

FREQUENTLY ASKED QUESTIONS ABOUT CONTINGENT CAPITAL

How would you define contingent capital?

Contingent capital securities are hybrid securities issued by financial institutions that are intended to provide leverage in good economic times and provide a buffer (i.e., loss absorption) under stress scenarios when it would be difficult for financial institutions to raise new capital. One type of contingent capital instrument consists of a debt instrument that automatically converts to equity or the principal of which is written down when certain conditions are met, such as, for example: (1) if the financial system is in crisis (either based on an assessment by regulators or based on objective indicators such as aggregate losses) or (2) if the issuer's capital ratio falls below a certain level.

There also are other types of contingent capital instruments, including some that have been used by insurance and reinsurance companies as an alternative to traditional protection against catastrophic events (in which case, the company would suffer a loss of income but its balance sheet would be protected and the company would be in a good position to benefit from the premium rate increase pressure to follow such an event) and by financial guarantee companies (in conjunction with rating agency approval) as a source of "soft capital" to help reduce operating leverage ratios.

These various types of contingent capital instruments all attempt to address the fact that in difficult times

issuers, including financial institutions (which rely on investor confidence), find it difficult to raise capital. In such circumstances, contingent capital acts as equity and provides a cushion.

What is the difference between contingent capital and "bail-in" capital?

"Bail-in" capital refers to debt instruments or other creditor claims that are written down or converted into equity, in whole or in part, by a country's resolution authority at the point a failing financial institution enters resolution (e.g., bankruptcy or administration). In such circumstances, the power exercised by the authorities is generally referred to as "statutory bail-in" or "bail-in within resolution." In contrast, in the case of contingent capital, the conversion to equity or the write-down of principal occurs before the failing financial institution enters resolution.

Which types of securities have been included in the "hybrid" bucket?

Hybrid securities are securities that have some characteristics of equity and debt and were considered an attractive, cost-efficient means of raising non-dilutive capital for financial institutions (including banks and insurance companies), as well as for corporate issuers (typically utilities). The types of securities in the "hybrid" bucket include certain classes of preferred

securities, mandatorily convertible debt securities and debt securities with principal write-down features. The most common of these hybrid securities had been preferred securities with additional features designed to achieve enhanced economics or other efficiencies, such as trust preferred securities, real estate investment trust (“REIT”) preferred securities and perpetual preferred securities. These preferred securities were also popular because they qualified for Tier 1 regulatory capital treatment and, in the case of trust preferred securities and REIT preferred securities, payments on such securities were tax-deductible by the issuer.

Why has there been such a focus on the part of regulators on contingent capital instruments?

Regulators have been focused on contingent capital instruments because of the need to bolster regulatory capital levels at financial institutions in the wake of the financial crisis. In addition, regulators would like to avoid (to the extent possible) having taxpayers bear the brunt of a financial institution bailout. As a result, regulators have been focused on setting higher regulatory capital requirements, as well as establishing other tools, such as “bail-in” features for certain debt securities, “buffers” or extra capital cushions, and contingent capital instruments with loss absorption features.

When or how did this discussion of contingent capital instruments begin?

The discussion of contingent capital instruments began in the aftermath of the financial crisis, when certain regulators and rating agencies concluded that certain hybrid capital securities did not provide the type of loss absorption during the financial crisis that they had anticipated. Early on in the financial crisis,

commentators noted that many hybrid securities absorbed “significant losses.” Academics from the Squam Lake Group, which was first organized in November 2008 in order to provide recommendations on how to fix the financial system, recommended in its June 2010 report that regulators aggressively encourage key financial institutions to invest in regulatory hybrid securities in the event that both the financial institutions and the economic system reach a certain defined level of financial stress.

Investors were accustomed to treating hybrid securities like debt instruments and had often assumed that hybrid issuers would exercise early redemption options on hybrid securities as they arose. Hybrid issuers, however, surprised investors when they opted (or were encouraged by regulators) not to exercise their option to redeem outstanding hybrid securities because alternative (or replacement) capital would have been more expensive or possibly unavailable. As the financial crisis worsened and governments intervened in the banking sector, taking extraordinary measures to restore confidence in the financial system, hybrid investors became more concerned about their prospects and in certain instances also suffered from principal write-downs of the hybrid securities. Commentators noted that many governments conditioned their aid to ailing banks on an agreement that the bank issuers would not pay coupons on hybrid securities. Many issuers also were forced (or chose) to undertake exchange offers or other liability management exercises in relation to their outstanding hybrid securities as part of recapitalization transactions. In addition, commentators raised concerns, particularly in relation to a number of hybrid instruments qualifying as Tier 2 capital, that principal write-down features were never

triggered as they were designed to take effect only in an insolvency scenario, while most bail-ins and injections of public funds actually occurred in advance of an insolvency in view of the perceived systemic consequences of a failure (i.e., the “too big to fail” concern).

How have recent regulatory developments addressed this?

Recent regulatory developments in both the U.S. and Europe have addressed concerns with the loss absorption of hybrid securities and increasing regulatory capital levels and the quality of such regulatory capital for financial institutions.

International Reforms (Basel III)

The Basel III framework, among other things, emphasizes the quality, consistency and transparency of the capital base and provides for enhanced risk coverage through the implementation of enhanced capital requirements for counterparty credit risk. To rectify perceived deficiencies relating to regulatory capital, the Basel III framework also emphasizes that (1) Tier 1 capital must help a bank remain a going concern, (2) regulatory adjustments must be applied to the common equity component of capital, (3) regulatory capital must be simple and harmonized for consistent application across jurisdictions, and (4) regulatory capital components must be clearly disclosed by financial institutions to promote market discipline. Tier 1 capital also must consist predominantly of “common equity,” which includes common shares and retained earnings. Thus, the new definition of Tier 1 capital is closer to the definition of “tangible common equity.”

According to the Basel III framework, the new minimum capital requirements were to be phased in

between January 1, 2013 and January 1, 2015, and regulatory adjustments were to be phased in between January 1, 2014 and January 1, 2018. The recognition of existing capital instruments that do not comply with the new rules were to be phased out from January 1, 2013, with their recognition capped at 90% from such date and the cap reduced by 10% in each subsequent year.

Instruments, such as hybrid securities, that do not qualify as Tier 1 capital may still constitute Tier 2 capital if they meet certain criteria, including having a minimum original maturity of at least five years with no incentive to redeem and being callable only by the issuer after a minimum of five years with prior supervisory approval. Such instruments also must have no credit-sensitive dividend feature and in liquidation must be subordinated to depositors and unsubordinated creditors.

U.S. Reforms

In many respects consistent with the proposed Basel III framework, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) has the effect of raising the required level of Tier 1 capital for banks, as well as the proportion of Tier 1 capital that must be held in the form of tangible common equity. The Collins amendment provision (Section 171) of the Dodd-Frank Act, which is applicable to all financial institutions, requires the establishment of minimum leverage and risk-based capital requirements. These are set, as a floor, at the risk-based capital requirements and Tier 1 capital to total assets standard currently applicable to insured depository institutions under the prompt corrective action provisions of the Federal Deposit Insurance Act. In addition, the Collins amendment provision limits regulatory discretion in adopting Basel III requirements in the U.S. and permit

additional capital requirements for activities determined to be “risky,” including, but not limited to derivatives.

By virtue of applying the prompt corrective action provisions for insured depository institutions to bank holding companies, certain hybrid securities, including trust preferred securities, will no longer be included in Tier 1 capital. The legislation applies retroactively to trust preferred securities issued after May 19, 2010. Bank holding companies and systemically important non-bank financial companies will be required to phase-in these requirements from January 2013 to January 2016. Mutual holding companies and thrift and bank holding companies with less than US\$15 billion in total consolidated assets are not subject to this prohibition.

Led by the U.S. Federal Reserve Board on July 2, 2013, the three U.S. federal banking agencies approved a broad and comprehensive revision of the regulatory capital rules applicable to all U.S. banks and bank holding companies (except those with less than \$500 million in total consolidated assets). The new rules are intended to replace existing Basel I-based capital requirements, implement the Basel III capital standards, and comply with certain requirements under the Dodd-Frank Act, including the Collins Amendment provision and the requirement that all references to external credit ratings be removed from federal agencies’ regulations and replaced with new standards of creditworthiness (Section 939A). The effectiveness of the new rules will be phased in according to different start dates, ranging from January 1, 2014 to January 1, 2019, and different phase-in periods, ranging from two years to nine years. The new rules consist of the following:

- The Basel III Capital Rule introduces the Basel III standards for the components of, adjustments to, and deductions from

regulatory capital (the numerator in risk-based capital and leverage ratios), as well as the new minimum ratios under the prompt corrective action framework. The Basel III Capital Rule, among other things:

- subjects U.S. banks and bank holding companies to the following minimum regulatory capital requirements: a common equity Tier 1 capital ratio of 4.5% (newly introduced requirement), a Tier 1 capital ratio of 6% (increased from the current 4%), a total capital ratio of 8% of total risk-weighted assets (unchanged from the current requirement), a Tier 1 leverage ratio of 4%, and, for those U.S. banks and bank holding companies subject to the Advanced Approaches Rule, an additional leverage ratio of Tier 1 capital to total leverage exposure of 3%; and
- introduces regulatory capital buffers above the minimum common equity Tier 1 ratio, including a capital conservation buffer of a further 2.5% of common equity Tier 1 capital to risk-weighted assets and, for those U.S. banks and bank holding companies subject to the Advanced Approaches Rule, a countercyclical buffer of up to 2.5% of common equity Tier 1 capital to risk-weighted assets that may be deployed as an extension of the capital conservation buffer.

- The Standardized Approach Rule, generally introduces a modified version of the Basel II standardized approach for calculating risk-weighted assets (the denominator in risk-based capital ratios) and would, together with the Basel III Capital Rule, become the new Collins Amendment “floor” for certain U.S. banks and bank holding companies.
- The Advanced Approaches Rule modifies the existing Basel II advanced approaches rules for calculating risk-weighted assets to implement Basel III and to comply with Section 939A and also applies (along with the Market Risk Final Rule) to U.S. savings associations and savings and loan holding companies that meet the applicable thresholds.
- The Market Risk Final Rule, modifies the existing market risk rules to implement rules for calculating capital charges for market risk (commonly known as “Basel 2.5”) and to comply with Section 939A. This rule applies to U.S. banks and bank holding companies that have significant trading activity and became effective on January 1, 2013.

In addition, in July 2013, the U.S. federal banking agencies proposed for comment a supplemental leverage ratio for U.S. banking organizations that are global systemically important banks (“GSIBs”), which would be fully effective as of January 1, 2018. The proposal consists of the following two elements:

- A minimum supplemental leverage ratio of 6% of Tier 1 capital for any insured subsidiary bank of a GSIB.
- A minimum supplemental leverage ratio of 3%, plus an additional “leverage buffer” of 2%, or a total 5% supplemental leverage ratio, of Tier 1 capital to be maintained at the holding company level, for GSIBs.

In January 2012, the U.S. General Accounting Office completed a study on the use of hybrid capital instruments and made recommendations for legislative or regulatory actions regarding hybrids. In July 2012, the Financial Stability Oversight Council (the “FSOC”) completed a study of a contingent capital requirement for certain non-bank financial companies and bank holding companies. Additional regulatory guidance will be required in the U.S. regarding the types of hybrid securities (in addition to non-cumulative perpetual preferred securities) that will benefit from favorable regulatory capital treatment.

EU Reforms

In July 2011, the European Commission published a draft of its proposed legislation to implement the Basel III requirements. The proposals were finalized and adopted by the European legislature in April 2013 and recast the existing Capital Requirements Directive (2006/48/EC and 2006/49/EC) in the European Union (“EU”). They are referred to as “CRD4”. CRD4 is comprised of a new directive that was required to be separately implemented into the national laws of the EU member states by the end of 2013 and a new capital requirements regulation (“CRR”) that has direct effect in member states (and will limit the scope for national legislators to apply their own interpretation on the EU rules). Both the CRD4 directive and CRR came into effect on January 1, 2014.

CRR implements the Basel III recommendations very closely as to the minimum levels of capital that a

financial institution must issue, although it provides a greater degree of detail as to regulatory adjustments and deductions. One departure from Basel III is that under CRD4, instruments do not have to be common or ordinary shares to be treated as common equity Tier 1 capital as long as they meet the detailed criteria set out in the Basel III rules.

In relation to instruments that previously qualified for regulatory capital treatment, but cease to be recognized as Tier 1 or 2 capital under Basel III, the Basel III rules specify a cut-off date of September 12, 2010. Any instrument issued before that date can be de-recognized gradually over a ten-year phase-out period and any instrument issued on or after that date would be fully excluded from the relevant class of regulatory capital from 2023. CRR adopts the same concept but with a phase-out date of December 31, 2021, and with some discretion given to national regulators to accelerate the rate of phase-out if considered appropriate.

In relation to the requirement under the Basel III rules that Tier 1 capital instruments must provide for a “going-concern” write-down of principal or conversion into equity at a pre-specified trigger point, CRR provides that the trigger point will be the time when the institution’s common equity Tier 1 capital, as a proportion of its total risk-weighted assets, falls below 5.125% or any higher percentage specified in the terms of the instrument.

The European Banking Authority (“EBA”) is mandated under CRD4 to draft technical standards regarding procedures and timing for the determination and notification of trigger points. The EBA also must specify the nature and extent of any such write-downs and whether the write-down has to be permanent or can be written back up again if the issuer’s financial position

subsequently improves. The EBA published “Final Drafts” of these technical standards on July 26, 2013, which provide for the possibility of instruments to be written back up subject to the requirements set out under CRD4 and the technical standards.

Under the Basel III rules, no Tier 1 capital instrument may contain any feature that would hinder the recapitalization of the institution, and dividend pushers and alternative coupon satisfaction mechanisms are expressly prohibited. CRR goes further and states that dividend stoppers will also not be permitted in Tier 1 capital instruments. CRR also does not contain the EU’s proposed legislation for the proposal of the Basel Committee on Banking Supervision (the “Basel Committee”) for all Tier 1 and Tier 2 capital instruments to include triggers to ensure that such instruments absorb losses at the point of an entity’s non-viability. This is expected to be dealt under the EU Bank Recovery and Resolution Directive, which is currently going through the EU legislation process.

As indicated above, CRD4 became effective from January 1, 2014. The EBA is required to draft various technical standards and drafts of some of these have now been issued for consultation by the EBA. Also, as indicated above, some of the provisions of the EU Bank Recovery and Resolution Directive will be relevant to certain aspects of Basel III. This directive is unlikely to be finalized until the second quarter of 2014, at the earliest.

In addition to the Basel III proposals, the UK and Switzerland have formally adopted rules and guidance pertaining to capital buffers and bail-in capital. See “Have other jurisdictions adopted any guidance on contingent capital instruments?” below.

Are there any outstanding issues with respect to the regulatory treatment of contingent capital?

As indicated above, CRD4 will become effective from January 1, 2014. The EBA is required to draft various technical standards and drafts of some of these have now been issued for consultation by the EBA. Also, as indicated above, some of the provisions of the EU Recovery and Resolution Directive are likely to be relevant to certain aspects of Basel III. This directive is unlikely to be finalized until 2014.

Is contingent capital a requirement in the United States?

No, at this time contingent capital is not required to be held by financial institutions or bank holding companies in the United States.

Have other jurisdictions adopted any guidance regarding contingent capital instruments or bail-in capital?

At this time, only the UK and Switzerland have formally adopted rules or guidance on contingent capital instruments or bail-in capital.

UK

In August 2013, the new Prudential Regulation Authority ("PRA") issued a consultation paper setting out its proposals for the implementation of CRD4 in the UK, including the proposed changes to the PRA's Handbook. The PRA's proposed rules are consistent with CRD4. The consultation closes on October 2, 2013 and the PRA's final rules are expected to be published shortly thereafter.

The PRA's consultation paper also emphasized that the aim of the trigger and conversion for additional Tier 1 instruments is to contribute to the firm's recovery

following a significant stress. Thus, if UK firms, especially those whose failure may have systemic consequences for the UK, issue additional Tier 1 instruments, the PRA expects them to set additional Tier 1 triggers at a level that is unambiguously consistent with being able to recover from a stress without entering into resolution, which may be at a level higher than a common equity Tier 1 capital ratio of 5.125%. The PRA also stated that it expects the conversion or write-down to be for the full amount of the instrument and to be permanent.

In September 2011, the Independent Commission on Banking recommended in a report (the "Vickers Report") that the UK's special resolution regime toolkit be augmented with an explicit bail-in power and the UK government supported the recommendation. The Vickers Report also recommended that all of the larger UK ring-fenced banks and UK-based systemically important banks be required to hold 17-20% of loss-absorbing capacity, with 10% of equity capital against risk weighted assets and an additional 7-10% which includes bail-in capital. In September 2012, the Bank of England's Financial Policy Committee indicated that UK banks should seek to retain earnings and raise outside capital with the options including debt conversion and the issuance of suitable contingent capital instruments.

Switzerland

The Vickers Report is expected to be largely implemented in the UK under the Banking Reform Bill, which is currently going through the UK legislative process. This does not, however, contain detailed provisions relating to bail-in and the requirement for banks to hold minimum amounts of loss-absorbing capital. The UK Parliament will be given the power to introduce these requirements through secondary

legislation and it is unlikely that this will be done until the EU Recovery and Resolution Directive is finalized.

In October 2011, the Swiss government published a proposal for the implementation of the Basel III framework. The new regulatory capital requirements entered into effect on January 1, 2013, with an implementation period extending to the end of 2018. The amount of required total capital (without taking into account required equity capital and countercyclical buffers) has not been changed, and remains at 8% of risk-weighted assets. However, Swiss banks must now hold common equity Tier 1 capital of 4.5% of risk-weighted assets (previously 2%) and they may hold additional Tier 1 capital of up to 1.5% and Tier 2 capital of up to 2% of risk-weighted assets. In addition, Swiss banks must create a capital buffer in the form of common equity Tier 1 capital of 2.5% of risk-weighted assets, resulting in total common equity Tier 1 capital of 7% of risk-weighted assets. Under certain credit market circumstances, a countercyclical buffer of up to 2.5% of additional common equity Tier 1 capital may temporarily apply to all categories of Swiss banks. In line with the Basel III framework, all Swiss banks organized as stock corporations may make use of contingent capital instruments, including bonds with a write-off feature, reserve capital and convertible capital, for purposes of establishing sufficient additional Tier 1 capital and Tier 2 capital.

How does the Basel Committee's August 2010 consultation document entitled "Proposal to ensure the loss absorbency of regulatory capital at the point of non-viability" relate to contingent capital?

The consultation document establishes a requirement that the contractual terms of capital instruments will

allow the capital instruments at the option of the regulatory authority to be written-off or converted to common shares in the event that a bank is unable to support itself in the private market in the absence of such conversions. In January 2011, the Basel Committee published minimum requirements for loss absorbency features at the point of non-viability of an entity to be included in all Tier 1 and Tier 2 capital instruments. The principal requirement is that upon breach of a specified trigger the relevant instrument must be subject to a write-down of principal or conversion into equity. The trigger occurs when the relevant authorities either (1) decide that a write-off of principal or conversion into equity is necessary or (2) decide to make a public sector injection of capital (or equivalent support), whichever takes place the earliest. The Basel Committee has proposed that instruments that are issued on or after January 1, 2013 must meet these minimum requirements as a pre-condition to receiving the relevant regulatory capital treatment. The Basel Committee also has published a set of FAQs on the Basel III definition of capital, most recently updated on October 20, 2011 (Basel III definition of capital – Frequently asked questions, www.bis.org/publ/bcbs204.htm).

In November 2011, the Basel Committee published final rules setting out a framework on the assessment methodology for GSIBs, the magnitude of additional loss absorbency that GSIBs should have and the arrangements by which the requirement will be phased in. The assessment methodology for GSIBs is based on an indicator-based approach and comprises five broad categories: size, interconnectedness, lack of readily available substitutes or financial institution infrastructure, global (cross-jurisdictional) activity and complexity. The additional loss absorbency

requirements will range from 1% to 2.5% common equity Tier 1 depending on a bank's systemic importance with an empty bucket of 3.5% common equity Tier 1 as a means to discourage banks from becoming even more systemically important. The higher loss absorbency requirements will be introduced in parallel with the Basel III capital conservation and countercyclical buffers (i.e., between January 1, 2016 and year-end 2018 becoming fully effective on January 1, 2019).

In October 2012, the Basel Committee published a new set of regulatory guidelines for domestically systemically important banks ("DSIBs"), similar to the process for identifying and supervising GSIBs, including a requirement for additional loss absorbency although no specifics were provided and it is unclear at this time which banks would be captured under the DSIB framework.

Contingent capital has been referred to as the latest incarnation of hybrids. Do you think this is true?

This is partly true. In the aftermath of the financial crisis, financial institutions have focused predominantly on issuances of common equity, non-cumulative preferred securities and fixed or floating rate debt. A few non-U.S. banks have issued contingent capital instruments, but the future role of contingent capital products for European banks remains unclear.

For example, CRR (which is discussed above) specifies trigger points for Tier 1 capital that may impact the cost of capital for contingent capital instruments. Structuring contingent capital instruments in order to create a viable market will inevitably involve tradeoffs among the competing interests of issuers, investors and regulators. Regulators and issuers also will need to

determine their objectives for contingent capital. Some issuers may opt for going-concern securities that create incentives for banks to reduce risk and leverage in times of stress, while other issuers may choose to use gone-concern contingent capital as part of a broader resolution regime.

Will contingent capital instruments replace hybrid securities?

It remains to be seen whether contingent capital instruments will completely replace hybrid securities. In November 2011, the Basel Committee issued its final principles as to the methodology for determining which banks are to be considered by regulators as GSIBs, as well as setting additional minimum capital requirements applicable to such banks, on top of the minimum capital requirements already intended to apply to all internationally active banks under Basel III. Many global institutions had hoped that the Basel Committee would recommend that such additional capital requirements for GSIBs could be met, at least partially, with contingent capital instruments, but their final recommendations proposed that only core Tier 1 capital instruments would be used for this purpose.

CRR does not address the GSIB recommendations, so it is not clear whether there may be a role for contingent capital when the Basel III framework is implemented. However, in December 2011, the EBA published a recommendation that European banks should maintain a minimum ratio of core Tier 1 capital to risk weighted asset ratios of 9% by the end of June 2012. As part of this recommendation, the EBA stated that newly-issued contingent convertible instruments are eligible to be considered as core Tier 1 capital if their terms are

consistent with a common term sheet published as part of the recommendation.

What types of instruments would be considered contingent capital?

Various types of instruments may qualify as contingent capital, including senior or subordinated debt securities with fixed or floating rate coupons and mandatory conversion to equity or write-down features in the event that certain regulatory capital ratios fall below certain levels or in the event of certain regulatory actions are taken with respect to the issuer (“triggers”).

What types of conversion features are possible?

There are two possible types of conversion features: (1) a conversion of debt to equity upon breach of the relevant trigger or (2) a write-down of debt upon the breach of the relevant trigger. In a conversion of debt to equity, the equity may be common shares or non-cumulative perpetual preferred shares.

Can you explain what happens in the event that the trigger is breached?

What happens once the trigger is breached depends on how the contingent capital instrument is structured. If the contingent capital instrument is convertible into equity upon breach of the relevant trigger, then the conversion is based on a specified conversion ratio. If the conversion ratio is set at a rate highly dilutive to existing shareholders (e.g., well in excess of 50%), then control of the issuer would automatically shift to the contingent capital holders, unless the conversion ratio is based on the current market price of the issuer’s common shares and subject to a floor, in which case the extent of any dilution would depend on the timing of the conversion. If the conversion to equity is paired

with an early trigger (i.e., the capital ratio or market metric is set a high level), then the contingent capital holders would gain control of the issuer with significant remaining enterprise value. Once in control of the issuer, contingent capital holders could replace existing management and reduce risk and leverage in order to return the issuer to sounder economic footing. The conversion to equity is far less attractive if the trigger operates late (i.e., the capital ratio or market metric is set at a low level) because this would leave contingent capital holders owning an issuer with little remaining enterprise value and potentially little upside in the resulting equity, depending on how much senior debt of the issuer is outstanding.

If the contingent capital instrument is subject to a write-down of principal upon breach of the relevant trigger, then the write-down is based on a specified percentage (which could be as high as 100%). Most fixed income investors appear to prefer a write-down of principal to an equity conversion, and some would not be able to invest in securities with a conversion feature that could result in their holding equity securities. The write-down of principal could either be permanent or it could include a write-back feature if the issuer regains its financial health. A permanent write-down carries the risk that contingent capital holders could take losses ahead of shareholders, or even ultimately lose more than shareholders, and not have any upside, which would effectively invert the priority of claims in the capital structure and may result in investors requiring higher coupons to compensate for this risk. A write-back is attractive to many fixed income investors because (1) it may result in investors regaining some or all of their principal, which would result in investors requiring lower up front coupons, and (2) some fixed

income fund mandates prohibit investing in securities with an embedded permanent write-down feature. A contingent capital instrument could also offer a partial return of principal to investors at the time of the write-down, but regulators most likely will not view this positively as such a feature would reduce liquidity at a time when it is needed most.

What are the possible conversion triggers and are some preferable to others?

There are three principal options for the conversion trigger: (1) capital ratios, (2) market metrics or (3) regulatory discretion.

A trigger based on capital ratios would force a mandatory conversion if and when the issuer's Tier 1 (core) capital ratio fell below a threshold specified either by regulators (in advance) or in the contractual terms of the contingent capital instrument itself. Some regulators and commentators believe that a capital ratio is the most effective trigger because it is transparent and objective. Investors would be able to assess and model the likelihood of conversion based on the issuer's public disclosures. A capital ratio trigger also removes the uncertainty regarding regulatory discretion and the vulnerability to market manipulation that the other options entail.

A trigger based on market metrics would force a mandatory conversion, for example, if and when, the issuer's share price or CDS spread passes a certain level over a set period of time.

Some regulators and commentators believe that a market metric is the most effective trigger because market discipline is generally considered less forgiving than regulatory discipline. However, this theory has produced mixed results when implemented in the past.

The notion that bond markets, for example, can discipline bank risk-taking may be overly optimistic. The financial crisis provides ample evidence that neither ratings agencies nor bond market investors possess any special informational advantages over regulators when it comes to the assessment of credit quality, and while market participants may have stronger incentives to monitor bank credit quality, their ability to do so is still constrained by the poor quality of available accounting data for banks. More importantly, there is a risk that market sentiment, or even market manipulation, could force a recapitalization unnecessarily through a share price or CDS spread "death spiral." Finally, equity holders and management could have incentives to take certain actions (such as fire-selling assets) in order to prevent a conversion.

A trigger based on market metrics would force a mandatory conversion, for example, if and when, the issuer's share price or CDS spread passes a certain level over a set period of time. Some regulators and commentators believe that a market metric is the most effective trigger because market discipline is generally considered less forgiving than regulatory discipline. However, this theory has produced mixed results when implemented in the past. The notion that bond markets, for example, can discipline bank risk-taking may be overly optimistic. The financial crisis provides ample evidence that neither ratings agencies nor bond market investors possess any special informational advantages over regulators when it comes to the assessment of credit quality, and while market participants may have stronger incentives to monitor bank credit quality, their ability to do so is still constrained by the poor quality of available accounting data for banks. More importantly, there is a risk that market sentiment, or even market

manipulation, could force a recapitalization unnecessarily through a share price or CDS spread “death spiral.” Finally, equity holders and management could have incentives to take certain actions (such as fire-selling assets) in order to prevent a conversion.

Is setting the trigger point a delicate balancing act?

Yes, setting the trigger point is a delicate balancing act. In the case of a capital ratio or market metric trigger, if the contingent capital is to be going-concern capital, then the trigger must be set at a high enough capital ratio level so that it is triggered while the issuer remains fully viable, but not so high that it is likely to be triggered in only a mild downturn. At the other end of the spectrum, the trigger also cannot be so low that it allows losses to mount for too long, leaving little or no value left in the issuer and effectively making the contingent capital the gone-concern kind. Capital ratio and market metric triggers also are vulnerable to financial reporting that fails to accurately reflect the underlying health of the firm. Lehman Brothers, for example, reported a Tier 1 capital ratio of 11% in the period before its demise, well above the regulatory minimum and a level most would have considered healthy. The same was true for Bear Stearns and Washington Mutual before they were acquired under distress. This issue most likely must be resolved in order for investors to embrace capital ratio or market metric triggers.

The effectiveness of a capital ratio or market metric trigger point also depends on greater or enhanced bank disclosure. Greater transparency would allow investors to properly assess the likelihood of whether and when a trigger could be breached and how much debt might be converted once triggered, thus allowing them to assess

the risk associated with a contingent capital instrument and therefore whether they should buy it and what is the appropriate price to pay. In the case of a discretionary trigger, greater transparency would make regulators less concerned about the market response to their decisions to require conversion because markets would have already had access to the information that would allow them to assess whether a problem had begun to emerge. It would also help investors make their own assessments, reassuring them that regulatory forbearance is not at play when a bank’s health is in question but a conversion has not yet been required. Nevertheless, many traditional fixed-income investors could be precluded by their fund mandates from investing in an instrument with a discretionary trigger.

It is also worth noting that investors and regulators might be able to find some common ground on the trigger. Investors might not object to giving regulators the flexibility to halt a trigger for a set period of time in disorderly markets. This would permit regulators to use their discretion to act in the best interests of the financial system.

Depending on the specifics, the conversion feature may raise the question whether the contingent capital holder has an entitlement to repayment regardless of the issuer’s financial circumstances. Does the contingent capital holder have creditor’s rights?

No, the contingent capital holder does not have creditor’s rights as the contingent capital holder would be (1) subordinated to the rights of the issuer’s depositors and debt holders and (2) equal in right of payment to equity holders.

Contingent capital has gained popularity with banks, notably Lloyds, Rabobank and Credit Suisse and more recently UBS and Barclays. Can you give us a brief overview of those transactions?

Several European banks have issued contingent capital products thus far, although no U.S. banks have issued such products.

Lloyds' Enhanced Capital Notes

In November 2009, HM Treasury announced that RBS and Lloyds, both recipients of substantial capital injections from the UK government in the form of preference shares, would offer subordinated debt holders contingent or mandatorily convertible notes in order to increase regulatory capital and reduce their exposure to the UK Government's Asset Protection Scheme (under EU state aid rules the European Commission had granted approval to national support schemes on condition of the banks not paying dividends or coupons on core Tier 1 capital instruments). Lloyds completed an exchange offer in which it issued GBP7.5 billion of enhanced capital notes, which are fixed rate, subordinated debt securities with a ten-year term that convert into a fixed number of ordinary shares if Lloyds' core Tier 1 ratio falls below 5%. The interest rate on the enhanced capital notes is equal to the interest or dividend rate on the exchanged securities plus a fixed premium between 1.5% to 2.5%. The enhanced capital notes received lower Tier 2 capital treatment and will only receive core Tier 1 capital treatment if the notes are converted into ordinary shares. The enhanced capital notes were not offered in the U.S. or to U.S. persons as defined under Regulation S ("Regulation S") under the U.S. Securities Act of 1933 (the "Securities Act").

Rabobank's Senior Contingent Notes and Perpetual Non-Cumulative Capital Securities

In March 2010, Rabobank issued EUR1.25 billion of its 6.875% senior contingent notes, which are senior unsecured notes with a ten-year term, the principal of which is subject to a write-down if the equity capital ratio (equity capital divided by risk weighted assets of the Rabobank Group) falls below 7% (the occurrence of an event of default will temporarily delay the write-down). Rabobank also has an early redemption right (at par plus accrued and unpaid interest) following a withholding tax gross up event or loss of tax deductibility, in each case under Dutch tax law. The senior contingent notes though were not used as regulatory capital and were not offered in the U.S. or to U.S. persons as defined under Regulation S.

Rabobank subsequently issued fixed rate perpetual non-cumulative capital securities in two separate offerings in 2011 (each for US\$2 billion). One has an initial interest rate of 8.375% to (but excluding) the first reset date and thereafter reset every five years based on the U.S. Treasury benchmark rate plus 6.425%, while the other has an initial interest rate of 8.40% to (but excluding) the first reset date and thereafter reset every five years based on the U.S. Treasury benchmark rate plus 7.49%. In both cases though interest payments are at Rabobank's discretion (not cumulative). The principal of the capital securities is subject to a write-down if (i) the equity capital ratio (equity capital divided by risk weighted assets) falls or remains below 8% or (ii) either Rabobank or the Dutch Central Bank believes that there has been such a significant reduction in Rabobank's retained earnings or similar reserves causing a significant deterioration in Rabobank's financial and regulatory solvency position that the

equity capital ratio will fall below 8% in the near term. If the trigger is breached, Rabobank will cancel any accrued but unpaid interest and write-down the prevailing principal amount of the capital securities. The write-down amount is determined by multiplying the losses precipitating the trigger relative to the equity capital ratio prior to the loss incurrence by the ratio of the aggregate outstanding principal amount of capital securities relative to equity capital and all similar loss absorbing securities. In addition, Rabobank may redeem the capital securities, in whole but not in part, prior to a specified date upon the occurrence of a tax event or a capital event, and upon the occurrence of a capital event or Basel III capital event, Rabobank may substitute or vary the terms of the capital securities so that they remain regulatory compliant securities. The capital securities received core Tier 1 capital treatment. The capital securities were not offered in the U.S. or to U.S. persons as defined under Regulation S.

Credit Suisse's Buffer Capital Notes

In February 2011, Credit Suisse issued approximately US\$6.17 billion of its Tier 1 buffer capital notes (issued through Credit Suisse Group AG) and US\$2 billion of its Tier 2 buffer capital notes (issued through Credit Suisse Group (Guernsey) I Limited), which are subordinated notes that convert into ordinary shares if Credit Suisse's reported Basel III common equity Tier 1 ratio falls below 7% or if the Swiss Financial Market Supervisory Authority ("FINMA") determines that conversion is necessary to prevent a capital injection or restructuring. The conversion price will be the higher of a floor price of USD 20/CHF 20 per share, subject to customary adjustments, or the daily weighted average sale price of Credit Suisse's ordinary shares over a trading period preceding the notice of conversion.

There are though some slight differences between the Tier 1 buffer capital notes and the Tier 2 buffer capital notes. The Tier 1 buffer capital notes (1) have no maturity, (2) pay interest only at Credit Suisse's discretion (not cumulative), (3) provide for early redemption only at Credit Suisse's option five years from the purchase or exchange and in certain other circumstances with the approval of FINMA, and (4) have an initial rate of USD 9.5% or CHF 9.0%, as applicable, to (but excluding) the first call date and thereafter reset every five years. The Tier 2 buffer capital notes (1) have a 30-year term, (2) are guaranteed on a subordinated basis by Credit Suisse Group AG, (3) upon the occurrence of a capital event or a tax event allow Credit Suisse to substitute or vary the terms so that they remain regulatory compliant securities, (4) provide for early redemption only at Credit Suisse's option on (i) the first optional redemption date or on any interest payment date thereafter, in whole or in part, or (ii) upon a change in tax or regulatory treatment or change in control, in whole, but not in part, and (5) have an initial rate of USD 7.875% to (but excluding) a specified date and thereafter reset every five years based on the mid-market U.S. dollar swap rate LIBOR basis having a five year maturity plus 5.22%. The Tier 1 buffer capital notes received core Tier 1 capital treatment, while the Tier 2 buffer capital notes received lower Tier 2 capital treatment (and will only receive core Tier 1 capital treatment if the notes are converted into ordinary shares). The Tier 1 buffer capital notes and the Tier 2 buffer capital notes were not offered in the U.S. or to U.S. persons as defined under Regulation S.

UBS' Subordinated Notes

In August 2012, UBS issued (through its Stamford branch) US\$2 billion of its 7.625% Tier 2 subordinated notes, with a ten-year term, subject to a full write-down of the principal amount if (1) UBS' ratio of core Tier 1 capital plus high trigger loss absorption contingent capital to risk-weighted assets falls below 5% or (2) if FINMA determines that a write-down is necessary in order to prevent UBS' insolvency, bankruptcy or failure or UBS has received public support in order to prevent UBS' insolvency, bankruptcy or failure. The subordinated notes also may be redeemed prior to their maturity at UBS' option, in whole but not in part, (i) at their aggregate principal amount, together with any accrued but unpaid interest thereon, upon the occurrence of a tax event, a regulatory event, or (ii) at 101 percent of their aggregate principal amount, together with any accrued but unpaid interest thereon, upon the occurrence of certain changes in Swiss banking laws or regulations that lower certain capital requirements that UBS subsequently meets or treats as Tier 2 capital securities with terms that if included in the subordinated notes would have resulted in the subordinated notes not having received Tier 2 capital treatment. The subordinated notes received lower Tier 2 capital treatment and were the first Basel III-compliant contingent capital securities to be offered in the U.S. The subordinated notes were exempt from registration with the Securities and Exchange Commission (the "SEC") pursuant to Section 3(a)(2) of the Securities Act.

Barclays' Contingent Capital Notes

In November 2012, Barclays issued (through Barclays Bank PLC) US\$3 billion of its 7.625% contingent capital notes, with a ten-year term, subject to the automatic transfer of the notes to the issuer's parent or other issuer

group company if Barclays' equity capital ratio (core Tier 1 capital to risk weighted assets of the Barclays Bank Group) falls below 7% as of any quarterly financial period end date or any day the equity capital ratio is calculated upon the instruction of the Financial Services Authority ("FSA"). In the event of an automatic transfer, holders will no longer have any rights against Barclays with respect to repayment of the principal amount of the contingent capital notes or the payment of interest on such notes for any period from (and including) the interest payment date falling immediately prior to the occurrence of such automatic transfer; and as a result, holders will lose their entire investment in the notes. The contingent capital notes also may be redeemed prior to their maturity at Barclays' option, in whole but not in part, at their aggregate principal amount, together with any accrued but unpaid interest thereon, upon the occurrence of a tax event or a regulatory event, but only with the prior approval of the FSA and compliance with the FSA's main Pillar 1 rules (as well as provision of a notice to the FSA regarding Barclays' capital adequacy in the case of a redemption within five years of the issue date). The contingent capital notes are subordinated notes and received lower Tier 2 capital treatment. The contingent capital notes were registered with the SEC.

Tax Treatment

Historically, what were the tax benefits associated with hybrid securities?

Historically, issuers and their advisers structured hybrid securities in order to allow issuers to make tax-deductible payments on such securities. From a tax perspective, the more debt-like hybrid securities are, the

more favorable the tax treatment. For example, in the case of trust preferred securities, the interest payments on the underlying junior subordinated notes (which mirrored the economic terms of the preferred securities issued by the trust) would qualify for a tax deduction.

Can you explain the tax treatment for some of the contingent capital products that have been issued, such as those for Lloyds, Rabobank, Credit Suisse, UBS and Barclays?

In the case of Lloyds' enhanced capital notes, the notes should fall within the UK's "quoted Eurobond" exemption and, therefore, there should be no withholding tax on interest. Some notes for UK tax purposes also may be deemed "deeply discounted securities" the disposal of which (including transfer, redemption or conversion) could be taxed as income. The notes would be treated as convertible equity and payments on the notes likely would be treated as dividends for U.S. tax purposes.

In the case of Rabobank's senior contingent notes, the notes are treated as debt and interest on the notes is tax deductible for Dutch tax purposes and it is unclear if and/or what portion would be treated as debt or equity or another instrument for U.S. tax purposes.

In the case of Credit Suisse's buffer capital notes, it is unclear how the notes and interest on the notes would be treated for Swiss tax purposes and the notes would be treated as convertible equity and payments on the notes likely would be treated as dividends for U.S. tax purposes.

In the case of UBS' subordinated notes, payments by the issuer of interest on, and repayment of principal of, the notes, will not be subject to Swiss federal withholding tax, provided that the proceeds from the

offering and sale of the notes are used outside of Switzerland (unless use in Switzerland is permitted under the Swiss taxation laws in force from time to time without payments in respect of the notes becoming subject to withholding for Swiss withholding tax as a consequence of such use of proceeds in Switzerland). The notes would be treated as convertible equity and payments on the notes likely would be treated as dividends for U.S. tax purposes.

In the case of Barclays' contingent capital notes, the notes should fall within the UK's "quoted Eurobond" exemption and, therefore, there should be no withholding tax on interest. The notes would be treated as convertible equity and payments on the notes likely would be treated as dividends for U.S. tax purposes.

Does the tax treatment differ by jurisdiction?

Yes, the tax treatment of contingent capital instruments varies by jurisdiction as there is no uniformity across national tax laws in characterizing such instruments for tax purposes.

Why is the tax treatment so important?

The tax treatment is very important because one of the main purposes of hybrid capital is to provide a lower after-tax cost of capital for issuers. The lower after-tax cost of capital results from the tax deductibility for issuers of interest payments on the hybrid securities.

Are there tax issues to be addressed in the United States?

Whether payments on contingent capital instruments are in fact deductible for U.S. federal income tax purposes depends on the characterization of the instrument for those purposes. Payments with respect to instruments characterized as indebtedness are

generally deductible for U.S. federal income tax purposes while payments with respect to instruments characterized as equity are generally not.

Although many factors are included in the determination of an instrument's characterization for U.S. federal income tax purposes, it must under current law generally represent an unconditional obligation to pay a sum certain on demand or at a fixed maturity date that is in the reasonably foreseeable future. As a result, there may be a need for Congressional or U.S. Treasury Department action before a U.S. issuer has reasonable certainty that distributions on a contingent capital instrument are deductible for U.S. federal income tax purposes.

Are there tax issues to be addressed in the UK?

Under the existing general tax regime, the interest on debt securities (whether term debt or perpetual debt) is not deductible if under the debt securities the consideration given by the company for the use of the principal depends (to any extent) on the results of (a) the company's business or (b) any part of the company's business, in which case such interest will be deemed to be a distribution and taxed like a dividend. However, on January 1, 2014, the Taxation of Regulatory Capital Securities Regulations 2013 came into effect. The key effect of these regulations is that instruments that are, or were previously, additional Tier 1 or Tier 2 instruments will be taxed in the UK as loan relationships and that where a principal amount is written down, or the instrument is converted to a common equity Tier 1 instrument, no debit or credit will be brought into account for corporation tax purposes, by the issuer or by a connected holder, in respect of the conversion or the writing-up or writing-down. However, an unconnected

holder of such an instrument can still bring into account for corporation tax purposes the debit incurred on the writing-down or conversion of the instrument. The regulations also have the effect that coupons will be deductible as interest and will not be viewed as distributions, and that no income tax will be withheld from payments on such instruments. For capital gains tax purposes, such instruments will be exempt as they will represent a "normal commercial loan". Transfers of the instruments also will be exempt from all stamp duties and stamp duty reserve taxes.

What is the relevance of Section 163(l) of the Internal Revenue Code of 1986?

Section 163(l) of the Internal Revenue Code of 1986 ("IRC") provides that no deduction will be allowed for interest paid on a "disqualified debt instrument." This provision only affects issuers of debt, not debt holders. A disqualified debt instrument is defined as one where: (A) a substantial amount of the principal or interest is required to be paid or converted into the equity of the issuer, or at the option of the issuer is payable in or convertible into the equity of the issuer, (B) a substantial amount of the principal or interest is required to be determined, or at the option of the issuer is determined, by reference to the value of such equity, or (C) the indebtedness is part of an arrangement which is reasonably expected to result in a transaction described above.

Neither the statute nor the legislative history relating to IRC Section 163(l) addresses contingent capital instruments. Rather, the section was directed at instruments then being issued in the market that were mandatorily convertible into equity at maturity or could be converted into equity at the option of the issuer. If a

contingent capital instrument is not mandatorily convertible into equity and the issuer in fact does not expect the instrument to be converted into equity and the issuer has no option to convert the instrument into equity, then the tax treatment may turn on whether clause (C) above applies to the instrument. Unfortunately, this is a gray area and one probably incapable of a precise determination in the absence of guidance from the U.S. tax authorities.

What is the tax position where the conversion generates cancellation of debt income?

Where the conversion generates cancellation of debt income, under general U.S. federal income tax principles such cancellation of indebtedness income is included in taxable income unless such income is specifically excluded (for example, if the taxpayer is insolvent or in a bankruptcy proceeding). To the extent indebtedness of a taxpayer is satisfied through an exchange for or conversion into equity, any cancellation of indebtedness income is calculated as the difference between the debt's adjusted issue price and the fair market value of the equity exchanged or converted into.

Therefore, to the extent any contingent capital product were treated as a debt instrument for U.S. federal income tax purposes, the issuer would realize cancellation of indebtedness income to the extent of the difference between the instrument's adjusted issue price and the fair market value of its equity exchanged or converted into. An issuer would also recognize cancellation of indebtedness income if the contingent capital instrument is permanently written-down.

To the extent any contingent capital product were not treated as a debt instrument but rather as an equity interest for U.S. federal income tax purposes, the issuer

would not realize cancellation of indebtedness income on the exchange or conversion into (a different class of) equity.

Ratings Agencies

Are the rating agency concerns relating to hybrid securities applicable to contingent capital instruments?

Yes, the rating agency concerns relating to hybrid securities are still applicable to contingent capital instruments. Hybrid securities receive varying degrees of "equity content" from rating agencies based on their features and their anticipated effect on the issuer's capital structure. Rating agencies limit the overall amount of traditional hybrid securities to which they give equity treatment when considered relative to the issuer's overall capital structure.

Historically, rating agencies had viewed hybrid securities favorably because they were believed to have some of the loss-absorbing features associated with common equity securities. The view was that, to varying degrees, hybrid securities would provide a "cushion" within an issuer's capital structure in the event of a bankruptcy or on the occurrence of other adverse events. Rating agencies also considered the effect of the hybrid security on the issuer's cash flows, although the analysis of the issuer's overall credit rating was treated as separate and distinct.

However, contingent capital instruments with conversion features present additional concerns for rating agencies. In such cases, the assessment of the "equity content" of the contingent capital instruments is difficult if the conversion triggers are not clearly defined or if the regulators have significant discretion to force a

conversion, which makes it difficult to predict the likelihood of conversion. The rating agencies have issued statements and/or new methodologies regarding the treatment of contingent capital instruments.

Moody's

In April 2013, Moody's published a request for comment that discusses proposed changes to the ratings approach for bank hybrids and contingent capital instruments. Based on the proposal, Moody's would rate contractual non-viability securities and junior securities that may be subject to bail-in, but would not rate "high trigger" contingent capital instruments. Moody's defines non-viability securities generally as junior securities, with or without coupon suspension mechanisms, that absorb losses either through conversion to equity or a principal write-down at the point of non-viability or upon the breach of a trigger that is set very close to the point of non-viability. Notwithstanding the proposal, Moody's will still rate bank hybrids and contingent capital instruments where loss absorption is tied to triggers that are credit-linked, objective and measurable (which have not been issued to date) and will not rate bank hybrids and contingent capital instruments where loss absorption occurs at the bank's option or is tied to triggers unrelated to the bank's financial health such as the bank's share price.

Fitch

In December 2012, Fitch published a revised rating criteria report ("*Assessing and Rating Bank Subordinated and Hybrid Securities*"), replacing its previously published contingent capital rating methodology ("*Rating Bank Regulatory Capital and Similar Securities*," dated December 2011) and rating criteria report ("*Treatment of Hybrid in Bank Capital Analysis*," dated July 2012). Fitch rates subordinated and hybrid

securities, which includes contingent capital, by notching down from a rating anchor, which is the issuer's viability rating ("VR"). The VR represents Fitch's view of the intrinsic creditworthiness of the issuer, excluding external support and constraints, and thus the capacity of the issuer to maintain ongoing operations and avoid failure. Fitch's notching methodology is based on an end-game scenario (either resolution or liquidation), and the notching is divided into two parts (loss severity and non-performance risk) which are additive and relate to the same anchor. For contingent capital securities, the base case for loss severity is two notches. If a bank issues a Tier 2 contingent capital instrument whose only loss-absorption feature is a contingent conversion/write-down feature at a pre-determined trigger, the trigger can give rise to incremental non-performance risk relative to the bank's VR, in which case Fitch may add up to two notches for incremental non-performance risk, dependent on whether it is minimal (i.e., the trigger is set so low that it is effectively "gone concern" capital), moderate or high.

In the revised report, Fitch defines contingent capital as instruments that are written-down, written-off or converted into a more junior instrument (usually common equity) upon a defined trigger, and indicates that it is only able to rate securities with triggers whose likelihood of being hit can be reasonably analyzed or assessed. Fitch also clarifies that securities where loss absorption arises only at the point of non-viability do not qualify as contingent capital for the purposes of the revised report.

S&P

In March 2013, S&P published a proposal regarding bank capital in which it notes that instruments that

qualify as Tier 1 capital and meet all other applicable S&P criteria would be eligible for intermediate equity content, even without a contingent capital feature. Going-concern contingent capital instruments would be eligible to receive intermediate equity content if they are classified as Tier 1 or Tier 2 capital and meet all other applicable S&P criteria because they are viewed as having strong capacity to absorb losses on a going-concern basis through write-down or conversion. Tier 2 instruments that do not have a contingent capital feature (gone-concern contingent capital) would receive minimal equity content as such instruments will only absorb losses in a non-viability situation.

Will rating agencies rate contingent capital instruments?

Yes, rating agencies will rate contingent capital instruments in certain instances. For example, Rabobank's perpetual non-cumulative capital securities were assigned a rating of 'A' by Fitch (they were not assigned any rating by Moody's or Standard & Poor's), Credit Suisse's Tier 2 buffer capital notes were assigned a rating of 'BBB+' by Fitch (they were not assigned any rating by Moody's or Standard & Poor's), UBS' subordinated notes were assigned a rating of 'BBB-' by Fitch and Standard & Poor's (they were not assigned any rating by Moody's), and Barclays' contingent capital notes were assigned a rating of 'BBB-' by Fitch and Standard & Poor's (they were not assigned any rating by Moody's).

Miscellaneous

Is contingent capital likely to be expensive and risky for issuers?

It remains to be seen whether contingent capital will be expensive and risky for issuers. There have been only a few issuances of contingent capital instruments thus far and it is not clear how new offerings of contingent capital instruments will be received by investors and what yields investors will require and what conversion triggers or write-down features will be satisfactory in exchange for being subordinated to equity during a financial crisis. Many of the contingent capital instruments that have been issued thus far have had fairly high coupons (comparable to coupons on high yield bonds) in order to compensate investors for the risk of a conversion or a full or partial write-down. It is also unclear how effective these instruments will be at loss absorption for issuers in the event of another financial crisis as there are varying amounts of regulatory discretion built into triggers and the conversion or write-down mechanisms.

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