements may become greater than 100% of a group's consolidated standalone TLAC imposition. Furthermore, many requested the 33% debt expectation not to apply to internal TLAC.

BASEL COMMITTEE

BCBS publishes consultation on accounting for expected credit losses: On 2 February, the Basel Committee on Banking Supervision (BCBS) launched a consultation on guidance on accounting for expected credit losses. Comprising 11 fundamental principles, the guidance sets out supervisory expectations for banks relating to sound credit risk practices associated with implementing and applying an expected credit loss (ECL) accounting framework. The guidance sets forth su-

pervisory expectations that are consistent with the applicable accounting standards established by the International Accounting Standards Board (IASB) and other standard setters. The deadline for comments is 30 April.

BCBS publishes revised Pillar 3 disclosure requirements: The Basel Committee issued on 28 January the final standard for the revised Pillar 3 disclosure requirements. Compared with the consultative version, the key changes involve: (1) rebalancing the disclosures required quarterly, semi-annually and annually; (2) streamlining the requirements related to disclosure of credit risk exposures and credit risk mitigation techniques; and (3) clarifying and streamlining the disclosure requirements for securitisation exposures. The revised disclosure requirements, which will apply from year-end 2016, are meant to enable market participants to compare banks' disclosures of risk-weighted assets.

BCBS consults on revisions to the standardised approach for credit risk and consults on capital floors: The Basel Committee released on 22 December a consultative document on revisions to the standardised approach for credit risk. Comments on the proposals should be sent by 27 March. The key aspects of the proposals are:

Bank exposures: would no longer be risk-weighted by reference to the bank's external credit rating or that of its sovereign of incorporation, but would instead be based on two risk drivers: the bank's capital adequacy and its asset quality.

Corporate exposures: would no longer be risk-weighted by reference to the borrowing firm's external credit rating, but would instead be based

on the firm's revenue and leverage. Further, risk sensitivity and comparability with the internal ratings-based (IRB) approach would be increased by introducing a specific treatment for specialised lending.

Subordinated debt, equity and other capital instruments: a specific category for all capital and equity instruments, whether issued by banks or corporates, will be introduced. To align the treatment of these exposures with those under IRB, the Committee proposes to apply a 250% risk weight for subordinated debt and capital instruments other than equities; and to use the IRB simple risk weight method for equity exposures (i.e. 300% for publicly-traded equity holdings, and 400% otherwise), unless these exposures are deducted or risk-weighted at 250% according to paragraphs 87 to 89 of the Basel III capital framework.

Retail category: would be enhanced by tightening the criteria to qualify for a preferential risk weight, and by introducing an alternative treatment for exposures that do not meet the criteria.

Residential real estate: would no longer receive a 35% risk weight. Instead, risk weights would be based on two commonly used loan underwriting ratios: the amount of the loan relative to the value of the real estate securing the loan (i.e. the loan-to-value ratio) and the borrower's indebtedness (i.e. a debt-service coverage ratio).

Commercial real estate: two options are under consideration: (a) treating the exposures as unsecured with national discretion for a preferential risk weight under certain conditions; or (b) determining the risk weight based on the loan-to-value ratio.

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

Credit risk mitigation: the framework would be amended by reducing the number of approaches, recalibrating supervisory haircuts and updating the corporate guarantor eligibility criteria.

The Basel Committee also on 22 December published a consultative paper on the design of a capital floor framework based on standardised, non-internal modelled approaches. The consultative paper is part of a range of policy and supervisory measures from the Committee that aim to enhance the reliability and comparability of risk-weighted capital ratios. The floor is meant to mitigate model risk and measurement error stemming from internally-modelled approaches, and would also enhance the comparability of capital outcomes across banks. Nevertheless, the floor's calibration was not included within the scope of this consultation. The Committee will instead consider it alongside its work on finalising the revised standardised approaches to credit risk, market risk and operational risk, taking into account its ongoing review of the capital framework and its balance of simplicity, comparability and risk sensitivity. Comments on this proposal should also be sent by 27 March.

BCBS publishes assessment of Basel capital regulations in the EU: The Basel Committee published on 5 December a report assessing the implementation of the Basel capital framework in the nine EU Member States that are members of the Basel Committee. The main findings are the following:

- The assessment concluded that 8 of the 14 components meet all minimum provisions of the relevant Basel standards and these were therefore graded as “compliant”. Four of the components were assessed as “largely compliant”, reflecting the fact that most but not all provisions of the global standard were satisfied;



- The calculation of minimum capital requirements and definition of capital, which include the Danish Compromise, was considered “largely compliant”. In this regard, the BCBS Assessment Team acknowledged that the current EU rules were formulated “in good faith” and were overtaken by the Basel Committee FAQ on consolidation vs. deduction published in December 2011. On the one hand, the Assessment Team is of the view that the FAQ is an agreed Basel Committee policy and should therefore be respected. On the other, EU authorities believe that the FAQ goes beyond an interpretation of Basel III and introduced additional requirements outside the due process for new Basel standards;

- The IRB approach for credit risk was assessed as “materially non-compliant” and pertained primarily to the treatment of exposures to SMEs, corporates and sovereigns;
- The EU's counterparty credit risk framework, which provides an exemption from the Basel framework's credit valuation adjustment (CVA) capital charge for certain derivative exposures, was also found to be “non-compliant”.

COMMISSION, COUNCIL, PARLIAMENT

EU Council decided not to object to the adoption of EBA RTS on Own Funds pt. IV: At the ECOFIN meeting of 17 February, the EU Council decided not to object to the adoption by the Commission of a Delegated Act amending Delegated Regulation (EU) No 241/2014, which supplements the CRR with regard to RTS for Own Funds requirements. The regulation, which derives from EBA RTS on Own Funds pt. IV, specifies whether and when multiple distributions would create a disproportionate drag on capital. It also clarifies the meaning of preferential distributions, namely preferential rights to payments of distributions and order of payments of distribution. The act will provide institutions with an alternative way to build CET1 capital.

ECON considers Hökmark Report on Bank Structural Reform: The ECON committee officially considered the Hökmark Report on “Structural measures improving the resilience of EU credit institutions” at its 21 January meeting. The report, presented by MEP Gunnar Hökmark and published on 7 January, drifts away from the original proposal, made in January 2014, which was in turn largely based on the Liikanen report. Following the release of the document, the European Banking Federation stated that it “shares banks’ concerns by acknowledging the importance of preserving vital liquidity-generating functions for economic growth whilst maintaining cost effective financial services for SMEs”. According to the British Bankers’ Association, the report offers “a neat solution for the UK, giving a de facto exemption for ring-fenced banks which can’t engage in such activity under the Vickers rules and thereby avoiding the consequence of them having to ‘double-separate’”. In addition, “it also broadly captures the French and German regimes in a way that the original derogation did not, perhaps with the exception of underwriting securities”. A vote was scheduled for 23

March, while the European Parliament indicative plenary sitting date was set for 28 April.

Leverage Ratio Delegated Regulations published in the Official Journal: On 12 January, the European Parliament and the Council gave their backing to Commission Delegated Regulation amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the Leverage Ratio. The Regulation was published in the Official Journal of the EU on 17 January.

Council adopts Regulation on SFR contributions and appoints members of the SRB: The Council adopted on 19 December a decision appointing the chairperson, vice-chairperson and four other full time members of the Single Resolution Board (SRB), along with a regulation determining the contributions to be paid by banks to the EU's Single Resolution Fund (SRF).

The SRF was established by a Regulation adopted in July 2014; it will be applicable from 1 January 2016. It will be built up over a period of eight years to reach a target level of at least 1% of the amount of covered deposits of all credit institutions authorised in all the participating member states.

ECB

ECB issues recommendation on dividend distribution policies: On 28 January, the European Central Bank (ECB) adopted a recommendation on dividend distribution policies (where dividends are defined as any type of cash pay-out that is subject to the approval of the General Assembly) targeting entities supervised by the Single Supervisory Mechanism (SSM). In addition, it is also addressed at the national competent and designated authorities with regard to less significant supervised entities and less significant supervised groups. The content of the ECB recommendations are based on the following categories:



Category 1: institutions that satisfy the applicable Pillar 1 and supervisory review and evaluation process (SREP) Pillar 2 capital requirements, and that have already reached their fully-loaded CET1, Tier 1 and Total Capital ratios, should only distribute their net profits in dividends in a conservative manner to enable them to continue to fulfil all requirements even in the case of deteriorated economic and financial conditions; Category 2: institutions that satisfy the applicable Pillar 1 and SREP Pillar 2 capital requirements, but that have not reached their fully loaded CET1, Tier 1 and Total Capital ratios, should only distribute their net profits in dividends in a conservative manner to enable them to continue to fulfil all requirements, even in the case of deteriorated economic and financial conditions. In addition, they should in principle only pay out dividends to the extent that, at a minimum, a linear path towards the required fully-loaded ratios is secured; Category 3: Credit institutions that under the 2014 Comprehensive Assessment have a capital shortfall that would not be covered by capital measures by 31 December 2014, or credit institutions in breach of the Pillar 1 or SREP Pillar 2, should in principle not distribute any dividend.

Danièle Nouy hints at possible capital requirements for sovereign exposures: Danièle Nouy, chair of the supervisory board of the SSM at the ECB, said during an interview on 28 January that there should be capital requirements for sovereign debt holdings. According to Bloomberg reports, Nouy stated the following: "It was confirmed during the crisis that there are no risk-free assets, so there should be a risk weight, capital requirements for sovereign exposures." However, she added that "probably at the end of the day ... the capital requirement will be limited, because on average those exposures are of good quality, but indeed, what is not risk-free should have a capital requirement".

EBA

EBA consults on MREL criteria: On 27 February a public consultation closed on European Banking Authority (EBA) draft Regulatory Technical Standards (RTS) further specifying the criteria to set the Minimum Requirement for Own Funds & Eligible Liabilities (MREL) laid down in the Bank Recovery & Resolution Directive (BRRD). The BRRD does not establish a common minimum MREL, but actual levels should be adapted to reflect the resolvability, risk profile, systemic importance and other characteristics of each institution. These RTS aim to further specify these minimum criteria in order to

achieve an appropriate degree of convergence in how they are applied and interpreted across Member States, and ensure that similar levels of MREL can be set for similar institutions.

The consultation was launched on 28 November. As per the BRRD, the EBA is expected to submit the final draft RTS to the European Commission by 3 July.

EBA advises on the definition of eligible capital:

The EBA published on 17 February its opinion on the review of the appropriateness of the definition of “eligible capital”, in response to a call for advice received from the European Commission in December 2013 in accordance with Article 517 of the Capital Requirements Regulation (CRR). From 1 January 2014, the eligible capital definition specified in Article 4(1)(71) of the CRR replaced the “own funds” definition for defining “large exposures” and setting large exposures limits. The definition is also used to determine the capital requirements applicable to investment firms with limited investment services and to determine the prudential treatment for qualifying holdings outside the financial sector. The difference between the two definitions is that the amount of Tier 2 capital recognised as eligible capital may not exceed one-third of Tier 1 capital whereas there was no limit for the inclusion of Tier 2 capital in the own funds definition. The EBA suggested conducting a comprehensive review of the EU large exposures regime at an appropriate point in time, in order to align it with the Basel Committee standards on the supervisory framework for measuring and controlling large exposures.

EBA publishes revised version of its final draft RTS on prudent valuation:

The EBA released on 23 January a specific and limited amendment to its final draft RTS on Prudent Valuation published on 31 March 2014. As a consequence of this decision, all occurrences of “volatility” in Article 9 and Article 10 of the final draft RTS published on 31 March 2014 should

be replaced by “variance” for the purposes of computing market price uncertainty and close-out costs additional valuation adjustments (AVAs). This amendment, which affects only institutions using the Core approach, will result in a slight relaxation of the calibration of the volatility test performed under these two articles, thus avoiding unwanted side-effects in the already challenging first year implementation of the Core approach.

EBA consults on procedures, forms and templates for resolution planning:

The EBA launched on 14 January a public consultation on draft Implementing Technical Standards (ITS) on procedures, forms and templates for resolution planning, part of the BRRD secondary legislation. The proposed draft ITS develop in detail the procedure that should be followed when resolution authorities require information about an institution for the purpose of drawing up a resolution plan. The deadline for the submission of comments is 14 April.

EBA updates list of CET1 capital instruments:

The EBA published on 23 December an updated list of capital instruments that Competent Supervisory Authorities across the EU have classified as Common Equity Tier 1 (CET1). This list is compiled in accordance with Article 26 of CRR and is updated on a regular basis. Since the publication of the first list, Finland’s non-voting cooperative shares, Portugal’s participation units and the UK’s deferred shares were assessed and evaluated as compliant with the CRR.

EBA publishes criteria to assess O-SIIs:

The EBA issued on 16 December its final Guidelines defining the criteria that EU competent authorities will use to identify institutions that are systemically important either at Union or Member State level, Other Systemically Important Institutions (O-SIIs). In line with the provisions laid down in the CRD, competent authorities can require O-SIIs to hold an

additional buffer of up to 2% of CET1. These Guidelines aim at setting uniform parameters at EU level while taking into account specificities of Member States’ individual banking sectors, so as to achieve an appropriate degree of convergence in the identification process as well as at ensuring a comparable, clear and transparent assessment of systemically important institutions in the EU. For this purpose, the Guidelines 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;
- 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;
- Finally, to reduce the reporting burden for small institutions, competent authorities may decide to exclude very small institutions from the identification process, if they assess that they are unlikely to pose systemic threats to the domestic economy.

EBA Q&A

2014_1382 relating to short positions in financial institution capital instruments:

The EBA published on 20 February a new set of answers to the Q&A tool. In particular, question 2014_1382 relates to short positions in financial institution capital instruments, more specifically whether a guarantee or CDS over an item treated as a financial institution capital instrument can be considered a short position for the purposes of Articles 45(a), 59(a) or 69(a) of the CRR. According to the EBA response, a derivative or a guarantee provided for a capital instrument in

which an institution directly holds a long position in respect of the underlying exposure may only be treated as an offsetting short position for the purposes of Articles 45(a), 59(a) or 69(a) of CRR if such a derivative is provided by an entity outside the accounting and prudential scope of consolidation of the institution at all levels of consolidation, and if the derivative is such that it fully and promptly offsets any changes in value arising in the long position in the own funds instrument. However, a derivative that would cover only losses occurring after a default has occurred would not comply with this treatment, and therefore may not be treated as an offsetting short position.

2015_1791 relating to the repurchase of own funds instruments for market-making purposes: The EBA added a new answer to the Q&A tool on 13 February relating to the timing applicability of the waiver for the repurchase of own funds instruments for market-making purposes. According to the EBA, having regard to the aim and nature of market-making activities and the limits set out in Article 29(3) of Regulation (EU) No 241/2014 (RTS on own funds parts 1 and 2), competent authorities may permit institutions to repurchase Additional Tier 1 or Tier 2 instruments for market-making purposes from the date of issuance in accordance with the conditions stipulated by this Regulation and Q&A 2014_1352. The latter previously noted that the predetermined amount for which the competent authority has given its permission should be deducted from the moment the authorisation is granted.

EBA launches Q&A Tool on BRRD: As anticipated, the EBA updated on 30 January its online Single Rulebook Q&A Tool with the inclusion of the BRRD. The authority has already released several answers. Two of the most relevant answers are:

2015_1779 The question relates to the application of bail-in to liabilities

guaranteed by third parties. According to the EBA, guarantees or liabilities guaranteed by a third party are not considered as secured liabilities in the meaning of Article 43(2)(b) of the BRRD because that concept must be interpreted as covering only liabilities secured/guaranteed by assets of the institution under resolution;

2015_1784 The question relates to the use of Deposit Guarantee Scheme (DGS) contributions towards the 8% requirement. According to the EBA, Article 44(5)(a) subjects the use of the resolution fund to a prior contribution of 8% of total liabilities including own funds, to be made by shareholders, holders of other instruments of ownership, holders of relevant capital instruments and of other eligible liabilities. The definition of eligible liabilities in Article 2 (71) excludes explicitly liabilities that are excluded from the scope of the bail in; this is the case of covered deposits. Therefore, if the bail-in of shareholders and eligible liabilities does not reach 8%, resort to the resolution fund is, in principle, not possible and the DGS will step in for covered deposits.

UK

PRA consults on the assessment of capital adequacy under Pillar 2: The UK Prudential Regulation Authority (PRA) launched on 19 January a new consultation paper (CP1/15) on the assessment of capital adequacy under Pillar 2. The CP1/15 sets out proposed changes to the PRA's Pillar 2 framework for the banking sector, including changes to rules, and supervisory statements. It also introduces the content of a new statement of policy, the "PRA's methodologies for setting Pillar 2 capital", which sets out the practices that the PRA proposes to use to inform its setting of firms' Pillar 2A capital requirements. The release also complements the EBA SREP guidelines launched on 19 December 2014.

The FCA publishes Policy Statement on BRRD implementation: The UK Financial Conduct Authority (FCA) published on 16 January a Policy Statement (PS15/2) containing the final rules to transpose the BRRD into the UK regulatory regime. The document also reports on the main issues arising from Consultation Paper CP14/15, originally published on 1 August 2014. The rules on recovery and resolution entered into force in the UK on 19 January, with the exception of the rules on the contractual recognition of bail-in, which will come into force on 1 January 2016.

Amendment to the Capital Requirements Regulation laid before UK Parliament: The UK Capital Requirements (Capital Buffers & Macro-prudential Measures) (Amendment) Regulations 2015 were laid before Parliament on 13 January. These Regulations implement Articles 133 and 134 of CRD IV, introducing a Systemic Risk Buffer in the UK legislation. The buffer will be applicable from 1 January 2019. The UK intends to use the systemic risk buffer to implement the recommendation made by the Independent Commission on Banking in 2011, and subsequently agreed by HM Treasury in its 2012 White Paper, that ring-fenced banks and large building societies hold additional capital due to their relative importance to the UK economy. The Bank of England's Financial Policy Committee (FPC) will be responsible for setting out the framework for determining which institutions should hold the buffer and, if so, how large the buffer should be.

BoE publishes approach to resolving failed institutions: The Bank of England on 8 December published in its Quarterly Bulletin an article by Andrew Gracie, Lucy Chennells and Mark Menary on the Bank of England's approach to resolving failed institutions. According to Bloomberg reports, Gracie stated that the TLAC framework will be finalised by November 2015 at a conference in December. ●

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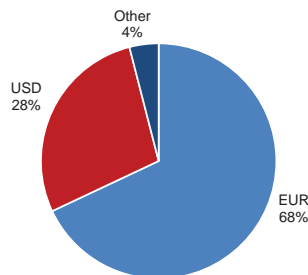
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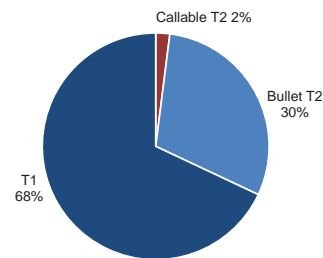
(1) Largest European asset manager based on total assets under Management (AUM)- Source IPE "Top 400 asset managers" published in June 2014 and based on AUM as at December 2013, all AUM having been re-calculated by Amundi to exclude (i) Wealth Management activities and (ii) asset managers having their parent/holding company outside Europe. Total assets under management: €843.9 billion. This material is solely for the attention of "Institutional" investors only, as defined as the case may be in each local regulations. It is not for any person, qualified investor or not, from any country or jurisdiction which laws or regulations would prohibit such material, nor for "US Persons". This material does not constitute an offer to buy or a solicitation to sell, nor does it constitute public advertising for any product, financial service or investment advice. Amundi S.A. French joint stock company with a registered capital of €596 262 615 - Portfolio Manager regulated by AMF under number GP 04000036 - Registered office: 90, boulevard Pasteur - 75015 Paris - FRANCE - 437 574 452 RCS Paris - www.amundi.com - February 2015 - Photo credits: Getty images. | W

Currencies, structures and distribution

Bank hybrid issuance by currency (2015 ytd)

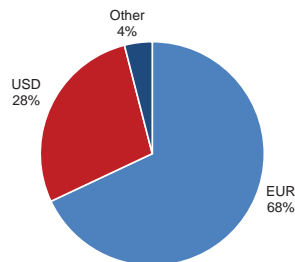


Bank issuance by instrument/structure (2015 ytd)

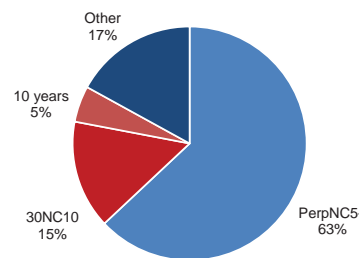


Source: Crédit Agricole CIB

Insurance hybrid issuance by currency (2014)

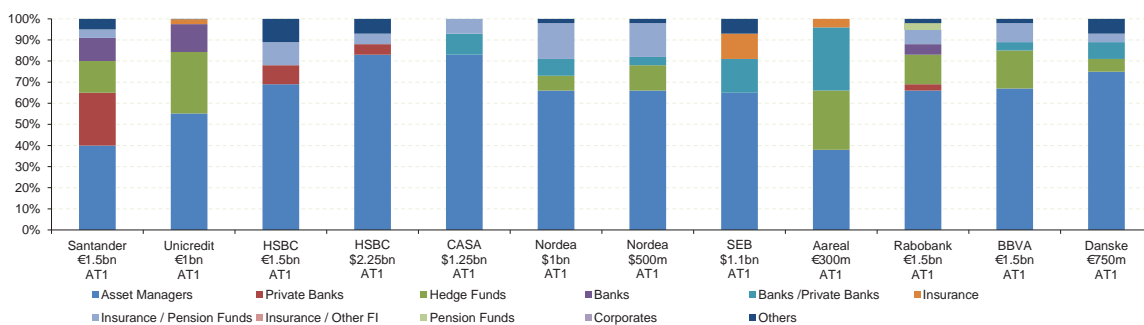


Insurance issuance by instrument/structure (2014)

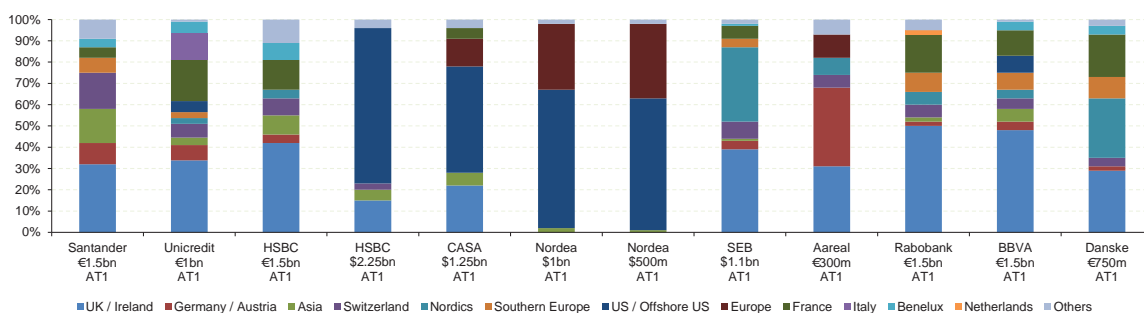


Source: Crédit Agricole CIB

Distribution by investor type



Distribution by geography



Source: Crédit Agricole CIB

AT1, Tier 2 CoCos

AT1 performance monitoring (as at 4/3/15)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	Principal loss absorption	Trigger	Price	I-Spread	Yield to call
19-Feb-15	NYKRE	-/-/BB+	EUR	500	6.250%	Perpetual	26-Oct-20	TWD	7.125%	102.25	549	5.78
13-Feb-15	UBS	-/-/BB+	EUR	1,000	5.750%	Perpetual	19-Feb-22	PWD	5.125%	104.88	442	4.90
11-Feb-15	DANBNK	-/BB+/BB+	EUR	750	5.875%	Perpetual	06-Apr-22	TWD	7.000%	102.25	506	5.48
10-Feb-15	BBVASM	Ba2/-/BB	EUR	1,500	6.750%	Perpetual	18-Feb-20	CE	5.125%	102.75	593	6.10
05-Feb-15	POPSM	-/-/-	EUR	750	8.250%	Perpetual	10-Apr-20	CE	7.000%	103.75	724	7.36
15-Jan-15	RABOBK	Baa3/-/BBB	EUR	1,500	5.500%	Perpetual	29-Jun-20	TWD	7%/5.125%	104.38	427	4.56
11-Dec-14	DEKA	Baa3/-/-	EUR	177	6.000%	Perpetual	20-Mar-22	TWD	5.125%	101.00	533	5.82
13-Nov-14	AARB	-/-/BB-	EUR	300	7.625%	Perpetual	30-Apr-20	TWD	7.000%	103.00	659	6.91
10-Sep-14	HSBC	Baa3/-/BBB	EUR	1,500	5.250%	Perpetual	16-Sep-22	CE	7.000%	103.63	419	4.67
03-Sep-14	UCGIM	-/-/BB-	EUR	1,000	6.750%	Perpetual	10-Sep-21	TWD	5.125%	102.00	603	6.37
02-Sep-14	SANTAN	Ba1/-/-	EUR	1,500	6.250%	Perpetual	11-Sep-21	CE	5.125%	101.63	564	5.95
13-Jun-14	BACR	-/B/BB+	EUR	1,077	6.500%	Perpetual	15-Sep-19	CE	7.000%	101.50	598	6.12
20-May-14	DB	Ba3/BB/BB+	EUR	1,750	6.000%	Perpetual	30-Apr-22	TWD	5.125%	101.50	523	5.74
25-Jul-14	VIRGMN	-/-/-	GBP	160	7.875%	Perpetual	31-Jul-19	CE	7.000%	102.12	586	7.31
19-Jun-14	COVBS	-/-/BB+	GBP	400	6.375%	Perpetual	01-Nov-19	CE (*)	7.000%	98.25	527	6.82
13-Jun-14	BACR	-/B/BB+	GBP	698	7.000%	Perpetual	15-Sep-19	CE	7.000%	99.63	564	7.10
20-May-14	DB	Ba3/BB/BB+	GBP	650	7.125%	Perpetual	30-Apr-26	TWD	5.125%	99.50	504	7.19
01-Apr-14	ACAFP	-/-/BB+	GBP	500	7.500%	Perpetual	23-Jun-26	TWD	7%/5.125%	101.75	531	7.27
20-Mar-14	LLOYDS	-/B+/BB	GBP	1,481	7.000%	Perpetual	27-Jun-19	CE	7.000%	102.25	495	6.40
20-Mar-14	LLOYDS	-/B+/BB	GBP	1,494	7.625%	Perpetual	27-Jun-23	CE	7.000%	104.75	505	6.87
20-Mar-14	LLOYDS	-/B+/BB	GBP	750	7.875%	Perpetual	27-Jun-29	CE	7.000%	105.50	519	7.25
04-Mar-14	NWIDE	-/BB/BB+	GBP	1,000	6.875%	Perpetual	20-Jun-19	CE (*)	7.000%	101.50	497	6.46
18-Feb-15	SHBASS	Baa3/BBB/BBB	USD	1,200	5.250%	Perpetual	01-Mar-21	TWD	8%/5.125%	100.00	330	5.25
13-Feb-15	UBS	-/-/BB+	USD	1,250	7.000%	Perpetual	19-Feb-25	PWD	5.125%	104.38	406	6.39
13-Feb-15	UBS	-/-/BB+	USD	1,250	7.125%	Perpetual	19-Feb-20	PWD	7.000%	104.38	426	6.07
12-Feb-15	SWEDA	-/-/BBB-	USD	750	5.500%	Perpetual	17-Mar-20	CE	8%/5.125%	102.25	325	4.99
18-Nov-14	DB	Ba3/BB/BB+	USD	1,500	7.500%	Perpetual	30-Apr-25	TWD	5.125%	102.25	481	7.18
06-Nov-14	SEB	Ba1u/-/BBB-	USD	1,100	5.750%	Perpetual	13-May-20	TWD	8%/5.125%	101.50	366	5.41
16-Sep-14	NDASS	Ba1u/BBB/BBB	USD	1,000	5.500%	Perpetual	23-Sep-19	TWD	8%/5.125%	103.75	294	4.57
16-Sep-14	NDASS	Ba1u/BBB/BBB	USD	500	6.125%	Perpetual	23-Sep-24	TWD	8%/5.125%	103.00	350	5.71
11-Sep-14	ACAFP	Ba2u/BB/BB+	USD	1,250	6.625%	Perpetual	23-Sep-19	TWD	7%/5.125%	100.00	504	6.63
10-Sep-14	HSBC	Baa3/-/BBB	USD	2,250	6.375%	Perpetual	17-Sep-24	CE	7.000%	103.25	371	5.92
10-Sep-14	HSBC	Baa3/-/BBB	USD	1,500	5.625%	Perpetual	17-Jan-20	CE	7.000%	101.38	360	5.30
19-Jun-14	SOCGEN	Ba2/-/BB	USD	1,500	6.000%	Perpetual	27-Jan-20	TWD	5.125%	95.00	553	7.23
13-Jun-14	BACR	-/B/BB+	USD	1,211	6.625%	Perpetual	15-Sep-19	CE	7.000%	99.75	511	6.69
10-Jun-14	CS	-/BB/BB+	USD	2,500	6.250%	Perpetual	18-Dec-24	PWD	5.125%	-	413	6.35
20-May-14	DB	Ba3/BB/BB+	USD	1,250	6.250%	Perpetual	30-Apr-20	TWD	5.125%	101.25	412	5.96

T2 CoCo performance monitoring (as at 4/3/15)

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-Mar-22	22-Mar-17	CE	7.000%	107.87	364	3.07
23-May-14	NYKRE	-/BBB/BBB	EUR	600	4.000%	03-Jun-36	03-Jun-21	PWD	7.000%	101.19	336	3.78
06-Feb-14	UBS	-/BBB/BBB+	EUR	2,000	4.750%	12-Feb-26	12-Feb-21	PWD	5.000%	111.75	219	2.58
11-Sep-13	CS	-/BBB/BBB+	EUR	1,250	5.750%	18-Sep-25	18-Sep-20	PWD	5.000%	116.25	220	2.56
29-Jul-11	BKIR	-/-/-	EUR	1,000	10.000%	30-Jul-16	-	CE	8.250%	108.77	332	-
08-May-14	UBS	-/BBB/BBB+	USD	2,500	5.125%	15-May-24	-	PWD	5.000%	104.75	224	-
12-Sep-13	ACAFP	-/BBB/BBB-	USD	1,000	8.125%	19-Sep-33	19-Sep-18	PWD	7.000%	114.38	232	3.73
01-Aug-13	CS	-/BBB/BBB+	USD	2,500	6.500%	08-Aug-23	-	PWD	5.000%	-	239	-
15-May-13	UBS	-/BBB/BBB+	USD	1,500	4.750%	22-May-23	22-May-18	PWD	5.000%	103.31	228	3.63
03-Apr-13	BACR	-/BB+/BBB-	USD	1,000	7.750%	10-Apr-23	10-Apr-18	PWD	7.000%	110.72	272	4.01
17-Jan-13	KBC	-/BBB/-	USD	1,000	8.000%	25-Jan-23	25-Jan-18	PWD	7.000%	-	208	3.31
14-Nov-12	BACR	-/BB+/BBB-	USD	3,000	7.625%	21-Nov-22	-	PWD	7.000%	-	303	-
10-Aug-12	UBS	-/BBB/BBB+	USD	2,000	7.625%	17-Aug-22	-	PWD	5.000%	121.66	216	-
15-Feb-12	UBS	-/BBB/BBB+	USD	2,000	7.250%	22-Feb-22	22-Feb-17	PWD	5.000%	108.00	206	2.96
17-Feb-11	CS	-/-/BBB-	USD	2,000	7.875%	24-Feb-41	24-Aug-16	CE	7.000%	-	275	3.43

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

Source: Crédit Agricole CIB

Latest bank Tier 2, insurance hybrids

Latest Tier 2 performance monitoring (as at 9/3/15)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	I-Spread	Yield to call
09-Mar-15	ACAFP	Baa3/BBB/A-	EUR	2,000	2.625%	17-Mar-27	-	186	-
09-Mar-15	ACAFP	Baa3/BBB/A-	USD	1,500	4.375%	17-Mar-25	-	219	-
04-Mar-15	SANTAN	Baa2/-/BBB+	EUR	1,500	2.500%	18-Mar-25	-	190	-
04-Mar-15	KBCBB	-/BBB-/BBB+	EUR	750	1.875%	11-Mar-27	11-Mar-22	172	-
03-Mar-15	BNP	Baa2/BBB/A	CNY	1,500	5.000%	17-Mar-25	17-Mar-20	149	-
19-Feb-15	SOCGEN	Baa3/-/BBB+	EUR	1,250	2.625%	27-Feb-25	-	169	-
10-Feb-15	BNP	Baa2/BBB/A	EUR	1,500	2.375%	17-Feb-25	-	147	-
09-Feb-15	DB	Ba1/BBB-/A-	EUR	1,250	2.750%	17-Feb-25	-	168	-
23-Jan-15	BPCEGP	-/BBB/A-	JPY	27,200	2.047%	30-Jan-25	-	157	-
23-Jan-15	BPCEGP	-/BBB/A-	JPY	7,900	1.943%	30-Jan-25	30-Jan-20	168	-
23-Jan-15	BPCEGP	-/BBB/A-	JPY	13,200	1.712%	30-Jan-25	-	#N/A N/A	-
12-Dec-14	RABOBK	A2/BBB+/A+	JPY	50,800	1.429%	19-Dec-24	-	87	-
19-Nov-14	ERSTBK	-/BBB-/*-/BBB	USD	500	5.500%	26-May-25	26-May-20	428	6.04
18-Nov-14	KBCBB	-/BBB-/BBB+	EUR	750	2.375%	25-Nov-24	25-Nov-19	130	1.59
14-Nov-14	STANLN	A3/BBB/A+	EUR	500	3.125%	19-Nov-24	-	158	-
14-Nov-14	YBS	Baa2/-/BBB+	GBP	250	4.125%	20-Nov-24	20-Nov-19	200	3.59
29-Oct-14	LLOYDS	Baa3/BB+/BBB+	USD	1,000	4.500%	04-Nov-24	-	185	-
06-Oct-14	BNP	Baa2/BBB/A	USD	1,000	4.250%	15-Oct-24	-	172	-
06-Oct-14	BNP	Baa2/BBB/A	EUR	750	2.625%	14-Oct-27	14-Oct-22	160	2.14
09-Sep-14	SOCGEN	Baa3/-/BBB+	EUR	1,000	2.500%	16-Sep-26	16-Sep-21	170	2.15
08-Sep-14	BPCEGP	Baa3/-/A-	USD	1,250	4.500%	15-Mar-25	-	215	-
08-Sep-14	ISPIM	Ba1/BB/BBB	EUR	1,000	3.928%	15-Sep-26	-	195	-
05-Sep-14	BACR	Ba1/BB+/A-	USD	1,250	4.375%	11-Sep-24	-	209	-
03-Jun-14	BPCEGP	Baa3/BBB/A-	USD	800	4.625%	11-Jul-24	-	209	-
26-Jun-14	BPCEGP	Baa3/BBB/A-	EUR	1,000	0.0275	08-Jul-26	08-Jul-21	164	2.07
19-Jun-14	ISPIM	Ba1/BBB-/BBBe	USD	2,000	5.017%	26-Jun-24	-	221	-
04-Jun-14	BKIR	Ba3/B+/-	EUR	750	4.250%	11-Jun-24	11-Jun-19	282	3.07
03-Jun-14	STANLN	A3/BBB/A+	GBP	900	5.125%	06-Jun-34	-	260	-
22-May-14	SEB	Baa2/BBB/A	EUR	1,000	2.500%	28-May-26	28-May-21	121	1.63
21-May-14	RBS	Ba3/BB/BBB-	USD	2,250	5.125%	28-May-24	-	228	-
20-May-14	LBW	Baa2/-/A-	EUR	500	2.875%	27-May-26	27-May-21	192	2.34
14-May-14	BFCM	Baa1/BBB/A	EUR	1,000	3.000%	21-May-24	-	117	-
14-May-14	RABOBK	A2/BBB+/A+	EUR	2,000	2.500%	26-May-26	26-May-21	138	1.80
14-May-14	RABOBK	A2/BBB+/A+	GBP	1,000	4.625%	23-May-29	-	169	-
13-May-14	BKIASM	-/B-/B+	EUR	1,000	4.000%	22-May-24	22-May-19	313	3.38
12-May-14	DANBNK	-/BBB/A-	EUR	500	2.750%	19-May-26	19-May-21	125	1.67

Insurance performance monitoring (as at 4/3/15)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	New issue spread	I-Spread
18-Feb-15	VIGAV	-/A-/A-	EUR	400	3.750%	02-Mar-46	02-Mar-26	294	278
28-Jan-15	ACHMEA	-/BBB/-	EUR	750	4.250%	Perpetual	04-Feb-25	355	258
08-Jan-15	ACAFP	-/BBB/-	EUR	1,000	4.250%	Perpetual	13-Jan-25	350	271
11-Dec-14	LAMON	-/BBB/-	EUR	768	5.050%	Perpetual	17-Dec-25	405	301
10-Dec-14	ISPVIT	-/BBB-	EUR	750	4.750%	Perpetual	17-Dec-24	-	285
09-Dec-14	SOGESA	-/BBB/-	EUR	800	4.125%	Perpetual	18-Feb-26	315	292
18-Nov-14	BNP	-/BBB/-	EUR	1,000	4.032%	Perpetual	25-Nov-25	293	250
06-Nov-14	ASSGEN	Ba1/-/BBB-	EUR	1,500	4.596%	Perpetual	21-Nov-25	350	314
12-Nov-14	CNPFP	-/BBB+/-	EUR	500	4.000%	Perpetual	18-Nov-24	310	244
06-Nov-14	AXASA	Baa1/BBB/BBB	EUR	984	3.941%	Perpetual	07-Nov-24	290	206
06-Nov-14	AXASA	Baa1/BBB/BBB	GBP	724	5.453%	Perpetual	04-Mar-26	300	251
23-Oct-14	LLYDIN	-/A-/A-	GBP	500	4.750%	30-Oct-24	-	-	178
07-Oct-14	ACAFP	-/BBB/-	EUR	750	4.500%	Perpetual	14-Oct-25	335	271
02-Oct-14	RSALN	Baa1/BBB+/BBB	GBP	400	5.125%	10-Oct-45	10-Oct-25	-	240
02-Oct-14	HELNSW	-/BBB+/-	CHF	400	3.500%	Perpetual	17-Apr-20	322	239
02-Oct-14	HELNSW	-/BBB+/-	CHF	225	4.000%	17-Oct-44	17-Oct-24	318	263
01-Oct-14	MACIFS	Baa1/-/A-	EUR	124	3.916%	Perpetual	06-Oct-24	280	310
17-Sep-14	SCOR	A3/A-/A-	EUR	250	3.875%	Perpetual	01-Oct-25	270	234
16-Sep-14	ASRNED	-/BBB/-	EUR	500	5.000%	Perpetual	30-Sep-24	395	321
16-Sep-14	ATRAID	Ba1/-/A-	EUR	250	5.250%	23-Sep-44	23-Sep-24	403	435
11-Sep-14	ALVGR	A2/A+/A	EUR	1,500	3.375%	Perpetual	18-Sep-24	220	168

Source: Crédit Agricole CIB

Bookrunners all financials (euros)
01/01/2015 to 30/03/2015

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	Crédit Agricole CIB	2	4,375	14.1
2	Deutsche Bank	10	3,987	12.9
3	UBS	3	3,887	12.5
4	HSBC	6	2,559	8.3
5	BNP Paribas	6	2,253	7.3
6	JP Morgan	10	1,815	5.9
7	Société Générale CIB	4	1,774	5.7
8	BAML	8	1,437	4.6
9	Goldman Sachs	6	1,249	4.0
10	Barclays	4	1,204	3.9
11	Citi	5	832	2.7
12	Credit Suisse	2	525	1.7
13	Rabobank	2	525	1.7
14	Morgan Stanley	2	524	1.7
15	Natixis	3	484	1.6
	Total	38	31,004	

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	Deutsche Bank	30	9,104	11.2
2	Société Générale CIB	19	6,261	7.7
3	Crédit Agricole CIB	10	6,173	7.6
4	Goldman Sachs	15	5,504	6.8
5	BNP Paribas	16	5,327	6.6
6	Natixis	9	4,538	5.6
7	Morgan Stanley	16	4,508	5.6
8	UBS	15	4,376	5.4
9	HSBC	18	3,277	4.0
10	Barclays	19	3,227	4.0
11	Citi	8	3,074	3.8
12	JP Morgan	20	3,061	3.8
13	Credit Suisse	10	2,203	2.7
14	Rabobank	4	1,730	2.1
15	BAML	10	1,606	2.0
	Total	128	81,184	

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


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Nykredit finds strong demand in opening ARMs offering

Nykredit has recently closed off automatic refinancing solutions in Denmark today (Thursday), with interest rates being "almost coming down" as it is offering its first ARM bundle, according to an official at the issuer, after an analyst said the outcome was not surprising.

FROM CRÉDIT AGRICOLE CIB

ECB changes repo indicate: What's the signal on Nordic markets?

Updating its collateral framework. The central bank's EOP down on a regular basis. To control the size against the requirements to reflect current market conditions and sometimes also to achieve a certain policy objective.

SWEDEX Swedish debt office bill is proposal seen as credit negative by Moody's

A Swedish National Debt Office spokesman provides an update to implement the EU paper recovery and resolution framework in Sweden is to start explore the latest amendment of the country's banks, particularly of the four largest. Moody's is a lead bidder (Tuesday).

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Thursday, 15 August 2013

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Crédit Agricole

Tier 2x2

Crédit Agricole on 9 March sold the largest ever Tier 2 issue, a dual-tranche transaction comprising Eu2bn and \$1.5bn pieces that attracted record demand and constituted the first dual-tranche Tier 2 benchmark. Here, Olivier Bélorgey, head of the financial management department, Crédit Agricole, outlines the issuer's strategy, while Bernard du Boislouveau, head of FI DCM France, and Vincent Hoarau, head of FIG syndicate, Crédit Agricole CIB, offer their market insights.

This is your first Tier 2 transaction since October 2010. What drove your choice of tenor and currency, and notably the dual currency format?

Olivier Bélorgey, Crédit Agricole:

Before going into the specifics of this transaction, let's concentrate first on the rationale for the deal and get the full picture from our perspective as an issuer: it is fair to say that Crédit Agricole SA benefits from a good relative positioning versus its peers, thanks to the consistent strategy implemented over recent years, putting the Crédit Agricole Group back on track after a more difficult period, when the Group had to redefine its strategy. This period is behind us and we have had the opportunity to gauge the strong market sentiment toward our signature thanks to regular roadshows and the successful transactions we have executed over the last 18 months. Our marketing of the trade during the week of 2 March, following the publication of our 2014 results in February, further reinforced this positive perception.

If we can now elaborate more on

the actual Tier 2 decision, our wish at Crédit Agricole SA level is to reach the 8% level for the MREL ratio by end-2016 and a minimum TLAC ratio of 19.5% (subject to changes in RWA calculation methodology) including buffers by 2019 whilst excluding senior unsecured debt. Why do we have these objectives? This is because we need to protect our market access, considering that, due to the French "bancassurance" model (i.e. French banks typically incorporate insurance operations in their business), our loan-to-deposit ratio is structurally above 100%, with life insurance contracts being a pivotal form of saving for French customers. Under these circumstances, ensuring open access to wholesale funding is thus something we need to protect.

Turning to market considerations, it's clear that many G-SIBs will be keen to enter the Tier 2 market, and for significant amounts, if our assumptions are correct. For that reason, why wait when the market trend is positive and investor appetite confirmed? But – and this is very important for our funding strategy – we want to have a clear dialogue with

our investor base: we want to communicate transparently our needs, i.e. Eu3bn in each of 2015 and 2016, and, markets permitting, we were keen to raise the entire Eu3bn yearly size in one transaction in order to bring predictability and an offering consistent with our needs. As an add-on, and to differentiate Crédit Agricole Group, it's fair to say that the global needs for Tier 2 issuance from major banks are not always clearly stated. Presenting this transaction as a unique opportunity for investors to participate in a Tier 2 issue of Crédit Agricole Group, after an absence under this format of some four years, brings clarity to the funding strategy and the way this strategy is perceived. The idea is to not come back with another Tier 2 issue in benchmark format in euros or US dollars in 2015. The success of this trade fully vindicated our strategy.

Vincent Hoarau, CACIB: We felt the market would be receptive to a jumbo transaction. The liquidity situation is extraordinary and the start of QE by the ECB offers huge traction to any type of



Crédit Agricole, Montrouge, Paris
Photo: Frédérique Thomas

transaction in the primary market. The impact of the ECB stimulus is spilling over into all asset classes, including subordinated debt. The performance of other recent euro Tier 2 benchmarks also paved the way for landmark execution combining euro and US dollar offerings to maximise size, without damaging the secondary market performance.

It was clear from the outset that our approach to pricing had to be consensual. Crédit Agricole SA was also very transparent with investors during the roadshow on subjects such as capital planning and MREL/TLAC projections. A combined target size of Eu3bn equivalent had even been openly communicated to investors met in France, Germany, the UK, New York and Boston. The issuer did not want to surprise anyone and was aware that the size element can be decisive in the subordinated market. The 10 year bullet structure in US dollars was practically fixed at the beginning of the roadshow since this is a pretty obvious tenor for the US investor base. That left a 12NC7 or 12 year bullet structure for the euro leg. We

even considered a 15 year bullet. 10NC5 is not a relevant structure with regards to TLAC regulation given the start of TLAC application in 2019. By the end of the roadshow we received confirmation from euro investors that 12 year euros and 10 year US dollars was the combination of choice.

Wasn't launch a little challenging given the execution risks across two tranches? What did you take into account when planning global execution across various time zones and investor bases?

Bélorgey, Crédit Agricole: Market conditions were globally supportive across markets. On top of this, US dollar investors have a positive view of Europe. As I said, we chose to have a clear, unambiguous communication with investors following our 2014 results on potential TLAC/MREL needs, explaining clearly the deal rationale.

We know, thanks to our experience in the subordinated market – and please refer to the four AT1 transactions we

did during 2014 – that top investors can take multi-currency exposure on a given name, hence the strategy of offering the euro first, then opening the US dollar tranche at the US market opening, to ensure investors have a real-time view of their global exposure across tranches.

Benchmarking the euro first was also a way of sending a strong signal to the US investor base, taking into account the strong performance both in terms of relative pricing and investor reach.

Combining a euro and a dollar was also in line with our wish of targeting the most liquid markets, where the Group also has natural RWAs and where we have already benchmarked the name in subordinated format via the 2014 AT1 offerings. We are proud to say that Crédit Agricole SA as an issuer is now benefitting, deal after deal, from one of the strongest footprints in the market. But, again, this is no miracle. This comes from the time invested during all our past roadshows. Investors do value this. I should also add that Crédit Agricole at Group level has the second strongest Tier 1 ratio amongst the Eu-

Olivier Bélorgey, Crédit Agricole

Key takeaways:

- Dialogue with the investor base is the key success factor in a moving regulatory environment.
- When comfortable on a given name, investors – who are all yield-focused in the current rate curve context – are keen to get exposure to it on more juicy transactions.
- Consensus, pricing-wise, is the key to successful secondary performance, as exemplified by our two tranches each trading above par.



ropean G-SIBs. Again, no miracles here, just the return on investment of a successful balance sheet restructuring.

Bernard du Boislouveau, CACIB: We considered execution over two days, but when the market showed evidence of a softer tone on Monday we decided to pull the trigger immediately, feeling that the correction could last more than a day after the very good sessions enjoyed the previous week. We also knew that demand out of Asia would be limited, so having books open overnight was not a sensible option. Risk of arbitrage and cannibalisation was extremely limited given the differentiation in tenors and the strong appetite of investors across the board for the signature in Tier 2 format and across currencies.

What was the pricing rationale?

Hoarau, CACIB: The recent BNP 2.375% 17/02/25 10 year bullet Tier 2 opened at i+150bp bid on the morning of execution, while Crédit Agricole SA does not have any recent Tier 2 deals outstanding. Its last benchmark was launched in October 2010, so in any case was not a relevant comparable. Discounting a limited credit spread differential of 5bp-10bp vs. BNP, and slightly more for the curve, put fair value for a 12 year in the context of mid-swaps+170bp. Therefore, a landing price of 180bp implies a 10bp new issue premium. This is at the tight end of recent premiums paid in Tier 2 new issues

and for a much bigger size than anyone around. In US dollars we started slightly back from the Société Générale subordinated curve. SG's 5 17/01/24 was trading in the context of UST+230bp when we opened books for the US dollar 10 year tranche. This is where big US real money accounts delivered indications of interest during the roadshow.

What are your takeaways from the distribution dynamics?

Bélorgey, Crédit Agricole: We anticipated, based upon our experience on the AT1 side, that London should be the leading area on the euro tranche. This proved to be true again, alongside significant domestic participation, with 26% of the final placement in France. The US leg, as expected, also demonstrated a high level of granularity. Both tranches found their respective key investors, those who quickly give momentum to the deal and allow for a fast bookbuilding process.

Are you satisfied with the level of granularity and the overall size outcome?

Bélorgey, Crédit Agricole: Yes, very satisfied indeed. It's a challenging task, satisfying such huge investor demand, which reflects global investors' views on our credit strength and limited subordinated needs, both in absolute and relative terms. Hence, we chose to increase the size of the transaction.

Our book on the euro deal reached the Eu10bn mark, with more than 450 accounts involved. The US leg showed a \$7bn+ book, with almost 300 investors participating. This granularity boded well for the secondary performance of both tranches. As we speak, both tranches have indeed performed in the market after the break, with many investors buying thanks to the very high bid-to-cover we had.

Hoarau, CACIB: Distribution in euros was driven by UK and French real money investors, with the remainder well spread across Europe. There were around 450 accounts in the book at the close, with more than Eu10bn of orders. The US dollar books closed at \$7bn, with almost 300 different accounts participating. With a total of 400 orders of Eu10m or less in the combined books, the level of granularity was exceptional. Fifteen key accounts across tranches drove the process. They positioned themselves very early on in the process. When we opened the books for the euro leg, IOIs were already in excess of Eu2.7bn. I don't remember any deal of this type having such a reception and the size was exceptional given the format.

Were you satisfied with the performance of the bonds off the break?

Hoarau, CACIB: Both the 12 year euro and the 10 year US dollar traded 5bp-10bp tighter off the break. Many real money accounts added in the secondary market and we had high quality two-way flows. So I think we ticked most of the boxes, if not all!

Bélorgey, Crédit Agricole: The performance after the break offered value to investors on both tranches. This has been our goal with our consensual approach since inception.

What were the key takeaways from this transaction?

Hoarau, CACIB: We are in a situation where more and more investors or dealers are ready to pay issuers when lending them money at the front end. Nega-

tive yields and excess cash offer a very supportive playground. Consequently, spreads are drifting tighter across the board and there was no advantage in being the first mover, particularly when the Greek situation was losing its relevance. Crédit Agricole funding management therefore proved correct in not rushing into the market but carefully preparing this landmark project. They were the only issuer to announce a roadshow and to dedicate a full week for dialogue with investors. I think it paid off.

How has your dialogue with investors evolved across your sub debt activity?

Bélorgey, Crédit Agricole: Our dialogue with investors is now focused on the most recent development of our Group, the ongoing regulation and its quite high complexity. We are no longer in a situation where investors, especially the US base, are keen to hear about the future of the euro and the Eurozone, the role of the ECB and the political measures taken to reassure market participants. This is behind us. We had almost no questions on the credit per se. The main questions were more focused on the usual topics of the day, but I must say we had a very complete investor presentation that was highly valued by investors, if I can rely on the feedback received during and after this roadshow. Our Financial Communications team did a great job.

As one of the most pro-active banks in terms of capital management, having issued four CRD IV-compliant AT1s since January 2014, how would you describe the development of the Tier 2 market in light of the recent transactions?

Bélorgey, Crédit Agricole: We view it as very resilient, the new transactions being driven by the publication of the TLAC paper. Investors seem to focus on differentiating between issuers and their different total capital profiles and strategies vis-à-vis the TLAC ratio. Recent comparable trades have been done without any deal-related roadshow, but



Bernard du Boislouveau, CACIB

we decided to invest time for our first big benchmark this year in the sub space, using the full-year 2014 results. The investor reaction was great and the roadshow proved extremely efficient in re-emphasising that the Crédit Agricole Group is on track. The Tier 2 market is a good mix in terms of risk-reward profile for investors who are comfortable with a given name. No doubt it will continue to develop on that basis given that, before taking into account any subordination features, a Tier 2 also represents liquidity – in other words, given that quite active Tier 2 issuance in the primary market is also substituting for a portion of senior unsecured funding.

How do you see the Tier 2 market evolving from now?

Bélorgey, Crédit Agricole: As already mentioned, we are anticipating a growing Tier 2 market, a stable to decreasing senior unsecured segment, and still limited growth, if any, on the covered bond side. All this looks sensible considering the recent changes in regulation.

For TLAC-driven reasons, we can't exclude the arrival of a nascent asset class, junior to senior unsecured and senior to Tier 2 deals, which would support G-SIBs' efforts when reinforcing their TLAC ratios. You will certainly notice that our Tier 2 notes include an update of the subordination clause in order to carve out a new subordination category between Tier 2 capital instruments and senior unsecured debt. This change will

allow for the future use of non-regulatory capital bail-in-able subordinated debt, increasing our flexibility for TLAC/MREL purposes. This is in line with other recent Tier 2 issues, also including French names, whether they are done on a stand-alone basis or via modifications to the issuance programmes.

Do you expect any impact from QE on the subordinated market?

Bélorgey, Crédit Agricole: Yes, we believe QE by the ECB will continue to put pressure on interest rates and credit spread globally in euros. This will support the Tier 2 market and maybe to a lesser extent the AT1 market. As these are the only remaining yielding assets issued by financials in the Eurozone we would expect investors to progressively shift towards these products given spread compression for other products. For us as an issuer, it fits with our funding mix.

Do you think that repeat issuers should adjust their strategy when approaching the market?

Du Boislouveau, CACIB: Yes, indeed. The most important takeaway from an issuer perspective is to actively seek dialogue with investors. They need to know what kind of offering they can expect from a given name on a given format. This is what Crédit Agricole SA tried to do with this dual-tranche issue.

Can you say anything about your plan in Tier 2 style debt for the rest of the year?

Bélorgey, Crédit Agricole: As stated consistently during the roadshow, this dual-tranche transaction completes Crédit Agricole SA's Tier 2 needs for 2015 in wholesale benchmark format in major currencies. Based upon our TLAC/MREL calculations, we can anticipate a similar need for 2016, everything being equal. As you know, experience proves that we can't exclude new parameters coming from the moving regulatory environment or other external factors. ●



Nordic season!

A year ago Nordic banks had yet to issue Additional Tier 1, but 12 months on virtually all the region's leading players have taken up the capital instrument — whether in euros, dollars or their local currencies. However, their ultimately limited AT1 needs have combined with high credit quality to ensure that issuance has in the main been easily absorbed. *Neil Day* reports.

As 2014 drew to a close, Moody's analysts joined their peers in making forecasts for the coming year and those charged with covering Sweden came out with their call: Swedish banks would make early, large issuances of Additional Tier 1 (AT1) securities, motivated by early implementation of increased capital requirements.

In its 12 December report, Moody's forecast that the four largest Swedish banks would issue at least Skr15bn-Skr22bn (\$2.0bn-\$2.9bn), excluding issuance to date, of AT1s by 2016, building up to Skr37bn (\$4.9bn) by 2019.

Just three months on and the upper end of Moody's shorter term forecast has al-

ready been all but reached by Sweden's big four. Indeed, including a further issue from SBAB, total AT1 supply from Sweden this year has reached \$3.05bn equivalent.

Swedbank and Svenska Handelsbanken debuted in February with \$750m and \$1.2bn deals, respectively. SBAB then launched its debut, a Skr1.5bn deal on 9 March, the week after Nordea had become the first Swedish repeat AT1 issuer with a \$923m equivalent issue across US dollars, Swedish kronor and Norwegian kroner.

These transactions came after Nordea had opened Swedish AT1 issuance with a \$1.5bn issue on 16 September 2014 that put down a strong marker for the coun-



World cup ski-jumping, Kuopio
Photo: Petri Damstén/Flickr

try by achieving the lowest coupon on an AT1 — 5.5% — with a \$1bn perpetual non-call five tranche that came alongside a 6.125% perpetual non-call 10, as \$10bn aggregate of orders were placed.

“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.”

Meanwhile Skandinaviska Enskilda Banken (SEB) in November filled out supply from the country’s four largest banks with a \$1.1bn debut, making overall Swedish supply some \$5.65bn.

The slew of issuance has been attrib-

uted to the Swedish authorities’ advanced and demanding move to the new post-crisis capital framework.

“We believe AT1 securities will be attractive for Swedish banks because Sweden adopted close to fully-loaded Basel III rules from 2014, ahead of most other European nations and well ahead of the mandated introduction schedule that allows a gradual move to Basel III by 2019,” said Daniel Forssen, associate analyst at Moody’s.

Meanwhile, the trigger for Swedish banks to start filling their AT1 buckets was the falling into place of the final pieces of the regulatory jigsaw governing

their capital requirements and related AT1 rules.

“The regulatory environment was still changing until the back end of last year, both on the European level but particularly on the Swedish side” says Julian Burkhard, head of capital solutions, Crédit Agricole CIB. “Swedish FSA consultations on capital requirements and specifically on the Pillar 2 requirement continued throughout the summer of last year and were only confirmed in the fall.

“Nordea was then the first to advance, as expected, but there were still outstanding questions on topics such as BRRD

implementation in Sweden and potential leverage ratio requirements, which is probably why you had a few banks waiting to have a better view on the regulatory context.”

AT1 jigsaw falls into place

Moody's also noted that most Swedish banks' legacy Tier 1 instruments do not qualify as Basel III capital and forecast that these would be replaced, and indeed this has been another factor in the timing of the inaugural AT1 supply.

John Arne Wang, head of treasury management at SEB, for example, explained that in its capital planning SEB had communicated that it planned to issue an AT1 before this summer, supplementing a strong CET1 capital ratio, with the bank having two legacy hybrid transactions that are callable this March equivalent to around Skr8bn (Eu865m, \$1.08bn).

“Given our excellent ratios, we could obviously have waited longer than that, but ideally we like to take the opportunity of refinancing ahead of such calls,” he said. “So in that respect we were always looking to optimise the capital structure on that kind of a timescale, and once we had the clarity on CRD IV from the Swedish FSA we were able to move ahead.”

Another key factor in the timing of the Swedes' deals has, of course been market conditions, which in the AT1 market have been variable, to say the least. SEB's Wang noted that after the regulatory and redemption considerations, the issuer had the choice of moving ahead before the end of 2014 or issuing in the first half of 2015.

“After the rather substantial market volatility seen in the first half of October, we have had a remarkable rebound, not only in equity markets but also in credit, where volatility has steadily declined,” he said after the deal was launched on 6 November. “In connection with that we have seen an increased appetite from investors and also the kind of positive backdrop we were looking for that would enable us to achieve attractive levels.”

“There hadn't been any European AT1 transactions since the Nordea transaction in September and it wasn't obvious

that was going to happen now, but we had several days with constructive market conditions spurred by the Japanese central bank and we felt fairly comfortable that throughout November there would be good opportunities. We also felt quite confident given the feedback from the market that investors would be open for business, with books not yet having started to close and indeed the rather dry period in the AT1 market having driven appetite higher, with significant cash to be put into action.”

SEB was able to reopen the AT1 market in successful fashion, pricing a \$1.1bn perpetual non-call 5.5 issue with a coupon of 5.75% after having attracted \$5.3bn of demand from over 360 accounts that helped the paper trade up in the aftermarket.

“I guess that's exactly what the market was looking for: a reopening of the AT1 market post-AQR with a deal as well received as this one, showing performance in the secondary market and encouraging investors to buy more ahead of year-end,” said a syndicate official at one of the leads. “Let's hope for more of the same.”

Swedbank shows Swedish sheen

For the Swedes, at least, further success arrived in the new year, although Swedbank and Handelsbanken waited until releasing their 2014 results before proceeding with their inaugural AT1 issues, Swedbank going first after announcing its plans on 6 February.

“We had been ready to issue an AT1 instrument for quite some time,” says Gregori Karamouzis, head of investor relations at Swedbank, “but we were not in a hurry as we have been filling the buffer requirement from the Swedish FSA with Common Equity Tier 1 capital. With the FSA finalising the capital requirement proposal last autumn, there was more clarity and you saw two of our peers move ahead back then, but they had more imminent needs whereas we don't really have any needs until the end of this year.

“And then there was still an uncertainty around additional Pillar 2 individual requirements and the FSA, although not finalising these, gave a clear indication of



Gregori Karamouzis, Swedbank:
‘There was a good opportunity to go ahead and get our deal done’

what they intend to do in the winter.”

With the capital framework falling into place, the bank then worked on getting its documentation in order to be ready to issue soon after its Q4 results.

“When we published our numbers we then looked at the market and assessed that there was a good opportunity to go ahead and get our deal done,” says Karamouzis, “really for the purpose of optimising the capital structure. We want to fill our buffers with types of capital other than CET1, which is the most expensive form of capital.”

After a three day roadshow a perpetual non-call five issue was launched on 12 February.

“Despite the slightly softer market tone and large amounts of anticipated supply, we received phenomenal investor interest from the outset, with initial price thoughts of 5.75% for a size of \$500m-\$750m,” said a banker at one of the leads.

After orders quickly reached more than \$2bn guidance was set at 5.5%-5.625% and a \$750m issue was ultimately priced at 5.5% on the back of a \$2.5bn book comprising over 200 accounts.

“There was minimal pricing sensitivity in when final terms were set at \$750m at 5.5%,” said the lead banker, “offering only a very modest new issue premium, which stands in stark contrast to recent AT1 issues that paid concessions in the region of 30bp-50bp. The deal traded up to 100.50 on the break, demonstrating investors' ongoing support for the issue in the secondary market.”

Unlike other Nordic AT1 issuance, Swedbank's instrument included equity conversion rather than temporary write-down language.

"The equity conversion feedback was very positive and was considered as a cleaner structure and more favourable to investors," said another lead banker. "Swedbank's mechanism was by some considered to be worth approximately 25bp in terms of spread reduction relative to peers."

He added that the level achieved by Swedbank was well through the secondaries of Nordea and SEB.

Swedbank CFO Göran Bronner said the issuer was very satisfied with the deal.

"Despite a turbulent market we successfully achieved a price at the same level as the lowest in the market for equivalent instruments," he said. "This demonstrates Swedbank's strong position and high confidence in the investor community."

Alex Sönnnerberg, Nordic FIG DCM origination at Crédit Agricole CIB, says that Swedish issuers across the board hold attractions for AT1 investors.

"They benefit from being much better quality than a lot of other European banks," he says. "They have very high fully-loaded capital ratios and also announced very strong results. In line with this, they enjoy pretty strong ratings that on the whole put their AT1s in investment grade territory, and there's not a lot of AT1s with IG ratings."

"Meanwhile, they have fairly limited requirements when it comes to filling their AT1 buckets — Swedbank, for example, said that they won't be back for 2.5 years."

Handelsbanken 'museum piece'

The week after Swedbank debuted, Svenska Handelsbanken on 18 February launched its first AT1 and backed up these arguments. The announcement of Handelsbanken's mandate came amid a wave of supply that included Swedbank's AT1, but Bengt Edholm, head of treasury at Svenska Handelsbanken, says that the issuer was not concerned about this.

"We knew that for a very long time there has been demand for this type of product from Handelsbanken, so we didn't really think about other issuers' supply," he says. "And everyone knows that we will not be a repeat issuer, that this will be a one-off, so that it would be sort of a museum piece when we came."

"\$1.2bn of AT1 is beneficial in the capital structure, so it makes sense to do such an issue at some point in time. Our overall view is that we want to combine the lowest risk with best in class capitalisation, and this transaction should be seen in that context."

The \$1.2bn perpetual non-call six deal attracted \$4.7bn of demand from some 250 accounts, enabling the leads to tighten from initial price thoughts of the 5.5% area to a coupon of 5.25% — the lowest coupon on a US dollar AT1.

"This is 0.25% inside Swedbank's initial pricing" noted Pascal Decque, financials credit analyst at Crédit Agricole CIB. "It is worth underlining that this is the first AT1 with three investment grade ratings, and with no further supply in the foreseeable future."

"Swedish banks are among the best capitalised banks in Europe — Handelsbanken has a CET1 ratio of 20.4% — and offer the best cushions for AT1 investors."



Bengt Edholm, Handelsbanken:
'We want to combine the lowest risk with best in class capitalisation'

Edholm says the issuer chose the dollar market because it provided a better level than euros, although he says that this also enabled the issuer to offer paper in a currency that more of its regular investors can buy.

"The target was to issue tighter than anyone else," says Edholm, "and that's always our aim when we go out in the market because we have the strongest credit metrics, we are the most stable bank, we have managed through the financial crisis with an annual growth in equity and dividends of 15%, very stable quarter by quarter, we have the lowest loan losses, etc, etc. And of course when you print an AT1 that difference is expected to be much, much bigger than when you print a covered bond."

"And we achieved this with a very broad margin, so we were very happy with the price. But when we go out to the market — whether it be with a covered bond or an AT1 — it is also very important that the investors get a good performance in the bonds, and that was the case here, too."

Moody's: Swedish banks are subject to one of the fastest implementations towards fully-loaded Basel III capital requirements

Capital Buffer	Sweden	Basel Committee Guidance
Capital Conservation Buffer	2.5% from 2014	Gradual rise between 2016 and 2019 to 2.5%
Systemically Important Institution Buffer (Global/Domestic)/Systemic Risk Buffer	3.0% systemic risk buffer from 2014 (for the four large Swedish banks); No decision has been made yet on the systemically important institution buffer	Phase-in of Systemically Important Institution Buffer from 2017 to between 1.0% and 3.5%
Grandfathering out of non-qualifying capital instruments	Fully grandfathered out by 2019	Fully grandfathered out by 2022
Phase-in of deductions from CET1	Full deductions from 2014	Gradual phase-in by 2018

Sources: Finansinspektionen, Moody's

SBAB finds local favour

SBAB was also pleased with its result when it debuted in the AT1 market on 9 March with a Skr1.5bn of perpetual non-call five notes split into fixed and floating rate tranches that were priced just 15bp wider than where Nordea had the previous week issued krona AT1.

"It's been a while since we last issued this type of instrument," says Fredrik Jönsson, head of treasury at SBAB. "We have some old hybrids in place, but they are being grandfathered and under that treatment become less efficient every year.

"And with the new regulatory landscape that we and every other bank is facing there is room for issuing these AT1 instruments, so it is efficient from a regulatory perspective to have these on our balance sheet."

The bank has Skr2bn of old hybrids coming up for call in June.

After a roadshow the issuer attracted some Skr4bn of demand and on the back of this the leads were able to tighten pricing from initial price thoughts of the 350bp over Stibor area to a re-offer spread of 325bp over. The transaction was split into Skr1.1bn of floating rate notes and Skr400m of fixed, reflecting the respective levels of demand.

The spread was only 15bp outside a 310bp level achieved by Nordea in Swedish kronor.

"All in all we are very pleased with the result," says Jönsson. "15bp is not that much in this kind of transaction and that's the ultimate proof that investors are very comfortable with an SBAB AT1 offering."

Under the Swedish FSA's latest Pillar 2 requirements announced on 17 February, SBAB has a required CET1 ratio of 21%, higher than those of the big four Swedish banks, and also the highest CET1 ratio, at 29.8%. The high requirement is driven by a 25% mortgage risk weight floor in Sweden that accounts for 11.7 points of SBAB's Pillar 2 requirement. Jönsson notes that this means SBAB's AT1 has the largest buffer to estimated MDA restrictions of any AT1, 21.8 points, while it has a buffer to the 7% group-level CET1 trigger of 22.8 points (the AT1 also has a 5.125% bank-level trigger).

"We have been looked at as a very safe



Thor Tellefsen, DNB:
'A huge part of the Norwegian investor community participated'

option even though we have an expected rated from S&P of BB+ compared with the investment grade ratings of other Swedish banks' AT1s," he says. "There has not been that much AT1 supply Swedish krona and we had more than 40 different accounts in our order book."

Until the Nordea trade — which also incorporated US dollar and Norwegian krone tranches — AT1 issuance from Sweden had been restricted to the dollar market for the reasons outlined by Handelsbanken's Edholm.

"The major Swedish banks have been out there and issued in dollars, but we, a smaller bank, issued in Swedish kronor for a few reasons," says Jönsson. "First of all, our size ambitions: you can, of course, do a sub-benchmark in dollars, but for a proper benchmark you need \$500m-plus.

The Skr1.5bn total size of SBAB's deal was equivalent to \$177m.

"Another thing," adds Jönsson, "is that our lending is in Swedish kronor, so it is more natural for us to issue in our domestic currency compared with the big banks — they of course also have lending in Swedish kronor, but they also have lending in euros and in dollars.

"And finally Swedish kronor is our major funding currency and it is important for us to give our domestic investor base an opportunity to buy our AT1 in their preferred currency."

DNB flies Norwegian flag

Norway's DNB likewise demonstrated enthusiasm from its domestic investors for the instrument when on 13 Febru-

ary it sold the first public AT1 from the country, a Nkr2.15bn (Eu247m, \$264m) perpetual non-call five issue paying three month Nibor plus 325bp. According to Thor Tellefsen, senior vice president and head of long term funding at DNB, around 125 investors participated in the transaction.

"A huge part of the Norwegian investor community participated," he says, "but not all have lines for these instruments yet."

Some 60% of the paper was placed in Norway, while almost 20% was sold to Sweden and the remainder to other international investors.

"Our capital is in Norwegian kroner so obviously if we could fill all our needs in Norwegian kroner we should do that," he says. "It was therefore a natural place to start but, as the Norwegian market isn't that big, we could see how much we could get and then fill up the remaining needs with other currencies."

The transaction turned out larger than expected, according to Tellefsen, and also achieved an attractive level for the issuer, with DNB coming 25bp-40bp inside where Swedbank had tapped the dollar market the previous day based on estimates as to where that would have swapped into Norwegian kroner. The floating rate format also suited both DNB and Norwegian investors, adds Tellefsen.

DNB has one legacy Tier 1 issue outstanding after having redeemed two in 2012 and 2013 that were not refinanced at the time.

"For a long time we have had much more core Tier 1 than we needed," says Tellefsen, "but as the requirements for core Tier 1 are increasing we also need to fill up the Additional Tier 1 buckets. We were also waiting for the new criteria to be confirmed because when they were redeemed we didn't know what the requirements would be."

DNB followed up its krone issue with a \$750m (Nkr6.12bn) 5.75% perpetual non-call five AT1 on 19 March that attracted \$2bn of orders, although the transaction hit a weak market and the book and level were off the highs experienced by DNB's Swedish peers.

Danish AT1 fills out

Danske Bank — which had opened the Nordic AT1 market in March 2014 — also faced a weak market when it sold a Eu750m perpetual non-call seven issue on 11 February, in the midst of the Swedish debuts and amid a bout of wider AT1 issuance. The Danish bank's deal came after it announced its latest results.

"We then saw several other issuers with the same idea and so there was a little bit more traffic than we had perhaps anticipated," says Peter Holm, senior vice president, group treasury, Danske Bank. "But we listened to our leads and stood by our initial plan."

"Since we had been on the road in Europe last year we thought that it was unnecessary to do so again, but rather hold a global conference call with investors and some one-on-ones the day before launch. We had some 80 participants on the call and this proved to be the right strategy."

Danske's leads went out with IPTs of the 6% area and, in spite of a weaker market backdrop of underperforming recent supply, built a book of over Eu2bn comprising some 200 accounts and priced the deal with a coupon of 5.875%.

Holm nevertheless notes how the book size contrasted with that of its inaugural AT1 in March 2014 and said that this reflected the way the market has changed in the interim.

"When we went out at that time there were not many issuers able to tap the market, but there was a lot of interest in

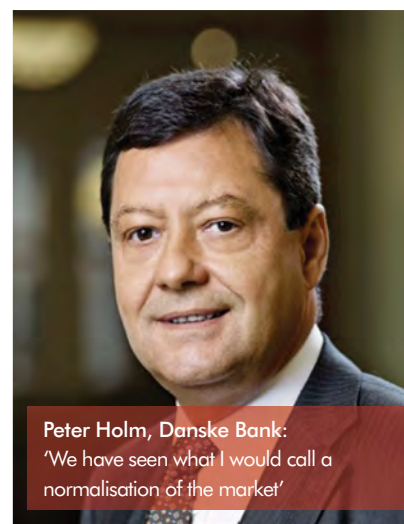
the product and we had a tremendously large book of close to Eu13bn, with some 700 investors," he says. "Since then we have seen what I would call a normalisation of the market."

"Particularly in the latter part of last year there were some hiccups in the market and, although the market recovered somewhat in January, we have not seen these huge order books that we saw at the beginning of 2014. We ended up with a little over Eu2bn this time, but we had the right investors in the deal for the right size and the right price, and overall we got a good result."

Alongside its results, Danske announced an increased dividend of Dkr5.5 per share and a Dkr5bn share buyback for 2015. It has also announced it will be calling a Eu700m Tier 2 issue in March.

"We have been adjusting to the new regime for capital instruments under CRR/CRD IV and this issue continues that process," says Holm. "The starting point is that we have a very strong capital position and in issuing the new Eu750m AT1 and repaying the Eu700m of Tier 2 we are increasing the quality of our capital base — although it should also be seen in the context of the share buyback."

Danske was the following week joined by fellow Dane Nykredit, which on 19 February sold a Eu500m (Dkr3.72bn) 6.25% perpetual non-call 5.7 debut. Ahead of the deal Nykredit announced its plan alongside the redemption of Eu900m of outstanding hybrid Tier 1 on 1 April, and then held a three day road-



Peter Holm, Danske Bank:
'We have seen what I would call a normalisation of the market'

show. Its leads then went out with IPTs of the 6.5% area for the Eu500m no-grow deal and ultimately set the coupon at 6.25% on the back of Eu1.3bn of orders from 126 accounts.

A banker at one of the leads said that the roadshow and deal had substantially expanded Nykredit's investor following, while another market participant noted that the issuer had, in contrast with Danske, been able to tighten pricing from IPTs.

"The performance has been seen as positive in spite of our name not being that well known in the AT1 market," says Erik Holbek, senior investor relations manager at Nykredit. "With this issue we have nearly filled up our whole bucket for AT1 issuance, so we will not be back in the market in the near future — it will depend on how the business develops — and we understand that helped appetite for our issue." ●

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EIOPA headquarters, Frankfurt

Solvency II Tier 1 take-off

The impact of Solvency II is expected to hit the capital markets in 2015 via the first Tier 1-style structures under the new framework. *Bank+Insurance Hybrid Capital* surveyed leading market participants to find out how the new asset class is likely to evolve, as well as its wider impact on insurers' funding and capital strategies, and how it fits in alongside bank AT1.

Jozef Bala, head of debt management unit, Assicurazioni Generali

Michael Benyaya, DCM Solutions, Crédit Agricole CIB

Marco Circelli, head of capital and treasury management, SCOR SE

Julien de Saussure, fund manager at Edmond de Rothschild Asset Management (France) (EDRAM)

Vincent Hoarau, head of FIG syndicate, Crédit Agricole CIB

Benjamin Serra, senior credit officer, Moody's Investors Service

Dominic Simpson, senior credit officer, Moody's Investors Service

Paul Gurzal, head of credit, La Française AM

Moderator:
Neil Day, Managing Editor,
Bank+Insurance Hybrid Capital

The EIOPA stress tests have not had much resonance in the market — what are the relevant takeaways from the results at the industry level?

Vincent Hoarau, CACIB: EIOPA released the results of its 2014 stress test for insurance companies in early December. In a nutshell, the results showed evidence of a strong capacity of resilience of the sector with, on the whole, a high level of capitalisation. Only a few instances of weakness were identified. The market hardly reacted to the result since the insurance sector had always been immune from the crisis — or almost immune — and the test was considered a non-event, as were the results. In addition, participants computed the results on a “best efforts” and no-name basis. Participants could use approximations whenever fi-

gures would not lead to fundamentally different results and used the Standard Formula, without making use of the Undertaking Specific Parameters (USP). So, nothing that compares to the stress test for banks. And this generated criticism.

Paul Gurzal, La Française AM: The EIOPA stress tests had limited impact, as it was an anonymous test with no names revealed. Nevertheless, those tests were useful to move forward to a new debt format.

Julien de Saussure, EDRAM: The EIOPA stress test has had far less resonance in the market than the AQR/Stress Test for banks. This is probably due to (i) name-specific feature of the banking exercise and (ii) immediate loss potential for equity and bondholders on some of these issuers.

The insurance industry seems relatively well prepared ahead of Solvency II. However, the level of preparedness in terms of SCR/MCR coverage, rollout of internal models and ability to use long term guarantees (LTGs) or transitional arrangements is largely skewed in favour of big entities.

Given where rates currently are in Europe, the ability to absorb low rates for longer is at the centre of insurance credit analysis going on at this point of the cycle.

Marco Circelli, SCOR: The results indicate that the European market is well capitalised and resilient. However, the exercise required companies to use the Standard Formula, which does not fully reflect all the risk profiles and makes it difficult to properly analyse the results.



Jozef Bala, Generali
 'We expect this market to grow relatively slowly'

Jozef Bala, Generali: The EIOPA stress test did not have much resonance in the market, most probably because it was not a pass or fail test, and there was no disclosure on individual names. A relevant takeaway is that the results suggest that the shortages were not in the top 30 biggest insurers, but also that structural differences across jurisdictions reveal that certain countries may be more vulnerable to a period of a prolonged interest rates, and therefore a coordinated supervisory intervention will be welcomed.

Dominic Simpson, Moody's: Overall, we believe that the stress test results provide investors with greater clarity around the Solvency II capitalisation and its sensitivity to shocks. One of the main messages is that 14% of the insurers which took part in the EIOPA survey have a Solvency Capital Requirement (SCR) ratio below 100% even before any stress is applied. Although this may appear a large percentage, these companies represent only 3% of total assets, confirming our view that smaller, less sophisticated, insurers are those more vulnerable to the introduction of Solvency II.

As concerns the stresses, of particular note is that in a prolonged low interest rate environment (the so-called Japanese scenario), around a quarter of European insurance companies would not meet their SCR as set by the standard formula, with German insurers losing 20% of their

eligible capital. The results also show pre-stress negative net cashflows in around eight to 11 years in various countries, including Germany and the Netherlands, which is broadly in line with our expectations, given the high guarantees and high duration mismatches we find in these countries.

The lack of company-specific information somewhat limits the conclusions that can be drawn from the stress tests, and further caution is warranted as the tests were based on year-end 2013 standard formula results. Insurers may have the opportunity to strengthen their capital position before Solvency II is implemented and/or have their internal model approved, which usually results in higher solvency ratios. However, with interest rates currently at a lower level than EIO-PA assumed even in its Japanese scenario and the ECB's QE program designed to prevent rates from rising, we can infer from the stress test results that the level of regulatory scrutiny will be even higher on insurers in the coming months, while investors will also be increasingly wary of insurers' solvency.

We expect insurance companies to sell Solvency II Tier 1-style bonds in the near future. How do you see the development of this new market segment?

Circelli, SCOR: The need for Tier 1 paper will vary from one insurer to another. Indeed some benefited from the transitional arrangement and already optimised their Tier 1 capital structure, while others didn't. For those who didn't, issuing Tier 1 paper from 2015 will be much more difficult but could enable some groups to optimise their remaining Tier 2 debt capacity and therefore increase their financial flexibility.

There are still some uncertainties about the loss absorption method, if it will be similar to the temporary write-down of Additional Tier 1 capital instruments, which have been issued mostly

by Eurozone banks. So far, no Solvency II Tier 1 paper has been issued by insurers. It is still unclear what price will be requested by investors for such a loss absorbency mechanism (temporary write-down), as needed for Tier 1.

De Saussure, EDRAM: It is also our understanding that these structures would be up for sale in H2 2015. Now, some opportunistic issuances ahead of the Solvency II cut-off has probably helped refinance some of bonds callable in 2015-2016.

It is likely to stay a small market, below Eu30bn-Eu50bn, restricted to bigger issuers in the EU.

Gurzal, La Française AM: The market environment is positive for new issues to come: interest rates are at lows and spreads are tight in the financial sector. In addition, with the insurance segment considered stronger than the banking segment and the grandfathering period being long, Solvency II Tier 1 should appeal some investors.

Bala, Generali: We expect this market to grow relatively slowly because of some uncertainties on the structure and the limited need for this kind of instrument due to the grandfathering and the wider space for Tier 2 instruments in Solvency

The market environment is positive for new issues to come

II. We expect issuers to prefer the write-down feature to the conversion mechanism because of the easier marketability of the instrument.

Would you expect the downbeat mood in the bank AT1 market in the second half of 2014 to affect the emergence of a similar segment for insurers?

Gurzal, La Française AM: The slowdown in issuance of bank AT1 during the second half of 2014 is not a worry, but has enabled this new market to be absorbed and let investors become spe-

cialised. Therefore we stay positive on the asset class.

Indeed, the growth was huge as Eu40bn was issued in the first half of the year out of Eu50bn in the whole of 2014. We think this period is temporary and closely linked to a troubled macro environment and volatile markets, with the surprising comments of Draghi at Jackson Hole last August, the two rounds of TLTROs, the FED tapering end, and an announcement on ECB QE that nevertheless lacked details...

If new issues were to be positively digested by the market then the whole industry should benefit from it, with some insurance bonds emerging. However, if the first issues are not well accepted by the market, the emergence of a new insurance segment will be tough with bank AT1 competing.

De Saussure, EDRAM: The renewed volatility on bank AT1 in H2 2014 is likely to weigh on the Solvency II Tier 1 segment. AT1s are likely to be the focal point in terms of relative value for Solvency II Tier 1. Wider spreads in AT1 will undoubtedly be reflected in early Solvency II Tier 1 deals.

Now, it could also be an opportunity to create a subordinated segment offering decent yield and some decorrelation versus bank AT1. Some risk factors specific to the banking industry do not have any impact on insurance companies, for example some regulatory developments (TLAC, RWA floor, resolution...) or risk areas (e.g. Russia, oil).

Obviously, any loss (coupon or trigger) on bank AT1s would jeopardize the rise of Solvency II Tier 1.

Bala, Generali: There has been an oversupply in the bank AT1 segment mainly due to the low interest rates and the relatively compressed spreads, and the oversupply was also driven by the rush to cover the capital requirement before the EBA stress test results. We do not foresee massive issuances of restricted Tier 1 in the insurance space mainly thanks to the benign grandfathering rules applying for a period of 10 years without any amortisation.

Hoarau, CACIB: I think the situation has evolved positively in the AT1 market since the beginning of the year. The mood is much more constructive and we can't talk about a downbeat tone anymore. Now, whether or not the Solvency II Tier 1-style segment for insurers will stay immune from any developments in bank AT1 remains to be seen.

Everything being equal, the new Solvency II segment is much more defensive than the bank AT1 segment given the perception of the probability of breach of the SCR for a given insurer. As has been rightly suggested, we don't expect any surge in supply and the segment should remain relatively small. Insurance companies are defensive animals and they demonstrated an outstanding track record during the crisis. The first issuance should surface in a recovered global credit market and will offer valuable investment opportunities for buy-and-hold investors struggling to find yield in a low interest rate environment. I expect this segment to stay relatively undersupplied compared with the rest of the deeply subordinated space. Investors want yield pick-up from rare and conservative bor-



Michael Benyaya, CACIB
'The current insurance hybrid rating criteria may be reviewed'

to address the grandfathering rules in their criteria, notably regarding equity credit?

Bala, Generali: Yes, we expect rating agencies to assure a smooth transition to the new Solvency world, especially for the equity credit/treatment that is surely a relevant contributor to the issuer's capital structure.

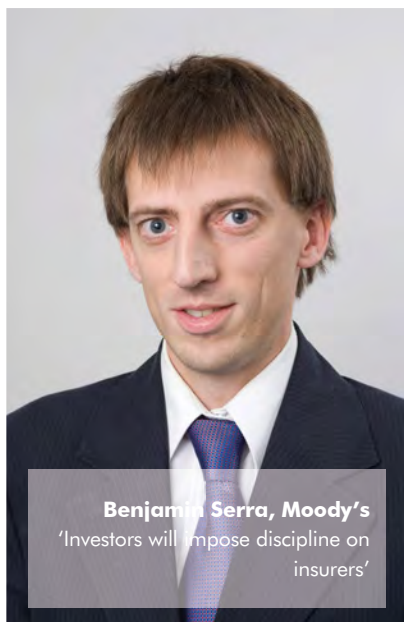
The new Solvency II segment is much more defensive than the bank AT1 segment

rowers issuing subordinated instruments with generally investment grade ratings. This is precisely what the segment will offer. Given the profile of the issuers — it's fair to say that insurers are safer institutions — we also expect investment constraints to be much more limited compared with what we can observe in the bank AT1 space. It will be very interesting to see the approach adopted by the Germans when the first issuance emerges. They have been reluctant to buy in bank AT1 so far — I would be surprised to see the same strict attitude toward Solvency II instruments.

What do you expect from the rating agencies in terms of rating approach with the upcoming finalisation of the Solvency II framework? How do you expect rating agencies

Circelli, SCOR: We cannot anticipate the rating agencies' reactions, but we don't think that this will impact the equity rating. The S&P rule is currently as follows: as long as the bond is eligible as capital under the current solvency regime and is also eligible as equity credit, according to their methodology, the bond is considered in the Total Available Capital. We expect this to remain the same under Solvency II.

Michael Benyaya, CACIB: Rating criteria in the FI space often move in tandem with the regulatory framework, although rating agencies can impose additional requirements. In the context of the transition to Solvency II and now that the Delegated Acts have been published in the EU Official Journal, we can expect rating agencies to communicate more



formally on the hybrid topic. In terms of grandfathering, I agree with Jozef. It is expected that insurance subordinated bonds will retain their respective equity credit as long as they form part of regulatory capital due to the transitional rules and meet all other rating agency requirements. I also think that the current insurance hybrid rating criteria may be reviewed, notably to include a framework to rate the future Solvency II Tier 1 instruments.

Internal model: some insurance companies have adjusted some of their assumptions — do you see any implications, notably in the context of internal model validation?

Circelli, SCOR: We don't see any impact/change in the treatment for hybrid capital under Solvency II. Delegated acts have been approved by the European Parliament and Council, and published, applying directly to French law. Internal model application may have an impact on the SCR calculation, but not on the hybrid capital treatment in the own funds.

Bala, Generali: We do not foresee any implication of the changes and adjust-

ments made on the internal models since these are the result of dialogue with the regulator and are aimed at obtaining the validation.

How do you see the volatility of the SCR ratio versus the Solvency I ratio? Is there any implication in terms of capital management?

Bala, Generali: The SCR ratio is sensitive to the interest rate movements on both sides of the ratio, while the Solvency I ratio is sensitive only on the numerator if the national regulation and the supervisor allows the use of unrealised gains (the local approaches are different also in terms of limits). Looking forward, capital management should take into consideration adequate buffers based on the new metric.

Circelli, SCOR: Given that Solvency II is an economic framework, one should generally expect a higher level of volatility compared to Solvency I. Overall, this is certainly impacting the industries' capital management approach. The increased volatility requires a close monitoring of capital levels and creates opportunities for innovative financing solutions.

Benjamin Serra, Moody's: In most jurisdictions the volatility in current Solvency I ratios is easy to understand and essentially tracks changes in the market value of assets and does not reflect the

volatility of liabilities. Overall, we expect that available capital (the numerator of solvency ratios) and solvency ratios will not necessarily be more volatile under Solvency II (and may actually be less volatile under certain circumstances) and this will depend on the assets/liabilities duration mismatch. However, required capital (the denominator of the ratio) will definitely be more volatile under Solvency II.

Solvency II ratios' volatility will surely gain investor attention and the complexity of this volatility will likely reinforce the already-existing perception of complexity within the insurance sector, especially for non-specialists. Higher solvency ratios' volatility, coupled in some instances with potential lower absolute levels of solvency coverage, would also increase the risk of approaching or breaching the 100% regulatory coverage threshold. Therefore, under Solvency II, we believe that investors' appetite to provide capital to insurers could be reduced compared with Solvency I, and/or cost of capital could increase. We expect that most insurers will strive to manage and reduce volatility in their solvency ratios, notably by improving their asset-liability management, but we also believe that investors will impose discipline on insurers, and indirectly impose higher levels of capital.

For many issuers, the overall subordinated debt capacity is higher in the Solvency II capital structure vs. Solvency I: does this have any implications regarding the role of senior debt?

Circelli, SCOR: We don't think so. The role of senior debt is and will remain cash financing, or in a structured way collateral funding, when hybrid debt aims to achieve capital credit. Each type of debt has its own purpose and this will not change under Solvency II.

Bala, Generali: In our capital structure the senior debt is already residual. In the near future this trend in the overall insurance space may be accentuated, increasing layers of subordinated instruments while lowering the weight of senior debt.

We still have some doubts on the structure

changes in market value of liabilities. In contrast, under Solvency II, solvency ratios' volatility will be more difficult to interpret. As a simple example, life insurers with reinvestment risk will show weakening Solvency II ratios as interest rates fall, whereas under Solvency I they would have shown a solvency strengthening. Conversely, companies with low interest rate risk (e.g. those who have good asset-liability matching) should show lower ratio sensitivity to interest rates under Solvency II than under Sol-

Simpson, Moody's: Under Solvency II, Tier 1 and Tier 2 hybrid instruments are able, on a combined basis, to represent up to 60% of an insurer's solvency capital requirement, compared to 50% (or 25% for dated instruments) under Solvency I. With the assumption that capital requirements for the majority of insurers will increase under Solvency II, then we would agree that the overall subordinated debt capacity is higher under a Solvency II capital regime. Whilst this might argue for increased levels of subordinated debt issuance, especially in such a low interest rate environment, we would caution that financial leverage remains a constraint and the European insurance sector has been reducing its leverage in recent years notwithstanding the exceptional low cost of financing. In fact, in 2013, financial leverage was at its lowest level for the industry since the 2008-2009 global financial crisis.

With regard to senior debt, the reality is that issuance is already small compared to subordinated debt and its relevance has been declining over the past few years; we expect this to remain the case going forward. According to our analysis, over 60% of the debt issued by European insurers at year-end



see this instrument as a buffer to cover the volatility of the Tier 1 unrestricted items, ensuring an overall good quality of capital. We still have some doubts on the structure, for example how the "appropriate margin" will be defined in different regulations, and the write-up mechanism details.

Circelli, SCOR: As mentioned before, the development of this market will depend very much on the price required

The PRA has already communicated on the future Solvency II Tier 1 (partial write-down not allowed) while EIOPA will probably not go beyond the Level 3 guidelines in terms of specifications. Would you like to see some form of harmonisation in terms of structures at the European level?

Circelli, SCOR: Solvency II is a major step for the European insurance and re-insurance industry. This single regulatory framework should be completed by uniform supervisory practices on all aspects of the regulation. In this respect, a single supervisory mechanism for (re) insurers, could contribute to the harmonisation of the EU (re)insurance market and to a truly level playing field for the European industry.

Benyaya, CACIB: Indeed I do not expect the Solvency II rules to be more specific than they are today in terms of structuring guidelines. The PRA has launched a consultation on the quality of own funds under Solvency II which includes some specific guidelines on Tier 1. I do not expect other regulators to communicate on the topic to a large audience, at least in the short term.

Some structuring aspects remain elusive at this stage, notably the write-up mechanism, which seems to be rather flexible in the Level 3 guidelines. In addition, the role of EIOPA remains to be seen and we don't know if it will develop along the lines of EBA's role in the banking space.

Bala, Generali: We understand that the regulators may have different sensibilities and focus on some points rather than others, but the harmonisation is surely welcome.

What is your view on the G-SII framework, notably the BCR? How do you envisage the development of the Higher Loss Absorbency (HLA) requirement? Do you see any potential conflict or inconsistencies between the G-SII and Solvency II frameworks?

Some structuring aspects remain elusive at this stage

2013 was subordinated in nature, with senior debt on average accounting for only around 25% of total debt. These proportions are reasonable given the regulatory solvency benefits of the subordinated instruments relative to senior debt and their generally longer term nature.

How do you see the role of Solvency II Tier 1 in the capital structure? What are the potential benefits of having these types of instruments in the capital structure? Do you have any concerns regarding the structure of this instrument?

Bala, Generali: Since the space is limited to the 20% of the total Tier 1, we

for such structures (e.g. loss absorbency mechanism), and could be limited to groups under pressure with little Tier 2 capacity. Other than the issuer's Tier 2 capacity limitation, there is no benefit for the issuer to raise Tier 1 debt.

Benyaya, CACIB: The instrument can partly address the potential volatility of the overall Solvency II capital position. This is because the 20% limit is set against total Tier 1 capital, whereas Tier 2 and Tier 3 cannot exceed 50% of the SCR. In terms of rating agencies, a Tier 1 is unlikely to be granted a higher equity credit than a 30 or perpetual non-call 10 Tier 2 in the S&P capital model. It could still be eligible in a higher basket under Moody's criteria.

Benyaya, CACIB: The development of the G-SII and more generally the Insurance Capital Standards will be a multi-year process and it's difficult to say today what will be the outcome and potential implications for insurance companies. The BCR framework was endorsed by the FSB in October 2014, but the FSB also stated that the ICS are expected to replace the BCR in its role as the foundation for higher loss absorbency requirements. It remains to be seen how this framework will interact with Solvency II.

More generally, it's probably an additional operational and reporting burden for insurance companies because they have to monitor their capital position in light of this specific framework along SII and the rating agencies' capital models. In this respect, I can understand that Insurance Europe supports the idea that Solvency II will represent an acceptable implementation of the ICS framework.

Bala, Generali: There has been a growing likelihood since the initial G-SII designation of a potential conflict between the G-SII policy framework and Solvency II. Europe comprises five of the nine global systemically important insurers so the impact could be significant. The insurance industry is no different from any other highly regulated industry in needing certainty and clarity



to revise the methodology of designation of systemic entities, with a switch of focus from an entity perspective to an activity perspective. Overall, current discussions on global capital standards, and the very simple design of the BCR, seem to threaten some important achievements of Solvency II, such as the ability to use internal models and economic valuation or the recognition of diversification.

Simpson, Moody's: Overall, we view G-SII designation as a credit positive because it carries additional regulatory oversight, and to the extent that the HLA

contrast to Solvency II. Furthermore, it doesn't appear to be a constraining capital requirement; in a field test, for G-SIIs, we note the BCR ratio was a high 380%. However, the BCR will be replaced by a potentially more risk-sensitive approach via the global insurance capital standard.

As for the HLA, it is to be set at a level that offsets any advantage arising from G-SII designation. Importantly, the key principle is that G-SIIs hold higher levels of regulatory capital than would be the case if they weren't so designated, which clearly holds out the potential for capital requirements to be higher than the Solvency II SCR.

Furthermore, because of differences of approach between the Solvency II and G-SII frameworks, some financial resources eligible as regulatory capital under Solvency II may not be eligible under the G-SII framework where HLA capacity requirements should be met by the "highest quality capital". G-SIIs may therefore have to hold higher levels of "core" capital, which we also see as credit positive.

In its report on financial stability, EIOPA highlighted the following key risks: weak macroeconomic climate, prolonged low interest rate environment, and sovereign credit risk. How do you manage these risks? Have you implemented any specific measures?

Circelli, SCOR: SCOR is well prepared to face any potential headwinds. We are a traditional Life & Non-Life reinsurance company. As presented during our Investors' Day in September, our liabilities are predominately exposed to biometric risks in Life and catastrophe risks in Non-Life. Therefore, our exposure to macroeconomic changes is low. We meanwhile have prudent asset allocation with good quality of fixed income (AA-on average), no government bonds from Greece, Italy, Spain, Ireland or Portugal, and a high liquidity with short fixed income duration.

We are following our key risks at all levels within the Group. SCOR's risk appetite framework is approved by the

There is an urgent need to digest the numerous regulatory initiatives

of purpose from its regulators. There is an urgent need to digest the numerous regulatory initiatives and consider their impact and interaction at the risk of not clearly seeing potential unintended consequences — specifically, hindering the important role insurance companies play in providing patient capital to the real economy.

Circelli, SCOR: First, we believe that there is no clear evidence that insurance or reinsurance is systemic. Before the development of an HLA, there should be an in-depth dialogue with the industry

requirements, which are not yet defined, result in G-SIIs holding more capital relative to current levels, then creditors and policyholders will benefit. However, these positive implications are muted by the extent to which it reduces insurers' ability to operate in existing lines of business that generate diversified earnings. In particular, the HLA could make G-SIIs less competitive than those not designated as they could need to raise prices to achieve current return targets.

Specifically on the BCR, we note its simple design, with no explicit treatment of ALM or risk diversification, in

Company's Board of Directors in connection with the review of new strategic plans, based on recommendations from the Group's Executive Management team and the Risk Committee of the company's Board of Directors.

Bala, Generali: Following the designation, G-SIIs have been required to implement a policy framework, including specifically a Liquidity Risk Management Plan and a Recovery Plan. These two plans have been designed, according to the G-SII policy framework, to demonstrate that global systemically important insurers would be able to restore capital and liquidity positions in case they would be deteriorating. Among specific measures, the two plans also highlight metrics and triggers, early warnings, governance and escalation process to promptly manage crisis situations, where EIOPA key risks are also considered.

No Solvency II Tier 1 instrument has been priced yet. What will be the main elements you will look at when assessing the instruments?

De Saussure, EDRAM: As for any other hybrid instruments, it is the fundamental analysis of the underlying issuer that matters most.

Solvency II Tier 1 will raise several questions, however. The hierarchy between equity-holders and bondholders will change, given that stoppers/pushers are banned, similar to in bank AT1. Then the relationship with policyholders will need to be reviewed in light of low rate risks and increased consumer protection. The exact capacity to share losses with policyholders ahead of a solvency breach (and therefore as a cure mechanism) needs to be clarified and tested through the issuer's track record. The same applies for bancassurance groups that have been big issuers recently, where the ability to upstream/downstream capital to the parent bank ahead of a SCR/MCR breach should be clarified/limited.

Obviously, insurers will progressively amend their financial targets to include

SCR/MCR guidance. SCR/MCR will need frequent disclosures. As credit investors, we need to get more familiar with these metrics and how insurers would prioritise bondholders versus other stakeholders (i.e. shareholders, reinsurance counterparts and policyholders) before being able to truly assess any buffer to SCR/MCR breach.

Benyaya, CACIB: Disclosure will clearly need to be enhanced. Investors will probably dig further into the SCR and the tiering of the capital structure. The current sensitivity analysis to market movements (e.g. equity, spreads, rates) needs to be expanded as investors will want to see scenarios articulated to assess the resilience of the capital position. I also believe that insurance companies will have to explain the role of risk mitigation techniques (e.g. cat bonds, reinsurance) in the SCR. But I reckon that this will be difficult given the complexity of the Solvency II framework.

Gurzal, La Française AM: To assess a Solvency II Tier 1, we will focus on several aspects: the quality of the issuer, looking at the senior rating; the qual-



policies will require some education as well. In the end, given the complexity of the Solvency II framework, I am afraid that the majority of investors will stick to basics and focus first on the issuer fundamentals more than the intrinsic risk of the underlying instrument. This was the case in the AT1 market when it emerged a bit more than a year ago. And the nature of the metrics used when assessing risks has evolved a lot since then.

There is no clear evidence that insurance or reinsurance is systemic

ity of its business, with the volatility of revenues, its size and its country of risk exposure; understanding the trigger conditions and the terms on the coupon; the currency of issue.

Hoarau, CACIB: The risks embedded in the Solvency II structure of loss absorbing instruments will come under less scrutiny compared with bank AT1s given that triggers are perceived to be less likely to be breached by insurance companies whose capital positions and business profiles are in general already very solid. Nevertheless, the market remains untested and I would expect investors to logically have greatest concerns around the volatility of the SCR ratio and subsequently the probability of a breach of the SCR. The interaction with cat bonds and reinsurance

What will matter the most the most when assessing this type of instrument: issue size, spread, credit, coupon cancellation, loss-absorbing metrics, etc?

De Saussure, EDRAM: Technical elements will of course matter — such as issue size, investment grade rating, risk of further issuance.

We will also pay attention to any perceived asymmetry in the early call mechanisms, if we feel bondholders bear most of the uncertainty on eligible structures going forward.

References to distributable items in Solvency II Tier 1 will also need a careful review, given the HoldCo/OpCo structures of most of the insurance companies in Europe.

But what really matters is to get familiar with new solvency metrics (whether SCR, MCR), the expected volatility of these metrics, and the resulting probability of trigger breach.

Gurzal, La Française AM: What matters most will be: the credit quality; the coupon cancellation method; the loss-absorbing metrics, to understand the risk and the available buffer; the currency of issue; and the time ahead of the next call date.

Hoarau, CACIB: We don't expect the size of this market to grow sharply, so I don't see the size element having the same type of relevance in insurers' Solvency II Tier 1 as in banks' Basel III Tier 1 issuance. The concept of a "repeat issuer" will not be relevant to the segment, which we expect to offer only rare and valuable investment opportunities. Per se, the risk of coupon cancellation and the likelihood of a breach of the SCR will be assessed, but only for the sake of doing the necessary due diligence. We all agree on the fact that Solvency II Tier 1 is a much safer segment. The absence of MDA restrictions and lower constraints on write-up mechanisms are elements that will appeal to



Paul Gurzal, La Française AM
Index providers should start considering the subordinated debt market as part of their indices'

De Saussure, EDRAM: Honestly, we are not there yet internally. All in all, we expect upcoming Solvency II Tier 1 to be priced inside bank AT1 to reflect (i) better overall ratings (issuer and structure), (ii) a better mix of issuers (only big issuers would issue), and (iii) relatively more palatable capital structures with fewer interactions with MDAs, Pillar 2, PoNV or other hard-to-quantify external requirements.

We don't expect the size of this market to grow sharply

investors beyond issuer fundamentals. Given the overall market backdrop, the hunt for yield and more importantly the profile of Solvency II issuers, we expect the segment to converge quickly to the average yield of the "must pay coupon" instruments.

What can you say about the spread differential between bank AT1 and upcoming Solvency II Tier 1 instruments?

Gurzal, La Française AM: The spread differential between bank AT1 and upcoming insurance Solvency II Tier 1 will be explained by lower volatility on the insurance segment, making both bonds similar in term of risk-reward profile.

That said, only few insurance companies disclose SCR and MCR levels. Even fewer have committed to a financial policy based on SCR/MCR. Therefore, any assessment of the "buffer to SCR/MCR trigger" or "buffer to coupon cancellation" is a guesstimate at this point in time. Another element is that Solvency II SCR/MCR metrics do not have a long track record (though it should somehow behave like economic capital models), hence the feeling that it is difficult to assess the probability of solvency buffers being consumed. We need to get used to the new solvency metrics and their expected volatility.

Optically, it looks like major insurance companies already operate with big-

ger buffers to SCR breach (most players report SCR of 180%-200%) than banks relative to their CET1 trigger breach, which should support tighter spreads for Solvency II Tier 1. That said, the added Combined Buffer Requirements for banks not only mean coupon cancellation risk is more prominent for banks than for insurance, but furthermore imply that banks have an incentive to maintain a solvency ratio way above the CET1 trigger breach. For insurance, the high levels of SCR currently observed seem to rely more on market practices and economic capital model than an explicit regulatory requirement.

As a consequence of this SCR/MCR volatility, we believe the write-up/equity conversion will actually prove more valuable for insurance companies, all the more so as the write-up mechanisms could be more straightforward for insurance companies (and not restricted by MDA quartile-equivalents, for instance).

Hoarau, CACIB: Julien is right to be cautious. Indeed we are not there yet, and the differential between both segments will be dictated by the liquidity situation when the first issuance surfaces, as well as the state of the convergence between high beta and lower beta instruments when this happens. The price discovery will not be trivial and as of today there is a consensus in the market that Solvency II Tier 1 should price 50bp-75bp tighter than Bank AT1.

How much insurance supply can the market absorb going forward?

De Saussure, EDRAM: The insurance Solvency II Tier 1 market is likely to be small compared to the bank AT1 market. The incentive to issue hybrid T1 for an insurance company seems less palatable than for a bank. It may therefore only be a big issuers' game, implying both a better quality mix of issuers but also a higher attention to the cost-effectiveness of the instrument. Though Swiss Re has a CoCo instrument outstanding, it is likely to be restricted to European insurers regulated by Solvency II. It is

our expectation that this market will not be bigger than Eu50bn.

From the sense of indigestion observed on insurance subs back in October 2014, we need to see banks allocate more risk budgets to insurance subs trading before being totally comfortable with the asset class. We understand insurance subs is very often only a portion of the total subordinated financials trading book.

In terms of demand, we expect this supply to be met by a decent appetite for the asset class considering (i) the likely investment grade ratings of these instruments (in any case, better ratings than bank AT1) and (ii) the search for yield in a zero yield environment. However, we still wonder whether institutional investors will be able to buy the asset class, as perpetual instruments are badly treated under Solvency II guidelines. The same applies for retail clients, where we anticipate that FCA restriction or ESMA guidelines on CoCos would include Solvency II Tier 1 at some point.

Jurisdictions where the “Solvency II perpetual Tier 2/grandfathered Tier 1” arbitrage has not been validated by regulators, such as the UK, Spain or to a lesser extent Germany, might be quicker to come to this market.

Gurzal, La Française AM: The market can probably absorb from Eu10bn-Eu20bn of insurance Solvency II Tier 1 bonds in 2015.

You are invested across formats in subordinated debt, between bank AT1/Tier 2 and sub insurance — where do you see most value taking into account risk, the profile of the issuer, current valuation levels and upcoming developments?

Gurzal, La Française AM: The yield differentials among the various layers of subordinated debt are justified by their priority in case of any trigger event. However, we position ourselves on premium companies with sound credit quality and a high senior rating, and offering large buffers before triggers are reached. On these companies, in the case of any

trigger event, we believe all layers should be affected. We therefore favour Tier 1 debt on these companies, providing a higher coupon and yield for a similar risk across the different layers.

De Saussure, EDRAM: Arbitraging the phasing-out of legacy instruments issued for Basel II and Solvency I has been and will continue to be our major performance driver. Insurance has also been one of our key calls, with close to 30% allocation in our financial subordinated portfolio. Though the bank legacy instruments are disappearing quickly, recently issued “Solvency II perpetual Tier 2/grandfathered Tier 1” somehow benefit from the same dynamics. Some of them might be truly Solvency II-compliant, but we actually expect the majority to be called at the end of the Solvency II transitional period, i.e. close to or at their first call date. We also like European insurance Tier 1s with short-dated calls, given some of them have already been refinanced ahead of the Solvency II cut-off date.

AT1s are attractive instruments on a spread and yield basis. But it feels like the supply/demand dynamic has not balanced yet. Hence the higher volatility potential on this segment, notwithstanding



Julien de Saussure, EDRAM
‘We need to see banks allocate more risk budgets to insurance subs trading’

De Saussure, EDRAM: We expect AT1 issuance to stay at a high level, similar to 2014, as issuers are incentivised to issue 1.5% of their RWAs. We expect Solvency II Tier 1 to be launched in the market at the end of H2 2015.

Though more investors can look at AT1s, we are not yet convinced that the supply/demand imbalances observed in

It is definitely a segment where we will be able to allocate more risk budget

any correlation risk, should one of the AT1 coupons get suspended. Therefore we are very selective in how we approach the asset class.

What are your expectations for 2015 in the global AT1/Solvency II Tier 1 market? What’s your bet in terms of issuance volume and yield spread evolution across sector (bank vs. insurance)?

Gurzal, La Française AM: In the context of Basel III implementation by 2019, banks should continue to fill the 1.5% of RWA with AT1 CoCos. We think that Eu40bn should be issued in 2015. However, spreads should stay unchanged due to a pressured primary market and the significant volatility on this new asset class.

H2 2014 have levelled out. The segment offers very decent yields and some spread tightening potential, but will likely continue to be volatile and to be heavily influenced by technical factors.

Though the Solvency II Tier 1 could be a niche market only, we see the supply/demand as more balanced. And it is definitely a segment where we will be able to allocate more risk budget throughout the year.

And finally, do you have any other expectations for 2015?

Gurzal, La Française AM: We think that in 2015 index providers should start considering the subordinated debt market as part of their indices, as it is becoming a significant segment. ●

Investor survey

Solvency II Tier 1

Crédit Agricole CIB DCM Solutions conducted an investor survey on Solvency II Tier 1 hybrid instruments in January and we are pleased to present the results here.

Perception of relative value vs. outstanding undated Tier 2 instruments and bank AT1s

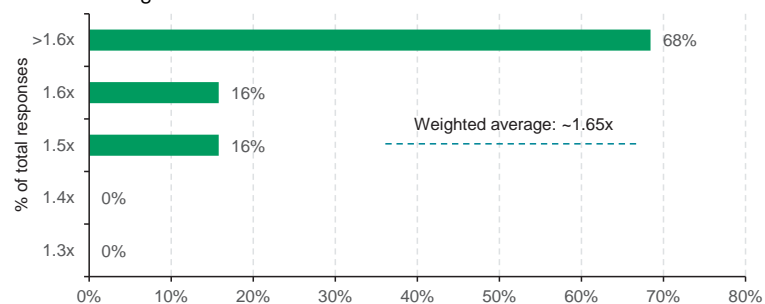
When comparing Solvency II Tier 1 with undated Solvency II Tier 2, the majority of survey respondents assess the potential multiple at approximately 1.55x for investment grade notes, and 1.65x for sub-investment grade notes. Nevertheless, the results show a high variance, especially on the investment grade side, which signals that the investor perception of the product is still developing.

In terms of loss absorption mechanism, investor friendly formats (temporary write-down, equity conversion) can carry an average 40bp premium over the permanent write-down structure for Solvency II Tier 1 instruments.

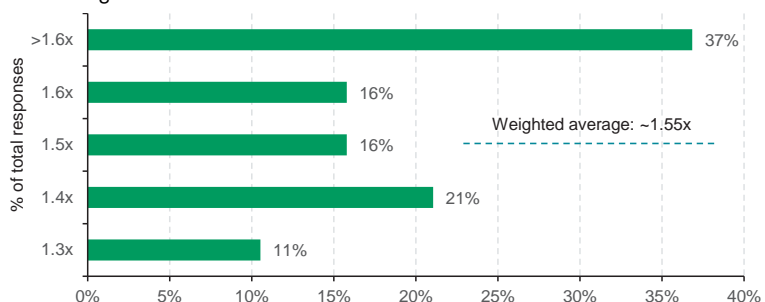
Respondents appear to appreciate the structural differences with bank AT1 instruments, mostly stemming from the absence of MDA restrictions on coupons, and lower constraints on write-up mechanism. 44% of the respondents see a Solvency II Tier 1 50bp tighter than a bank AT1 and 28% value the differential at 75bp.

Where should a Solvency II Tier 1 trade, relative to an undated Solvency II Tier 2 instrument, to compensate for the loss absorption features (fully discretionary non-cum coupons and trigger-based principal loss absorption)?

Sub-investment grade notes



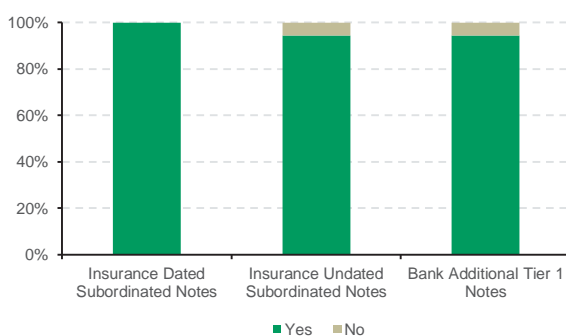
Investment grade notes



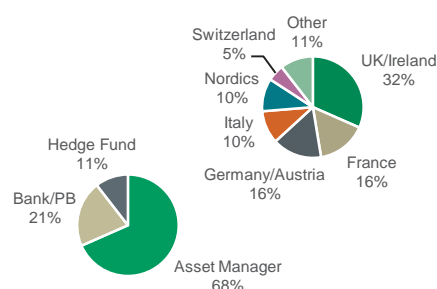
Respondent universe

We collected answers from a relevant sample of investors based in Europe (92%) and the US (8%), with the majority composed of asset managers (68%). All survey respondents are already active in insurance dated subordinated debt, 96% in insurance undated subordinated debt and 92% in bank Additional Tier 1 (AT1) instruments.

Are you active in the following markets?



Survey respondents by business category and region



Source: Crédit Agricole CIB

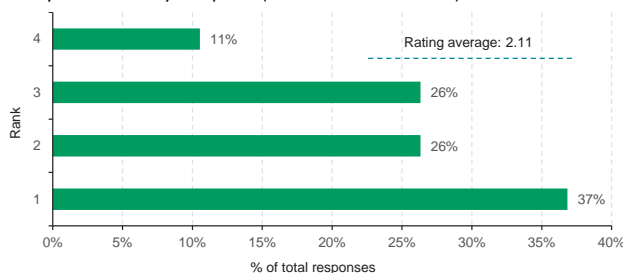
Perception of the main risk drivers of the spread differential

How do you rank the following drivers of the differential estimated in the previous question? (1 being the most important and 4 being the least important)

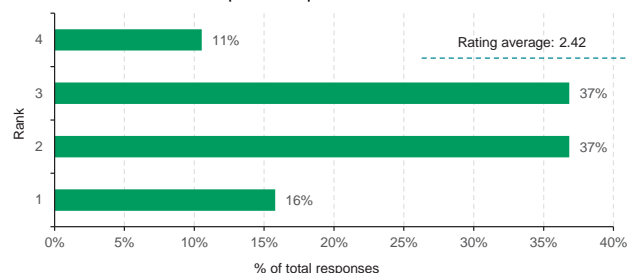
Respondents mainly identified potential restrictions on coupons (full discretion and distributable items cap) as the main drivers of the differential between undated Solvency II Tier 2 and Solvency II Tier 1.

Given the definition of trigger events, the bulk of investors (64%) believe that the SCR Margin should be above 180%. The disclosure of the Solvency II capital structure, including the composition of Tier 1 capital, was identified as the most important factor in the investors' analysis of an insurance capital instrument.

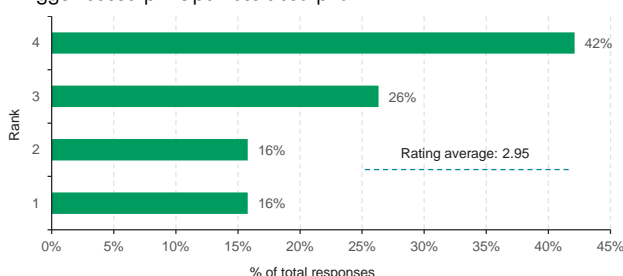
Fully discretionary coupons (non-cumulative basis)



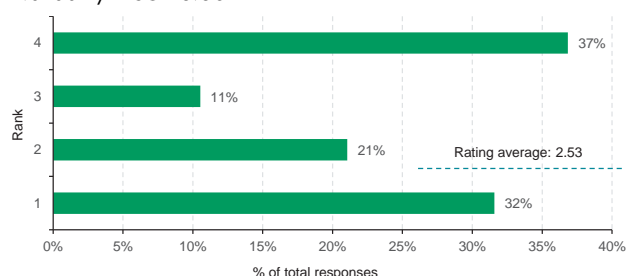
"Distributable items" cap on coupons



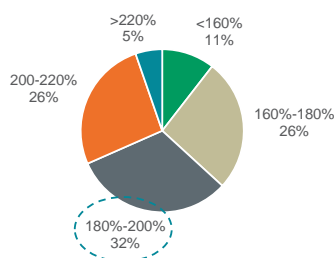
Trigger-based principal loss absorption



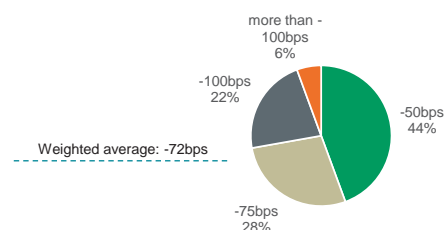
Variability in SCR levels



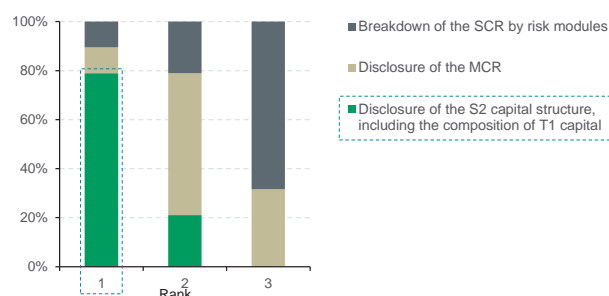
Given the definition of Solvency II Trigger Events, where should the SCR Margin be?



A Solvency II Tier 1 may be considered as relatively more investor friendly than a bank AT1 instrument (absence of MDA restrictions on coupons, less constraints on write-up mechanism). Under current market conditions, and assuming an identical credit strength, how much would you value the spread difference between the two instruments?



In addition to the SCR Margin, how do you rank the following criteria in your analysis of an insurance capital instrument?



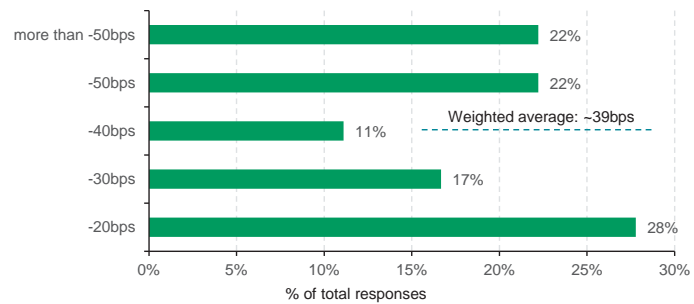
Source: Crédit Agricole CIB

Relative costs of forms of loss absorption mechanisms

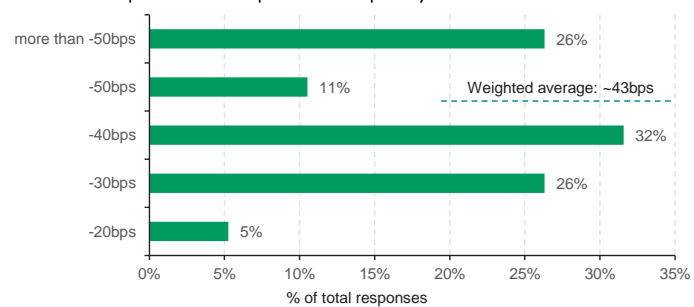
Where should the following Solvency II Tier 1 notes trade relative to an equivalent Solvency II Tier 1 with a permanent write-down mechanism?

Investor friendly formats can carry an average 40bp premium over the permanent write-down structure for Solvency II Tier 1 instruments.

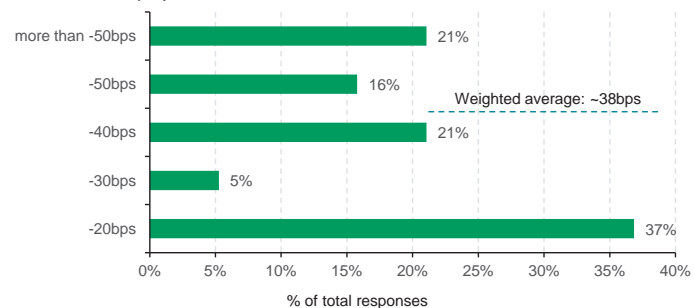
Solvency II Tier 1 with “digital” temporary writedown



Solvency II Tier 1 with “partial and sequential” temporary write-down



Solvency II Tier 1 with equity conversion



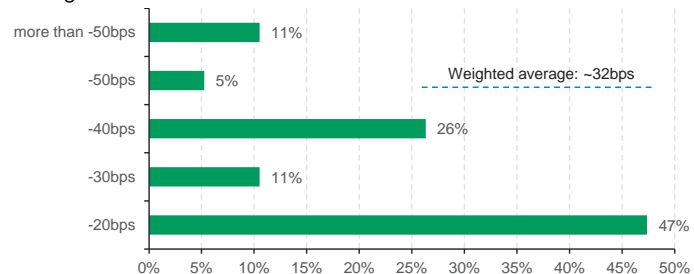
NB: Please note that, throughout the survey, weighted average figures assume mid-point of ranges or estimates based on the answers' intervals

Use of optional ACSM clauses

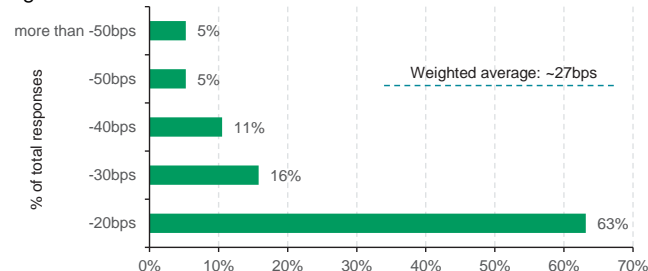
Since dividend stoppers or pushers are not permitted for Solvency II Tier 1 instruments, how much would you value the presence of an optional “Alternative Coupon Settlement Mechanism” (ACSM) clause in a Solvency II Tier 1?

Based on the weighted average of the responses, an optional “Alternative Coupon Settlement Mechanism” (ACSM) clause could compress the Tier 1 premium by approximately 25bp-30bp and potentially more for sub-investment grade notes. This is in line with the findings on the perception of the main risk drivers, which indicate a focus on coupon cancellation risk.

Sub-investment grade notes



Investment grade notes



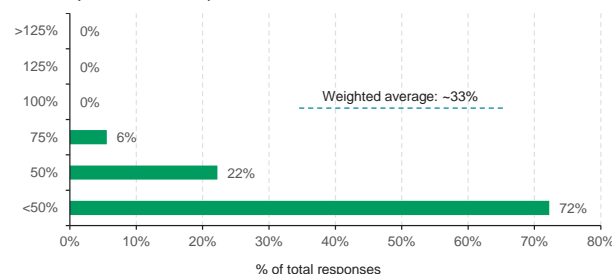
Source: Crédit Agricole CIB

Appetite for forms of loss absorption mechanisms

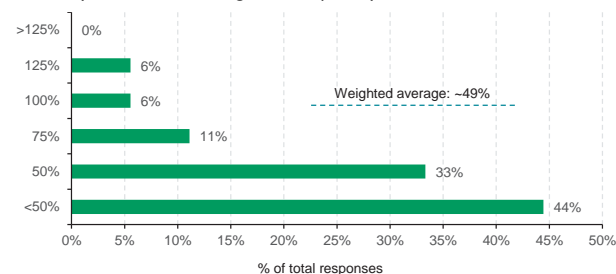
What would be your size appetite (as a percentage of your appetite for undated Solvency II Tier 2 instruments) for the following notes?

Overall, investors seem to show a lower appetite for Solvency II Tier 1 compared with undated Solvency II Tier 2, at least under current market conditions. In line with the results on relative value, permanent write-down is the least favoured loss absorption mechanism, as opposed to “partial and sequential” temporary write-down, which is confirmed to be the preferred format.

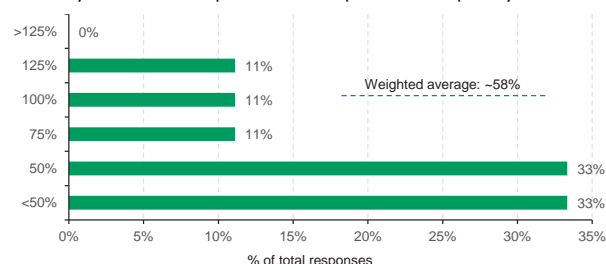
Solvency II Tier 1 with permanent writedown



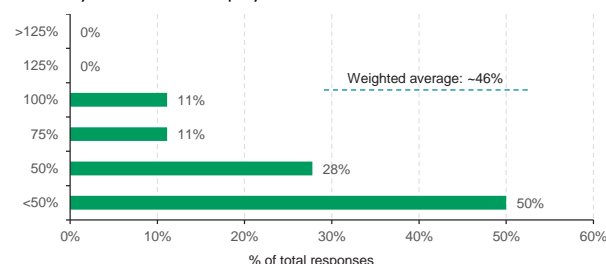
Solvency II Tier 1 with “digital” temporary writedown



Solvency II Tier 1 with “partial and sequential” temporary write-down



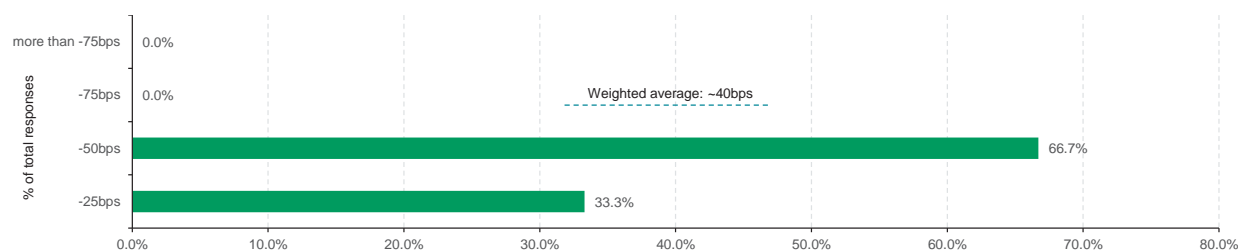
Solvency II Tier 1 with equity conversion



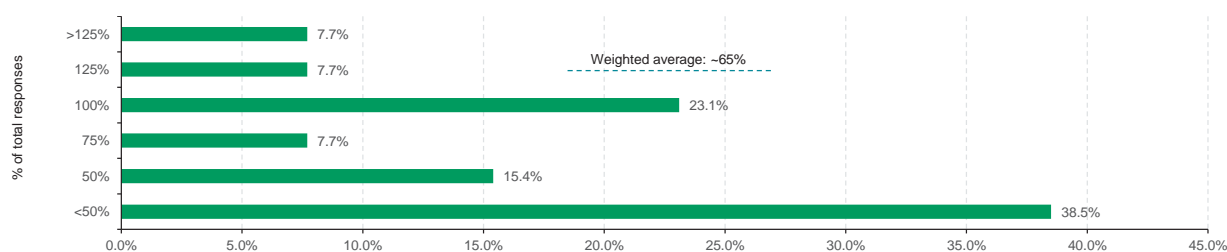
Solvency II Tier 3

We took this opportunity to also test investors’ perceptions of Solvency II Tier 3 instruments. Respondents seem to award an average 40bp spread differential to dated Solvency II Tier 3 instruments relative to dated Solvency II Tier 2 instruments with the same maturity. On the other hand, appetite appears to be in general more limited, although this could be the consequence of lower familiarity with the product.

Where should a 10 year Solvency II Tier 3 trade relative to a dated Solvency II Tier 2 instrument with an identical maturity?



Where should a 10 year Solvency II Tier 3 trade relative to a dated Solvency II Tier 2 instrument with an identical maturity?



Source: Crédit Agricole CIB

Tier 1 under Solvency II

A tool to satisfy capital requirements

As the details of the Solvency II are fleshed out, Hervé Ekué, partner, Allen & Overy LLP, Paris, offers an overview of Tier 1 issuances under the insurance industry framework.

In July 2007, the European Commission proposed a ground-breaking revision of EU insurance law designed to improve consumer protection, modernise supervision, deepen market integration and increase the international competitiveness of European insurers (and reinsurers). Under the new system, known as Solvency II (Directive 2009/138/EC dated 25 November 2009) and which will enter into force on 1 January 2016, insurers (or reinsurers) would be required to take account of all types of risk to which they are exposed and to manage those risks more effectively.

The aim of EU solvency rules is to ensure that insurance undertakings are financially sound and can withstand adverse events, in order to protect policyholders and the stability of the financial system as a whole. The pre-Solvency II EU solvency system was over 30 years old and financial markets had developed dramatically in the 2000s, leading to a large discrepancy between the reality of the insurance business today and its regulation. Also, many Member States had introduced their own additional rules at national level, leading to a range of different regulatory requirements across the EU, which ultimately was seen by many commentators as undermining the Single Market and especially hindering insurance groups. Solvency II replaces this patchwork of different rules, with a view to ensuring a level playing field and a uniform level of consumer protection and introducing more

sophisticated solvency requirements for insurers in order to guarantee that they have sufficient capital to withstand adverse events.

From 1 January 2016, insurers will also be required to focus on the active identification, measurement and management of risks, and to consider any future developments, such as new business plans or the possibility of catastrophic events, that might affect their financial standing. Solvency II is a risk-based system, meaning that capital requirements are set based on the underlying risks of the company.

The three pillar approach

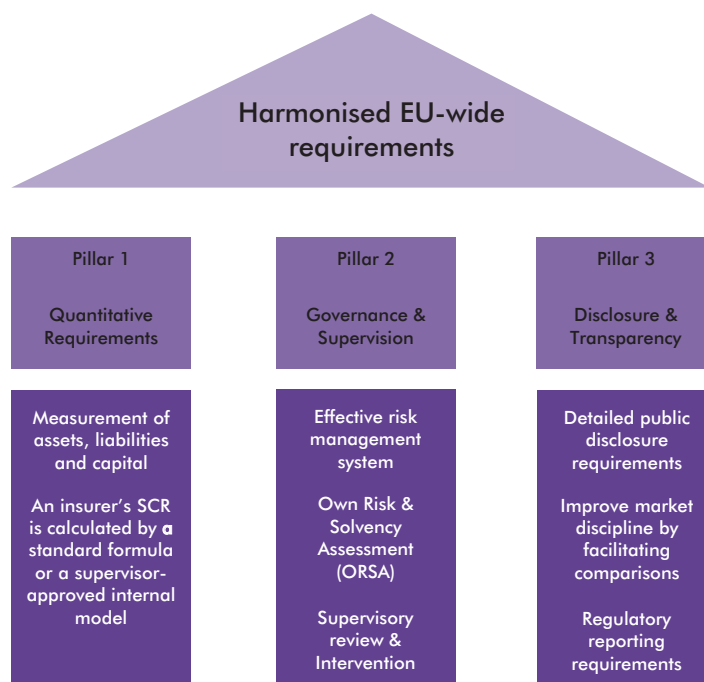
"Solvency II is not just about capital. It is a change of behaviour" — Thomas Steffen, former chairman of CEIOPS

Solvency II is based on a three-pillar approach, as illustrated in the accompanying diagram.

Often called "Basel for insurers", Solvency II is somewhat similar to the banking regulations of Basel II.

From January 2016, regarding Pillar 1, insurers will have to classify their own fund items into three tiers.

Regarding Pillar 2, insurers will have



Source: Allen & Overy

to undertake an Own Risk & Solvency Assessment (ORSA) and assess their capital needs in light of this assessment. Tier 1 assets play a crucial role in the ORSA.

Pillar 3 focuses on disclosure, reporting and transparency requirements around these risks and capital requirements, notably Tier 1 issuances.

Why issue Tier 1 instruments?

Capital requirements

Capital requirements are put on top of the technical provisions in order to cover unexpected losses *with a given confidence of 99.5% over a one-year time horizon*. To this end, a supervisory ladder of intervention is embedded in the system via the setting of two layers of capital:

- (i) the Solvency Capital Requirement (SCR) which has been determined as the economic capital to be held by insurance and reinsurance undertakings in order to ensure that ruin occurs no more often than once in every 200 cases;
- (ii) the Minimum Solvency Capital Requirement (MCR), which triggers ultimate supervisory action.

The own funds of the company obviously therefore play a key role. The Directive provides that own funds comprise the sum of “basic own funds” and “ancillary own funds”. Basic own funds which include in particular subordinated liabilities shall be classified into three tiers (referred to as Tier 1, Tier 2 and Tier 3 items, respectively) depending on various elements, including:

- (i) sufficient duration;
- (ii) absence of incentives to redeem;
- (iii) absence of mandatory servicing costs;
- (iv) absence of encumbrances; and
- (v) specific features (*please see “Key features of Tier 1 items” below*).

As far as compliance with the SCR is concerned, the eligibility of Tier 2 and Tier 3 items are subject to a double quantitative limit such that (i) the proportion of Tier 1 items must be higher



Hervé Ekué, Allen & Overy

than one-third of the total amount of eligible own funds and (ii) the eligible amount of Tier 3 items must be less than one-third of the total amount of eligible own funds. Quantitative limits also exist in relation to the MCR such that, as a minimum, the proportion of Tier 1 items in the eligible basic own funds must be higher than one-half of the total amount of eligible basic own funds. As a result of these rules, the majority of the eligible amount of own funds to cover the MCR and SCR should be composed of Tier 1 items.

According to findings published in June 2013 by the European Insurance & Occupational Pensions Authority (EIOPA), the average coverage rate of the SCR stood at 77% based on the 2011 financial statements, which could also be understood as revealing a collective capital shortfall of Eu90bn euros.

Impact of the Stress Test carried out by EIOPA

The 2014 Stress Test published by EIOPA on 28 November 2014 is the second such exercise to be carried out by EIOPA and represents a significant step forward in terms of technical specifications and methodology. EIOPA reported that in aggregate terms:

- (i) the overall surplus (i.e. own funds minus SCR) for the sample

was reported as Eu234.7bn, which represents a Eu637bn excess of assets over liabilities in absolute figures and a ratio of assets over liabilities of 110.1% (please note that the core sample includes 29 members of the so-called “Top-30” group).

(ii) the capitalisation levels of the sample of undertakings are solid, especially looking at the largest European insurers. There is, however, a significant minority of undertakings that do not meet the requirements of Solvency II in the baseline case.

In short:

- (i) In total, 86% of the Core Module participants (96% of the Top 30 sub-sample) reported a SCR ratio of 100% or better at year end 2013. More than 25% of the core module participants have a very strong starting position (SCR ratio > 200%).
- (ii) The 14% of participants that did not reach the 100% threshold represent only 3% of total sample assets. For the Top 30 participants, only one falls below the 100% SCR ratio in the baseline scenario.
- (iii) Quite importantly, a need for immediate restructuring of the composition of own funds was seen by 66%

of participants. It was felt that this restructuring would be attained through an increase of capital, a change of the investment portfolio, and other measures including subordinated debt capital raising and/or asset sales.

Key features of Tier 1 items

Based on the Level 1 and Level 2 texts of Solvency II that are now available — after completion by Directive 2014/51/EU dated 16 April 2014, the Omnibus II Directive — Tier 1 own funds should be made up of own fund items of a high quality and which fully absorb losses to enable an insurance company to continue as a going concern. The key features of Tier 1 items look very much like a long list of items that are to a certain extent unconnected and includes the following:

- (1) the item must be a lowest ranking debt instruments such that it ranks after Tier 2 and Tier 3 items and after the claims of all policy holders and non-subordinated creditors;
- (2) the item does not include features that may cause the insolvency or which may accelerate the process of the company becoming insolvent;
- (3) the item is immediately available to absorb losses and possesses

one of the loss absorbency mechanisms (such as write-down of the nominal amount) in case of non-compliance with the SCR;

(4) the item absorbs losses at least once there is non-compliance with the SCR;

(5) the item is undated and the first call date does not occur before year five from the date of issuance;

(6) redemption between year five and year 10 after the date of issuance is only allowed where the SCR is exceeded by an appropriate margin;

(7) the instrument is only repayable at the option of the issuer (i.e. no event of default and no investor put in any circumstance);

(8) any redemption is subject to the prior approval of the insurance regulator;

(9) the terms and conditions do not include any incentives to redeem the instrument that increases the likelihood that the insurer will redeem the instrument where it has the option to do so;

(10) the terms and conditions provide for the suspension of redemption of the instrument or payment of interest where there is non-compliance with the SCR or redemption or interest payment would

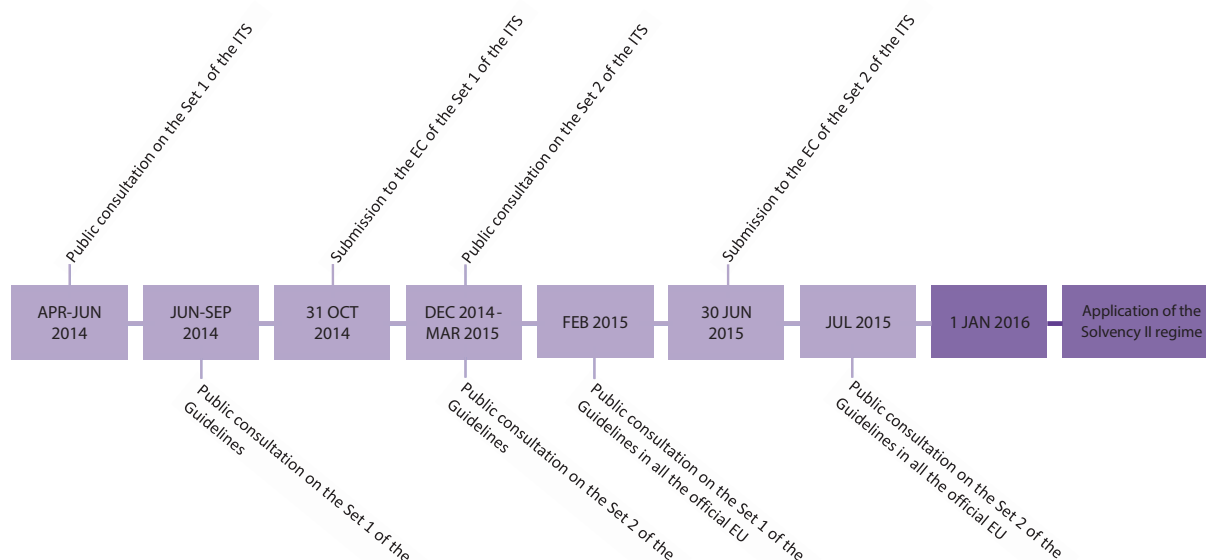
lead to such non-compliance and more generally payment of interest is always at the full discretion of the issuer on a non-cumulative basis (meaning that interest not paid on a given date is cancelled without this triggering any event of default or right of claim including in insolvency).

Not surprisingly, the devil is in the detail and, for instance, an area of particular focus will be the analysis of the provisions aiming at clarifying the concept of full flexibility over the payment of interest. Indeed the relevant provisions specify that full flexibility in this context means among others that distributions are paid “*out of distributable items*”. This criterion requires careful consideration when combined with certain other features.

More generally, it remains to be seen how these criteria will be applied in the terms and conditions of the Tier 1 instruments and the views of the regulators on these terms and conditions.

Solvency II: Next steps

EIOPA will issue a set of general, overarching recommendations addressing the follow-up actions set out in its June 2013 report. The key steps are summarised in the diagram below. ●



Source: Allen & Overy

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building SUCCESS together ✓

MARCH 2015

DEXIA
DEXIA CRÉDIT LOCAL
EUR 2,000,000,000
0.250% Senior Unsecured
Guaranteed Notes
Due 2020
Joint Bookrunner

MARCH 2015

MünchenerHyp
MÜNCHENER HYPOTHEKENBANK AG
EUR 750,000,000
0.50% Mortgage Pfandbrief
Due 2025
Joint Bookrunner

FEBRUARY 2015

Danske Bank
DANSKE BANK A/S
EUR 1,000,000,000
0.250% Covered Bond
Due 2020
Joint Bookrunner

FEBRUARY 2015

National Australia Bank
NATIONAL AUSTRALIA BANK
EUR 1,000,000,000
0.875% Covered Bond
Due 2027
Joint Bookrunner

FEBRUARY 2015

COMPAGNIE DE FINANCEMENT FONCIER
COMPAGNIE DE FINANCEMENT FONCIER
EUR 1,000,000,000
0.125% Covered Bond
Due 2020
Joint Bookrunner

FEBRUARY 2015

Belfius
Banque & Assurances
BELFIUS
EUR 1,000,000,000
0.75% Covered Bond
Due 2025
Joint Bookrunner

JANUARY 2015

CRÉDIT IMMOBILIER DE FRANCE
CAISSE CENTRALE DU CRÉDIT
IMMOBILIER DE FRANCE
EUR 850,000,000
0.125% Senior Unsecured
Guaranteed Notes
Due 2020
Joint Bookrunner

JANUARY 2015

CréditMutuel Arkéa
CRÉDIT MUTUEL ARKÉA
EUR 500,000,000
1% Senior Unsecured Notes
Due 2023
Joint Bookrunner

JANUARY 2015

INTESA SANPAOLO
INTESA SANPAOLO S.p.A.
EUR 1,000,000,000
OBG
0.625% Notes
January 2022
Joint Bookrunner

JANUARY 2015

BBVA
BANCO BILBAO VIZCAYA
ARGENTARIA S.A.
EUR 1,250,000,000
0.75% Cédulas Hipotecarias
Due 2022
Joint Bookrunner

JANUARY 2015

ING
ING BANK N.V.
EUR 1,500,000,000
0.7% Senior
Unsecured Notes
Due 2020
Joint Bookrunner

JANUARY 2015

PRUDENTIAL
PRUDENTIAL PLC
GBP 300,000,000
1.375% Senior Unsecured
Due 2018
Joint Bookrunner

Crédit Agricole Corporate and Investment Bank is authorised by the Autorité de Contrôle Prudentiel et de Résolution (ACPR) and supervised by the ACPR and the Autorité des Marchés Financiers (AMF) in France and subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority in the United Kingdom. Further details about our regulation are available upon request.