Nov-Dec 2015

Bank+Insurance HybridCapital

Dutch enter new era

AT1 arrives, but latest proposals raise concerns

Bank resolution
New strategies

TLAC
Finally finalised

MuniFin
SSA AT1 first

building success together

NOVEMBER 2015

ING BANK N.V.

EUR 500,000,000
0.750% Senior Unsecured Notes Due 2020

USD 800,000,000
4.375% Unsecured Notes Due 2018 Green Bond

Joint Bookrunner

NOVEMBER 2015

BANCO BILBAO VIZC AYA ARGENTINA S.A.

EUR 1,250,000,000
0.625% Cédulas Hipotecarias Due 2021

Joint Bookrunner

NOVEMBER 2015

CAIXABANK S.A.

EUR 1,000,000,000
0.625% Cédulas Hipotecarias Due 2020

Joint Bookrunner

OCTOBER 2015

UBI BANCA

EUR 750,000,000
1.000% OBG Due 2023

Joint Bookrunner

OCTOBER 2015

WELLS FARGO & CO

EUR 1,500,000,000
2.0% Senior Unsecured Bond Due 2026

Joint Bookrunner

OCTOBER 2015

ROYAL BANK OF CANADA

EUR 1,000,000,000
3mE+43 bps Senior Unsecured Notes Due 2018

Joint Bookrunner

SEPTEMBER 2015

ARKEA HOME LOANS SFH

EUR 500,000,000
0.625% Covered Bond Due 30th September 2022

Joint Bookrunner

SEPTEMBER 2015

KUTXABANK S.A.

EUR 1,000,000,000
1.25% Cédulas Hipotecarias Due 2025

Joint Bookrunner

SEPTEMBER 2015

CARIPARMA S.P.A

EUR 1,000,000,000
0.875% OBG June 2023

Joint Bookrunner

SEPTEMBER 2015

LBBW

EUR 1,000,000,000
0.875% September 2025 Public Sector Pfandbrief

Joint Bookrunner

SEPTEMBER 2015

LLOYDS BANK PLC

EUR 1,250,000,000
0.625% Covered Bond Due 2022

Joint Bookrunner

SEPTEMBER 2015

BAYERISCHE LANDESBANK

EUR 500,000,000
0.875% September 2025 Public Sector Pfandbrief

Joint Bookrunner

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CRÉDIT AGRICOLE CORPORATE & INVESTMENT BANK

Bank+Insurance Hybrid Capital

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Bank+Insurance Hybrid Capital

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We're not quite back in Kansas

Was it all a nightmare?

I have a rather bizarre memory of some guy with a penchant for Burberry scarves threatening to implode the Eurozone. Then there was something about big trouble in big China.

And that guy in Frankfurt… He couldn't have cared less. Get used to it? Thanks for nothing, Mario. The less said about regulators the better.

Seriously, did we really make it through all that?

It appears so.

Indeed when it comes to hybrid capital, not only did we survive, but we came out alive and kicking.

Who can argue with AT1 achieving the best returns in the credit markets? Those who braved the subordinated markets in 2015 can be pleased with their call.

Supply may have disappointed, but this at least eased pressure on spreads and allowed the maturing asset class of AT1 to find a better equilibrium, while Tier 2 avoided a potentially dangerous deluge.

Are we home and dry?

Not quite, Dorothy.

Federal Reserve chair Janet Yellen is not the Wicked Witch of the West and is cognisant of the tornado that rising US rates could unleash on the financial markets, but they may prove to be forces beyond her control.

Regulators, meanwhile, will continue to pull the levers behind the curtain, but can they be trusted? The final TLAC terms sheet released in November sprung no nasty surprises. However, we may yet be humbugged as further details emerge on MREL, Pillar 2, RWA floors and the like.

Those looking for some place where there isn't any trouble might therefore wish to search elsewhere.

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Market news

Happy AT1 returns seen despite quiet Q4

After a handful of deals in September, Additional Tier 1 (AT1) issuance in the last quarter of 2015 was confined to just one benchmark, but market participants said the lack of supply does not hold any negative implications for the asset class and that indeed the outlook for 2016 is promising.

Only Allied Irish Banks (AIB) tapped the market with a public AT1 issue in the last quarter, selling a Eu500m perpetual non-call five on 26 November *(see separate article for more)*, which took AT1 issuance for the year to some Eu29bn on the back of some Eu10.5bn of supply in the third quarter, including in September names such as HSBC, Intesa Sanpaolo and Société Générale.

However, market participants said that the lack of supply is from a position of strength, rather than weakness.

"There was a bit of a risk-off phase, with the global growth scare in September/October, and then we now have the issue of rising US rates," said Dierk Brandenburg, senior credit analyst at Fidelity. "So it's not been a good time to buy, and those issuers who could afford to hold off did so — most issuers have enough capital right now so they are not forced into the market at any price, and that helps.

"Otherwise, we had three new issuers coming to the market, and that shows that the product remains attractive," he added, noting, besides AIB, ABN Amro and Municipality Finance debuts in September *(see separate articles for more)*. "There may be a bit of a macro overhang from the US, but come next year, I would expect issuance to resume."

The asset class has meanwhile held its own in the secondary market, according to market participants. Nigel Brady, credit financials trader at Crédit Agricole CIB, noted, for example, that AT1 outperformed amid broader market weakness at the beginning of December.

"What has been notable is how relatively stable the AT1 market has been," he said. "Even when you saw the iTraxx Main gap out 10bp-12bp, so 10%-15%, you were looking at 2 to 4 points in AT1, which is actually only 2%-4%.

"And the stability of AT1 compared to other asset classes is helping the product."

According to Brady, this is tied in with the continued development of the investor base.

"A sea change has been the growth in dedicated CoCo funds," he said. "Because AT1 remains outside investment grade mandates, there have been a lot of new funds set up specifically to buy this product and therefore remain outside investment grade restrictions, and they have been some of the biggest players."

Such factors have contributed to a stellar year for AT1 in terms of returns. According to figures from Markit and Crédit Agricole CIB, CoCo AT1 returned 6.6% in 2015, making it the best-performing asset class *(see chart opposite)*.

"Overall it's been quite a good year for CoCos, despite the supply and despite the volatility we had on the rates side," said Brandenburg at Fidelity. "And the argument for generating strong carry out of this market, that's going to be as relevant next year as it was this year."

Brady and his colleagues at Crédit Agricole CIB forecast some Eu40bn of AT1 supply in 2016, compared with this year's Eu29bn and some Eu42bn in 2014. But despite the pace picking up again, he does not anticipate supply pressures being an issue.

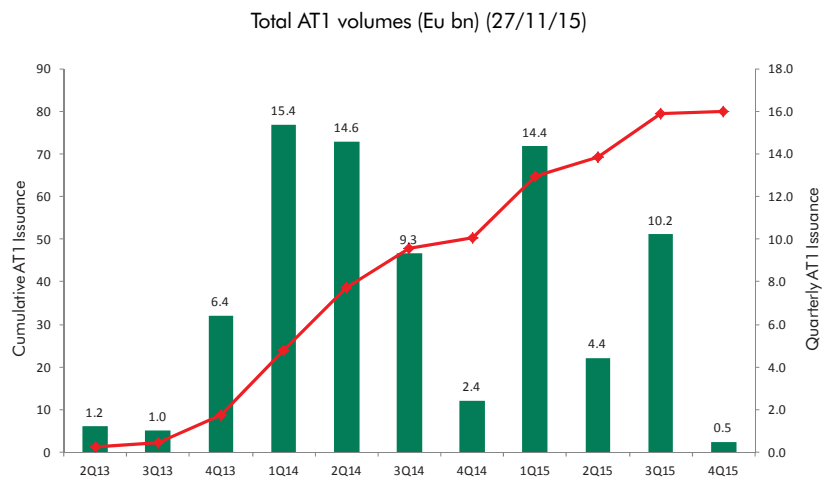
"We are well past the hump of the issuance," said Brady. "People were scared of the figures that were being forecast — and we had our shaky moments back in 2014 and even in February this year — but generally the market has managed to digest it.

"The perception now is that ongoing issuance is going to be a lot more opportunistic."

However, Vincent Hoarau, head of FIG syndicate at Crédit Agricole CIB, noted the wider market volatility in the run-up to the FOMC and sounded a note of caution about potential widening in the subordinated/hybrid space in the medium term.

"Expectations for the first quarter of 2016 are that there will be a large

Strong AT1 supply expected in 2016



Source: Markit, Crédit Agricole CIB

amount of Tier 2 transactions, new AT1 issuers and continued heavy supply in insurance Tier 2," he said. "Those factors will increase pressure on issuers and further challenge performance.

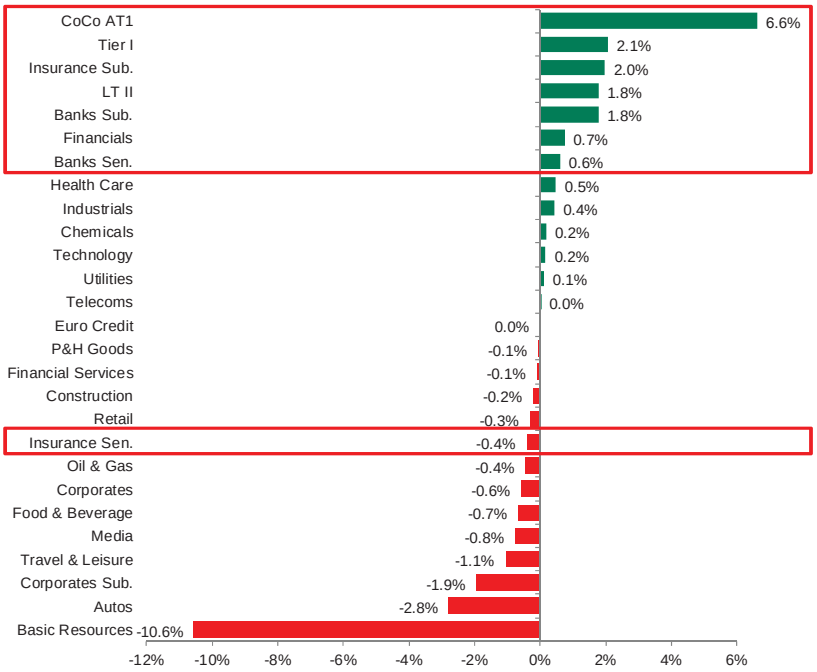
"New issue premiums are set to increase or remain elevated across asset classes, with investors wanting to be fairly rewarded for the risk they are taking in primary, and to absorb potential upcoming shocks in capital markets. 2016 will be another challenging year with intense periods of volatility, and we may again see the stop-go, window-driven markets that characterised 2015, before things hopefully normalise in H2."

Hoarau also highlighted that regulatory developments could again impinge on market dynamics.

"Meanwhile uncertainties regarding the treatment of senior debt or Pillar 2 disclosures remain intact," he added. "These are negative factors for spread performance in senior and Tier 2, and sub-optimal for AT1 issuance." ●

Financials outperform corporates in 2015 returns

Total returns within iBoxx Credit Index 2015 to 27/11/15



Source: Markit, Crédit Agricole CIB

IRELAND

AIB in two step capital comeback

Allied Irish Banks on 26 November launched the f rst Additional Tier 1 transaction in euros in two months, a Eu500m perpetual non-call f ve deal that came just a week after the Irish bank made its return to the subordinated debt market with a Eu750m 10NC5 Tier 2 issue.

The two transactions were launched alongside the implementation of other capital measures and among wider restructuring at the f nancial institution, and aimed towards the repayment of Eu1.7bn to the Irish state by the end of the year, with a move to privatisation possible in 2016.

"These issuances are key stepping stones in ensuring the completion of the simplif cation of our capital structure by the end of 2015," said Bernard Byrne, chief executive off cer of AIB.

"This will enable the repayment of capital to the state and positions us well for a return to private ownership."

Leads Bank of America Merrill Lynch, Davy Stockbrokers, Deutsche Bank, Goodbody Stockbrokers, HSBC and Morgan Stanley skipped initial price thoughts and went out with guidance of the 7.5% area for the PerpNC5 temporary write-down AT1 securities, rated B- by Fitch, before f xing the pricing at 7.375% on the back of some Eu4.75bn of demand.

Philip O'Sullivan, chief economist at Investec Ireland, said that the level was an excellent result for AIB.

"Indeed, the issue was more than nine times oversubscribed at this level, testament to the substantial progress AIB has made in recent years from both a prof tability and a capital perspective," he added.

A week earlier, on 19 November, AIB had attracted Eu5bn of demand for its Eu750m 10NC5 Tier 2 issue. Leads BNP Paribas, Deutsche, Goodbody, Morgan Stanley, Nomura and UBS priced the issue at 395bp over mid-swaps and a yield of 4.153% on the back of some Eu5bn of orders comprising over 300 accounts.

"The outstanding success of our two recent capital raising transactions is very encouraging," said Byrne at AIB. "The results demonstrate market conf dence in AIB as an issuer.

"The signif cant participation by overseas investors, in both transactions, is an endorsement and acknowledgement of the progress that the bank has made in recent years in restructuring and repositioning itself as a sustainable, prof table and investable business." ●

Nordea blowout reopens Tier 2 after hiatus

Nordea attracted over Eu4.5bn of demand for a Eu750m (Skr7bn) 10 year non-call five Tier 2 issue on 2 November that was the first investment grade Tier 2 transaction since the beginning of September, paving the way for a series of its peers to follow.

"It certainly was a blowout and a very encouraging response," said a syndicate official away from the leads. "You would think that would be enough to reawaken the market, which is now clearly wide open."

Nordea Bank leads BAML, Goldman Sachs, Nordea and Société Générale launched the new issue with initial price thoughts of the 185bp over mid-swaps area, before moving to guidance of the 170bp-175bp area and setting the size at Eu750m with order books in excess of Eu3.5bn. The book then closed at over Eu4.5bn with more than 250 accounts, before the spread was fixed at 170bp. The deal was trading around 10bp tighter by the next morning.

An official at one of Nordea's leads said the deal offered a limited new issue premium of around 18bp, based on the secondary level of other Swedish Tier 2 issues, with Handelsbanken Tier 2s callable in January 2019 seen at 130bp, Swedbank callable February 2019s at 135bp, and SEB callable May 2021s at 164bp.

The new issue was Nordea's first euro denominated Tier 2 trade since 2012 and followed a Skr4bn (Eu434m) transaction of a similar structure in early September.

Fund managers took 62% of the deal, pension funds and insurance companies 26%, central banks and official institutions 4%, banks 2%, and others 6%. Investors from the UK and Ireland were allocated 32%, France 23%, the Benelux 16%, Germany, Austria and Switzerland 13%, the Nordics 12%, southern Europe 3%, and others 1%.

Barclays followed Nordea two days later, taking over Eu5bn of orders for a Eu1.25bn 10NC5 Tier 2 that was the first such issue out of its holding company. Syndicate officials said it was surprising that there had not been more activity that week, given supportive issuance conditions and the impressive books built by Nordea and Barclays.

"It's hard to see why there's not been more supply," said one. "Most issuers are out of blackouts and the market feels good."

The following Tuesday La Banque Postale and Nykredit Realkredit duly obliged with 12NC7 Tier 2 issues.

> 'It's hard to see why there's not been more supply'

La Banque Postale's Eu750m deal proved a hit, attracting more than Eu3.25bn of orders from around 270 accounts, with the level of demand allowing leads Barclays, BNP Paribas, Citi, Crédit Agricole CIB and UBS to tighten from IPTs of the mid-swaps plus 240bp area to guidance of 225bp-230bp and ultimate pricing of 225bp over. The leads put the new issue premium at slightly below 15bp, and the deal tightened a couple of basis points in the aftermarket.

Nykredit Realkredit attracted more than Eu2bn of demand for its Eu800m 12NC7 issue after having announced its third quarter results the previous week. According to Morten Bækmand Nielsen, head of investor relations at Nykredit, the issuer had been ready to approach the market for several months and was encouraged by the reopening of the sub debt market by Nordea.

"It was encouraging that you had such a name as Nordea going out and printing," said Bækmand. "Up until then we had seen new issue premiums going out and out and out, but that kind of stabilised things.

"We were then able to dip our toes into Tier 2 ourselves, and into calmer waters, so that helped us a lot."

Leads BNP Paribas, Goldman Sachs, JP Morgan, Natixis and Nykredit went out with IPTs of the 235bp over mid-swaps area, then set guidance at 220bp-225bp, and priced the issue at 220bp over.

"It was a very, very strong book," said Bækmand, "and we were quite impressed by its depth and breadth. It was very broad-based, and with a lot of good names, as well as geographically diverse."

However, Nykredit's issue underperformed relative to La Banque Postale.

"We feel that we priced it right versus comparables and given market conditions," Bækmand. "It was a bit disappointing that it traded wider, but we had the impression that this was due to technical factors." ●

Santander returns to US with $1.5bn T2

Banco Santander launched its first subordinated transaction in eight months on 12 November, a $1.5bn (Eu1.38bn) 10 year bullet that represented a return to the US dollar Tier 2 market for the Spanish national champion.

Santander's last visit to the subordinated debt market had been in March, when it sold a Eu1.5bn Tier 2 transaction.

"Our issuance plans for 2015 called for two benchmark Tier 2 transactions, as we are gradually building our 2% Tier 2 buffer," said Antonio Torío, head of funding at Santander. "We had successfully accessed the market in the first quarter of the year with a euro 10 year bullet and felt the market was receptive for a new transaction.

"In this context, Banco Santander had not been present in the US Tier 2 space for a few years, and felt a US dollar transaction was a good complement to the euro trade. It added diversification and broadened the investor base."

Given the strategic nature of the transaction, the issuer conducted investor meetings on the US East Coast on the Tuesday before launch and received encouraging feedback.

After a public holiday in the US on the Wednesday and a global investors call on Thursday morning EST, leads BAML, Crédit Agricole CIB, Morgan Stanley and Santander went out with initial price thoughts of Treasuries plus the high 200s.

Orders approached $2bn within two hours and after guidance was set at Treasuries plus 285bp the deal was ultimately priced at that level with a $1.5bn size on the back of a $2.6bn book comprising some 170 investors.

"The transaction went very smoothly and its price and volume were within our expectations," said Torío.

US investors were allocated 85% of the SEC-registered deal, Europe 7% and Canada 5%. Asset managers took 79% and insurance companies and pension funds 13%. ●

League tables

Bookrunners all European FI hybrids (euros and US dollars) 01/01/2015 to 14/12/2015

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	UBS	23	8,858	9.7
2	HSBC	21	8,282	9.1
3	BNP Paribas	24	6,967	7.6
4	Deutsche Bank	26	6,398	7.0
5	Barclays	20	6,010	6.6
6	Crédit Agricole CIB	10	5,614	6.1
7	BAML	25	5,602	6.1
8	JP Morgan	28	5,285	5.8
9	Citi	23	4,945	5.4
10	Morgan Stanley	25	4,607	5.0
11	Goldman Sachs	21	3,873	4.2
12	Société Générale CIB	14	3,819	4.2
13	Credit Suisse	10	2,794	3.1
14	Natixis	13	2,177	2.4
15	RBS	6	1,722	1.9
	Total	149	91,382	

Source: Dealogic, Thomson Reuters, Crédit Agricole CIB

Bookrunners all financials (euros) 01/01/2015 to 14/12/2015

	Managing bank or group	No of issues	Total EUR m	Share (%)
1	BNP Paribas	80	17,650	8.5
2	Deutsche Bank	72	14,711	7.1
3	UBS	46	13,729	6.6
4	Société Générale CIB	48	12,929	6.2
5	Goldman Sachs	46	12,482	6.0
6	JP Morgan	65	11,064	5.3
7	HSBC	51	10,045	4.8
8	Crédit Agricole CIB	27	9,876	4.8
9	Barclays	61	9,501	4.6
10	Morgan Stanley	47	8,593	4.1
11	Natixis	28	7,827	3.8
12	Citi	44	7,620	3.7
13	Credit Suisse	32	5,607	2.7
14	UniCredit	42	5,488	2.6
15	BAML	33	5,297	2.6
	Total	433	207,632	

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

CNP, Scor in uplifting insurance coda

CNP Assurances and Scor SE provided some year-end cheer for the insurance sector at the beginning of December with Eu750m and Eu500m subordinated bond issues, respectively, that represented the first such benchmark euro issuance in six weeks.

The last previous euro benchmark in insurance sub debt had been a Eu1.25bn 32 year non-call 12 Tier 2 issue for Generali on 20 October, and since then issuance had been confined to smaller trades or sterling.

However, the two French insurance companies were able to benefit from improved market sentiment to successfully reopen the sector.

CNP Assurances returned just over a year after its last issue, a Eu500m PerpNC10 issue in November 2014, to sell a 31.5NC11.5 Tier 2 issue on 1 December via Barclays, JP Morgan, Natixis and UBS. They went out with initial price thoughts of the mid-swaps plus 370bp area and then guidance of 360bp-365bp before pricing the Eu750m BBB+ (S&P) issue at 360bp over, with a coupon of 4.5%.

Scor went out with its Eu500m 30NC10 Tier 2 issue the next day, launching its deal ahead of the August 2016 call date of a Sfr600m (Eu554m) subordinated issue, which the new transaction was intended at refinancing. Its last deal had been a Eu250m 32NC12 Tier 2 at the beginning of June.

Leads Barclays, BNP Paribas, Citi, Crédit Agricole CIB, Deutsche Bank and Natixis priced the A/A- (S&P/Fitch) deal at 225bp over mid-swaps on the back of more than Eu2.3bn of demand following IPTs of the 240bp area and guidance of 225bp-230bp. Robert Chambers, FIG syndicate at Crédit Agricole CIB, said the new issue premium paid by Scor was comparable to CNP Assurances's, compared to their dated curves, noting that Scor's 3.25% 2047NC27 was trading at around swaps plus 195bp. However, he noted that Scor came much further inside its outstanding perpetual than did

CNP Assurances, and, given that Scor's dated comparable was squeezed, its new issue premium was arguably lower.

France and the UK were the largest takers of Scor's issue, which Chambers put down to the Eu500m size.

"They did Eu500m for the first time in the last three deals," he said, "and it actually opened up a new buyer base, particularly in the UK, with investors who need that minimum Eu500m size."

The structure of the CNP Assurances and Scor trades included new tweaks to their gross-up language to reflect the recent opinion of French regulator ACPR of gross-up being an incentive to redeem. Under CNP's structure, optional early redemption following a gross-up or withholding tax event is only possible after 10 years, as is the payment of additional amounts, while mandatory redemption for tax (gross-up) reasons has been removed.

Michael Benyaya, DCM solutions at Crédit Agricole CIB, noted that Scor's trade also absorbed the ACPR's position, although it includes an automatic alignment event in case the regulator changes its view on gross-up.

Post-summer blues

The insurance sector had not reopened with Eu500m-plus deals in the autumn until Danica Pension and ASR Nederland launched Eu500m 30NC10 issues on 21 and 22 September, respectively. They did so after roadshows, but not before concerns about the Chinese economy and volatility caused by anticipation of a Fed rate hike complicated their plans. The Danish and Dutch insurers ended up paying new issue premiums that market participants put at as much as 60bp.

"Danica Pension and ASR Nederland both got caught up a bit in that volatility in mid-September and ended up paying larger premiums because of the unfortunate timing," said Chambers, "and so the insurance hybrid market in euros was kind of the visible point for that volatility."

Generali's deal a month later impressed with a book of almost Eu5bn *(see separate article for further details)*, and Chambers noted that the premiums paid by CNP Assurances and Scor represented a further recovery in the levels required of the sector, but said that they remain slightly above those demanded in the bank capital space.

"We have seen bank capital trades with new issue premiums as tight as 5bp, and with the standard about 15bp-20bp," he said. "The insurance structures are a little bit riskier, with their deferrable coupons, but it is more a question of the insurance sector having got caught in the crossfire and not having had much of a chance to show its strength since then."

The sector's challenges did not stop activity picking up in the UK, where Legal & General on 19 October sold the largest post-summer sterling issue, a £600m (Eu833m) 30NC10 deal, and was followed by smaller issues including a £275m 30NC10 debut for Hiscox on 17 November that attracted over £2bn of demand.

2015 is set to conclude without the arrival of much-anticipated Solvency II Tier 1 structures from the insurance industry, with market participants now expecting such instruments to arrive later in 2016.

"We have seen a lot of issuers focusing on the 30NC10 structure whilst we wait for further clarity on potential Tier 1 issuance under Solvency II," said Chambers. ●

Generali Eu1.25bn Tier 2 impresses

Assicurazioni Generali on 20 October sold the largest euro-denominated insurance sub debt issue since March, a Eu1.25bn 32 year non-call 12 Tier 2 issue on that attracted almost Eu5bn of demand and helped the sector onto a firmer footing after signs of weakness in previous supply.

The Italian company's deal was the first benchmark insurance sub debt in euros in almost a month, since Danica Pension and ASR Nederland had on September 21 and 22, respectively, sold Eu500m 30NC10 transactions into a difficult market *(see separate article for more)*. The issue was the largest since Allianz at the end of March sold a Eu1.5bn 30NC10 deal that was the largest euro-denominated insurance sub debt transaction of the year.

Generali's new benchmark was its first visit to the debt capital markets in almost a year, after it in early November 2014 had launched a tender offer for three outstanding subordinated issues and sold a new Eu1.5bn PerpNC11 deal.

Its latest transaction was launched to refinance some Eu1.25bn equivalent of subordinated debt that has its first call in June 2016.

"Our policy is to have a proactive approach to the debt capital markets in order to maintain our high flexibility as we have demonstrated also in the past," said Andrea Nobile, head of debt management at Generali. "And in addition to that it is market standard to refinance a strategic transaction a few months in advance."

He acknowledged that the market had not been wholly auspicious, but said that Generali's status among investors had stood it in good stead.

"Investor sentiment towards our issuance was really positive," said Nobile. "In recent years the Generali Group has done a lot of work to strengthen the relationships with credit investors around Europe, so as to establish an open and constructive dialogue with them.

"All of them were expecting this refinancing," he added, "and that's why we think the transaction was so well received by the market. We have been able to issue in stressed market situations thanks to the good perception of credit investors."

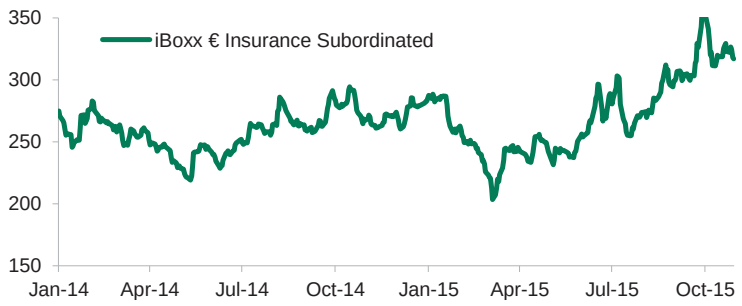
Lead managers Banca IMI, Barclays, Citi, Mediobanca, Morgan Stanley and UBS priced the Eu1.25bn 32NC10 Baa3/BBB/bbb+ (Moody's/Fitch/AM Best) issue at 435bp over mid-swaps on the back of almost Eu5bn of orders comprising around 400 accounts. The re-offer of 435bp followed initial price thoughts of the 450bp area and guidance of the 440bp area, and gave a coupon of 5.5%.

"The level of pricing is in line with our target and with the cost of the refinanced bonds, also thanks to the high quality of the book, which was around four times covered," said Nobile.

The UK and Ireland took 49% of the issue, Italy 11%, France 9%, Germany 9%, and the Nordics 4%, with Asia also allocated.

After the refinancing of Generali's sub debt callable in June 2016, the next earliest callable subordinated debt has a first call date in February 2017. Nobile meanwhile said that the company does not plan to increase its stock of debt and hence has no plans to issue additional debt. ●

Secondary insurance subordinated indices



Source: Markit, Crédit Agricole CIB

TLAC term sheet **Finally finalised**

The Financial Stability Board (FSB) and Basel Committee on Banking Supervision released the f nal term sheet for TLAC (total loss-absorbing capacity) on 9 November ahead of its adoption at the G20 meeting in Ankara, Turkey. This was largely unchanged from a version leaked in August and subsequent pointers. Here, we highlight selected items of interest from the f nal text.

TLAC term sheet: Key points of interest	
Calibration	• Minimum risk-weighted assets (RWA) requirement: set at 16% on 1/1/2019, increasing to 18% by 1/1/2022. Buffers apply on top of these minima • Min. leverage ratio exposure (LRE) requirement: set at 6% on 1/1/2019, increasing to 6.75% in 2022, including buffers (i.e. these are not on top) • These are Pillar 1 minimum requirements. Discretion left to national authorities to "gold plate" requirements, e.g. through f rm-specif c requirements, if this is required to ensure an orderly resolution strategy
Effective Date/ Conformance Period	• For 2015 G-SIBs remaining G-SIBs until end-2018: 1/1/2019 • For new G-SIBs between 2016-end 2018: 2022 min. requirements apply, as of 1/1/2022 • For new G-SIBs after periods above: 36 months to comply with 2022 requirements after designation as G-SIB • For EME G-SIBs: 2019 min. requirement apply from 2025, 2022 requirements apply from 2028 • Acceleration if EME's debt capital markets, excl. SSA issuers, exceed 55% of relevant EME country GDP, but same 6 year two-step conformance period applies
Eligible Regulatory Capital Instruments	• CET1 ex amounts allocated to meeting buffers, Additional Tier 1 and subordinated Tier 2 debt • CET1 capital issued by subsidiaries will count in TLAC, subject to minority interest haircuts, at all times • AT1 and Tier 2 issued by subsidiaries, subject to minority interest haircuts, will count in TLAC until 1/1/2022 (s.t. conditions) • Thereafter, AT1 and Tier 2 only issued by the resolution entity(ies) will count towards TLAC • Exception from the above AT1/T2 limitation only for cooperative banks "that have in place an institution-al protection scheme or other cooperative mutual solidarity system that protects the solvency and liquidity of the aff liated cooperative banks and institutions"
Minimum TLAC eligible debt requirement	• 33% of minimum TLAC requirement to be fulf lled by (i) AT1 and Tier 2 debt instruments and (ii) other TLAC-eligible debt instruments not included in regulatory capital
Maturity and Redemption Restrictions	• No debt instruments with residual maturity of less than one year can count in the TLAC computation (incl. T2) • Issuer calls subject to regulatory approval if calling the issue would result in breach of TLAC • Investor puts only allowable if time between put announcement and actual redemption > 1 year

Source: Crédit Agricole CIB

Role of Senior Unsecured Instruments

A list of TLAC-excluded liabilities is included in the FSB TLAC term sheet. It is broad enough to include the liabilities excluded by the local statutory framework, so it should absorb the Bank Recovery & Resolution Directive (BRRD) in the EU. However, liabilities arising from derivatives are explicitly excluded from TLAC, while they can, under certain assumptions, be subject to write-down and conversion powers under Art. 49 of the BRRD.

TLAC-Excluded Liabilities
Insured deposits
Sight deposits and short term deposits (deposits with original maturity of less than one year)
Liabilities that are funded directly by the issuer or a related party of the issuer, except where the relevant home and host authorities in the crisis management group (CMG) agree that it is consistent with the resolution strategy to count eligible liabilities issued to a parent of a resolution entity towards external TLAC
Liabilities arising from derivatives or debt instruments with derivative-linked features, such as structured notes
Liabilities arising other than through a contract, such as tax liabilities; liabilities which are preferred to normal senior unsecured creditors under the relevant insolvency law (e.g. covered bonds, other secured borrowings)
Any other liabilities that, under the laws governing the issuing entity, cannot be effectively written down or converted into equity by the relevant resolution authority
Source: Crédit Agricole CIB

Senior unsecured instruments can be included in the TLAC computation under one of the following three alternatives

Base Alternatives to Compute Senior Unsecured Instruments under TLAC
Contractual subordination: contractually subordinated to all excluded liabilities on the balance sheet of the resolution entity; OR
Statutory subordination: junior in the statutory creditor hierarchy to all excluded liabilities on the balance sheet of the resolution entity; OR
Structural subordination: issued by a resolution entity which does not have excluded liabilities on its balance sheet (for example, a holding company) and the proceeds are down-streamed from the resolution entity to subsidiaries in a form that subordinates the eligible liabilities to the excluded liabilities of subsidiaries. Therefore there is no need for the TLAC issued from the resolution entity itself to be contractually or statutorily subordinated
Source: Crédit Agricole CIB

The final TLAC Term Sheet includes two waivers for a pari passu ranking of excluded liabilities alongside TLAC-eligible liabilities (i.e. exemptions from the subordination requirement for TLAC-eligible liabilities) (TLAC term sheet Section 11):

- Primarily aimed at resolution entities without structural subordination: Excluded liabilities can rank pari passu with TLAC-eligible liabilities up to a maximum of 2.5% of RWA's where the TLAC min. requirement is set at 16% (increasing to 3.5% of RWA when the RWA min. requirement increases to 18% of RWA in 2022)
- Primarily aimed at resolution entities with structural subordination: Excluded liabilities can rank pari passu with TLAC-eligible liabilities up to a maximum of 5% of the resolution entity's eligible external TLAC (this allows for a minimum amount of tax and derivative liabilities necessary to run the balance sheet of e.g. a non-operational HoldCo)

Only one of the two exemptions may be used. Another constraint is that the usage of one of these exceptions must not give rise to material risk of successful legal challenge or valid compensation claims.

Points of Interest on the TLAC Needs as per Basel Committee QIS

The following Basel Committee table summarises the aggregate shortfalls (RWA buffers considered) by case, including and excluding emerging market G-SIBs, and the potential impact of the 2.5% exemptions. The shortfalls are calculated as the larger of the RWAs requirement or the 2×3% leverage requirement at each G-SIB level.

- Case 1: only includes TLAC instruments meeting all criteria of the final TLAC term sheet, including the subordination requirement.
- Case 2: same as Case 1, but with additional requirements on Tier 2 capital as per Basel III.
- Case 3: same as Case 1, but includes senior unsecured debt issued by resolution entities.
- Case 4: same as Case 3, plus structured debt and senior unsecured issued by non-resolution entities.

Shortfall (RWA buffers considered)	Case 1	Case 2	Case 3	Case 4
16% RWA or 2×3% leverage	Eu767bn	Eu790bn	Eu526bn	Eu307bn
20% RWA or 2×3% leverage	Eu1,388bn	Eu1,406bn	Eu1,025bn	Eu662bn
16% RWA or 2×3% leverage ex. emerging market G-SIBs	Eu498bn	Eu520bn	Eu260bn	Eu42bn
20% RWA or 2×3% leverage ex. emerging market G-SIBs	Eu949bn	Eu966bn	Eu588bn	Eu227bn
Impact of 2.5% exemptions	Up to Eu137bn			

Sample size: 30 G-SIBs in Case 1 and 29 G-SIBs in Cases 2 to 4 (one G-SIB excluded from Cases 2 to 4 due to insufficient data).

Sources: Basel Committee on Banking Supervision, Crédit Agricole CIB

- Overall, significant needs identified, providing potential support for German/Italian law style approaches within the Single Supervisory Mechanism (SSM) area.
- However, potentially unlevel playing field for e.g. UK and Swiss banks, which must fill their TLAC buffers through eligible HoldCo issuance.

NEW ELEMENT: Basel Committee Consultation Paper on TLAC Holdings by Banks

Alongside the final TLAC documentation package, the Basel Committee published a consultative document titled "TLAC Holdings". The paper is open for consultation until 12 February 2016.

The Basel Committee proposes that banks treat TLAC-eligible debt holdings, (i.e. in addition to qualifying reg. cap. Instruments, other TLAC-eligible instruments, such as potential Tier 3 debt, fully qualifying senior debt (e.g. German bank senior post 2017)) as they currently treat Tier 2 debt holdings, i.e. net (long minus short positions, subject to conditions of Basel III paras. 80 and 84). TLAC holdings are:

- If the investor bank holds less than 10% of the common shares of the bank invested in: below a Basel III threshold, the net TLAC holdings are risk-weighted and any excess above the Basel III threshold is fully deducted against Tier 2 capital;
- If the investor bank holds more than 10% of the common shares of the bank invested in: the net TLAC holdings fully deducted against Tier 2 capital;
- To the extent that Tier 2 capital is insufficient to fully absorb the deductions, any excess deduction is applied first against AT1 capital and then against CET1 capital.

Of note, also TLAC liabilities ranking pari passu with Excluded Liabilities are included in the Tier 2 deduction (when original maturity > 1 year). The Basel Committee proposes this approach in order to create a level-playing field between G-SIBs (who will have TLAC liabilities other than reg. cap. Instruments) and non-G-SIBs (who are unlikely to have TLAC liabilities other than reg. cap. Instruments). Thus, the usual correspondence approach for deductions (e.g. Tier 2 vs. Tier 2) is abandoned.

Impact on Trading and Liquidity

In its proposal, the Basel Committee states that "one of the aims of the Basel III deduction threshold is to permit a limited level of activity, such as market-making, to occur without banks being subject to a deduction". Thus, the Basel Committee appears potentially cognizant of the negative impacts that the proposed Tier 2 deduction approach could have on secondary trading levels and market liquidity. Hence, as part of the consultation process, the Basel Committee is seeking feedback on "whether any adjustment to the existing threshold, set at 10% of a bank's own common equity, is warranted".

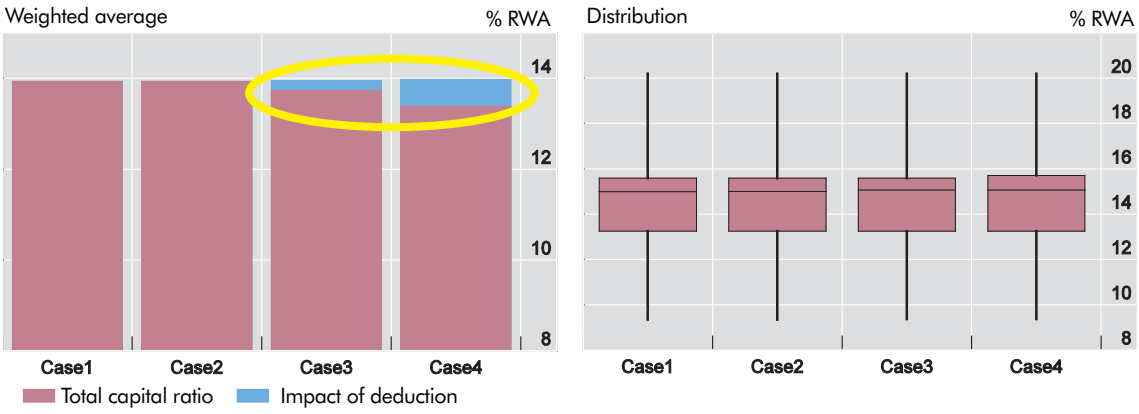
We anticipate banks with market-making operations and other debt market stakeholders to focus significantly on this issue in the coming months.

Basel Committee Consultation Paper on TLAC Holdings – Quantitative Impact

Below is a summary of the essential impacts found by the Basel Committee on the proposed Tier 2 deduction approach. We note that this Basel Committee QIS seems to ignore existing deductions against Tier 2, which is a drawback of the analysis, in our view.

Impact on G-SIBs (ex EME G-SIBs), with relevant cases highlighted

Total capital ratios and impacts of deduction (SPE and aggregated MPE resolution groups, % of RWA)

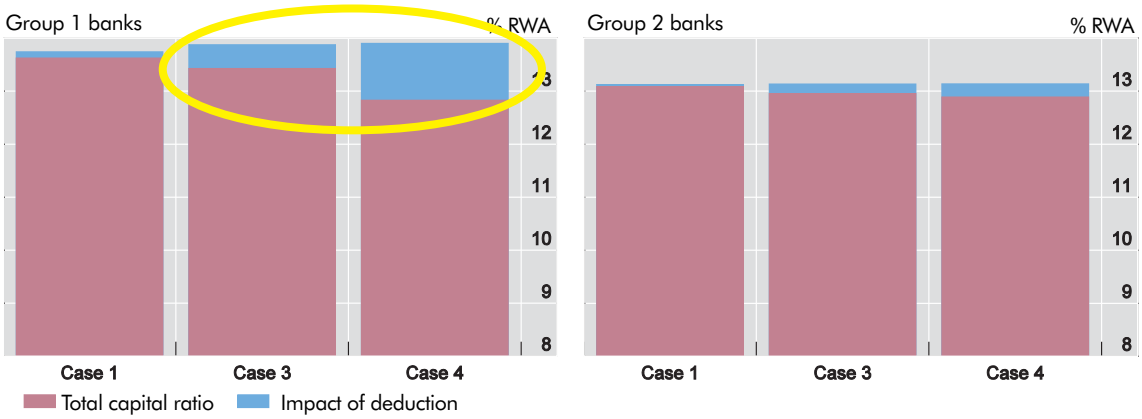


Sample size: 26 G-SIBs

Sources: Basel Committee on Banking Supervision, Crédit Agricole CIB

Impact on non-G-SIBs, with relevant cases highlighted

Total capital ratios and impacts of deduction



Sample size: Group 1: Case 1 = 44, Case 3 = 43, Case 4 = 44; Group 2: Case 1/3/4 = 72.

Sources: Basel Committee on Banking Supervision, Crédit Agricole CIB

- The overall impact of TLAC deductions against Tier 2 for G-SIBs appears limited
- However, the Basel Committee states that the impact can be significant for some individual G-SIBs
- The impact is much more pronounced on non-G-SIB banks
- The relevant Group is Group 1, i.e. internationally active banks with CET1 of more than Eu3bn
- As a result of a shortage of Tier 2 to absorb the required deductions, around one-third of the Group 1 banks, ie 44 banks, have to deduct part of their TLAC liabilities from AT1 and almost half of the 44 banks have to deduct part of them from AT1 and CET1 in Case 4 – the CET1 ratio is reduced on average by 1 percentage point.

PROPOSED TLAC DEDUCTION APPROACH: AREAS OF CONCERN

The proposed deduction approach applies to "internationally active banks" – the scope of application of the proposed regime must be clarified. Will the proposed application also extend to DSIBs and hence to MREL-eligible liabilities in the EU?

Considerations on likely impact

- As per Basel Committee QIS, the proposed approach seems to result in significant deductions only for a minority of G-SIBs and comparable banks, though it can't be ignored
- Thus, the risk weightings below the 10% threshold appear to be the binding constraint (though a bank must look at all its senior unsecured bank exposures, incl. look-through approach on index exposure when determining whether it is above 10% of own funds)
- In this context, the proposed revisions to the risk weighting of senior unsecured and subordinated debt bank exposure appear key. The impact must be looked at on an aggregated basis across the banking and the trading book

Proposed Banking Book Risk-Weighting Approach

Proposed Standardised Approach for risk-weighting non-TLAC senior unsecured bank exposure with External Credit Rating					
	External Credit Risk Assessment Approach				
Counterparty Rating	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-
"Base" RW	20%	50%	50%	100%	150%
Short Term RW	20%	20%	20%	50%	150%
Effective RW assuming a 70% f oor					
	External Credit Risk Assessment Approach				
Counterparty Rating	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-
"Base" RW	14%	35%	35%	70%	105%
Short Term RW	14%	14%	14%	35%	105%
Grey denotes metrics applicable to majority of EU banks					*Sources: BCBS, Crédit Agricole CIB*

- Even assuming a softening of the proposed approach and application of a generous floor for IRB risk weights based on 70% of SA risk weights, the impact may be such that in certain jurisdictions the applied risk weights for senior bank debt exposure increase significantly
- Moreover, subordinated debt is proposed to be risk-weighted at 150% across the board
- Given the new role of senior unsecured debt to specifically fulfill MREL/TLAC purposes in certain jurisdictions, it cannot be excluded that the Basel Committee may in time define new harsher risk weights for lower-ranked senior unsecured debt in the future

Proposed Revision to Trading Book exposure through the Fundamental Review of the Trading Book (FRTB)

More clarity on the potential impact of the FRTB should come from the anticipated publication of a nearly final paper by BCBS on the subject in the coming weeks.

The impact on the trading book may result in higher risk weights due to two reasons:

Value at Risk (VaR) and Stressed VaR (SVaR):

- Horizon extension to 10 days: potentially higher risk weights due to the lengthening of the horizon for the VaR/SVaR calculation
- Bail-in-able senior debt should exhibit ceteris paribus higher volatility than non-bail-inable senior debt -> VaR/SVaR should be higher, thus higher risk weights

Non-modellable risk factors (NMRF)

- Whilst point of non-viability (PONV), although not a precisely defined event, can be modelled on proxy parameters such as CET1 ratio with a good degree of confidence, the decision of the resolution authority to bail in senior unsecured debt may be a NMRF. In the latest QIS on FRTB, NMRFs were one of the biggest contributors to higher risk weights

Central Bank Eligibility of bail-in-able/lower-ranked senior unsecured debt

The jury as to whether lower-ranked senior unsecured debt (relative to Excluded Liabilities) is Central Bank-eligible is still out and can be answered ultimately only by the Central Banks. Technical factors such as structured senior unsecured debt being higher-ranked, e.g. in the German law, may influence the decision towards exclusion of Central Bank repo eligibility. Central Bank repo eligibility is a key factor in the private repo market: without Central Bank repo eligibility, private market repo eligibility may severely decline. This may further reduce liquidity and tradability of the product.

Bringing it all together…

- Potentially higher risk weights across banking and trading book and loss of repo eligibility are potential factors common to all banks and may restrict the ability of banks to invest in the product (with the exception of specific bank sectors benefiting from more lenient risk weight treatment).
- Higher risk weights may also impact insurers as another key constituent of the investor community.
- Secondary trading of the product may become hampered to a degree that is not commensurate with the size of the asset class and the liquidity it needs.

Regulatory updates

EBA publishes details of the 2016 EU-wide stress test: On 5 November, the European Banking Authority (EBA) published the following information regarding the 2016 EU-wide stress test:

- The 2016 EU-wide stress test will be launched at the end of February 2016 with a publication of the final methodology and templates as well as the scenarios
- The 2016 stress tests will broadly follow the same criteria as those carried out in 2014 and will apply to over 70% of the European banking sector
- Banks will be assessed against a baseline macroeconomic scenario that will last until the end of 2018 and a more "adverse" scenario
- Their resilience will be tested against a common framework of risks (market, operational and counterparty risks) and against conduct risk and FX lending (key change for the 2016 tests)
- The outcomes are expected to be published at the beginning of the third quarter of 2016.

The EBA had on 15 July released other key features of the stress test. It said the 2016 exercise will be based on a constrained bottom-up approach, including a static balance sheet assumption and wide risk coverage to assess EU banks' solvency. The 2016 test will build on the lessons learned from previous exercises and will now be more closely aligned with the cycle of the annual supervisory review and evaluation process, to ensure that results of the test are incorporated as an input to that process.

EBA Q&A on market-making in AT1 and Tier 2 instruments: On 25 September, the EBA published a Q&A on market-making in several Additional Tier 1 (AT1) and Tier 2 instruments. The question referred to the permission for repurchase of several AT1 or Tier 2 capital instruments for market-making purposes according to Article 29(3) of the Capital Requirements Regulation (CRR). The EBA confirmed that it is possible to obtain one permission to repurchase several AT1 or T2 instruments for a predetermined amount that shall not exceed the limits set in Article 29 of the CRR.

EBA consults on harmonised definition of default: On 22 September, the EBA launched a consultation on its draft Guidelines together with a QIS on the definition of default. The paper covers key aspects such as the days past due criterion for default identification, indications of unlikeliness to pay, conditions for the return to non-defaulted status, treatment of the definition of default in external data, application of the default definition in a banking group and specific aspects related with retail exposures. The consultation is part of the EBA's upcoming work on improving consistency and comparability in capital requirements. The deadline for the submission of comments is 22 January 2016.

EBA and Basel Committee publish results of the Basel III monitoring exercise as of 31 December 2014: The EBA on 15 September published its eighth report of the Basel III monitoring exercise on the European banking system. It conducted the exercise in parallel with the one run by the Basel Committee on Banking Supervision (BCBS) at a global level. The purpose of the monitoring exercise is to gather aggregate results on capital ratios and leverage ratios, as well as on liquidity ratios for banks in the EU.

- At the European level, the CET1 ratio of the largest internationally-active European banks would be on average 11.4% (fully-loaded) and 12.2% (phased-in). None of those banks would face a CET1 capital shortfall to achieve the minimum requirement of 4.5%, while the same group of banks would be short of Eu1.5bn to reach the 7.0%. The fully-implemented leverage ratio would be 4.2%.
- Regarding the 100 large internationally active banks (BCBS exercise), the average CET1 ratio is 11.1% (fully-loaded). The average CET1 ratio of G-SIBs is 10.8% (fully-loaded).

EBA updates on Net Stable Funding Requirements and Leverage Ratio: On August 19, the EBA informed that it will conduct further analysis on Net Stable Funding Requirements (NSFR) and Leverage Ratio as requested by the European Commission. The EBA has the mandate

to elaborate a calibration report on NSFR by the end of 2015 and on Leverage Ratio by October 2016 (likely to be issued in July 2016).

BASEL COMMITTEE

Basel Committee publishes FAQs on implementation of the countercyclical capital buffer: On October 19, the BCBS published frequently asked questions and other supporting information on the implementation of the countercyclical capital buffer. The FAQs cover the following topics: national buffer decisions, jurisdictional reciprocity, identification and calculation of geographic credit exposures, final bank-specific buffer add-on, public disclosure requirements and timing and frequency of changes in the buffer rates. The BCBS has also published a list of all prevailing and pre-announced buffers, as well as developments related to domestic rule-making

Stefan Ingves updates on the Basel Committee's future work agenda: In a Speech at the IIF Annual Membership Meeting on 9 October, Stefan Ingves, chairman of BCBS and governor of Sveriges Riksbank, discussed the following topics relating to the ongoing review of the calculation of risk-weighted assets:

- Internal ratings-based (IRB) approaches for credit risk: A consultation will be launched around the end of 2015 that will include:
  - constraints on credit risk model parameter estimates (e.g. LGD)
  - simplification and harmonisation of the credit risk mitigation framework
  - alignment of the definitions of exposures under the IRB and revised standardised approaches.
- Standard approach for credit risk: The Committee received around 180 comment letters on the proposal. It now intends to consult on revised policy proposals by year-end and conduct a quantitative impact study in early 2016. For simplification purposes, it is likely to reintroduce a role for external credit ratings into the credit risk capital framework.
- Operational risk: By end-2015, the Committee will publish for consultation a revised standardised approach as well as a proposal to remove the Advanced Measurement Approach for operational risk.
- Market risk standard: both the standardised and internal model-based approaches to be finalised by year-end.
- Finally, the calibration of the capital floor depends on the overall package of reforms.


Danièle Nouy

ECB

ECB's consultation on national discretions: On 15 September, Danièle Nouy, Chair of the Supervisory Board of the Single Supervisory Mechanism (SSM), announced the launch of a public consultation on options and national discretions (ONDs) at the beginning of November. This followed the adoption mid-July by the Supervisory Board of the European Central Bank (ECB) of a policy package on close to 100 ONDs. During a speech at the Austrian Financial Market Authority, she highlighted that "material and controversial ONDs include, for instance, the treatment of insurance holdings within conglomerates for the purpose of calculating the CRR capital ratios (Article 49(1) of the CRR), as well as the longer phasing-in of the deduction of deferred tax assets ('DTAs') relying on future profitability that existed prior to 2014 (Article 478(3) of the CRR)". We understand that the treatment of insurance holdings under Article 49(1) of the CRR is not part of the list of 100 ONDs. We also note that the laws adopted in Italy, Spain, Portugal and Greece allowing banks to convert certain categories of DTAs into claims towards the State in the event of losses or liquidation are subject to a European Commission investigation to determine whether they constitute illegal state aid.

AFME

AFME publishes the Model Clause for the contractual recognition of bail-in under Article 55 BRRD: On 24 September, the Association for Financial Markets in Europe (AFME) published its Model Clause for contractual recognition of bail-in. Article 55 of the Bank Recovery & Resolution Directive (BRRD) requires the inclusion of contractual recognition clauses in a broad range of liabilities governed by non-EU law. This Model Clause is intended for UK issuers of New York-governed debt securities subject to the requirements of Article 55. Model Clauses aimed at debt instruments issued by UK issuers under other third-country governing laws, and issued by other issuers in other EU jurisdictions subject to Article 55 and governed by New York and other third-country law, are also being developed by AFME. The requirements of Article 55 come into effect from 1 January 2016 at the latest.

IASB

IASB announces a consultation on temporary measures relating to the effective dates for IFRS 9 and the new insurance contracts Standard: On 23 September, the International Accounting

Standards Board (IASB) confirmed that it will consult on a package of temporary measures to address concerns about issues arising from implementing the financial instruments Standard before the new insurance contracts Standard comes into effect. The measures would amend IFRS 4 (Insurance Contracts) to introduce 2 options:

- Deferral approach: option to defer the effective date of IFRS 9 until 2021
- Overlay approach: option to remove from profit or loss some of the accounting mismatches and temporary volatility that could occur before the new insurance contracts Standard is implemented

The insurance contracts Standard is being deliberated by the IASB and a final Standard is expected to be issued in 2016. An Exposure Draft setting out these measures will be published later this year for public consultation.

EFRAG issues its final endorsement advice on IFRS 9: On 15 September, the European Financial Reporting Advisory Group (EFRAG) submitted its Endorsement Advice Letter on IFRS 9 to the European Commission. EFRAG notes that "overall IFRS 9 is conducive to the European public good, except for the impact on the insurance industry of applying IFRS 9 before the finalisation of the forthcoming insurance contracts standard". EFRAG further recommends "all businesses other than those carrying out insurance activities are required to account for their financial instruments in compliance with IFRS 9 in 2018 and businesses carrying out insurance activities are permitted to do so in compliance with IFRS 9 from the same date". IFRS notably covers the following areas:

- Classification and measurement of financial instruments: it will be based on a more principles-based approach
- Impairment of financial instruments: measurement of credit losses will be based on an expected-loss model
- Hedge accounting: more hedging transactions to qualify for hedge accounting

UK

PRA consults on identification of other systemically important institutions (O-SIIs): On 19 October, the Prudential Regulation Authority (PRA) launched a consultation, which closes on 18 January, on its approach to identifying O- SIIs. In particular, it consults on the following:

(i) which firms can be identified as O-SIIs;
(ii) application of discretion afforded within the EBA's mandatory scoring methodology for O-SII identification;
(iii) application of a supervisory overlay to adequately capture systemic risk in the UK banking sector, and proposals to use the methodology of the PRA's existing "potential impact" framework to inform this assessment; and
(iv) the timetable for O-SII identification, and publications related to O-SII identification.

PRA consults on ring-fencing and operational continuity in resolution: On 15 October, the PRA issued two consultation papers, which form part of the post-crisis reforms to enhance the resilience and resolvability of firms. The rules will come into force in 2019.

- The implementation of ring-fencing: prudential requirements, intragroup arrangements and use of financial market infrastructures — CP37/15. This consultation closes on 15 January 2016. The final rules and supervisory statements are expected by mid-2016.
- Ensuring operational continuity in resolution — CP38/15. The PRA will issue an addendum to this consultation defining the scope of application alongside a planned Bank of England consultation on the calibration of the MREL.

Key point from the consultation on the implementation of ring-fencing include:

- Capital requirements: The PRA estimates that banks subject to ring-fencing will need to increase their total capital by an aggregate of £2.2bn-£3.3bn — a marginal amount compared to the total CET1 of the six largest banks. Ring-fenced banks (RFB) and their sub- groups will also be subject to systemic risk buffers, which are expected to be finalised in 2016.
- Management of intragroup exposures and arrangements: any intragroup exposures to entities outside the RFB sub-group would be treated as a third party when calculating single name, sector and geographic credit concentration risk. Therefore RFBs must limit their large exposures to individual entities or groups to 25% of their eligible capital. The PRA will allow dividend payments from the RFBs to the parent company.

GERMANY

Bundestag adopts the bank resolution law: On 24 September, the Bundestag approved a revised version of the bank resolution law that introduces a change of wording compared to the draft. The new text no longer refers to the "subordination" of senior unsecured bonds but now grants a preferential ranking to senior liabilities such as corporate deposits, derivatives and structured notes. In addition, the final law delays the statutory preference until 1 January 2017.

Following a request from the German Federal Ministry of Finance, the ECB had on 2 September published an opinion on the original German draft law. According to the ECB, the statutory subordination of senior unsecured debt according to

Donchev joins CapSol from CASA

Doncho Donchev has joined Crédit Agricole CIB's Capital Solutions (CapSol) team as an Executive Director. In his new role, he will focus on providing structuring solutions for f nancial institutions.

Donchev joins from Crédit Agricole SA (CASA) where he ran the London Branch funding desk, which is the execution arm of the French bank for wholesale debt funding across the capital structure. In Donchev's time in this role, CASA won numerous awards for its funding activity, including Overall Most Innovative Financial Institution Borrower and Most Impressive FIG Issuer of Subordinated Debt & Hybrid Capital in 2014 and 2015 by *GlobalCapital*.

Prior to joining CASA in 2010, he worked as Vice President in hybrid capital at Dresdner Kleinwort.

Donchev reports to Julian Burkhard, Head of the Capital Solutions team at CACIB, with whom he also worked at Dresdner Kleinwort.

the earlier draft facilitates bail-in in resolution and TLAC compliance. In terms of potential negative impacts, the ECB noted the disqualification of senior unsecured bank debt as eligible collateral for ECB financing, higher funding costs and fragmentation of the European senior debt market.

AUSTRIA

Austria amends its Resolution Act to clarify the rights of legacy guaranteed debtholders: At the beginning of October, the Austrian Ministry of Finance proposed amendments to the Federal Banking Restructuring & Resolution Act (BaSAG) aimed at clarifying the rights of holders of legacy debt benefiting from a deficiency guarantee in case of the application of the bail-in tool. Austrian Civil Law requires the actual existence of a claim for such guarantees to be valid and enforceable. Yet those legacy instruments are subject to bail-in, which created legal uncertainties regarding the enforceability of the guarantee. The proposal clarifies that the recourse remains intact independent of the application of the bail-in tool.

FRANCE

ACPR position on automatic redemption provision and gross-up: French regulator Autorité de contrôle prudentiel et de resolution (ACPR) has recently updated the webpage on the Authorizations to issue/redeem capital instruments under Solvency II. At this occasion, the ACPR has confirmed the following points:

- Automatic redemption clauses (e.g. Mandatory redemption for Tax reasons) are not allowed because the redemption can only be at the issuer's initiative.
- A gross-up clause is deemed an incentive to redeem. Therefore, this clause prevents an instrument to be eligible as Tier 1, and as Tier 2 if it applies in the first 10 years from the issue date.

France adopts the BRRD: On 21 August, the BRRD was enacted into French national law by way of ordinance. The transposition of BRRD into French law is in line with the European Directive. Unlike the German and Italian proposals, which have introduced amendments to the ranking of different classes of senior unsecured creditors, the French transposition does not deviate from the BRRD.

ITALY

ECB publishes opinion on Italian legislative decrees: The ECB on 16 October released an opinion on law changes in Italy implementing the BRRD. The ECB seems to welcome the introduction of general depositor preference as it would "render the bail-in of senior unsecured bank debt more effective and credible, thus fostering effective resolution action and reducing the need to have recourse to the resolution fund". It has identified one issue as regard to TLAC compliance, because derivative liabilities continue to rank pari passu with vanilla senior debt and this is not compatible with the TLAC term sheet. Finally, the ECB states that the introduction of EU-wide legislation with respect to depositor preference would help to avoid fragmentation of the common market.

NORWAY

Norway adopts a regulation to transpose Solvency II: The Norwegian Finance Ministry on 25 August adopted a regulation to implement the Solvency II Directive into Norwegian law. The regulation allows for a transitional measure on technical reserves over a 16 year period under Article 308d. The adjustment is reduced over a 16 year period on a linear basis. The text also includes a floor where technical provisions shall be no lower than what is required under the pre-Solvency II framework when an insurer's aggregated technical provisions increase under Solvency II.

Insurance

EIOPA announces a review of the methodology to derive the Ultimate Forward Rate: On 9 October, the European Insurance & Occupational Pensions Authority (EIOPA) announced that the review of the Ultimate Forward Rate (UFR) will include a public consultation in 2016. EIOPA intends to decide on the outcome of the review and on how and when to implement it in September 2016. The UFR of 4.2% for the term structure for euro obligations will remain unchanged until the end of 2016.

EIOPA's opinion on group solvency calculation in the context of equivalence: On 25 September, EIOPA published an Opinion on group solvency calculation that is relevant for insurance groups that operate outside the European Economic Area (EEA) in third countries whose solvency regimes are considered equivalent to Solvency II. EIOPA's recommendations to national competent authorities include:

- Group supervisors should apply the highest level of capital requirement in the third country for calculating the group solvency position
- Own funds should be deemed unavailable in case they are below the threshold triggering intervention by the third country supervisory authority
- The monitoring of the solvency position over time should be part, if relevant, of the group own risk and solvency assessment (ORSA)

Insurance Europe responds to IAIS consultation on HLA requirements for G-SIIs: On 25 August, Insurance Europe published its key messages on the International Association of Insurance Supervisors' (IAIS) higher loss absorbency (HLA) consultation.

Key issues raised include:

- The HLA should remain focused on activities that give rise to systemic risk. Insurance Europe is concerned by the widened scope of the HLA, beyond the Non-Traditional Non-Insurance activities
- Risk of unlevel playing f eld with other regulated sectors e.g. if the HLA is applied to an asset management business owned by a G-SII
- Inappropriate link between size and level of HLA penalty: Higher HLA requirements should ref ect the size of more systemically risky business
- Volatility of the BCR (basic capital requirements)/ HLA framework, which can cause challenges to risk management
- Need for transitional measures for both capital resources and BCR uplift

Insurance Europe comments on the progress of the implementation of Solvency II: On 24 August, Insurance Europe commented on the results of its survey on Solvency II implementation. While insurance companies have already made signif cant progress, the following concerns have been reported:

- Implementation burden due to the full compliance required by national supervisors to the EIOPA guidelines (approximately 700 guidelines)
- Additional requirements set by member states: several members state are "gold plating" Solvency II when transposing it into national law
- Delayed approval process of internal models due to extensive documentation requirements

SWITZERLAND

The Swiss Federal Council announces new leverage requirements for Swiss G-SIBs: On 21 October, the Swiss Federal Council officially announced amendments to the current too-big-to-fail provisions, including new leverage requirements. The new rules must be met by the end of 2019. As expected, the minimum "going-concern" leverage ratio for UBS and Credit Suisse will be 5% of leverage exposure and 14.3% of risk-weighted assets (implying a ratio of RWAs to total leverage exposures of 35%). The leverage ratio needs to be covered with at least 3.5% of CET1 and high-trigger AT1s may account for the remaining 1.5%. Outstanding low-trigger AT1s and Tier 2 CoCos will be grandfathered. In addition, a gone concern ratio — the Swiss implementation of TLAC — will be established and will require again a minimum 5% of the total leverage exposures. Eligible liabilities will included AT1 and Tier 2 not eligible in the going concern ratio and senior debt issued by holding companies.

These updates are split into bank and insurance, and listed according to the relevant body, topic or country, with the most recent first therein.

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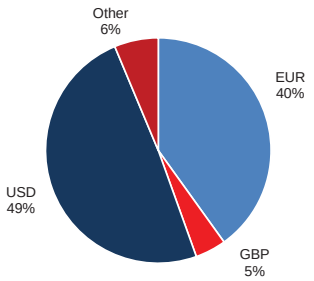
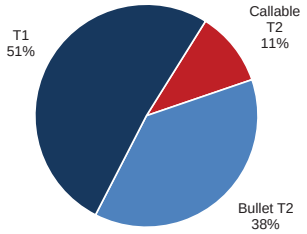
Currencies, structures and distribution

Bank hybrid issuance by currency (2015 ytd)

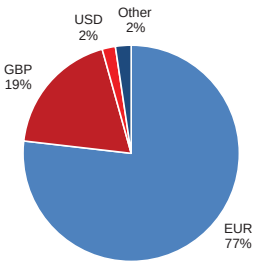


Bank issuance by instrument/structure (2015 ytd)

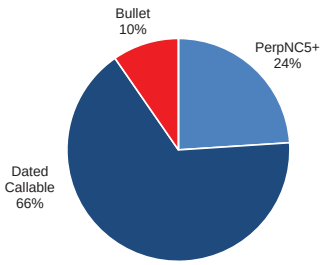


Source: Crédit Agricole CIB

Insurance hybrid issuance by currency (2015 ytd)

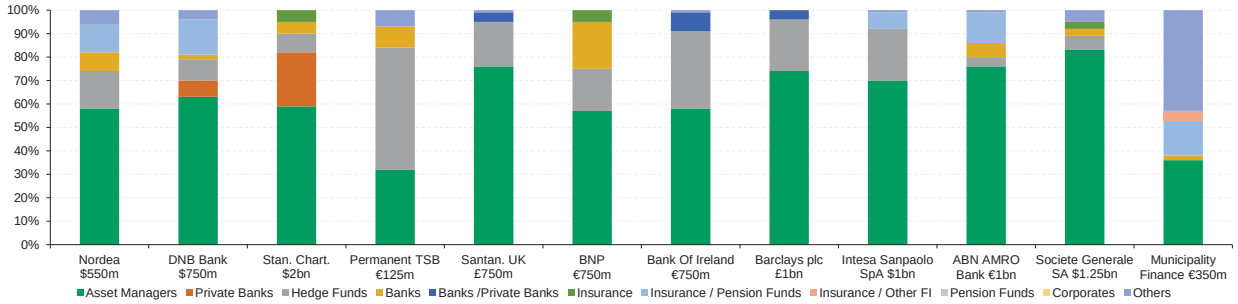


Insurance issuance by instrument/structure (2015 ytd)

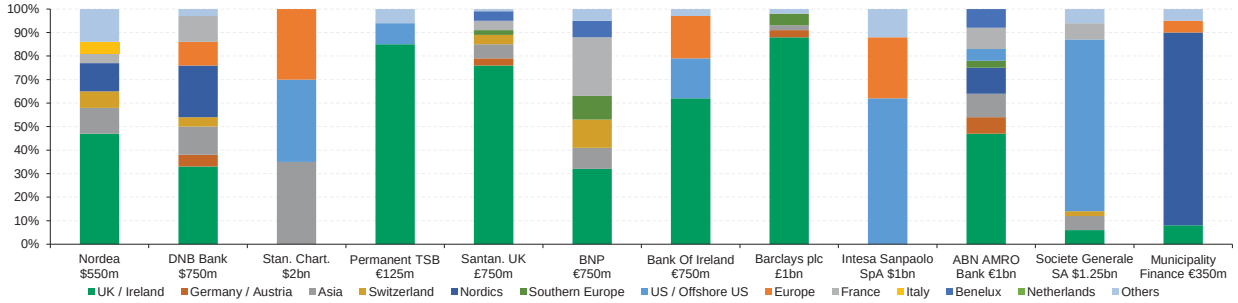


Source: Crédit Agricole CIB

AT1 distribution by investor type



AT1 distribution by geography



Source: Crédit Agricole CIB

AT1, Tier 2 CoCos

AT1 performance monitoring (as at 5/11/15)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	Principal loss absorption	Trigger	Price	I-Spread	Yield to call
22-Sep-15	HSBC	Baa3/-/BBB	EUR	1,000	6.000%	Perpetual	29-Sep-23	CE	7.000%	101.37	517	5.78
15-Sep-15	ABNANV	Ba2u/BB/BB+	EUR	1,000	5.750%	Perpetual	22-Sep-20	TWD	5.125%	100.42	546	5.65
11-Jun-15	BKIR	B2/B+/-	EUR	750	7.375%	Perpetual	18-Jun-20	TWD	5.125%	103.43	634	6.47
10-Jun-15	BNP	Ba1/BB+/BBB-	EUR	750	6.125%	Perpetual	17-Jun-22	TWD	5.125%	102.81	518	5.61
27-Apr-15	IPMID	-/-/-	EUR	125	8.625%	Perpetual	01-Apr-21	CE	7.000%	101.23	798	8.32
19-Feb-15	NYKRE	-/BB+/BB+	EUR	500	6.250%	Perpetual	26-Oct-20	TWD	7.125%	103.63	520	5.41
13-Feb-15	UBS	-/BB/BB+	EUR	1,000	5.750%	Perpetual	19-Feb-22	PWD	5.125%	104.00	452	4.99
11-Feb-15	DANBNK	Ba1u/BB+/BB+	EUR	750	5.875%	Perpetual	06-Apr-22	TWD	7.000%	101.25	523	5.64
10-Feb-15	BBVASM	Ba2/-/BB	EUR	1,500	6.750%	Perpetual	18-Feb-20	CE	5.125%	98.91	705	7.05
05-Feb-15	POPSM	Caa1u/-/-	EUR	750	8.250%	Perpetual	10-Apr-20	CE	7.000%	98.57	871	8.64
15-Jan-15	RABOBK	Baa3/-/BBB-	EUR	1,500	5.500%	Perpetual	29-Jun-20	TWD	7%/5.125%	101.00	508	5.25
11-Dec-14	DEKA	Baa3/-/-	EUR	177	6.000%	Perpetual	20-Mar-22	TWD	5.125%	104.95	459	5.06
13-Nov-14	AARB	-/-/BB-	EUR	300	7.625%	Perpetual	30-Apr-20	TWD	7.000%	100.38	729	7.50
10-Sep-14	HSBC	Baa3/-/BBB	EUR	1,500	5.250%	Perpetual	16-Sep-22	CE	7.000%	97.76	518	5.65
03-Sep-14	UCGIM	-/-/BB-	EUR	1,000	6.750%	Perpetual	10-Sep-21	TWD	5.125%	98.18	686	7.13
02-Sep-14	SANTAN	Ba1/-/-	EUR	1,500	6.250%	Perpetual	11-Sep-21	CE	5.125%	97.00	665	6.88
04-Aug-15	BACR	Ba2/B+/BB+	GBP	1,000	7.875%	Perpetual	15-Sep-22	CE	7.000%	101.50	596	7.59
03-Jun-15	ABBEY	Ba2/B+/BB+	GBP	750	7.375%	Perpetual	24-Jun-22	PWD	7.000%	102.55	527	6.89
25-Jul-14	VIRGMN	-/-/-	GBP	160	7.875%	Perpetual	31-Jul-19	CE	7.000%	101.03	632	7.56
10-Sep-15	ISPIM	Ba3/B+/BB-e	USD	1,000	7.700%	Perpetual	17-Sep-25	PWD	5.125%	102.00	532	7.41
12-Aug-15	BNP	Ba1/BB+/BBB-	USD	1,500	7.375%	Perpetual	19-Aug-25	TWD	5.125%	103.75	476	6.84
05-Aug-15	RBS	B1u/B/BB-	USD	2,000	7.500%	Perpetual	10-Aug-20	CE	7.000%	104.50	492	6.39
05-Aug-15	RBS	B1u/B/BB-	USD	1,150	8.000%	Perpetual	10-Aug-25	CE	7.000%	105.50	520	7.21
31-Jul-15	UBS	-/BB/BB+	USD	1,575	6.875%	Perpetual	07-Aug-25	PWD	7.000%	99.57	474	6.93
09-Apr-15	INTNED	Ba1/BB-/BB+	USD	1,000	6.000%	Perpetual	16-Apr-20	CE	7.000%	100.13	450	5.97
09-Apr-15	INTNED	Ba1/BB-/BB+	USD	1,250	6.500%	Perpetual	16-Apr-25	CE	7.000%	98.13	471	6.77
26-Mar-15	STANLN	Ba1/BB/BBB-	USD	2,000	6.500%	Perpetual	02-Apr-20	CE	7.000%	98.25	551	6.97
23-Mar-15	HSBC	Baa3/-/BBB	USD	2,450	6.375%	Perpetual	30-Mar-25	CE	7.000%	100.63	423	6.28
19-Mar-15	DNBNO	Baa3u/BBB/-	USD	750	5.750%	Perpetual	26-Mar-20	TWD	5.125%	95.69	534	6.91
05-Mar-15	NDASS	Ba1u/BBB/BBB	USD	550	5.250%	Perpetual	13-Sep-21	TWD	8%/5.125%	94.75	456	6.35
18-Feb-15	SHBASS	Baa2/BBB/BBB	USD	1,200	5.250%	Perpetual	01-Mar-21	TWD	5.125%	96.80	426	5.96
13-Feb-15	UBS	-/BB/BB+	USD	1,250	7.000%	Perpetual	19-Feb-25	PWD	5.125%	105.25	409	6.23
13-Feb-15	UBS	-/BB/BB+	USD	1,250	7.125%	Perpetual	19-Feb-20	PWD	7.000%	105.25	418	5.70
12-Feb-15	SWEDA	Baa3u/BBB/BBB-	USD	750	5.500%	Perpetual	17-Mar-20	CE	8%/5.125%	99.34	422	5.67
18-Nov-14	DB	Ba3/BB/BB+	USD	1,500	7.500%	Perpetual	30-Apr-25	TWD	5.125%	95.88	591	8.13
06-Nov-14	SEB	Ba1u/-/BBB-	USD	1,100	5.750%	Perpetual	13-May-20	TWD	8%/5.125%	98.66	462	6.10
16-Sep-14	NDASS	Ba1u/BBB/BBB	USD	1,000	5.500%	Perpetual	23-Sep-19	TWD	8%/5.125%	97.70	482	6.17
16-Sep-14	NDASS	Ba1u/BBB/BBB	USD	500	6.125%	Perpetual	23-Sep-24	TWD	8%/5.125%	98.50	433	6.35
11-Sep-14	ACAFP	Ba2u/BB/BB+	USD	1,250	6.625%	Perpetual	23-Sep-19	TWD	7%/5.125%	99.25	554	6.85
10-Sep-14	HSBC	Baa3/-/BBB	USD	2,250	6.375%	Perpetual	17-Sep-24	CE	7.000%	99.50	444	6.45
10-Sep-14	HSBC	Baa3/-/BBB	USD	1,500	5.625%	Perpetual	17-Jan-20	CE	7.000%	100.25	413	5.55

T2 CoCo performance monitoring (as at 5/11/15)

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%	105.54	376	2.92
08-Jun-15	ZKB	-/A/-	EUR	500	2.625%	15-Jun-27	15-Jun-22	PWD	5.000%	99.72	216	2.67
23-May-14	NYKRE	-/BBB/BBB	EUR	600	4.000%	03-Jun-36	03-Jun-21	PWD	7.000%	100.39	355	3.92
06-Feb-14	UBS	-/BBB/BBB+	EUR	2,000	4.750%	12-Feb-26	12-Feb-21	PWD	5.000%	107.52	285	3.17
11-Sep-13	CS	-/BBB/BBB+	EUR	1,250	5.750%	18-Sep-25	18-Sep-20	PWD	5.000%	110.94	301	3.28
08-May-14	UBS	-/BBB/BBB+	USD	2,500	5.125%	15-May-24	-	PWD	5.000%	102.49	272	-
12-Sep-13	ACAFP	-/BBB-/BBB-	USD	1,000	8.125%	19-Sep-33	19-Sep-18	PWD	7.000%	111.25	279	3.92
01-Aug-13	CS	-/BBB/BBB+	USD	2,500	6.500%	08-Aug-23	-	PWD	5.000%	110.00	302	-
15-May-13	UBS	-/BBB/BBB+	USD	1,500	4.750%	22-May-23	22-May-18	PWD	5.000%	103.00	240	3.49
03-Apr-13	BACR	-/BB+/BBB-	USD	1,000	7.750%	10-Apr-23	10-Apr-18	PWD	7.000%	109.00	279	3.81
17-Jan-13	KBC	-/BBB-/-	USD	1,000	8.000%	25-Jan-23	25-Jan-18	PWD	7.000%	110.88	192	2.88

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

Source: Crédit Agricole CIB

Latest bank Tier 2, insurance hybrids

Latest Tier 2 performance monitoring (as at 5/11/15)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	I-Spread	Yield to call
29-Oct-15	SNSBNK	Ba2/BB/BBB-	EUR	500	3.750%	05-Nov-25	05-Nov-20	365	3.93
20-Oct-15	BPCEGP	Baa3/BBB/A-	AUD	175	5.400%	27-Oct-25	27-Oct-20	302	5.43
25-Sep-15	VICEN	-/-/B	EUR	200	9.500%	29-Sep-25	29-Sep-20	864	8.63
21-Sep-15	BNP	Baa2/BBB/A	USD	1,000	4.375%	28-Sep-25	-	243	-
18-Sep-15	POHBK	Baa1/A-/A	EUR	100	2.405%	25-Sep-25	-	147	-
10-Sep-15	NDASS	-/A-/A+	SEK	1,700	1.212%	17-Sep-25	17-Sep-20	-	1.46
10-Sep-15	NDASS	-/A-/A+	SEK	2,300	1.935%	17-Sep-25	17-Sep-20	181	2.22
08-Sep-15	ABBEY	Baa1/BB+/A-	USD	500	5.625%	15-Sep-45	-	306	-
08-Sep-15	ABBEY	Baa1/BB+/A-	USD	1,000	4.750%	15-Sep-25	-	274	-
03-Sep-15	BFCM	A3/BBB/A	EUR	1,000	3.000%	11-Sep-25	-	173	-
10-Aug-15	HSBC	A2/BBB+/A+	USD	1,500	4.250%	18-Aug-25	-	210	-
28-Jul-15	RABOBK	A3/BBB+/A	USD	1,500	4.375%	04-Aug-25	-	206	-
28-Jul-15	RABOBK	A3/BBB+/A	USD	1,250	5.250%	04-Aug-45	-	239	-
21-Jul-15	ABNANV	Baa3/BBB-/A-	USD	1,500	4.750%	28-Jul-25	-	226	-
21-Jul-15	CAZAR	B2/B/BB	EUR	500	5.000%	28-Jul-25	28-Jul-20	547	5.72
24-Jun-15	COOPBK	-/-/-	GBP	250	8.500%	01-Jul-25	01-Jul-20	817	9.85
24-Jun-15	HSBC	A2/BBB+/A+	EUR	1,500	3.000%	30-Jun-25	-	201	-
23-Jun-15	ABNANV	Baa3/BBB-/A-	EUR	1,500	2.875%	30-Jun-25	30-Jun-20	203	2.27
09-Jun-15	LBBW	Baa2/-/BBB-	EUR	500	3.625%	16-Jun-25	-	264	-
27-May-15	BPCEGP	Baa3/BBB/A-	USD	130	5.350%	01-Jun-45	-	327	-
26-May-15	SOCGEN	Baa3/BBB/A-	CNY	1,200	5.200%	03-Jun-25	03-Jun-20	231	5.80
22-May-15	SOCGEN	Baa3/BBB/A-	AUD	125	5.500%	02-Jun-27	02-Jun-22	227	4.95
16-Apr-15	ISPIM	Ba1/BB/BBB	EUR	500	2.855%	23-Apr-25	-	232	-
08-Apr-15	SOCGEN	Baa3/BBB/A-	USD	1,500	4.250%	14-Apr-25	-	257	-
27-Mar-15	DB	Ba1/BBB-/A-	USD	1,500	4.500%	01-Apr-25	-	287	-
18-Mar-15	BPCEGP	Baa3/BBB/A-	CNY	750	5.750%	26-Mar-25	26-Mar-20	-	-
12-Mar-15	BPCEGP	Baa3/BBB/A-	EUR	375	2.250%	12-Mar-25	-	221	-
12-Mar-15	CRDEM	-/-/BBB	EUR	200	3.125%	13-Mar-25	13-Mar-20	329	3.49
09-Mar-15	ACAFP	Baa3/BBB/A-	EUR	2,000	2.625%	17-Mar-27	-	211	-
09-Mar-15	ACAFP	Baa3/BBB/A-	USD	1,500	4.375%	17-Mar-25	-	252	-
04-Mar-15	SANTAN	Baa2/BBB/BBB+	EUR	1,500	2.500%	18-Mar-25	-	226	-
04-Mar-15	KBCBB	-/BBB-/BBB+	EUR	750	1.875%	11-Mar-27	11-Mar-22	192	2.39
03-Mar-15	BNP	Baa2/BBB/A	CNY	1,500	5.000%	17-Mar-25	17-Mar-20	221	-
19-Feb-15	SOCGEN	Baa3/-/A-	EUR	1,250	2.625%	27-Feb-25	-	211	-
10-Feb-15	BNP	Baa2/BBB/A	EUR	1,500	2.375%	17-Feb-25	-	190	-
09-Feb-15	DB	Ba1/BBB-/A-	EUR	1,250	2.750%	17-Feb-25	-	242	-

Insurance performance monitoring (as at 5/11/15)

Launch	Issuer	Issue ratings	Currency	Amount (m)	Coupon	Maturity date	First call date	New issue spread	I-Spread
29-Oct-15	Old Mutual	Ba1/-/BB+	GBP	450	7.875%	03/11/2025	-	-	553.04
22-Oct-15	Rothesay Life	-/-/-	GBP	250	8.000%	30/10/2025	-	-	554.00
20-Oct-15	Gothaer Versicherung	-/BBB/-	EUR	250	6.000%	30/10/2045	30/10/2025	504	499.44
20-Oct-15	Assicurazioni Generali	Baa3/-/BBB	EUR	1,250	5.500%	27/10/2047	27/10/2027	435	371.85
19-Oct-15	Legal & General	Baa1/-/-	GBP	600	5.375%	27/10/2045	27/10/2025	-	347.74
24-Sep-15	Humanis	-/-/-	EUR	250	5.750%	22/10/2025	-	-	481.88
22-Sep-15	ASR Nederland	-/BBB-/-	EUR	500	5.125%	29/09/2045	29/09/2025	420	418.41
21-Sep-15	Danica Pension	-/BBB/-	EUR	500	4.375%	29/09/2045	29/09/2025	338	346.62
16-Sep-15	FBD Holdings	-/-/-	EUR	70	11.660%	23/09/2025	-	-	-
02-Sep-15	Helvetia	-/BBB+/-	CHF	300	3.000%	Perpetual	23/11/2022	302	259.67
20-Jul-15	UNIQA Insurance	-/BBB/-	EUR	500	6.000%	27/07/2046	27/07/2026	482	439.95
09-Jul-15	Ethias	-/-/BB	EUR	403	5.000%	14/01/2026	-	-	673.52
08-Jun-15	Swiss Life Holding	-/BBB+/-	EUR	750	4.375%	Perpetual	16/06/2025	330	371.08
02-Jun-15	SCOR SE	-/A/A-	EUR	250	3.250%	05/06/2047	05/06/2027	220	201.21
02-Jun-15	Prudential	A3/A-/BBB+	GBP	600	5.000%	20/07/2055	20/07/2035	-	357.05
02-Jun-15	KLP	Baa1/BBB/-	EUR	600	4.250%	10/06/2045	10/06/2025	340	371.00
28-May-15	Aviva	Baa1/BBB/-	EUR	900	3.375%	04/12/2045	04/12/2025	255	302.70
28-May-15	Aviva	Baa1/BBB/-	GBP	400	5.125%	04/06/2050	04/06/2030	-	375.64
01-May-15	CIS General Insurance	-/-/-	GBP	70	12.000%	08/05/2025	08/05/2020	-	-
16-Apr-15	Zurich Insurance	A2/A/-	USD	300	4.250%	01/10/2045	01/10/2025	-	293.72
30-Mar-15	Allianz SE	A2/A+/A	EUR	1,500	2.241%	07/07/2045	07/07/2025	165	227.25

Source: Crédit Agricole CIB

RBS Improving proposition

Royal Bank of Scotland launched its inaugural Additional Tier 1 transaction on 5 August, a $3.15bn two-tranche deal. Afterwards, Scott Forrest, head of capital strategy and debt capital markets, RBS, spoke to Bank+Insurance Hybrid Capital about how the launch of the issue f tted into the UK bank's strategy and how investors bought into its improving credit story.

What was the rationale for RBS issuing its inaugural AT1 transaction?

We wanted to issue CRD IV-compliant Additional Tier 1 to strengthen our capital base and had given an undertaking to our regulator that we would do this in 2015. It's really there to support the transition of our capital base from old-style legacy Tier 1 into new-style CRD IV-compliant AT1.

Why did you choose to issue in US dollars?

We are cognisant of all markets and all currencies. Issuing in dollars made commercial sense for us because it is the biggest, deepest and most liquid market for AT1. So there was a pricing benefit for us to access dollars over other currencies.

What influenced the maturity structure of the AT1?

We view RBS as an improving credit story and we therefore wanted to reflect this in our choice of maturity. When we engaged with investors we recognised that there would be an opportunity to upsize our transaction to £2bn equivalent if we supplemented a perp non-call five structure [sized at $2bn] with a perp non-call 10 structure [$1.15bn].

Scott Forrest, RBS

Were you satisfied with the result?

We were very happy with the overwhelming demand from investors for the instrument. We had an extremely strong order book, with significant orders from key real money accounts coming in.

We had signalled to the market for a considerable period of time that we would be looking to issue AT1 at some point in 2015. August isn't necessarily a traditional time when you would look to come to market with AT1 or in our case an inaugural transaction, but considering that there was potential uncertainty in the markets ahead, we saw this as a window which was open to us, and it therefore made a lot of sense to get our £2bn requirement done in one go.

There had also been volatility in the market earlier in the year. Had you been ready to go earlier?

Yes, we had been in a position to proceed on our side and back in March we looked at the possibilities in the market, but there were some slight wobbles. After that, announcements relating to our FX settlements were expected so we opted to step back and reassess conditions after our interim results.

What feedback did you get from investors on the roadshow? Were there any particular things that people were focusing on?

We had three teams, doing two days in London and with two teams in the US — one on the East Coast and one on the West Coast — so we could fully engage with as many investors as possible.

From our perspective, we have got very much an improving credit story. You just need to look at our CET1 position: two years ago we were at 8.6%; at the half year we were at 12.3%. We are quite far down the road in relation to the disposal and deconsolidation from a regulatory perspective of the US subsidiary, Citizens Financial Group, and when it completes that will add about another 3% to our CET1.

Investors, I believe, readily got onside in terms of this improving credit story. The one ongoing theme is the previous conduct and litigation issues, and we were still waiting for some of those to settle. So whilst we have shown great improvement in the underlying CET1 position, there may still be a few bumps on the road to come.

You mentioned that a consideration in the timing was potential uncertainty going into the autumn – was the September Fed meeting related to that?

If we look at the sort of instability there has been in the market, immediately after our deal there was a short window of issuance in the early part of August and then after that it was shut. So we just saw that there was a small window of opportunity there to come in — we had a shortened roadshow, doing it in two days, whereas normally for an inaugural AT1 we would have probably have looked to do three days. We decided to launch on an accelerated timetable so we could be in and out of the market quickly.

Did the way the market has been affect the kind of premium and price you had to pay? How did your positioning relative to peers work out?

Throughout the build-up to the transaction we looked at what our underlying building blocks were in terms of pricing, and probably the closest comparable instrument for us would be Barclays. At the point of pricing, we printed close to Barclays, and then in subsequent aftermarket trading, through Barclays. So that's a great position for our AT1 given the credit differential — but it is not necessarily something that is reflected in our Tier 2 or our senior debt instruments, which are still trading wider. So from a fundamentals point of view, it was a successful transaction.

At the same time as being pleased with the way the deal went and the underlying pricing, since we are an improving credit story we would hope that, all things being equal, the next transactions that we bring would be tighter.

What might you have planned looking ahead?

For AT1 we are done for the year. Looking ahead to the end of this year and into next year, our focus will be on senior TLAC instruments. To my mind there still isn't sufficient clarity on the underlying terms and conditions of TLAC, of how that will be positioned internally, so we still require further guidance on those points, and with all these things the devil is in the detail. On TLAC we have seen a range there of 16%-20%: it may be 16%-18% initially and then increasing in subsequent years — we'll see where that comes out at the time of the G20. But based on the earlier guidance of 16%-20%, the upper end of that would put our sort of TLAC senior issuance somewhere in the region of Eu3bn-Eu5bn per annum.

Was that something which investors focused on?

Yes, investors always want to get a little bit of a sense of just what your issuance plans are and when you are next going to be coming to market — i.e. is this a deal that I participate in today or am I better off waiting for the next transaction to come along? We were pretty open with them in terms of what our issuance requirements would be in AT1, Tier 2 and senior.

In AT1 we have got a total of £4bn-£5bn to do. We have now done £2bn of that and we would look to do the balance over the next couple of years — and bear in mind that we have got this story here of improving credit quality, such that it should become cheaper for us the longer that we wait. ●

Source: European Commission

Bank resolution Constructing new strategies

BRRD, MREL, RWAs... The "alphabet soup" of regulation shows no signs of cooling, and f nancial institutions are being forced to reassess balance sheet managment and funding in light of the paradigm shifts in bank resolution and other areas. Here, issuers and other market participants discuss the new strategies that are being adopted.

This article is based on a panel discussion at a FIG day in Milan on 16 October, organised by Crédit Agricole CIB and Banca Akros. The participants were:

Renee Bauer, head of long term funding, Erste Group Bank

Nicolò Bocchin, portfolio manager, Aletti Gestielle

Pascal Decque, financials credit analyst, Crédit Agricole CIB

Doncho Donchev, executive director, DCM origination, hybrid capital and liability management, Crédit Agricole CIB

Taos Fudji, director, financial institutions ratings, Standard & Poor's

Mattias Persson, head of group funding, Nordea

Carlos Pinheiro, deputy head of investor relations, Caixa Geral de Depósitos

Moderator:
Neil Day, managing editor, Bank+Insurance Hybrid Capital

Neil Day, BIHC: At what stage are the various countries with respect to implementation of the Bank Recovery & Resolution Directive (BRRD)?

Mattias Persson, Nordea: It's being implemented, but it has not yet passed parliament, where it is still being discussed. It has been out for consultation in the domestic market and has been discussed between the different authorities. It needs to be in place January next year, and we understand it will be done.

A problem we have is that this law that will implement BRRD in Sweden will also formulate which authority will be the resolution authority, and as the legislation is not finalised we don't yet have this counterparty. We know who it is supposed to be – it will be under the Swedish National Debt Office – but as they are still not the authority from a legal perspective they can't interact with us yet.

So BRRD is coming, albeit a bit late.

In the end it will not resemble BRRD in many other countries — there are twists in the Swedish implementation for national reasons — but I will come back to those in more depth later.

Carlos Pinheiro, Caixa Geral de Depósitos: In Portugal we enacted in March this year a law that is aligned with the final BRRD regime. As you will know, we were, let's say, early adopters of banking resolution. Already in 2012 there was a financial assistance programme and then a bank that was resolved, which fostered some adaptation of banking laws. But yes, the final BRRD regime has now been adopted.

Renee Bauer, Erste: We have implemented it. The main topic we have now is senior funding going forward and what will happen vis-à-vis the German and Italian approaches, and if there will be an EU consultation.

Nicolò Bocchin, Aletti Gestielle: BRRD is one of the themes, one of the acronyms we have read and heard a lot about over the last two or three years. And to tell you the truth, from my point of view it's kind of a mess, because there are always new rules, new proposals, new acronyms to take care of. From time to time they change the proposal and therefore I decided to take a very practical approach. This is first of all based on waiting until the rules are finally set and only then eventually going deeper into them. The second is in the meantime to be sure

Mattias Persson, Nordea
'Rather than focusing on the probability of default, we have these higher capital requirements'

about those ratios that really matter from a portfolio management point of view. To my mind so far the triggers are just MDA (maximum distributable amount) and the buffer to trigger. Then, finally, be comfortable with the issuer — that's really the most important point.

The process is a very difficult one to handle, but it has been made longer and longer just to get investors to digest the fact that even senior bonds at the end of the day can be part of the capital structure. This is something that really was unbelievable up until a couple of years ago when you had the Cyprus crisis and senior bonds were not touched, or even last year when you had the Banco Espírito Santo fraud and the seniors are still out there.

The Italian case is to me really interesting, because moving up the corporate deposits and leaving the derivatives at the same layer as the senior bonds basically make the senior bonds un-bail-in-able. What the regulator wants to make sure of is that they can bail in a bank over a weekend to preserve financial stability, but derivatives are basically impossible to be resolved within a weekend. Therefore I guess that even with the current legislation, senior debt of Italian banks will be moved to a new bank in case of bail-in.

Doncho Donchev, Crédit Agricole CIB: First of all, we have to ask why we have these various approaches. I think this is an important point that needs to be clarified.

In the European Union obviously we have the BRRD and in the Eurozone we have Banking Union, with supervision and resolution two key components of the framework, so resolution is clearly within the remit of the EU. But when it comes to the point of ranking of senior unsecured under the "no creditor worse off" principle, this links to insolvency laws and proceedings for liquidation, which are a national remit. We then have 28 different countries with 28 different laws — less in the SSM but more than enough for a potential myriad of national approaches. This, really, is the crux of the problem. And because insolvency remains within the remit of the national states, and hasn't yet been given up to the level of the EU, I think we are likely to see more and more national laws emerge. But eventually, in my view, the Commission will probably consider that this results in a fragmentation of the Common Market principle, and may take some action. But obviously it takes two, or in this case one and 28, to tango, meaning the Commission and all the different countries needing to agree on this principle, that there needs to be a European solution. My view is that we are not at this stage yet.

The clearer the structure, the better it is for actually resolving investors' uncertainties

Day, BIHC: Mattias, you referred earlier to differences in the Swedish approach. How and why is it different? And is it tenable that you will be able to maintain that going forward?

Persson, Nordea: The strategy has been to focus not on resolution, but rather on the probability of default. If you go back a couple of years, the Swedish authorities have set much higher capital requirements for Swedish banks. It's a question of making the banking system safer — making sure that there is a lot of buffer before you actually go into resolution, so authorities can intervene early — rather than having a big pot of money stashed away somewhere for a situation where you go into resolution. So the strategy has been completely different.

Then on top of that, it has been very, very clear since the Cyprus meetings of EU finance ministers on BRRD two years ago that Sweden had a different view on bail-in. Sweden had a severe banking crisis in the early 1990s and so the Swedish authorities know how to take over a bank over a weekend, but not using bail-in — and many of the people who were involved then are still around: the governor of the central bank, for example, was very much involved, and so were some of the people in the finance ministry. If you also look at the structure of the Swedish financial system, we have less deposits — ordinary deposits — than many other banks, but we have a very well developed domestic market throughout the Nordics in covered bonds, which is more or less recycled deposits, because our savings patterns are very different. And I think the view among Swedish policy-makers has been that bail-in is a less successful strategy for managing the risk in the financial system. So, again, rather than focusing on the probability of default, we have these higher capital requirements. We today have total capital of 20.7%, Tier 1 at 16% in Q2. And then we can discuss other things that are coming on top of that.

So there is from a policy perspective a clear difference between Swedish authorities and some other European authorities.

Regarding your question, will they be able to maintain that? I think that's really up to the authorities, how they have set up Pillar 2, how they think about the strategy. And that is more in relation to TLAC (total loss-absorbing capacity) and other things that are coming as well now, and when you are moving things

from Pillar 2 to Pillar 1, potentially, with RWA (risk-weighted assets) harmonisation… So it's a lot for the authorities to think about. What we understand is that they are happy with the capital that we have, so we don't expect them to want to increase capital even further. Then it's more on how they can adapt and how we can adapt to the new situation.

Day, BIHC: What is the better approach out of what has variously been proposed so far?

Taos Fudji, Standard & Poor's: From a ratings perspective, the clearer the structure, the better it is for actually resolving investors' uncertainties. It's also very much driven by local considerations.

For example, what we have seen is that in the UK, where they have moved ahead in creating this HoldCo structure, is that the ratings outcome for banks has been much more favourable than the ratings outcomes for German banks.

The fact that there is still this very big level of uncertainty on the final tuning means that in Germany we haven't seen such a strong commitment to build up what we call the Additional Loss Absorbing Capacity (ALAC) buffers. So far there has therefore been quite a divergence in those two countries — which are, along with Austria, the only ones for which we have taken rating actions on in relation to BRRD.

Bauer, Erste: The Austrian approach will probably be to join the EU approach, a solution at the EU level. I don't think they will go their own route with a new law, it doesn't look like that would happen. I personally like the Italian approach better than the German one. With the German approach there has of course been the difficulty with the ECB-eligibility of senior bonds. The Germans changed the law, or at least they extended things by a year, so that the EU has a chance to come up with their solution. But obviously the insolvency rules and regulations of all the different countries and the national discretions will make this difficult — as in all the other topics we face: TLAC, MREL (minimum requirement for own funds and eligible liabilities), etc. It is just taking too long, and then we have the harmonisation of RWAs coming up as a new topic… It's a never-ending story and I don't know how banks are supposed to get back to doing their business when they are facing regulatory changes on a monthly basis.

Pinheiro, Caixa Geral: We have to recognise that having 28 jurisdictions with different national approaches is a challenge when you are striving for harmonisation. Harmonisation really is the key issue, otherwise there's no use in having supranational bodies coming out with regimes that aim at having a level playing field. I think these regimes will be better if we converge. For instance, if you take TLAC and MREL, it would be very beneficial for all stakeholders if there is a certain convergence between the two regimes. There are of course some differences at the national level, but I think we should strive to mitigate those differences. So to single out the Italian, German or whatever approach is from my standpoint already biased.

Nicolò Bocchin, Aletti Gestielle
'Be comfortable with the issuer — that's really the most important point'

> I don't know how banks are supposed to get back to doing their business

But I'm not too optimistic about it, because in financial markets we really see fragmentation — that's a fact, it's not an interpretation.

Donchev, CACIB: As we are hearing in this discussion and also seeing on the news, the approaches are very divergent — from doubting the value of resolution capital buffers and emphasising recovery and early intervention measures in certain jurisdictions, to creating accomplished facts, as expected shortly in Italy and Germany[1]. This makes it very difficult to have a pan-EU or even SSM discussion on the topic, although the ECB, for instance, invariably stresses the need for a common approach.

I presume that we will first see more national approaches emerging, and we may need to see evidence of market fragmentation within the senior unsecured debt market that goes as far as to begin to affect the efficiency of the credit transmission mechanism within the EU before the Commission has sufficient material to pressure weary legislators with opposing views to reopen the BRRD on the topic of senior unsecured ranking. This, coupled with pressure from supranational resolution and supervision authorities seeing a serious impediment to discharging their obligations effectively and efficiently. And let us not forget that there is the added difficulty of national resolution regimes. But I would presume some European solution emerges eventually, though it may take a few years before we see this implemented.

Day, BIHC: To what extent — if at all — is the market pricing in the different approaches that are being taken?

Pascal Decque, Crédit Agricole CIB: What I have heard up to now is very much in line with what I am hearing on my side when I'm meeting either issuers or investors, and that's the reason why we called our outlook for the year "The

Pascal Decque, CACIB
'There is much more complexity and much less transparency'

Alphabet Soup of Regulation" — and I don't see any reason to change the title for the coming year. In fact, all the investors we have met recently — and there is quite a long list — they told me that they were spending at least 50% of their time on regulation. And I am not so sure that's the thing they like most about their job…

They are trying to understand the regulations and they are trying to assess the value of the different debt instruments — which is not an easy call, as there is much more complexity and much less transparency. And typically they are all waiting – as was mentioned earlier — for the final rules on TLAC and MREL before taking any big decisions. Once the rules are clear, that will determine the funding strategies of the banks, which in turn will determine their own investment strategies. Up to now they have been very much in a holding position.

Regarding harmonisation, I understand that there are different insolvency laws in every country, but personally I find the situation very strange. Every day on my screen I can see the various European authorities insisting on more harmonisation, going back to what has been done on DTAs (deferred tax assets) and so on, but then with the latest rules we are discussing they are not going for harmonisation — it's something that I have a problem with.

There is also an expectation from investors on a French solution, but we do not have clarity on that.

Donchev, CACIB: What is important to keep in mind on this point is that France has four G-SIBs, more than any other SSM country, and they are all dependent on wholesale senior funding for their business models.

Given the different starting points and business models, it may not necessarily be evident what and if any French solution will emerge. We will see.[2]

Day, BIHC: You mentioned the different rating outcomes of the UK and Germany so far. How complex will it be with different approaches in different countries?

Fudji, S&P: As we have all discussed, it is very much company-specific and country-specific. Right now, in advanced countries, for almost all the banks we rate our approach is to focus on the standalone credit profile (SACP) characteristics. For some of the banks that are highly systemically important there is still one notch of additional government support, and this notch of support may be substituted by some banks that have enough TLAC or what we call ALAC uplift beyond the standalone rating. We consider today that these banks, if they ever enter a recovery or resolution, will continue to receive significant liquidity support from the authorities, because actually you cannot resolve an institution simply over a weekend without central banks giving support, without organising this, or else you will disrupt the market. So what we are saying is that some banks will get less support because the support is less timely, and less predictable, because there is the resolution. That said, we take something out from the extraordinary support on the going-concern basis — so we don't expect any more banking groups to be completely bailed out with the moral hazard effects that this has created, such as in 2008-2009 — but we include ongoing institutional framework support in the standalone credit profiles. And when we look at the standalone credit profiles — and this is the basis of our counterparty rating and on the rating of most of the liabilities of the banks — we see stable, and in some countries positive trends. We have seen positive trends in Portugal, positive trends in Spain, and positive trends in Ireland so far, because the banks have been restructured, and have got to grips with the pace of inflow of NPAs. In Italy we believe the peak in NPAs will be some time next year, so potentially this can follow. So the trend is mostly now stable.

How much do we want to split up every single little piece of liability? Well, there is not enough clarity today to be able to make this split. What we split out today is covered bonds.

We have seen in recent weeks that getting senior funding is very difficult

Persson, Nordea: There are some other aspects that are important when it comes to support, such as resolution funds, how they are prefunded and the speed at which they can be used. Again, I think this is one area where Sweden has a different solution. At least in the draft documentation we have seen, there are actually two resolution funds, one financial stability fund that can be used prior to resolution for solvent institutions, and then also a typical BRRD resolution fund. So again, there is a much more flexible approach. That is also something that needs to be reflected in ratings, for example, and which just highlights the fact that we have no harmonisation, with everybody having their own policy — for good reason.

Day, BIHC: Nicolò, What would your wishlist be for the financial authorities in terms of getting certainty?

Bocchin, Aletti Gestielle: First of all, about the rules. I'm not spending 50% of my time following what the latest new proposal are; I am waiting until the very end of the process before looking at them.

When you have an AT1 or a covered bond of a bank, you more or less know how comfortable you are with the issuer and what will happen to your bond in the event the bank goes bust. In terms of what I would like to see — and hopefully we will get that within a few months — is that when the rules are set banks make a full disclosure themselves what are the pillars, the buffers and the clear specific numbers. The most important, as I said earlier, is the MDA, and not every G-SIFI bank has published that; you have to recalculate it yourself or trust some analysts on the Street. So to me the most important point is not really to give the rules, but to force banks to disclose those numbers. Up until a few years ago we just were looking at total Tier 1 capital, then there were new rules and the banks started reporting Tier 1, core equity Tier 1, total capital — in the future we will have other acronyms with the relevant number together with these.

Day, BIHC: Indeed, alongside what we have discussed, there are lots of things like risk weighted assets, leverage ratio, IFRS 9 coming along — which of those are the most notable for you?

Bauer, Erste: The leverage ratio is not a problem. We are a very retail-oriented, stable bank, so we have different problems than the big investment banks. RWA harmonisation will of course be a topic going forward. With IFRS 9, there are lots of open points at the moment, so we are still looking at the impact that will have for us.

Otherwise it's the MREL/TLAC harmonisation — when is it going to come, how big is it going to be, is senior going to be included? And that is easily the biggest topic we have. We have seen in recent weeks that getting senior funding is very difficult, and what will it be like going forward? We have seen the big banks doing a lot of short floaters and over a two year time period investors can think, OK, there won't be too much going on until then, but what about five year paper? The investor has no idea if it is bail-in-able senior or what's it going to be after maybe three years. So I see senior funding very much as an important topic, and it all is connected with MREL/TLAC. What we have also seen is that MREL could be even harsher than TLAC, which seems kind of strange if the smaller banks face harsher ratios than the G-SIFIs.

> We have no harmonisation, with everybody having their own policy — for good reason

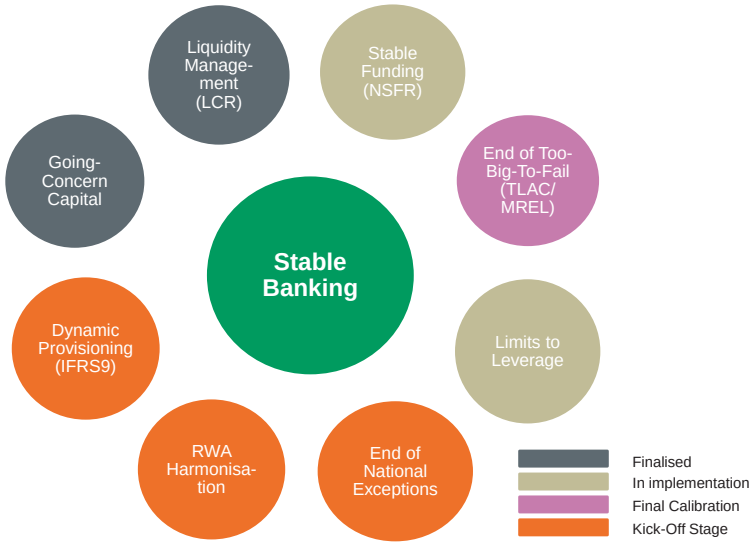
Pinheiro, Caixa Geral: The leverage ratio is also not a problem for us, being a retail bank. Managing and adapting to all the criteria for RWAs is of course critical. The good news from my standpoint is IFRS 9, because it is proposing a forward-looking measure — I think that is beneficial for markets. There is then this challenge to have models to predict your NPLs, and, again, if each country, even each institution has to come up with its own model with different outcomes… So although it is a very good measure and from my standpoint beneficial, we have to take care not to be too inventive on the models. It's a learning process and we are very focused on this issue because it has an impact on your capital stack and so on.

Persson, Nordea: I think all of what you mentioned, and then you can add Capital Markets Union, fundamental review of the trading book, interest rate risk in the banking book… There are probably some more. It's true, there is a lot of uncertainty. It's very much a question of where it will all end.

Donchev, CACIB: You have heard from the bank issuers what their pressure points are. The accompanying chart lists the menu of regulatory uncertainty facing the banks. I don't believe my list is exhaustive, but these are some of the topics driving the discussion today. And of course, every bank will have a different pressure point among this menu, as we just heard.

What we will have for some time is

After Basel III, Remaining Items on the Regulatory Agenda



Source: Crédit Agricole CIB

further uncertainty. In this context it is important for banks to drive the communication with investors themselves and be as transparent and logical as possible.

Capital, strategic and organisational plans can be adjusted several times without market penalisation provided the communication is transparent, logical and the likely path over three to five years can be seen. The known unknowns must also be named. Whether and to what degree there can be communication on that is another question.

Day, BIHC: On the uncertainty issue, when you have been coming to market this year — Renee mentioned about the difficulties in the market — to what extent is that already a factor in the ability to get deals done, the levels you are paying, and the investor base, and how that might be evolving for senior paper and other instruments?

Persson, Nordea: I think it will change, but I also think there will probably be differences between different issuers, depending, again, on all the regulations that we have and their implementation. We will see different changes in different jurisdictions on the back of how they implement the regulations.

Carlos Pinheiro, Caixa Geral
'Of course, if you want to have profitability, you have to have risk'

more quality capital is probably a very good thing — I remember at the time of the crisis when many people discovered that what was behind capital ratios was in fact not that much capital in the end. But if the ultimate goal is stable banking, my personal view is that "stable" and "banking" probably don't go together very well.

Banking is about taking risks, but being good at assessing those risks and pricing them well. So, some are good bankers, and others are not such good bankers. And if you absolutely want stable banking what you end up with won't actually be banking.

> There's been a lot of internal focus on how we can do things smarter, more capital-light

So far we have not seen any big changes. It has been, looking back a couple of years, the case in covered — again, driven by regulation. I think it's a bit too early — everybody is just trying to understand what is going on. That's also why some investors are sitting on their money, or investing elsewhere.

Day, BIHC: Are there any aspects to these developments that are underappreciated?

Decque, CACIB: I think personally that banks having more capital and

Pinheiro, Caixa Geral: Of course, if you want to have profitability, you have to have risk — that's in the textbook. There is certainly ever more uncertainty in the market, hailing from different directions — not only from financial markets, but society, political risk, and all that. But it is by taking risks that you make money — if everything were predictable then every investor would have a portfolio of the market and no-one would buy or sell. The efficient market hypothesis is only academic, a starting point, or a base for further analysis – in practice it works very differently, there are very different scenarios that we have to cope with.

But if you don't price risk appropriately, you will end up like in 2007 and 2008, and perhaps it is difficult because some things really are in flux. So we all have more and more capital, with instruments that can absorb some shocks — not only those that we have experienced but also shocks that we cannot imagine, because if you look back over the past 50 years you see many different crises, and the next crisis won't be like the last.

I agree that we are in a better shape in terms of having capital and instruments that can absorb losses more effectively. But it's a challenge being profitable. We have to acknowledge that and adapt models and pricing to this new reality.

Day, BIHC: How in your analysis do you balance a bank having perhaps a stronger capital base versus the ability to generate capital?

Fudji, S&P: That's a very fundamental question. In our methodology we clearly give a bigger weight to the amount of capital today than to the generation. That said, we do not actually think that holding an oversized amount of capital can significantly uplift your creditworthiness. So we have institutions that are what we consider averagely capitalised under our methodology, and we have those stronger ones to which we can give one notch uplift, and then we have extraordinarily capitalised companies which we may give two notches uplift to — but it will not go beyond that.

What we do recognise is that it is fundamentally important that banks have viable business models, that earnings do not need to be very high but they should be relatively predictable, and that actually very high profitability is probably an indicator that there are risks that are being taken that are maybe not fully reflected in regulatory capital ratios. And so at the end of the day we give equal weighting to business position and to risk position as well as to capital. So capital can help you a little bit, but actually it will not determine whether or

not you are more in the single-A range rather than the triple-B range.

Day, BIHC: How are the banks balancing the way in which they meet the greater capital requirements in terms of building up capital, reducing RWAs or any other strategies?

Bauer, Erste: As a retail bank the strategy has been to concentrate on our core businesses. We took a look at that a long time ago, which businesses or areas we want to be active in and which not, and which countries. We left one country and decided to stay in others, and basically decided on our core business area and reduced our non-core business. That's very important, especially on the RWAs side.

The bank has been very stable with regard to balance sheet and RWA developments — we have not seen excessive RWA development in recent years. Of course, with the new harmonisation we will have to see what they do going forward. But otherwise it's a question of staying with your core business, as the gentleman mentioned, and seeing that you make money out of it.

Persson, Nordea: I very much agree. The strategy that we have had from 2013 and onwards, and will also continue for the next couple of years, has very much been focused on what we are good at, and the core markets. We also focus a lot on cost efficiency. Something that we see in the Nordics is a huge change in how our customer behaves, so we do much more digital — so mobile, internet — it's completely different. That has implications for how we do banking and, again, will help us on cost efficiency.

Then, on capital, we build capital each quarter, organically. We have communicated clearly now a strategy as to how we see the management buffer, which we did at our capital markets day in May in London. So we are getting there.

It really is a matter of focusing on cost, on capital. There's been a lot of internal focus on how we can do things smarter, more capital-light, yet still supporting our customers, across our business. We manage that, but it is a challenge.

Pinheiro, Caixa Geral: Our bank, too, has for the last few years been concentrating on its core business, which is retail banking in Portugal where we have a very strong franchise. We have divested in several areas of business that were not core, while cost reduction has also been on our agenda — not only for a few years but for the last 10 years or so. And also in terms of RWAs, we haven't had much change recently. Of course, the challenge is being profitable in an environment where growth is not as strong as we would like it to be, so we are still deleveraging. And although there is more demand for credit these days, being in a small and open economy we are of course dependent on what is happening globally.

I think that in banking in general, both in developed and emerging countries, we have to somehow reinvent ourselves when it comes to business models. We are of course discussing what is going on in banking, but we see also shadow banking, with non-bank entities. Banks are being penalised through having all this loss-absorbing capacity while you have certain sectors of the economy that are just bypassing banks. So that is just one more challenge.

Doncho Donchev, CACIB
'It is important for banks to drive the communication with investors'

Stability is not completely in line with being more profitable

And, again, while there is this mantra of being concentrated on your core business and being a dull retail banking guy, this stability is not completely in line with being more profitable. You have to be innovative in terms of products and addressing your customers. But at a certain point regulation, even if it is very important, normally hinders such innovation. So these are new challenges that we really have to address. ●

1. Since the panel discussion took place, Germany and Italy have introduced their national laws and the ranking of senior unsecured has been changed, in Germany valid from 1/1/2017 and in Italy from 1/1/2019, with retroactive application.

2. French regulator ACPR has since communicated on this topic that a French solution may be forthcoming and that a solution agreed by French G-SIBs may not be impossible.

Dutch enter new capital era

The Dutch Additional Tier 1 market kicked off in January when Rabobank took advantage of long-awaited domestic clarity over treatment of the instrument to open the market. Since then Dutch banks have been active across the capital structure, but they face renewed uncertainty over the next big regulatory steps. *Neil Day* reports.

When Rabobank launched a Eu1.5bn Additional Tier 1 transaction in January it could claim two impressive landmarks: the first AT1 from a Dutch bank, and the first AT1 of 2015.

However, thanks to the Dutch authorities lagging their European peers in laying the foundations for the CRD IV-compliant instruments, the issuer could only notch up these achievements after watching from the sidelines as the asset class developed through 2013 and 2014.

"If you look at what Rabobank has done historically, we have wanted to be one of the first into new markets," says Rogier Everwijn, head of capital and secured product at Rabobank, "and we are referred to as quite an innovative issuer. So waiting for others to open the market was indeed frustrating to a certain extent."

Rabobank had, after all, been among the pioneers of CoCos when it sold a $2bn deal in January 2011 that was the first write-down instrument in the evolving asset class. Holding it back in the latest hybrid capital revolution were the Dutch authorities.

"We were not able to issue earlier because there was a debate in the Netherlands about the tax deductibility of the coupons of AT1 instruments," says Everwijn, "so that means that the whole issuance plans were delayed already over the course of 2014."

The Dutch Ministry of Finance last June paved the way for Dutch AT1 by setting out proposals to amend the country's corporate income tax act and following parliamentary approval the necessary legislation was in place for issuance to begin at the start of this year. And just two weeks into the year, on 15 January, Rabobank kicked off activity.

"The reason for us coming in January was just that we wanted to be one of the first out in the market," says Everwijn. "We had seen basically zero issuance in the last quarter of 2014, and so to avoid any competing pent-up supply we wanted to go ahead as soon as possible in the year.

"Markets were not in an overly positive fashion in that period, but they were stable enough for us to go ahead and we were comfortable with the feedback from the roadshow," he adds. "In hindsight, it was good timing, well ahead of the competition."

Rabobank went out with IPTs of the 5.625% area for its perpetual non-call 5.5 issue and was able to tighten to 5.5% on the back of a Eu4bn book. Everwijn says that the result was as good as could have been hoped for, particularly given that on the day of launch the Swiss National Bank shook the market by announcing the removal of an upper limit on the strength of the Swiss franc, which led to renewed volatility and some investors deciding not to participate.

Dutch Minister of Finance Jeroen Dijsselbloem
In his domestic role and internationally as Eurogroup president Dijsselbloem has been at the heart of negotiations towards the new regulatory framework, and notably the topic of bail-in
Photo: Government of the Netherlands

Rabobank
'We achieved the best outcome that was possible'

"In terms of pricing, the best comparable at that time was an HSBC transaction, and if you add in a new issue concession then we achieved the best outcome that was possible," he adds.

Four years had passed in between Rabobank's innovative CoCo in January 2011 and its first Dutch AT1, and Everwijn says that developments in investors' attitude towards such instruments explained the choice of euros this time around.

"In 2011 that was basically the first Basel III-compliant structure and we issued in dollars because investors in continental Europe and also the UK were not ready to invest in these kinds of structures, so we were focusing on Asian high net worth private banking demand," he says. "But since then we saw a lot of European banks in the euro market and the investor community was interested in investing in these structures.

"That made us wish to issue in euros to achieve the largest and deepest book."

ING followed Rabobank into the AT1 space on 9 April, but opted for the dollar market and enjoyed a book of some $20bn for its $2.25bn debut. Issued by ING Groep and rated Ba3/BB, the deal was split into $1bn 6% perpetual non-call five and $1.25bn 6.5% perpetual non-call 10 tranches. The pricing was some 37.5bp tighter than initial price thoughts while some 55bp wider than where an HSBC $2.25bn perp non-call 10 priced in late March.

ABN sales across capital structure

ABN Amro debuted in the AT1 market on 15 September, selling a Eu1bn 5.75% perpetual non-call five issue. The move into AT1 came after the Dutch issuer had in June tapped the Tier 2 market and ahead of a long-awaited IPO on 20 November that valued the bank at some Eu16.7bn when NL Financial Investments sold a Eu3.3bn stake on behalf of the government.

"As you have seen, we have had quite a heavy calendar this year," says Michael Tromp, head of capital management at ABN Amro. "We wanted first to have our Tier 2 instrument issued, and after summer started looking at an AT1 issuance to have this instrument done before a potential IPO.

"We have an old-style Tier 1 outstanding that will lose its capital qualification in line with the CRR grandfathering rules in Q1 2016," he adds, "so then the 1.5% versus RWA bucket will be empty of Tier 1 instruments. So in order to optimise that part of the capital structure and also to benefit our leverage ratio it made sense to do an AT1 instrument."

Although Dutch issuers were latecomers to what is by now a relatively mature AT1 market and ABN Amro was the third from the country after Rabobank and ING, important discussions with the regulator and investors remained, according to Tromp.

"Even if the instrument is in general better understood since we have seen many issues," he says, "the AT1 structure in itself is of course very much related to the structure of the issuer and its balance sheet. And although we have cleaned the balance sheet up, it is for legacy reasons a bit more complex than some. Our AT1 structure, for example, has three different triggers, and refining the instrument and having discussions with the regulator takes some time.

"Most of the questions from investors on the roadshow were instrument-related," he adds, "but also involving what our ambitions are on Total Capital and CET1 levels, the interplay between dividend payments and AT1 distributions, and such topics."

ABN Amro's temporary write-down AT1 has a 7% CET1 trigger at group level and two 5.125% CET1 triggers at the bank level, and was rated BB/BB+ by S&P and Fitch.

The perpetual non-call five issue was launched with IPTs of the 5.875% area and was priced in the middle of final guidance, at 5.75%, on the back of an order book of some Eu3.5bn.

The scarcity of ABN Amro AT1 versus its peers is identified by Tromp as a factor in the success of the debut.

"We don't need a lot of AT1 if you look at the 1.5% versus RWAs of roughly Eu110bn-Eu115bn," he says. "And in light of our profitability and leverage targets, AT1 supply from ABN Amro will be relatively limited in the coming years."

As you have seen, we have had quite a heavy calendar this year

"Investors had for a year already been asking when we were coming with our AT1, and I think that also materialised when we launched the deal in a lot of high quality names coming into the book."

The deal also succeeded in the face of ongoing volatility.

"We had been looking at the market on an ongoing basis and from around May, June the markets weren't that fantastic," he says, "first with Greece and after that China, and during our AT1 the markets weren't very smooth, either. So then you have to pay up a little bit and rely on your strength, and hope that the pricing will tighten from IPTs due to the quality and number of orders in the book."

ABN Amro had undergone a similar experience with its

Tier 2 issue on 23 June, when it sold a Eu1.5bn 10 year non-call five deal. The market for such debt had been closed for almost a fortnight on the back of rising Bund yields and Greek fears, but the Dutch bank had reopened the market with IPTs offering an enticing new issue premium of as much as 50bp to generate a book of some Eu8bn. The trade was ultimately priced 15bp inside IPTs, at 235bp over mid-swaps, before conditions soon deteriorated on the back of worsening Greek news again.

"We saw some trades that struggled to achieve their ambitions," said Daniëlle Boerendans, head of long term funding and capital issuance at ABN Amro Bank, at the time, "so together with the joint leads, we decided that this was probably the best strategy and then to take it from there. In these kinds of markets, you should really choose the right execution strategy, that is to get investors' attention and I think that ours was the correct approach.

"From the start, when we saw that there were Eu2bn of orders in the book after one hour, we were already quite happy," she added, "and now we are even more pleased. I think it's quite hard to get the timing right nowadays, but in hindsight we couldn't have done it better."

SNS makes comeback in Tier 2

SNS Bank chose a Tier 2 offering for its return to the capital markets on 29 October. The comeback came a month after ownership of the Netherlands' fourth largest bank was transferred to the Dutch state in the latest move following the nationalisation of the SNS group in February 2013 – its privatisation will not take place until at least mid-2016, under government plans.

"It was known to the market that SNS Bank should return to the capital markets as soon as the SNS Bank was fully disentangled from SNS Reaal," says René Genet, senior dealer, at SNS. "This was the case at 30 September, and markets were relatively supportive for an SNS transaction, so we decided to go ahead, on 19 October starting roadshowing through Europe.

"We tried to get over that SNS has a solid balance sheet and that we have shown a solid financial performance in 1H15," he adds. "SNS is now solely a retail bank and the retail bank activities have been profitable throughout the years. SNS is targeting the Dutch retail client with mortgages, deposits and payments, and there are no ties left with commercial property and SNS Reaal Group."

Genet says SNS chose to return via a Tier 2 instrument to further strengthen and diversify its capital base, with the 10 year non-call five format for the first issuance contributing to optimising the bank's capital structure and supporting its credit rating by showing market access.

Leads Deutsche Bank, Goldman Sachs, ING Bank, JP Morgan and UBS opened books for the Ba2/BB/BBB 10NC5 issue with a level of the mid-swaps plus 375bp area before pricing the Eu500m 3.75% deal at 365bp.

"The transaction was very well received and gathered a Eu1.1bn order book," says Genet. "Pricing the deal was a discovery process for all involved, but through intense communication we managed to print at the right level."

SNS Bank
'Markets were relatively supportive, so we decided to go ahead'

Fund managers took 77% of the transaction, hedge funds 11%, banks and private banks 6%, insurance companies 5%, and others 1%. The UK and Ireland was allocated 64%, the Benelux 9%, Switzerland 7%, France 6%, Nordics 6%, Iberia 3%, Germany and Austria 2%, and others 3%.

Genet says that henceforth SNS Bank plans to be a frequent issuer in various instruments, although this will depend on the various regulatory developments facing the industry, such as bail-in and MREL/TLAC.

Regulatory positioning

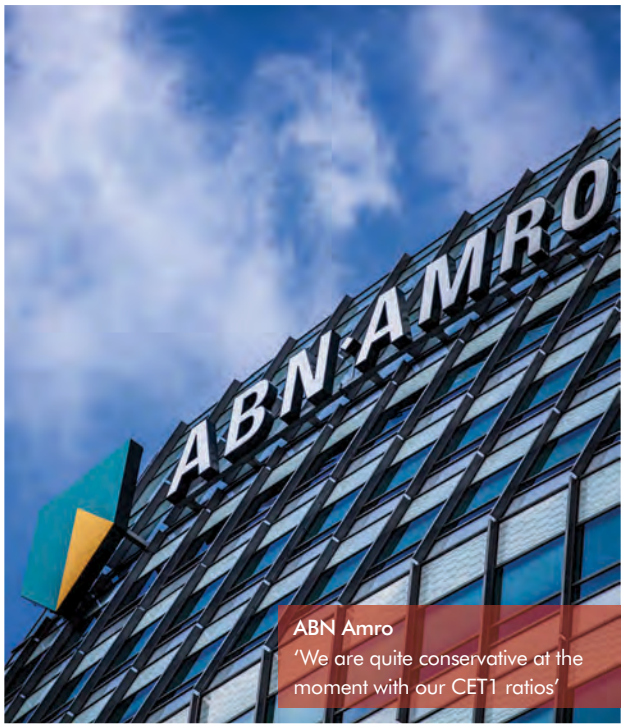
Other Dutch banks are in the same position, awaiting regulatory clarity at the same time as doing their best to anticipate the exact shape of the incoming framework. And, naturally, they are also seeking to try to influence its form.

Rabobank, for instance, in September published a position paper on the then legislative proposal in Germany to change the hierarchy of claims in case of insolvency by subordinating specific senior debt instruments, notably senior unsecured bonds, to address Bank Recovery & Resolution Directive and MREL/TLAC issues. The bank said it understands De Nederlandsche Bank (DNB) with the ECB, the Dutch National Resolution Authority (NRA), and the Dutch Ministry of Finance to be analysing the German plan.

"BRRD was recently implemented in Dutch legislation in line with the EU directive," says Laurent Adoult, FIG DCM at Crédit Agricole CIB. "The creation of a statutory layer of bail-in-able senior was not addressed, but we would not rule out a statutory solution at some point."

Rabobank came out strongly against the German way, noting that it runs contrary to a position paper the Dutch bank had published back in July 2013.

"Rabobank is in favour of building up high capital buffers to protect all senior unsecured liabilities," it said. "Addition-



ABN Amro
'We are quite conservative at the moment with our CET1 ratios'

ally, Rabobank supports the approach whereby on a statutory basis losses can be spread over as many senior liabilities as possible — the so called comprehensive approach — to reduce the amount of losses on this category.

"This in contrast to the targeted approach, whereby only designated instruments can be written down. Rabobank thinks that by the German Proposal the price (cost of fund), but more importantly the availability of senior unsecured funding could be at risk as investors can step away from this asset class as risk (and reward) are not the same or could no longer fit the mandate."

The Dutch bank has some Eu150bn of senior unsecured debt outstanding and it highlighted that a 50bp increase in spread could result in an increase in funding costs of around Eu750m per annum. It also noted that it had increased its Total Capital target from 20% to 25% on the back of TLAC proposals.

"Rabobank builds up high capital buffers to protect senior unsecured liabilities and additionally, Rabobank supports the comprehensive approach whereby losses can be spread over as many senior balance sheet liabilities as possible," it concluded. "By this strategy, Rabobank aims to ensure access to funding through the cycle, also in volatile market conditions which is of high importance to Rabobank and banks in general."

ABN Amro is meanwhile excluding senior debt from its MREL thinking.

"We are currently at a 6.4% MREL level, and that's solely in subordinated form," says Tromp, "and we aim — pending changes to regulations, laws, etc — to fulfil the 8% in subordinated debt, even if senior unsecured can count towards it."

Adoult at CACIB identifies as another key regulatory development the proposed introduction of risk weight floors under "Basel IV", notably for residential mortgages.

"The next thing for the Dutch banks could be the whole discussion around risk weights for mortgages because that's really the heart of their businesses," he says. "The linkage to loan-to-values that is being discussed could penalise Dutch banks, because in Holland these are structurally higher than in most European countries due to tax incentives."

Indeed Rabobank has also come out against such developments, describing the move as "a big step back to Basel I" and saying that due to the anchoring of floors to a revised Standardised Approach there is a limited reflection of the underlying risk in the solvency requirement.

"It's still not clear what the impact will be, with the Basel Committee and others reviewing the current state of play," says Everwijn, "but I think that the direction of travel is clear: risk weights will go up — otherwise you would not undertake such a process.

"The big question is, by how much?"

According to Moody's, the average risk weights of Rabobank's mortgage loan book at the end of June was 12% and the rating agency in October estimated that based on a 25% risk weight under Basel IV the Dutch bank's tangible common equity to RWA ratio of 16.6% would decrease by 181bp.

"Nonetheless, although 25% is the minimum boundary of the 25%-100% proposed range, which might make the final outcome more punitive for Rabobank depending on loan-to-value ratios, we believe that the outcome remains uncertain and that the final standards may be less constraining," it added.

We would not rule out a statutory solution at some point

Moody's said that the three largest Dutch banks will be particularly affected by the new rules because of the high proportion of their private sector loan portfolios comprised of residential mortgages: 47% for Rabobank, 52% for ING, and 54% for ABN Amro.

Tromp at ABN Amro agrees that a "one size fits all" approach to RWAs is misguided, further citing as an example how roughly one-quarter of the Dutch bank's mortgage portfolio comprises Nationale Hypotheek Garantie (NHG) loans as well as the low impairments on the mortgage portfolio through the crisis.

However, he anticipates a long phase-in period and some local discretion if the regulation is implemented in a certain form.

"The BIS proposals have been commented on and we need to see in which form a final proposal will be implemented in Europe," says Tromp.

"We are quite conservative at the moment with our CET1 ratios," he adds. "We are currently operating at a CET1 ratio of just above 14.9% — that's also from a prudency perspective, and to be able to absorb the phase-in of potential risk weight increases or capital floors." ●

Bail-in Uninvestable consequences?

The Bail-In Working Group (BIWG) of the International Capital Market Association (ICMA) wrote to the European Central Bank over the summer to set out views on the operation of the bail-in mechanism, notably that the regulatory complexity bail-in entails may render bank capital uninvestable. Here, we publish their views and arguments in full.

Regulators, government officials, central bankers and investors maintain the same goal: to reinforce the safety, soundness and ultimately, the stability of the financial system.

The Bail-In Working Group (BIWG) generally concurs, in varying degrees, with many of the comments that have flowed through the market regarding the proposed TLAC term-sheet and issues regarding bail-in and ultimately bank resolution. But the BIWG stresses the need to create conditions that allow investors to assess the range of potential risks — a crucial part of the investment decision making process. The BIWG is concerned that extra layers of regulatory complexity may not only make it more difficult for banks to raise capital in the first place, but also ultimately negatively impact investor demand and investor behaviour, and thereby render bank capital uninvestable.

Complexity of triggers

The main focus of concern is the development of regulatory measures to which investors, especially in the credit world, will now be subjected. More specifically, regulators have set a number of triggers, including: Pillar 1, Pillar 2, Minimum Requirement for Eligible Liabilities (MREL), Total Loss Absorbing Capacity (TLAC), Maximum Distributable Amount (MDA), risk-weighted basis, leverage basis, stressed basis/unstressed basis, and most crucially, Point of Non Viability (PONV). The location of these triggers along a now more complex, revised capital structure is not entirely clear and may indeed be varied through time. Moreover, many of these triggers are subject to significant degrees of regulatory discretion. The absence of a track record of new-style interventions leaves investors with almost no insight into the risks associated with such discretion. Consequently, it is impossible to reasonably price such contingencies.

Transparency

The more complexity in the underlying framework of the capital structure, the greater will be the challenges around transparency and predictability for both balance sheet and resolution regime.

Under new and more intrusive supervision, regulators are likely to be privy to more detailed information. As such, the BIWG is keen to avoid a situation whereby credit investors are not only underwriting the risk of management failures, but are essentially underwriting the risk of regulatory failure which arises due to regulatory complexity, and a lack of available information by which to price risk. Investors are arguably compensated for the former through the credit premium. (However given the loose monetary policies deployed at present by many central

The views represent a range of inputs provided by the Bail-In Working Group (BIWG), which in turns reports to the Asset Management & Investors Council (AMIC) of ICMA. As such, it represents a well informed and considered view of the bail-in proposals from the buy-side perspective.


Robert Parker, chair of the ICMA AMIC

banks, it is far from clear that markets are correctly pricing a variety of risks including both credit risk and liquidity risk). It is however unlikely that investors are being adequately compensated for the latter as there is currently no reliable means by which to price this risk.

Asset quality/legacy bad loans

While primarily responding to questions regarding the liability structure, many asset quality issues arising from the financial crisis remain, to a large degree, unresolved — in particular, the high stock of bad loans remaining on the books of many of the euro area banks. The concern here is that investors may be called upon to fund these bad loans years after the onset of the financial crisis and as part of the bail in/resolution of a bank. Arguably this is the case with the resolution of Heta in Austria. In dozens of cases, particularly across the euro area, these bad loans exceed the tangible common equity of many banks and are at historically high levels to the GDP of individual countries and the Euro 19 collectively. While growth in the banking system via the credit markets is a common goal, there is a need to dramatically reduce over time the legacy bad loans that remain. Present levels of pre-provision profitability show that this may take years to even out.

Market and individual bank estimates of loss-absorbing capital required (under the present TLAC Term Sheet) exceed upwards of Eu1tr. This roughly equals the ECB reported stock of NPE (Non Performing Exposure) under the "simplified definition" of the EBA following the latest Europe-wide AQR/Stress tests. To address the liability mix without addressing the issue of the other risks of the balance sheet would be a missed opportunity, and credit investors will be less willing to fund new capital and TLAC instruments if the perception is that these funds will be deployed to clean up legacy problems. In other operating environments — such as the US market — a unified regulatory disclosure is substantially more detailed.

Quality of underlying risk – equity – capital

The quality of the underlying risk capital — i.e. the equity buffer that comes in before bail-in debt — also needs to be assessed before trying to price capital instruments, which today adds an additional level of complexity for investors.

Preserving conf dence

Banks remain viable entities as long as they are perceived to be solvent. Therefore it is crucial to preserve depositor and investor confidence through the journey to increased levels of required regulatory capital. While a period of stability in the rule-setting process would be welcomed, consideration of the following issues, which could be implemented by way of streamlining and simplifying the regulatory treatment of banks, could help to encourage this confidence:

> 'There is currently no reliable means by which to price this risk'

I. Enhanced Transparency

Enhanced transparency is at the core of investment decision making. Greater visibility, for example on asset encumbrance and Pillar 2 requirements, is necessary. Mindful of the technical challenge it may pose, the development of a unified, detailed and publicly available chart of accounts and financial reporting for the euro area financial system is crucial (whilst respecting the need for confidentiality in certain instances), for reasons set out further below. In this regard, the BIWG is fully supportive of the detailed work of the Enhanced Disclosure Task Force (EDTF) of the FSB.

A significant number of euro area bank assets do not fall under the remit of direct regulation of the ECB. In addition, many banks are not listed, and hence are not subject to the additional market discipline and scrutiny of the capital markets. Fixed income investors may be indifferent as to ownership structure and size of balance sheet, but consider that consistent disclosure of data is vital. A unified, detailed and publicly available chart of accounts and financial reporting (especially on asset quality) is a medium-term goal that could be achieved in parallel to the new capital requirements and resolution regimes.

In particular, given the concerns raised above regarding underwriting regulatory failure, authorities should be encouraged to establish the maximum possible degree of parity between what the banks disclose to the market and what they disclose to the regulators, as to which a unified, detailed and publicly disclosed chart of accounts and financial reporting for banks in the euro area would help. Given the intended shift from a bail-out regime (with costs largely borne primarily by the public sector — ultimately, taxpayers) to a bail-in regime (with costs born primarily by private-sector investors), a fundamental shift in the mind-set of the authorities regarding disclosure is required.

Investors are likely to be at a considerable information disadvantage versus the regulators in resolution planning, and should receive significantly better ex-ante disclosure as to the manner in which a resolution would likely unfold at any given institution. This should go beyond the mere disclosure as to which entities in a group are resolution entities and is perhaps of particular importance in groups which deploy a HoldCo/OpCo structure and/or are intending to operate

a "multiple point of entry" structure.

Even with significantly enhanced transparency, it remains unclear that the rights of creditors will be adequately protected under the new regime given the levels of discretion accorded to both bank management and regulators especially with regard to Additional Tier 1 instruments. In this particular regard, the "No Creditor Worse Off" protection is of no value. Members of the BIWG would welcome further debate and disclosure around this topic.

II. Enhanced Simplicity

The future development and success of the market for TLAC and regulatory capital instruments will be best served by a high degree of standardisation/homogeneity. The rules of the game therefore need to be clearer.

There is in Europe a significant challenge regarding the manner in which subordination of TLAC-eligible instruments is achieved. For example: HoldCo/OpCo structure (UK); Statutory Subordination (German Proposal); and Contractual Subordination (discussions around "Tier 3" TLAC instruments). Whilst these potential solutions address national idiosyncrasies, a common framework would be simpler, and therefore, preferable.

Equally, as noted above, the multiplicity of trigger points for the imposition of losses on TLAC/regulatory capital instruments is a concern. In this regard, it is important for investors to be able to determine which the effective triggers are given any reasonably foreseeable scenario, rather than whether losses are imposed via coupon restrictions or losses to principal via write-down or equity conversion.

III. Enhanced Predictability

The BIWG recognises that the resolution regime is still in the development/transition stage. However, with many of the pieces of the jigsaw now in place, an extended period of stability in the rule-setting process would be welcomed. Where possible, any further changes should avoid retroactive application, especially regarding such fundamental issues as the creditor hierarchy/relative subordination.

The BIWG understands the need for limited flexibility in order to vary capital requirements throughout economic cycles. Nonetheless, further fundamental shifts in the quantum of capital required would be very damaging especially given the long-term nature of the proposed TLAC instruments. This is particularly the case were it to impact the proximity of bail-in.

> 'The rules of the game therefore need to be clearer'

The BIWG supports and recognises the value of the stress testing regimes that have been introduced in the main jurisdictions. Ultimately, these should enhance discipline within the banking sector and lower the risk to regulators and investors alike. However, concerns remain that the outcome of stress-testing both in terms of the capital outturns and the regulatory response to "failure" may lack a degree of predictability. This is especially the case depending upon the stresses applied in the actual exercises.

The advent of resolution regimes puts all interested parties — regulators, government officials, central bankers and investors into unchartered waters. It may take many years before a pattern of resolutions emerges, and not every resolution may be the same. Nonetheless, the BIWG would encourage the authorities to establish, at the earliest opportunity, a consistent approach that can then be clearly and transparently articulated to the market.

Conclusion

The BIWG looks forward to engaging the ECB and other regulatory bodies in a constructive and open dialogue to achieve the ultimate goal of fortifying the safety, soundness and, ultimately, the long term stability of the financial system. ●

The ICMA is a pan-European self-regulatory organisation and an influential voice for the global capital market. It has a membership of over 400 firms and represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years.

Replot Bridge, Finland
Source: Mika Kuusela/Wikimedia Commons

Municipality Finance Bridge to the future

Finland's Municipality Finance on 24 September sold the f rst Additional Tier 1 instrument from an SSA issuer, a Eu350m 4.5% perpetual non-call 2022 BBB+ deal that had the lowest coupon and highest rating of any AT1. Esa Kallio, executive vice president, deputy to the CEO and head of capital markets, Municipality Finance, discusses the rationale for the landmark.

What was the rationale for your Additional Tier 1 transaction?

There was one reason behind it and that is the leverage ratio. If you look at all the regulatory burdens facing financial institutions in general, we don't have problems complying with them — with the exception of the leverage ratio. And there, it is simply because unfortunately the leverage ratio doesn't look at the level of risk you are running on your balance sheet.

If you look at our business model, there are key differences between ourselves and a traditional bank: our only source of income is the margin we are able to make on top of our average funding cost — we don't have any kind of fee income — and meanwhile our customer base is very, very restricted. So the level of risk of our asset base is completely different to what you can see on a typical bank balance sheet.

How did your thinking evolve in how you would address this capital need? Did you have alternative options?

Here we have to rewind back as far as 2009 to 2010, because that was when the authorities gave their first indications as to the new regulations that would be coming up, and then it became clear that we would have to comply with all of them, the leverage ratio included.

At that time, in 2010, our leverage ratio was below 1% — somewhere around 0.8%-0.9%. Yet by that time it was quite widely discussed that the required leverage ratio would probably be 3%. Since then, in terms of the necessary levels, we have heard very little on the regulatory side and nothing will be set before 2017, so we have been working with the 3% as a target. And in reality you have to reach a leverage ratio of 3% before 2017-2018 because investors, rating agencies and others who are monitoring your business will most probably expect institutions to have a really good plan as to how they can be sure they will comply with the set level if and when it is finally set.

Regarding the question of what alternatives we had, in our case there were only two options in 2010: either continuing with the very low margin business we had been doing until then and going to our shareholders some time in 2015-2016 to request a substantial amount of fresh capital; or raising our lending margins quite significantly and then starting to grow our equity base through organic profitability.

AT1-type instruments were available, but at that time you had to have this so-called equity conversion clause included in your instrument and in our case that would not have worked, the reason being that our shareholders are restricted to being either Finnish municipalities or some other operators in the Finnish public sector that need to be individually approved by our board. So AT1 was not any kind of option for us. Then last year, in early 2014, we discovered that regulations changed to allow more flexibility whereby you can also use either temporary or permanent write-down features. This meant that AT1 potentially became an alternative way for us to increase our equity base.

Did you need to come up with any new structural elements to reflect your atypical business model?

No. Indeed during our roadshow we didn't even go through the structure because it is a very straightforward, standard structure that was used by banks in many previous AT1 transactions in the past year. So there was nothing special in the structure itself.

It is the first AT1 transaction from the SSA sector. How did this affect the preparations?

It was really challenging. First of all, this was not only the first AT1 issued by an SSA; it was at the same time the first AT1 issued by anybody out of Finland. So it wasn't only investors that we had to communicate with, but the local regulators and authorities, too. While the structure was nothing special in itself, it was new to our regulator and also the whole concept was something completely new for our tax authorities.

Then the second part was who the suitable investors were. This came down to finding, with the help of the banks we had chosen, the right type of investors. In the AT1 world these are slightly different to who we were used to through our usual issuance.

What were the key messages you were trying to get across to these investors?

The main messages were really that although we are a financial institution — i.e. we have to comply with all the regulatory burdens in the market — we are different, and that we are very low risk to start with. Honestly speaking, from our business perspective the fact is that we don't need this capital; this is only to comply a leverage ratio that is not appropriate for us in the first place. The parameters that we should be monitored against are therefore quite different to what investors have been used to when investing in previous AT1s issued by various banks. So it was a question of making it very clear how much we differ from other banks.

How did you find an appropriate price in light of this?

That was also a really challenging exercise, the reason being that, as you


Esa Kallio, Municipality Finance

mentioned, we are the first SSA issuer. Also, if you look at the rating of this transaction, it is the best you can find in the whole marketplace, i.e. there was no reference point whatsoever. We did try to use the ratings as a kind of starting point and at the end of the day there were a couple of different models that were used but which all landed in the same ballpark.

Are you happy with where you ended up?

Yes, even if you can always argue over what the correct price is. Whenever we are issuing in any market we try to be fair, meaning something that is a good price for us but which is also a good price for the investors. The secondary market is quite a good indicator in this respect, meaning there should be a healthy development with a little tightening, but not too much, and indeed the performance of our issue demonstrated this, in the first couple of days, at least. It could be seen as having been quite tightly priced, since we were able to tighten the level through the execution process, with the book being huge, but there was still this positive development in the secondary market. That tells me that it was a good price for everybody.

How did you go about allocations with such a big order book?

As you can imagine, that was also really challenging because we were nearly three times oversubscribed, meaning that we had to use certain parameters when allocating the bonds. We tried, once again, to be as fair as possible and to do our best to satisfy everyone, even if this was difficult.

The order book was also of a really good quality. I have heard that in those AT1 transactions where there has been huge oversubscription the main driver has been more or less inflated orders, but we didn't see that much in our transaction.

Why did you choose the maturity?

It was really for ALM reasons. As I already mentioned, our original decision was to try to grow our equity base through organic profitability, and that's exactly what we will be doing in the future. We have run various calculations as to how our balance sheet will grow under this scenario and they show that we will easily be able to grow our CET1 figure sufficiently high so as to comfortably comply with a 3% leverage ratio plus an internal buffer after five years on this basis, meaning that we will be able to pay down this transaction.

That's the simple reason behind it and internally we have been speaking about this as a transaction that is only necessary to bridge our capital needs over time. This is the first and only AT1 that we are planning to issue provided that the required leverage ratio will be set at the level of 3%.

Other SSAs may be looking at similar transactions — what advice would you give them?

There are always rumours flying around in the capital markets and naturally I have heard some names who might be looking at the market. Really, the only advice I am able to give is: first of all, put aside enough time to do your homework in terms of your local authorities, tax authorities, and the rating agencies; and secondly, make sure you refine your story so that investors can easily see how you are different from typical banks — that's the only way to explain the also different price, and to help investors find a fair value for your transaction. ●

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