

Regulatory capital developments

Definition of own funds

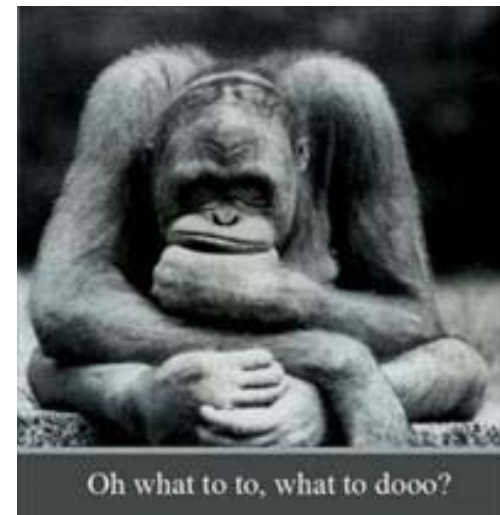
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24 February 2010

Time of much uncertainty in relation to the definition of capital

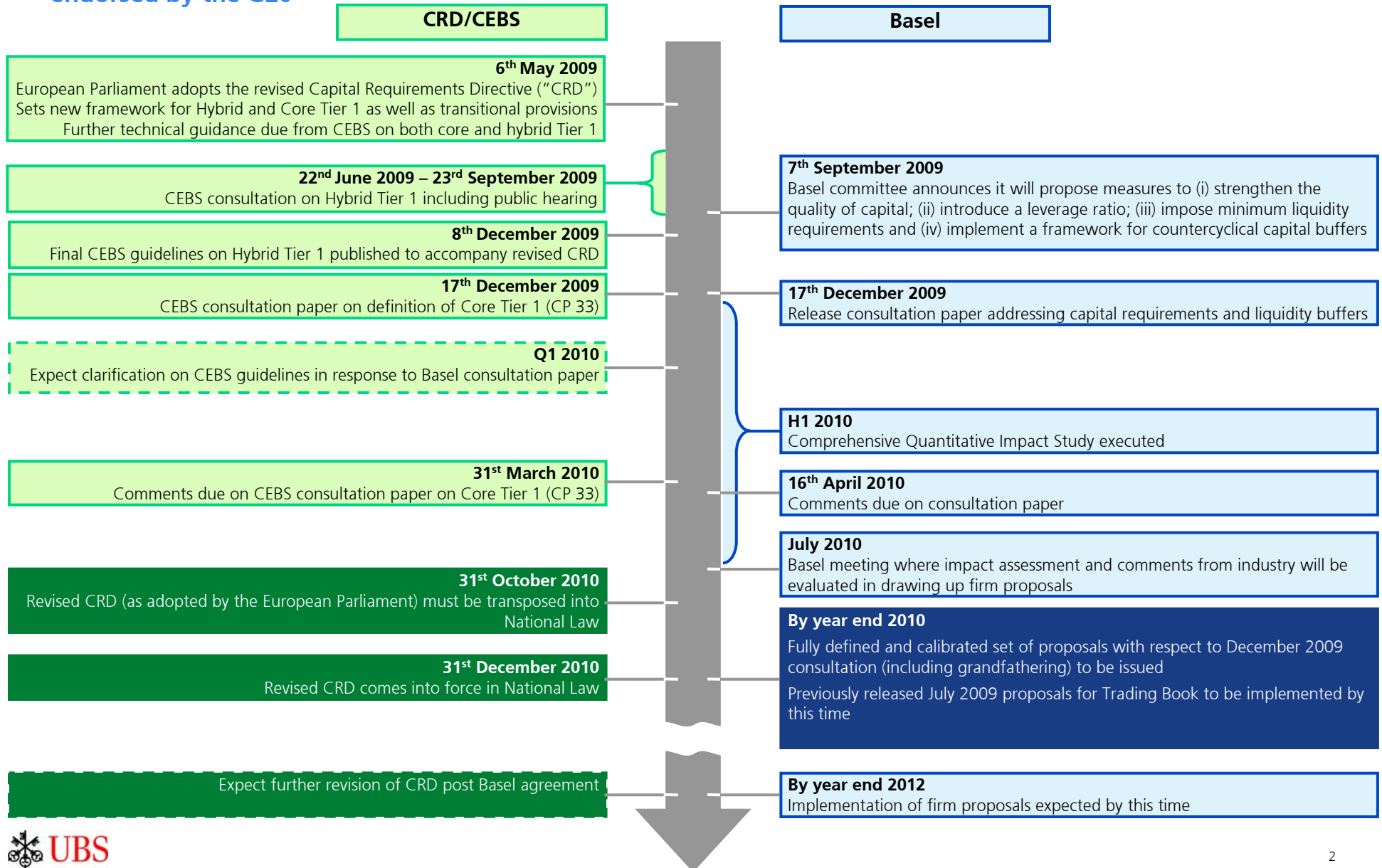
Issuers' and Arrangers' current perspective on hybrid capital issuance

- 1 What will be the new minimum capital requirements, going forward ?
- 2 What forms of capital can be utilised to satisfy the new minimum capital requirements ?
- 3 How significant will the role of Tier 2 be and will additional loss absorption requirements be imposed ?
- 4 How does the EC (CEBS) process interact with Basel in relation to the definition of Tier 1 ?
- 5 Where will Solvency II end up ?
- 6 What role will contingent capital play ?
- 7 What grandfathering will be permitted ?



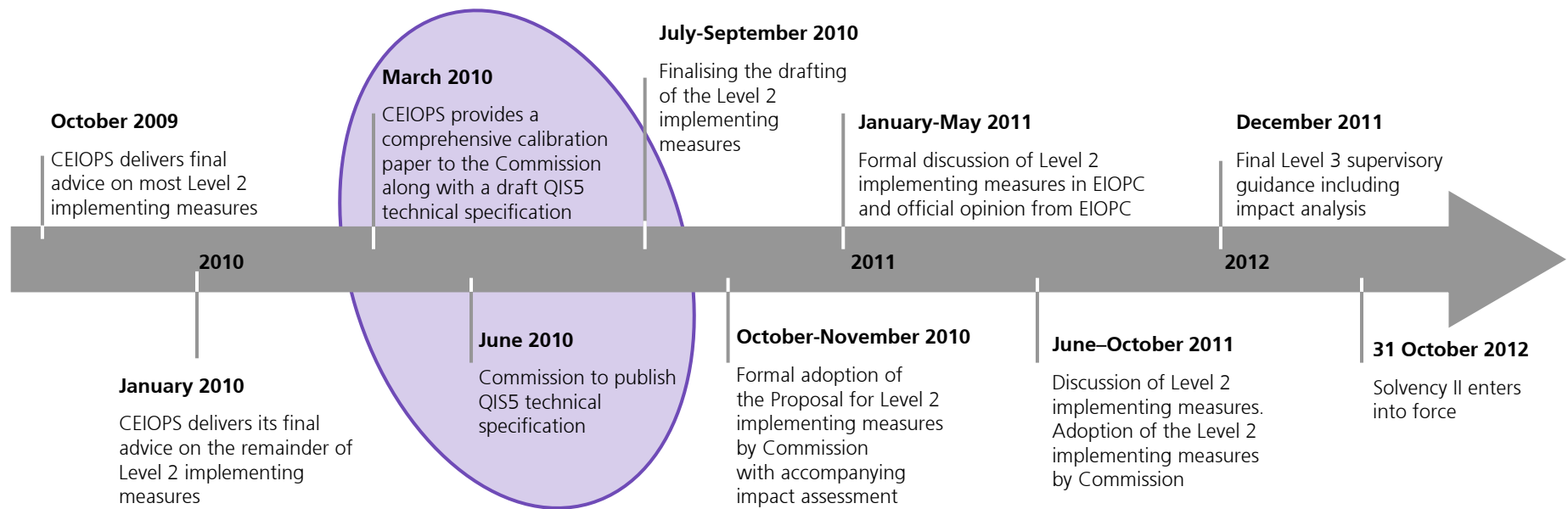
Basel and CRD process overview – the source of confusion

Basel process is expected to lead to further changes of the CRD in the future, once proposals are agreed and endorsed by the G20



Solvency II—the source of confusion

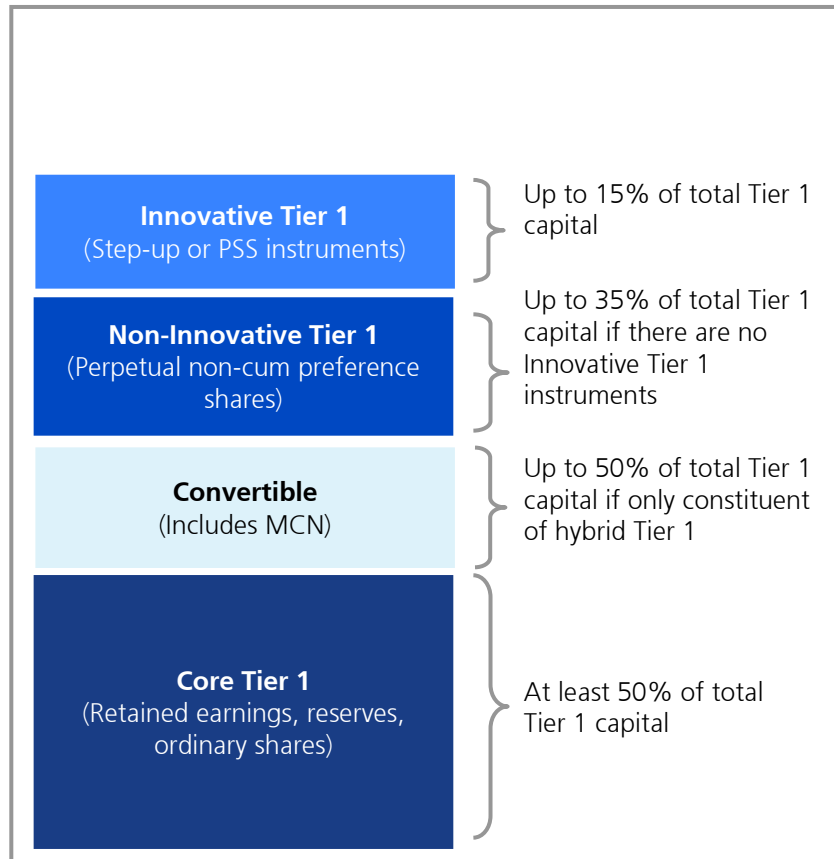
Indicative timeline



Composition of Tier 1 – hybrid tier 1 expected to survive

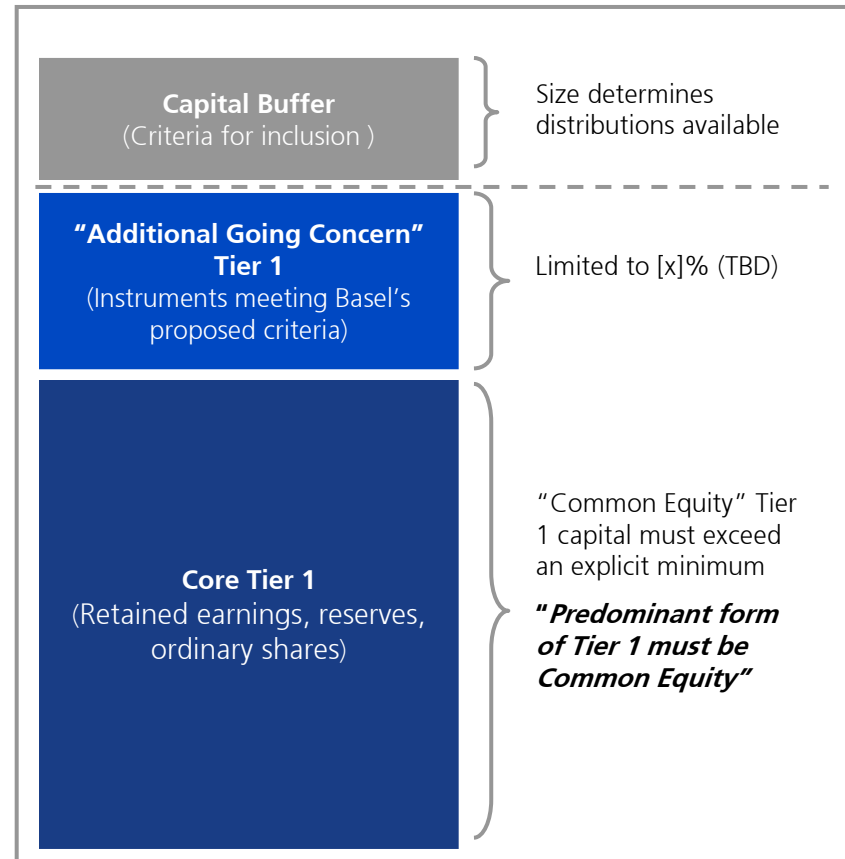
EC CRD/CEBS

- ◆ Introduces new layer of hybrid Tier 1, which results in 3 forms of hybrid Tier 1
- ◆ New 35-50% bucket aimed at guaranteeing a degree of hybrids that “convert” into equity



Basel proposals

- ◆ Explicit minimum requirements for total, Tier 1 and core Tier 1 capital
- ◆ Requirements will be determined following impact assessments in H1 2010
- ◆ Banks will also need a capital buffer above minimum capital requirements



Definition of Tier 1 – summary of direction

1 Loss absorption of principal

- ◆ There seems to be consensus amongst all the proposals that non-common equity elements included in Tier 1 must absorb losses on a going concern basis, beyond mere deferral of coupons
- ◆ The key proposals are that upon breach of a pre-defined trigger, either of two things happens:
 - conversion to equity (whether fixed or variable number of shares, TBD), or
 - write-down of principal feature (whether write-up is permissible, TBD)

2 Loss absorption of coupons

- ◆ Banks will need to have greater flexibility to restrict coupons, so dividend pushers are coming under scrutiny; dividend stoppers may survive as they are considered less restrictive
- ◆ Coupons may also need to be “more” non cumulative
 - Basel have remained silent on whether capital neutral deferral remedies i.e. whether ACSM will survive
 - CEBS have allowed for ACSM to survive but any deferral will have to be immediately remedied so as not to build up a backlog of equity issuance which may hinder recapitalisation in distressed times

3 Permanence – abolishing incentives to redeem

- ◆ Basel proposes no incentives to redeem (eg. step-ups or principal stock settlement); additionally, the bank must not create an expectation: (a) that the call will be exercised, or (b) that supervisory approval will be given for redemption
 - Note that CEBS propose to continue to include incentives to redeem up to 15% of total Tier 1
 - CEIOPS proposals also exclude incentives to redeem

Grandfathering – Issuers’ current options

Issuance Options Today

- ◆ Issue a “New Style” instrument by implementing the most “prudent” of the regulatory proposals
- ◆ Issue an “Old Style” Instrument relying on existing national law, with the risk of no grandfathering



1 Basel III

- ◆ Grandfathering in relation to instruments issued prior to 17th December 2009 is likely
- ◆ In relation to instruments issued after the publication of the proposals, intentions remain unclear and there is a material risk of no grandfathering

2 CRD / CEBS

- ◆ Legislated grandfathering as part of the CRD
- ◆ Any instruments in existence prior to 31 Dec 2010 will be grandfathered for up to 30 years
 - Limited to 20% of Tier 1 between years 10 and 20
 - Limited to 10% of Tier 1 between years 20 and 30
- ◆ This had provided certainty to investors and issuers and was to be transitioned into national law
- ◆ Uncertainty as to how CRD will change to reflect Basel proposals

3 CEIOPS

- ◆ No proposals as yet but guidance is imminent

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