

International Capital Market Association

SURVEY

on

“Buffer Contingent Capital Securities”

17 January 2012

1) Introduction

On 8 December 2011, the European Banking Authority (the “**EBA**”) published a formal recommendation (the “**Recommendation**”) on the creation of temporary capital buffers, the objective of which is to create an exceptional and temporary capital buffer to address current market concerns over sovereign risk (the “**Stress Capital Requirement**”), and which may include very strong newly issued buffer convertible capital securities (“**BCCS**”) if consistent with the EBA “Buffer Convertible Capital Securities Common Term Sheet” (the “**Termsheet**”).

One of the key advantages of issuing BCCS to meet the temporary Stress Capital Requirement is that it gives issuers access to the fixed income investor base to raise EBA Core Tier 1 eligible capital, and therefore the possibility of using BCCS to tap supplementary investor sources for Core Tier 1 capital is welcomed.

However, in order for the BCCS to be fit for purpose, as well as achieving the regulatory objectives, the host instrument needs to be sufficiently attractive and marketable.

With marketability being the main influential factor, we conducted a survey on the matter among major market participants. More precisely, we asked a series of questions comparing the market impact of BCCS with a Tier 2 host with otherwise identical BCCS with an Additional Tier 1-style host.

The results of our survey are presented below.

2) Survey

SUMMARY:

The key findings of our survey are:

- There is significantly more appetite in the market for BCCS with a Tier 2 host than for BCCS with an Additional Tier 1-style host with otherwise identical characteristics.
- At the same time, market participants estimate the coupon commanded by a BCCS with a Tier 2 host to be lower than the coupon of otherwise identical BCCS with an Additional Tier 1-style host.
- It would appear that it will be much more difficult for issuers with lower credit ratings (and who need to be able to issue the BCCS to meet their Stress Capital Requirement) to place BCCS with an Additional Tier 1-style host than with a Tier 2 host.

CONCLUSION:

According to our survey, it is widely considered that, in times of stress such as these, it may be difficult for issuers to place the BCCS with an Additional Tier 1-style host. However, a BCCS with a Tier 2 host, which would be a dated security which carries current pay coupons and would still meet the EBA Buffer Contingent Capital minimum requirements, would be a more widely accepted form of capital.

In particular, issuers with lower ratings (whereby "rating" reflects also the combination of various factors such as distance of current capitalisation to trigger level and inherent risks/earnings potential in the balance sheet leading to a quasi-equivalent credit situation) who cannot access alternative sources of EBA Core Tier 1 (such as retained earnings, reduced bonus payments and new issuances of common equity) are likely to require access to the market in BCCS but will find it more difficult, not least economically non-viable, to issue BCCS with an Additional Tier 1-style host.

SURVEY CONDITIONS:

In total, 48 institutions participated in the survey in their capacities as issuers, investors and intermediaries (listed in point 3 below). Respondents were asked a series of questions regarding the marketability of 2 alternative structural BCCS:

- **Alternative 1:** A "Buffer Contingent Capital Security", i.e.: a convertible instrument (with a trigger of 7% CT1) with an Additional Tier1-style PerpNC5 non-step instrument as a host, as devised by the EBA and
- **Alternative 2:** An equivalent "Buffer Contingent Capital Security" but with a Tier 2 host.

Regarding the composition of the participants, 12 responded in their capacity as issuers, 24 as investors and another 12 as intermediaries.

Question 1

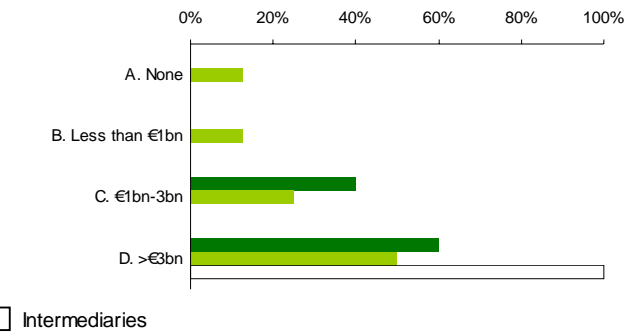
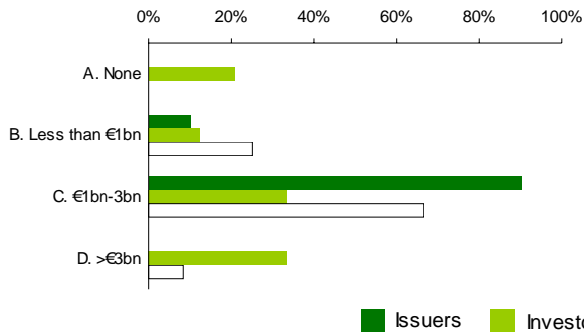
What is your current 12 month view on new issue market capacity for an “AA-“ rated issuer:

Alternative 1

BCCS with Additional Tier 1-style host

Alternative 2

BCCS with Tier 2 host



Question 2

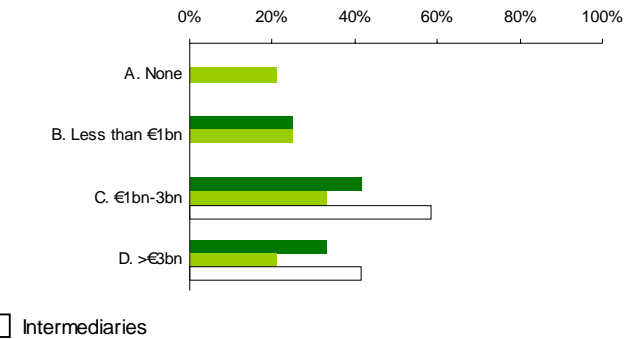
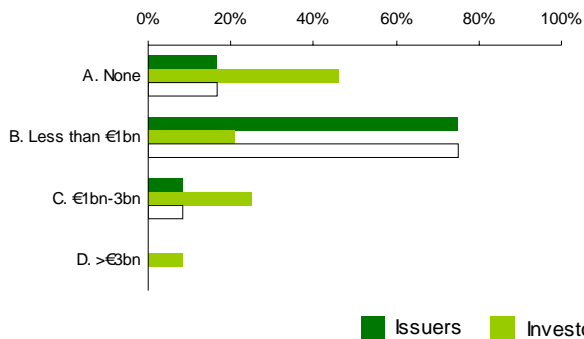
What is your current 12 month view on new issue market capacity for an “A” rated issuer:

Alternative 1

BCCS with Additional Tier 1-style host

Alternative 2

BCCS with Tier 2 host



Question 3

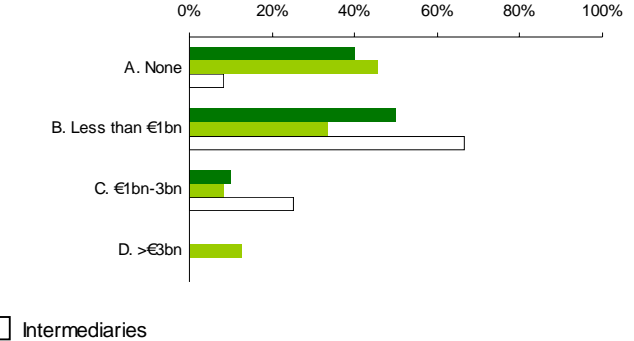
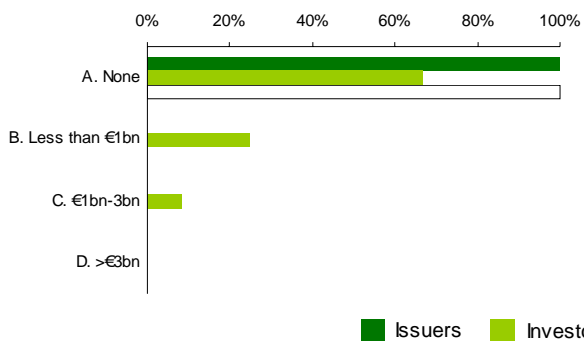
What is your current 12 month view on new issue market capacity for a “BBB” rated issuer:

Alternative 1

BCCS with Additional Tier 1-style host

Alternative 2

BCCS with Tier 2 host



Conclusion for Questions 1, 2 & 3

While the majority of the issuers, investors and intermediaries we questioned consider it feasible for an “AA-“ and an “A” rated issuer to be able to issue BCCS with an Additional Tier 1-style host, albeit in varying amounts, we note that for a lower-rated issuer (“BBB”) the consensus among issuers and intermediaries is that it would be virtually impossible to be able to issue anything at all. However, the survey suggests that there would be significantly more issuing potential for such an issuer if the BCCS had a Tier 2 host.

Hence, the potentially considerable imbalance between demand for a BCCS with an Additional Tier 1-style host and a BCCS with a Tier 2 host may have a significant impact on a lower-rated issuer to be able to issue BCCS and thereby meet its Stress Capital Requirement, as prescribed by the EBA Recommendation.

Question 4

In the context of a voluntary exchange of “old style” Tier 1 and Tier 2 securities into fairly priced Tier 1 CoCos by a bank that is expected to remain a going concern meeting its minimum capital requirements under applicable regulations, please rank the following decision parameters in order of importance (where 1 is the most important and 6 is the least important):

Alternative 1

BCCS with Additional Tier 1-style host

<input checked="" type="checkbox"/> Issuers		<input checked="" type="checkbox"/> Investors		<input type="checkbox"/> Intermediaries	
Rank	Parameter	Rank	Parameter	Rank	Parameter
1	Size of buffer	1	Economics	1	Size of buffer
2	Economics	2	Structure of Tier 1 CoCo	2	Economics
3	Floor Price	3	Size of buffer	3	Structure of Tier 1 CoCo
4	Structure of Tier 1 CoCo	4	Floor Price	4	Floor Price
5	Rating of issuer and the Tier 1 CoCo	5	Expected liquidity of the Tier 1 CoCo	5	Rating of issuer and the Tier 1 CoCo
6	Expected liquidity of the Tier 1 CoCo	6	Rating of issuer and the Tier 1 CoCo	6	Expected liquidity of the Tier 1 CoCo

Alternative 2

BCCS with Tier 2 host

<input checked="" type="checkbox"/> Issuers		<input checked="" type="checkbox"/> Investors		<input type="checkbox"/> Intermediaries	
Rank	Parameter	Rank	Parameter	Rank	Parameter
1	Economics	1	Economics	1	Size of buffer
2	Size of buffer	2	Structure of Tier 2 CoCo	2	Economics
3	Structure of Tier 2 CoCo	3	Size of buffer	3	Structure of Tier 2 CoCo
4	Floor Price	4	Floor Price	4	Floor Price
5	Expected liquidity of the Tier 2 CoCo	5	Expected liquidity of the Tier 2 CoCo	5	Rating of issuer and the Tier 2 CoCo
6	Rating of issuer and the Tier 2 CoCo	6	Rating of issuer and the Tier 2 CoCo	6	Expected liquidity of the Tier 2 CoCo

Question 5

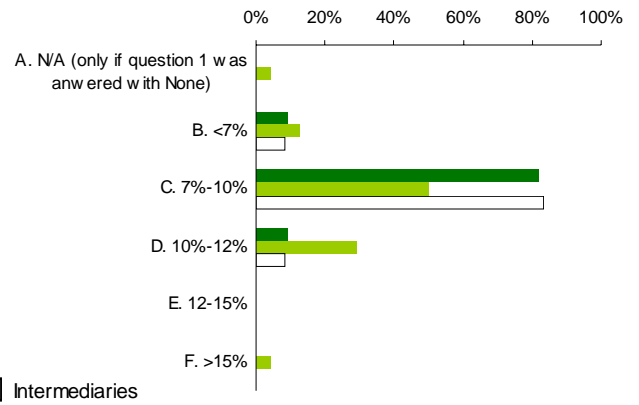
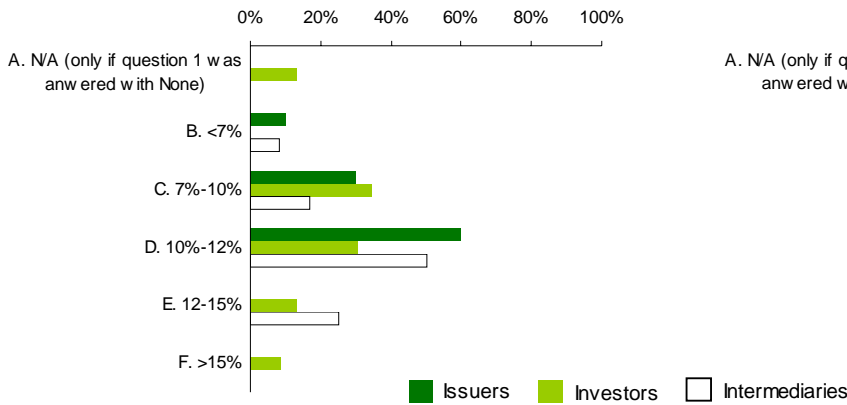
What is your current 12 month view on estimated new issue coupon for an “AA-“ rated issuer:

Alternative 1

BCCS with Additional Tier 1-style host

Alternative 2

BCCS with Tier 2 host



Question 6

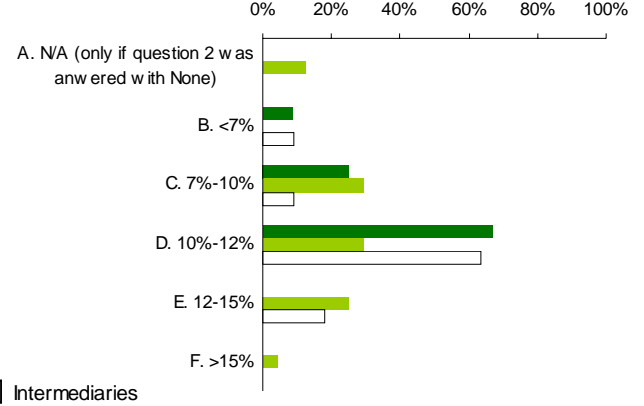
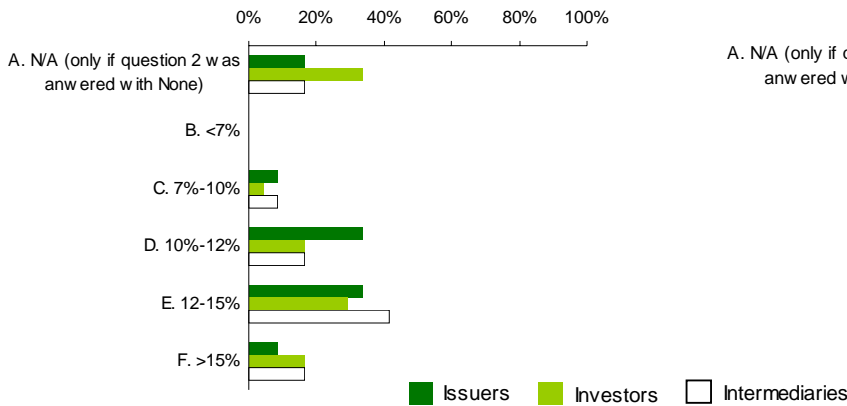
What is your current 12 month view on estimated new issue coupon for an “A” rated issuer:

Alternative 1

BCCS with Additional Tier 1-style host

Alternative 2

BCCS with Tier 2 host



Question 7

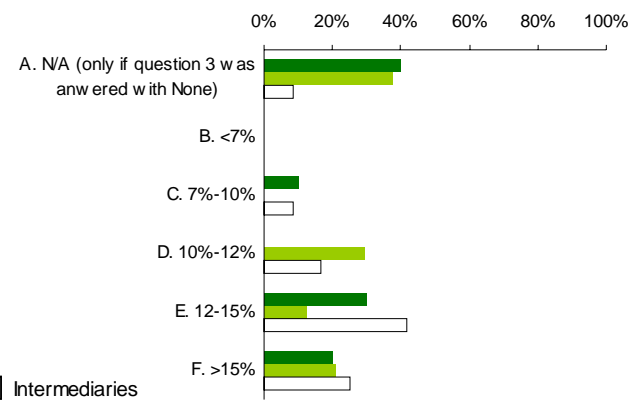
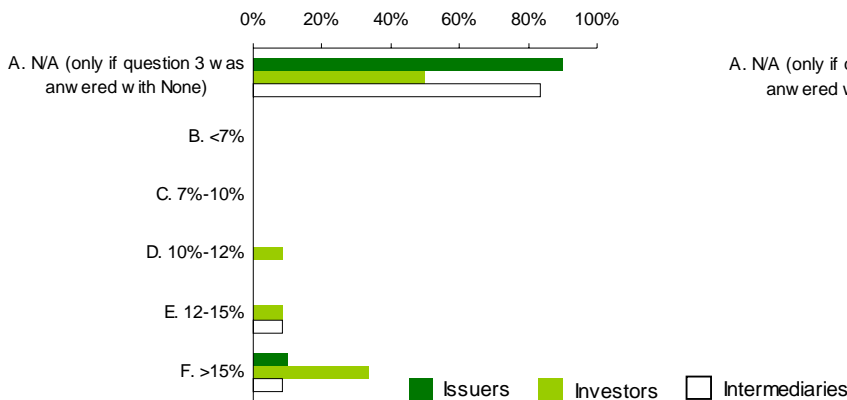
What is your current 12 month view on estimated new issue coupon for a “BBB” rated issuer:

Alternative 1

BCCS with Additional Tier 1-style host

Alternative 2

BCCS with Tier 2 host



Conclusions for Questions 5, 6 & 7

The survey suggests that the estimated coupon for an issuer with a “AA-“ rating issuing BCCS with a Tier 2 host is most likely to fall in the range of 7-10%. However, the estimated coupon for a similar issuer issuing BCCS with an Additional Tier 1-style host is higher, most likely in the 10-12% range.

As demonstrated in question 3, most respondents did not believe that a lower-rated (“BBB”) issuer could issue any BCCS with an Additional Tier 1-style host. However, most of those who did consider it possible estimated a coupon for such an issue in the range of 12-15%, with many considering 15% to be the minimum.

This differential in pricing between a BCCS with an Additional Tier 1-style host and a Tier 2 host would make it economically much more viable for a lower-rated issuer to issue BCCS, leading in turn to a higher retention of earnings.

Question 8

Please feel free to add any general remarks or suggestions

“Based on our experience, allowing a Tier 2 host for the CoCo will fundamentally improve the prospects for successfully raising EBA stress test capital through liability management. This approach reduces greatly the execution risk as there is enough subordinated capital already in issue that could be targeted. We feel that an [Additional Tier 1-style] hosted BCCS is currently not feasible to be placed by any bank that might choose to use this instrument to meet EBA capital buffer requirements.”

“Tier 2 type CoCos are viable precisely because they are hosted in an instrument with contractual obligations to pay coupons.”

“The proposed [Additional Tier 1-style] host instrument is not a viable structure for almost all European banks over the next 12-24 months at least. It will likely increase pressure on banks to recapitalize by shrinking RWAs as all tier 1 capital will need to be replaced by common equity in an environment where banks are trying to build rather than just maintain capital.”

3) List of Participants

Among others, the following institutions participated in the survey:

<u>Issuers</u>	<u>Investors</u>	<u>Intermediaries</u>
Banco Popolare	Aberdeen	Barclays Capital
Banco Popular Espanol	Algebris	BNP Paribas
Barclays PLC	Aviva	Citi
Commerzbank	BayernInvest	Credit Suisse
Monte dei Paschi di Siena	Bluemountain	Goldman Sachs
SNS	CQS	HSBC
UBI Banca	DK Partners	JP Morgan
	Oceanwood	Lloyds Banking
	Schroders	Royal Bank of Scotland
	Scottish Widows	UBS
	Standard Life	
	Swisscanto	
	Wellington	
	GSIC	

We would like to thank all parties for their participation in this survey.